



ORIGINAL

No. CT-94/3

THE COMPETITION TRIBUNAL

IN THE MATTER OF an Application by the Director of Investigation and Research under sections 77 and 79 of the Competition Act R.S.C. 1985 c. C-34, as amended

COMPETITION TRIBUNAL TRIBUNAL DE LA CONCURRENCE		PRODUIT
AUG AOUT	29 1995	
REGISTRAR - REGISTRAIRE		#152
OTTAWA, ONT.		

BETWEEN:

THE DIRECTOR OF INVESTIGATION AND RESEARCH

Applicant

- and -

COMPETITION TRIBUNAL  
TRIBUNAL DE LA CONCURRENCE

File No. CT-94/3  
No. du dossier

Dir v Tele-Direct  
et

TELE-DIRECT (PUBLICATIONS) INC.,  
TELE-DIRECT (SERVICES) INC.

Exhibit No. [Redacted]  
No. de la pièce

Respondents

Filed on Jan 22/96; 10h02  
Date de dépôt

- and -

Registrar Ahagari  
Greffier

ANGLO-CANADIAN TELEPHONE COMPANY,  
NDAP-TMP WORLDWIDE LTD.,  
DIRECTORY ADVERTISING CONSULTANTS LIMITED  
AND THUNDER BAY TELEPHONE

Intervenors

*In rebuttal*

AFFIDAVIT OF ROBERT WILLIG  
FILED IN REBUTTAL

*Aug 30 1995*

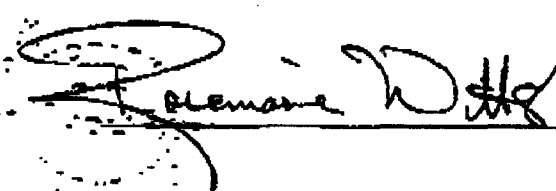
I, Robert Willig, of the Township of Princeton in the State of New Jersey,  
MAKE OATH AND SAY AS FOLLOWS:

- I have reviewed the opinions of Professor Richard Schwindt and Professor Margaret Slade, to be filed with the Competition Tribunal on behalf of the Director of Investigation and Research.

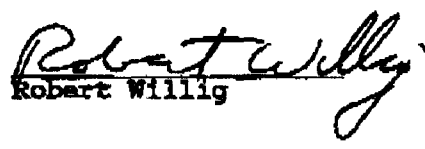
-2-

- 2. Attached as Exhibit "A" is a copy of my opinion in reply.
- 3. I make this affidavit pursuant to Rule 47(2) of the Competition Tribunal Rules.

SWORN BEFORE ME in the  
 County of New York  
 in the State of New York  
 this 30<sup>th</sup> day of August, 1995



ROSEMARIE WITTER  
 Notary Public, State of New York  
 No. 01W1303159  
 Qualified in New York County  
 Commission Expires Sept. 12, 1996



Robert Willig

**REBUTTAL REPORT BY ROBERT D. WILLIG**  
**Filed On Behalf of Tele-Direct (Publications) Inc. and Tele-Direct (Services) Inc.**  
**In Re: The Director of Investigation and Research v.**  
**Tele-Direct (Publications) Inc. and Tele-Direct (Services) Inc.**  
**Proceedings Before the Competition Tribunal**

1. In his report, Professor Schwindt claims to apply the evaluative criteria for defining the relevant product market that appear in the Director's Merger Enforcement Guidelines. He also claims that these criteria lead to the conclusion that there is very limited substitutability between directory advertising and advertising in other media. In Section I of this Rebuttal, I show that Professor Schwindt has failed to marshal evidence that properly applies the evaluative criteria; that the evidence he cites in no way logically leads to his conclusion of "limited substitutability;" and that proper application to substantive evidence of the same evaluative criteria does lead to the correct conclusion that the relevant market for assessing the degree of competition facing Tele-Direct's directory advertising includes most local advertising (*i.e.* advertising which promotes the business of local establishments), irrespective of whether it appears in newspapers, flyers, other directories, or any other advertising medium.
2. In Section II of this Rebuttal, I show that all but one of the arguments articulated by Professor Slade in her Report on the subject of the relevant market to assess the competition faced by Tele-Direct's directory advertising are much the same as arguments made by Professor Schwindt, and are equivalently inapposite. The one argument of hers on this subject that is not a duplicate of those made by Professor Schwindt is: "In this industry, the most compelling evidence of market power comes from the outcome of the market process itself. Profits are large; estimates put them in the range of 40 percent of total assets." As discussed more fully below, and as I believe is generally understood, accounting measures of rate-of-return are not meaningful evidence of market power, especially in businesses where intangible assets are important.
3. In Section III, I return to the market definition efforts of Professor Schwindt, focusing here on geographic markets. It is to be noted that Professor Schwindt's Report is not in clear disagreement with mine on this subject, but that he is very ambiguous.
4. In Section IV, I focus on the claims of Professor Schwindt that there are significant barriers to entry into the publication of independent directories. The many "incumbent advantages" that Professor Schwindt asserts are central to his conclusion in most part are misinterpreted. For one fairly typical and obvious example of a confusion between anticompetitive influences and aspects of competition, within the category of strategic behaviour from utility publishers Professor Schwindt mentions "genuine attempts to improve the quality of their products and services."
5. Finally, in Section V, I explain that I disagree with the conclusions reached by Professor Slade about tying, that I agree with the Rebuttal of them by Professor Trebilcock, and that I disagree with the way Professor Slade reached her conclusions.

## I. Application of the Evaluative Criteria

6. The evaluative criteria for market definition that Professor Schwindt selects for application from the Director's Merger Enforcement Guidelines are: End use; Views, strategies, behaviour, and identity of buyers; Trade views, strategies and behaviour; Physical and technical characteristics; Price relationships and relative price levels; Cost of adapting or constructing production processes, distribution, and marketing; and Switching costs. According to Professor Schwindt, switching costs are relatively low for the advertising in question, and the costs of adaptation or construction are best discussed in the context of analysis of entry barriers. The remaining criteria are all closely related to the categories that I employed in my Report to organize the evidence. The end use and physical and technical characteristics criteria correspond to my category of evidence about functional similarity. The criterion on views, strategies, behaviour, and identity of buyers corresponds to my category of evidence from the perspective of buyers (advertisers). The criterion of trade views, strategies, and behaviour, together with the criterion of pricing relationships and relative price levels arose within my category of evidence from the perspectives of suppliers of advertising.

### IA. End Use

7. The totality of the evidence presented in this category by Professor Schwindt is a few quoted passages from academic sources and TD training material on the view that telephone directory advertising is directional in nature rather than creative. According to the quoted passages, directional advertising directs consumers to the distribution outlet for a product or service, or, in other words, directs buyers to a particular business. In contrast, creative advertising creates or stimulates demand. With no cited additional basis, Professor Schwindt asserts (at p. 9): "Based upon this, the primarily creative media (television, radio, magazines, outdoor signage, and at least national advertising in newspapers) cannot be viewed as close substitutes for telephone directory advertising."

8. This key assertion by Professor Schwindt is dramatically wrong, both as a matter of fact and as a matter of logic. First, as a matter of fact, Professor Schwindt seems to be unaware that Canadian radio and television advertising revenues are like newspaper advertising revenues in that they too have been formally divided into the categories of local and national advertising. Major sums of revenues from television and radio advertising are for local advertising, according to *1994: a Report on Advertising Revenues in Canada*, prepared by G. Mitchell and published by CARD. Local advertising is defined to be that which promotes the business of particular establishments. In contrast, national advertising promotes demand for a product or service, without any specific reference to an outlet. Thus, local advertising is in essence what Professor Schwindt termed as directional, and national advertising is akin to the definition of creative advertising that he employed.

9. Even accepting as a given the incorrect conclusory assertion of Professor Schwindt that creative advertising cannot be a close substitute for directory advertising, Professor Schwindt

is dramatically wrong about the other media. Local advertising in all media has the same essential end use as the directional category of advertising on which Professor Schwindt focuses. By their very definitions, both directional advertising and local advertising are advertising that directs consumers to particular establishments. Yes, most advertising in telephone directories can be categorized as directional, or equivalently as local, and there is a great deal of local advertising in many other important media. According to the Mitchell Report, Canadian spending on local radio ads in 1993 was \$554.9 million. Canadian spending on local TV ads in 1993 was \$377 million. Although the Mitchell Report gives no data on the breakdown of revenues between national and local advertising for magazines and outdoor signage, it is plain that some portion of the advertising in these media is indeed local. Finally, the Mitchell report indicates that for 1993, \$943.2 million and \$512.6 million of the newspaper advertising revenues of the dailies and weeklies, respectively, are explicitly categorized as local advertising revenues. An additional \$520.8 million is categorized as revenues from classified advertising in the dailies.

10. Despite the fact that all the above local advertising has the same defining characteristic as that cited by Professor Schwindt as characterizing directional advertising, none of their revenues are included by Professor Schwindt as being competitive with directory advertising in the relevant market. His sole grounds for this pivotal exclusion is that directory advertising is directional rather than creative and (at p. 9): "Based upon this, the primarily creative media (television, radio, magazines, outdoor signage, and at least national advertising in newspapers) cannot be viewed as close substitutes for telephone directory advertising."

11. Having highlighted the error of fact committed by Professor Schwindt in his key assertion, I now turn to the additional error of logic here. Without any support, or evidence, Professor Schwindt asserts that creative advertising cannot be a close substitute for directional advertising. As a matter of logic, it is easy to accept the proposition that an ad for Brand X shaving cream is not a substitute for an ad for Pharmacy Y, since the first promotes the product, and the second promotes the establishment. But this proposition is entirely inapposite for the issue of what is the competition facing directory advertising. Here, the question is simply whether an ad in the newspaper, or over the radio, or elsewhere, that exploits the flexibility of the medium is a substitute for a directory ad placed by the same establishment to promote its business. Consider an ad placed by a florist in the newspaper with the message "buy flowers in a Brand Z pot for your favourite teacher in honour of Teachers' Day -- at Flower Shop X -- 921-1234 -- 10 Main Street." This ad has elements of being creative and of being directional, and Professor Schwindt presents no evidence and has no basis in logic for a conclusion that it would not be a close substitute, from the perspective of the florist seeking to build its patronage, for a directory ad with the message "flowers in great arrangements and pots, for all occasions -- Flower Shop X -- 921-1234 -- 10 Main Street."

12. One of the passages quoted by Professor Schwindt suggests that directional advertising is complementary to creative advertising, but that term is evidently not used with its economic

meaning — two products are complements in their demands if a price rise in one would discourage demand for the other. While this might be true for movie tickets and popcorn, or golf balls and golf greens' fees, it is evidently not true of directory advertising and creative advertising by the same advertiser.

13. According to the complementarity story, creative advertisements in media other than directories motivate customers to seek a particular good or service. However, customers ultimately must turn to the directory to find a vendor's telephone number. If a vendor has not placed a prominent display ad, then the customer may well select a competitor, and the vendor's advertising in other media will be wasted.

14. This complementarity story undoubtedly applies to some circumstances, but it is implausible, for several reasons, as an overarching universal empirical truth. If it were, first of all, every vendor would have an incentive to "free ride" on non-directory advertising by competing vendors. No individual vendor would have an incentive to advertise in any other medium, and all would concentrate exclusively on Yellow Pages advertising. For most heading categories, this is factually incorrect. Indeed, as I have noted, it is not at all uncommon to find, within a single heading category, some vendors who advertise only in other media, and other vendors who advertise in both the Yellow Pages directory and in another medium. Second, the complementarity story cannot explain the fact that numerous advertisements in other media, such as newspapers, television, radio, direct mail, and so forth, contain the vendor's telephone number. If the vendor truly believed that a reference to the directory would ultimately be required, this information would be superfluous.

15. Most importantly, the hypothesis that directory advertising is complementary, in the economics sense, with creative or other forms of local advertising is flatly contradicted by the documented behaviour of market participants. If, for example, advertisements in newspapers and directories were complementary in the sense of economics, then an increase in newspaper advertising by any given establishment would increase the value of, and demand for, directory advertising by that establishment, and vice versa. The publishers of directories would have strong incentives to encourage the use of newspaper advertisements, and newspaper publishers would have strong incentives to encourage the use of directory advertisements. In practice, precisely the opposite pattern is observed. As I have discussed at length in my report, the undisputed evidence clearly demonstrates that TD's sales strategies reflect competition with other media, and other media discourage the use of directory advertising in an attempt to stimulate their own revenues. These patterns establish definitively that directory advertising is a substitute for local advertising in other media -- not a complement.

16. To sum up the discussion of the application by Professor Schwindt of the important evaluative criterion of end use, he has presented no evidence about real end users or end uses, he has made very consequential errors of fact, and the conclusory assertions that are key to his principal opinion do not stand up to logic or fact. In contrast, my Report presented evidence from many surveys and studies of real end users and end uses.

17. While it is clear that Tele-Direct directory advertising and other forms of local advertising have the same basic function for those who purchase them -- namely to promote the patronage of the advertised establishment -- the evidence presented in my Report sheds more light on similarities in functionality by studying directory advertising end users and their end uses. The data all basically show that Yellow Pages are a significant source of information and ads that are influential to consumers, but they are by no means unique or dominant in these roles. Taken together, other media are generally rated as far more influential over end users than Yellow Pages, and for various groups, newspapers, TV, and direct mail catalogues were ranked as more influential. For each group studied, directory advertising did not appear to be dominant, and did appear to face effective alternatives for the function of influencing patronage. Yellow Pages users are exposed to advertisements that run in a wide variety of other media, including TV, radio, daily newspapers, community newspapers, and outdoor and mall displays. Advertisers can seek to reach and influence the group of Yellow Pages users by means of directory advertising, or by means of any of a wide array of the other local media because the Yellow Pages users are largely exposed to these media as well. Thus, all the local advertising, regardless of the medium, share the same end-use functionality with directory advertising, and belong in the same relevant market.

#### **IB. Views, Strategies, Behaviour, and Identity of Buyers**

There is no doubt that information about buyers, their perspectives, and their behaviour can be very useful in the delineation of relevant markets. Professor Schwindt begins his application of this evaluative criterion by inferring that (p.12) "telephone directory advertising is particularly important to suppliers of goods or services when telephone communication is integral to the purchase, when the product or service is purchased infrequently, particularly in emergency situations, and when the purchase involves comparative shopping." He draws his inference from an academic quote about consumers who use directories (i.e. not about buyers of advertising), from a table on Characteristics of Yellow Pages Users (again, not about buyers of advertising) from TD promotional literature, and from the list of Top 25 Directory Headings (by revenue, 1995). Professor Schwindt concludes his presentation of evidence in this category with a table from an industry source entitled "Characteristics of the Yellow Pages and Competitive Media: Advertisers' View of Usefulness." To me, the most informative aspect of this table is the fact that its title and subtitles label as media that are competitive with Yellow Pages "Newspaper, Radio, TV, Direct Mail." Professor Schwindt's conclusion to his use of this evaluative criterion is just "In sum, advertiser behaviour (usage) and views are consistent with the notion that telephone directory advertising is directional in nature."

18. As Professor Schwindt seems to recognize by the conclusions that he articulates in this section, none of the pieces of evidence that he presents in any way indicates or even suggests a lack of substitutability between directory advertising and other media local advertising. His final conclusion that directory advertising is directional, as discussed above, certainly does not suggest that directory advertising is not a close substitute for other local advertising. His conclusion (quoted above from p. 12) that "telephone directory advertising is particularly

important to suppliers of [particular types] ..." also does not imply anything about lack of substitutability. Professor Schwindt does not contradict, and his evidence could not belie, the proposition that the suppliers of those particular types find other media local advertising to be important also, and to be substitutable for directory advertising. This proposition is supported by the search I reported through a number of regional newspapers for ads promoting establishments in the businesses represented by the top five Yellow Pages headings in the region's Tele-Direct directories. This search found 542 newspaper advertisers in these categories, of whom 39% had display ads in both the searched newspaper and in the local Tele-Direct Yellow Pages directory, while 61% had no display ad in their local Tele-Direct Yellow Pages directory. Thus, advertisers in top Yellow Pages headings (top 5, rather than the top 25 that Professor Schwindt's table listed) evidently do advertise in newspapers, many advertise in both, and many advertise in the newspaper and do not buy a display ad in their local Tele-Direct directory. Inspection of the directory ads alongside the newspaper ads shows many that are very similar, and many that are similar except that they exploit the superior ability of the newspaper ad to convey a timely message. None of this evidence is consistent with a notion that some particular types of suppliers are somehow dependent on directory advertising.

19. Nevertheless, it is worthwhile to explain that my conclusion about the relevant product market in which to assess the competition facing Tele-Direct's directory advertising would not be changed by a finding (hypothetically) that there are some types of suppliers who rely on directory advertising and for whom other forms of local advertising are not close substitutes. The reason is that rates for directory advertising are uniform across heading categories. In other words, the market for local advertising is not characterized by price discrimination across lines of business. In the absence of price discrimination, an increase in the price charged to one class of establishment coincides with an increase in the price charged to all establishments. The profitability of a price increase therefore depends on the average substitutability between directory advertisements and other local advertising media across heading categories, rather than on the substitutability for any particular heading category. When the average degree of substitutability is high, the existence of other advertising media will preclude the exercise of significant market power, even if substitutability is low for some particular heading categories.

20. To put this point somewhat differently, if the prices for local advertising do not differ across lines of business, then it is not economically meaningful to attempt an analysis of competition in, say, the market for local advertising by plumbers, or by businesses in any specific heading or group of headings. Rather, there is only a single market for local advertising. Likewise, it is not meaningful to attempt to assess the market power held by Tele-Direct in advertising in any particular heading or group of headings. Rather, it is meaningful to assess only the market power over directory advertising in all headings, and for this purpose local advertising is the relevant market.



21. Finally, I believe that it is important to contrast the evidence that I presented from the perspective of advertisers with the presentation of Professor Schwindt. My Report summarizes the details of a number of large and smaller in-depth surveys of the behaviour and attitudes of advertisers. In short, these surveys show that the advertisers in Tele-Direct Yellow Pages advertise to a very significant extent in a wide variety of other media. Yellow Pages advertisers find the value of advertising in other media to be comparable or superior to that of directory advertising. In the view of Yellow Pages advertisers, much directory advertising is vulnerable to cut-back or cancellation in favour of expanded spending on other local advertising media. These survey findings on the views and behaviour of advertisers are further confirmed by reports of the experiences with advertisers of the Tele-Direct sales force and examinations of the actual ads taken in Yellow Pages and in newspapers by advertisers.

### IC. Physical and Technical Characteristics

22. In discussing this evaluative criterion, Professor Schwindt lists a number of characteristics of directory advertising that he says are in some cases unique and that set it apart from other media. He also quotes a 1991 letter from T. J. Bourke to the Director on the same subject. The characteristics are: time-insensitive, permanent, comprehensive in its listings and distribution, and restricted in format and content.

23. It is obvious that most products and services are unique in some respect. Consumers certainly understand that Fords, Chevrolets, Toyotas, Nissans, and Volkswagens are not identical, and that each has unique features. Yet it would be inappropriate and incorrect to conclude on this basis alone that competition among these auto manufacturers is ineffective. The relevant question is not whether a product is unique in some respect that is recognized by buyers, but rather whether the product is unique in some respect that significantly limits the extent to which buyers are willing to substitute other products for the product at issue. Professor Schwindt fails to present evidence that in any way suggests that the unique or special characteristics that he attributes to directory advertising limit significantly the ability or willingness of its buyers to substitute out and into other local advertising.

24. First of all, two of the characteristics cited by Professor Schwindt, time-insensitive and restricted in format, seem to be negative aspects of directory advertising from the perspective of advertisers. As a matter of economics, it is difficult to see how negative characteristics can contribute to a showing of dominance in a narrow relevant market. Instead, negative characteristics contribute to the willingness of buyers to substitute out of the product at issue, and so their recognition should, if anything, argue for a wider market to be relevant, not a narrower one.

25. In discussing the characteristic of a Yellow Pages directory as being comprehensive in its listings, it is important to be clear about the distinction between lightface listings and advertisements. The Yellow Pages directory is as comprehensive as it is in its listings due to its classified lightface listing for every business subscriber as part of that service. Businesses

need not advertise in the Yellow Pages directory to be part of the comprehensive listing and to have their addresses and phone numbers available to consumers in that way.

26. Tele-Direct directories are distributed comprehensively to telephone subscribers. This characteristic provides advertisers with high potential exposure, but none at all if the consumer does not open the directory to the applicable heading. In contrast, advertisers in a newspaper get exposure to each individual who chooses to read the paper, and analogously for other media. As already discussed, high percentages of directory users are readers of daily and community newspapers, readers of magazines, radio and television users, and travellers exposed to out-of-house advertising. Further, the ad in the directory is permanent, as pointed out by Professor Schwindt, so that it remains available for exposure, albeit frozen in its content, until the telephone subscriber disposes of the directory or replaces it with its successor.

27. Thus, these characteristics of directory advertising are elements that may influence the extent and nature of the exposure that the ads obtain, just as the traits of other media shape the extent and nature of the exposure that their ads obtain. There are no obvious dominance relationships here -- no clear winners for an advertiser among the media as a matter of logic - - and so no conclusions can be logically drawn about any lack of substitutability among local advertising media on the basis of the characteristics discussed by Professor Schwindt.

#### **ID. Price Relationships and Relative Price Levels**

28. The lead evidence that Professor Schwindt presents for this evaluative criterion is a quoted passage from the 1991 letter from T.J. Bourke, the President of Tele-Direct, to the Director. The passage asserts that because Yellow Pages advertising is directional, it is not readily substitutable with the creative advertising provided by other media. "This lack of substitutability has been confirmed by the fact that changes in price for Yellow Pages advertising historically have not varied consistently with changes in price for the advertising in other media."

29. This letter is not written by an economist, and so isolated excerpts should be accorded no weight when they set out bald conclusions that seem to be about subjects of economics. The very next paragraph of the letter, right after the quoted passage, is: "Competitors, Advertisers traditionally set one advertising budget from which they fund all their advertising needs. Therefore, although the Yellow Pages provides a different service than do the creative advertising media, it competes with newspapers, radio, and television for advertising dollars. Newspapers and radio stations have purchased programs designed to sell advertisers on reducing the amount of advertising dollars they spend on directional advertising and reinvesting them in creative advertising services." Thus, immediately after declaring that Yellow Pages advertising is not readily substitutable with the creative advertising of other media, that pricing patterns confirm this, and that the markets are distinct, the letter proceeds to declare that Yellow Pages advertising competes with newspapers, radio and television, and

that newspapers and radio stations actively seek to induce advertisers to substitute their ads for directory advertising. Shortly afterward, the letter declares that Yellow Pages is the fastest-growing and fourth ranked advertising medium in terms of revenue, and displays its percentage share of all net advertising revenues, still within the portion of the letter entitled "Competitors."

30. Evidently, this letter is not cast in the language of economics. It simply does not employ the phrases "readily substitutable," "substitutability," and "markets are distinct" with the meanings they have in economics and with the meanings they should have in the legal and public policy analysis of competition. If the reader of the letter did impute these meanings to those key words, the letter would starkly contradict itself in adjacent paragraphs. Professor Schwindt chose to quote only the first of the two adjacent contradictory paragraphs, for the point that he sought to support.

31. Professor Schwindt goes on to opine that Tele-Direct's own pricing process is influenced by the pricing of other media, but to a lesser extent than it is by "cost and value conditions." According to Tele-Direct personnel, it is difficult for their pricing decision process to take the prices of other media into account in a formal fashion. The pricing decision process at Tele-Direct needs to be started well before the typical canvas, which in turn significantly precedes publication and the commencement of billing. As input into this process, Tele-Direct consequently seeks projections of future changes in the prices of other media advertising from its advertising agency sources, but frequently has found these projections to be inaccurate. Moreover, in the experience of Tele-Direct personnel, marketplace prices of other media advertising are flexibly discounted from the listed rate-card levels, so that projections of and past data on rate-card levels are not accurate reflections of the pricing conditions they face in selling directory advertising in competition with other media. (Perhaps this is what the quote from the Bourke letter was alluding to.) As a result, competitive conditions are factored into Tele-Direct's pricing decisions, and decisions about other aspects of the business -- e.g. scoping -- through the direct input and participation of sales force management in the decision making processes. According to Tele-Direct personnel, this avenue of influence of and response to changes in market conditions is far more important and reliable than an approach based on formal pricing data.

#### **IE. Trade Views, Strategies and Behaviour**

32. Professor Schwindt begins his application of this important evaluative criterion with consideration of Tele-Direct's own perspectives, and whether it views other media as direct competitors. He asserts (p.17): "If Tele-Direct did hold such views, one would expect to see as much attention paid to the activities of the other media as was paid to independent directories." Professor Schwindt takes brief note of Tele-Direct attention to competitive activities by newspapers, but seems to suggest that their rivalry was confined to the early 1990's. In fact, this rivalry was not confined to that time period, and is very active today. The only specific attention paid by Tele-Direct to other media that Professor Schwindt

recognizes here is a passage quoted from Tele-Direct's director of communications that reflects a studiously cocky public attitude, as well as a stance consistent with a concern that competitors be given too much credence (n. 36).

33. It is surprising that this is the only specific instance of Tele-Direct attention to other media that Professor Schwindt recognizes. The impacts of rivalry with other media are institutionalized deeply into the business practices of Tele-Direct. As I detailed more fully in Section IB of my Report, these indications include the nature and content of the programs used to train the sales force, the information about other media routinely provided to the sales force just before a canvas, the contents of the sales aids routinely employed by the sales force to use with potential advertisers, the nature of the marketing studies performed or commissioned by Tele-Direct, and the responsive business decisions that Tele-Direct has made. In all of these categories, there are strong examples in the record of Tele-Direct attention to other media that are far more reliable evidence about competition than public utterances of a firm's director of communications.

34. In general, it can be expected that internal memoranda and meetings will be most stimulated by changes in business conditions, rather than by conditions that are equally or more important in their impacts, but that are not currently in a state of flux. Thus, it would not be surprising to find more Tele-Direct documents about a new newspaper marketing program, or the activities of a new independent directory, than about the steady ongoing state of the appeal of Yellow Pages to restaurants, or the steady force of competition against other media. The indications are that Tele-Direct responds to changes in the conditions of the markets in which it operates, and the relevant product market includes local advertising in all other media.

35. In the category of views of the trade outside of Tele-Direct, Professor Schwindt begins with the assertion that (p. 18): "Advertising research agencies treat the Yellow Pages directories as a separate medium when reporting on advertising revenues. [fn. See, for example: CARD, *A Report on Advertising Revenues in Canada*, September 1994]" I find this a curious assertion in its context. The cited CARD Report does indeed provide a distinct revenue figure for Yellow Page directories, as it does for radio; television; daily newspapers; weekend supplements to newspapers; weekly and semi/tri newspapers; general magazines; business papers; farm papers; religious, school, other; catalogues, direct mail; and outdoor. This report also totals the revenues from these media, including Yellow Pages, and calculates per cent shares by media, including Yellow Pages, whose latest (1993) share is listed as 9.5%. Thus, the report cited by Professor Schwindt treats the Yellow Pages like all the other advertising media, includes its revenues in the same total as the others, and finds its share to be inconsistent with a conclusion of dominance.

36. Next, Professor Schwindt mentions as evidence the fact that there are trade journals which focus on directory advertising. This is evidence only about a group of readers with a focused interest in directory matters, and not at all evidence about what other media compete

with directory advertising. For example, the fact that there are trade journals which focus on trucking certainly is not evidence that trucks and railroad boxcars fail to compete in many of the same relevant markets.

37. Professor Schwindt next mentions that general advertising agencies are not interested in Yellow Pages advertising. This is not evidence of lack of substitutability of directory advertising for local advertising in other media. General advertising agencies tend to focus on national rather than local advertising. Nevertheless, in her Report (p. 8), Professor Slade does explicitly include "general or multimedia-advertising agencies" as one of the four sorts of agencies supplying "advertising services" to commissionable directory advertising accounts.

38. As his last piece of evidence in this category, Professor Schwindt claims that conventional measures of advertising effectiveness, like cost-per-thousand (CPM), are not used and have been eschewed by publishers in the selling of directory advertising. In n.41 he states that "Apparently Tele-Direct believed that CPM measures were useful when competing with other directories. The lack of competition in this regard explains the lack of a CPM measure." It is difficult to see these issues as evidence of non-substitutability. There are clearly issues of how to measure exposures to and effectiveness of directory advertising that are different technically and conceptually than the issues of measuring exposures to other media -- just as measuring exposures to a radio station's advertising entails different issues than measuring exposures to direct mail or newspapers. For example, a Tele-Direct document on this subject, *CPM STUDY, MARKETING RESEARCH, 1989*, discusses some of the possibilities, the difficulty and cost of obtaining directory measures comparable to those of other media, and as a CPM objective, the ability to compare Yellow Pages advertising value to other directories and/or other media.

39. Thus, the evidence on views of the trade outside Tele-Direct that Professor Schwindt marshalls in no way suggests that local advertising in all media fail to compete with directory advertising. In contrast, the evidence presented in my Report in this category goes right to the matter of such competition. Included were many press items about the active marketing efforts of newspapers, magazines, and radio stations to sell local advertising as direct substitutes for directory advertising. These public reports are confirmation of the unambiguous evidence from the internal evidence of Tele-Direct that directory advertising competes head-to-head with local advertising in other media.

#### **IF. Conclusion on the Relevant Product Market**

40. In concluding this section, I would like to emphasize that I find the evaluative criteria listed by Professor Schwindt to be an appropriate framework for assessing the scope of the relevant product market in which directory advertising competes. The categories that I employed to organize the evidence are consistent with this framework. Professor Schwindt fails to apply the evaluative criteria in an appropriate way with appropriate evidence. In my Report, I presented lines of evidence that are appropriate for the evaluative criteria that show

unambiguously that directory advertising competes in the same relevant market with local advertising in other media.

## II. The Market Definition Opinion of Professor Slade

41. In this section, I show that all but one of the arguments articulated by Professor Slade in her Report on the subject of the relevant market to assess the competition faced by Tele-Direct's directory advertising are much the same as arguments made by Professor Schwindt, and are equivalently inapposite. The one argument of hers on this subject that is not a duplicate of those made by Professor Schwindt turns on a measure of profitability that should not be employed as an indicator of market power.

42. Professor Slade begins her discussion of the relevant market issue in her Report with remarks like (p. 3) "The only choice for many businesses is not whether to place an ad but what sort of ad to place." Assertions of this sort are not only unsupported by Professor Slade, as well as by Professor Schwindt, but do not withstand confrontation with the available data. Professor Slade proceeds to recognize that: "Some customers must decide on expenditures on each medium, and therefore, in some sense, all media compete for their advertising dollars."

43. Then, she claims that directory advertising has many unique features that distinguish it from other media. The first of these is that "directory advertising is informative. Unlike much advertising on TV or in magazines, it conveys factual information that often includes type of business, geographic location, hours of operation, and advertiser-telephone number." Here, it seems, Professor Slade is sensing the distinction between local advertising and national advertising that promotes a product rather than an establishment. The other traits that are mentioned here are equivalent to those Professor Schwindt identified and that I discussed above -- permanent, comprehensive in distribution, and comprehensive in coverage.

44. It is useful to note that Professor Slade points out, in a different context, (Report, p. 5) that a Yellow Pages advertising customer faces many choices including the allocation of total advertising expenditures among Yellow Pages directories and other media, and also a host of choices that will have large implications for the total spending on Yellow Pages advertising. It is clear that both of these articulations of choices to be made bespeak elements of competition facing Tele-Direct. That competition is not only over whether or not an establishment will place an ad in a Tele-Direct directory, but also over all the questions of ad size and quantity that Professor Slade lists.

45. Later in her Report, Professor Slade asserts that (p. 10) "The market power of a directory-publishing company derives principally from its affiliation with its related telephone company." This assertion is completely conclusory, not only with respect to its neglect of

competition among directories, but first with respect to its presumption about the relevant market. It is important to note that Professor Slade offers no analysis or discussion of this matter, apart from that which I have referenced above, nor any reliance on analysis done by anyone else, including Professor Schwindt.

46. Finally, Professor Slade states (p. 11): "In this industry, the most compelling evidence of market power comes from the outcome of the market process itself. Profits are large; estimates put them in the range of 40 percent of total assets." Such estimates of accounting measures of rate-of-return are not, as I believe is generally understood, meaningful evidence of market power. It is well known that there are many reasons why accounting measures of profits can deviate both randomly and systematically from being an indicator of the theoretical notion of economic profits. One reason for systematic deviation is of general significance in businesses where intangible assets are important. Here, the value of the intangible assets does not appear on the accounting books. Then, when operating margins are expressed as a percent of the book value of assets, the resulting percent is systematically too large, relative to economic meaning, simply because the book's list of assets misses the intangible ones. This effect is likely to be of specially great quantitative significance where trademarks, brand-names, product or service reputation, proprietary technology, and organizational capital are important to the business.

47. Of course, service industries typically contain leading instances of businesses where intangible assets are important. For example, the business of any successful magazine is unlikely to rest on significant tangible assets, and instead to depend on intangible assets that include the name and design of the magazine, and perhaps the organizational capital embedded in the editorial and advertising sales teams. The rate of return on tangible assets earned by such a business will turn sensitively on whether the books include ownership of the business office and a fleet of trucks or autos, or whether the business leases such properties. In either event, the assets that really drive the success of the business will not be valued on the books, and so the rate of return on assets will indicate nothing about the economic profitability of the enterprise, and certainly nothing about market power.

48. It goes without saying that the directory publishing business is a prime example of the effects just discussed. For all the conventional reasons alluded to, the rate of return on assets, or other accounting measures of profits, are not reliable indicators of market power. If this is, as Professor Slade suggested, the "most compelling evidence of market power," then there is really no evidence of market power at all.

### III. The Relevant Geographic Market

49. I agree with Professor Schwindt inasmuch as he believes that the relevant geographic market is local (p.20, Report). He goes on to say that it is bounded in many instances by the extent of the local free calling area. That may or may not be accurate in any given instance,

but it is not a reliable principle or indicator. Professor Schwindt comments that Tele-Direct's Toronto neighbourhood books are substitutes for the more widely scoped metropolitan book, and I agree.

50. He then says "Nevertheless, it is generally true that a telephone directory aimed at one geographic area is not a substitute for one directed at a different geographic area." I agree with this articulation to the extent that the two geographic areas in question do not have significant economic overlap. For example, consider a directory that is distributed to the population in area A, and it attracts advertising from establishments in areas A and B, because they find the area A population to be likely patrons of their businesses. Another directory, or community newspaper, is distributed to consumers in part of area A and in area C. Suppose this group of consumers is attractive enough to many of the establishments of areas A and B to stimulate their advertising demand. Then, it may well be the case that advertisements in the first directory compete as substitutes for the ads in the second directory or in the community newspaper from the perspective of the establishments that find both attractive as vehicles to promote their businesses.

51. The correct general principle here is that the relevant geographic markets include any other local advertising to which some consumers in the area of directory circulation are exposed -- so that local media are included if they are capable of promoting the businesses of overlapping groups of establishments. Of course, in order to compete with each other, it is not necessary for two different local advertising media to have the exact same groups of consumers exposed to them. To the extent that Professor Schwindt agrees with this principle, I am in agreement with him. However, based on the material in his Report, I am not sure what is his view on geographic markets.

#### **IV. Claims of Significant Barriers to Entry into Publication of Independent Directories**

52. In this section, I focus on the claims of Professor Schwindt that there are significant barriers to entry into the publication of independent directories. His lead argument on this subject (p. 22) is that Yellow Pages directory publication is very profitable both in the United States and Canada, but that consequential entry has not been evident. As I discussed above in Section II., there is no reliable evidence on the profitability of directory advertising, either in the U.S. or in Canada. There is no economic logic to the proposition that high accounting profitability in a service sector, either with or without "consequential" entry, is indicative of significant entry barriers.

53. There is also no economic logic to the next important assertion of Professor Schwindt -- that the general lack of financial success experienced in the U.S. by telephone company directory entrants attests to the existence of significant entry barriers. As a matter of economics, it is surely not the case that the absence of entry barriers assures financial success to entrants. Rather, the absence of entry barriers means that incumbents must be efficient in meeting the demands of customers at competitive prices, or else be disciplined by actual



entry. It also means that entrants will themselves succeed in the markets they enter, based on their relative efficiency and appeal to customers, rather than be disadvantaged by merely their position as entrant. But absence of barriers is not an assurance, and should not be seen to be an assurance of financial success for entrants. That mistaken view would be dangerous to market players, and perhaps even more so to those with a role in competition analysis and the resulting public policy.

54. On the other hand, a record of actual entry attempts, either ultimately successful or not in gaining prosperity, is an informative indicator that entry barriers are not of major importance. After all, if repeated instances of entry decisions result in the market presence of new participant suppliers, then any feared barriers are evidently not successful in either deterring entry or in stopping entry from having the impact that is required for potential competition to have its force over incumbents. Thus, the record of entry is reassuring about the insignificance of any barriers, both in the U.S. and in Canada. In particular, the concerns expressed by Professor Schwindt about the barriers raised by the need to operate for free with a prototype directory, and to gather a staff, should be assessed not just with abstract theory, but also from the standpoint of the historical record of considerable actual entry in the U.S. and Canada. As far as theory is concerned, prototype directories is only one entry strategy of many that are possible, and in general, the directory entrant has the ability to conserve sunk costs by selling ads before publishing the book and advertising it to consumers. Entrants into directory publishing with affiliations with local newspapers, of course, may already have sufficient name recognition and reputation, as well as advertising sales staff resources, to make these issues raised by Professor Schwindt entirely moot. In general, in Canada, I understand from Tele-Direct, there is no scarcity of talented individuals with the right qualifications to go to work in directory sales, and to internalize the requisite training with speed and efficiency.

55. The many "incumbent advantages" that Professor Schwindt asserts are central to his conclusion about entry barriers in most part are misinterpreted. First is Professor Schwindt's concern about lists and updates. This is another example of a purported barrier for which actual entry examples can be informative. If this has been a barrier, many entrants into the Canadian directory publishing business have apparently not found it to be of major significance. Going forward, I understand that the CRTC has proposed a resolution of the listing issues which resolve them in a fashion that has eliminated the complaints of the Director.

56. Professor Schwindt's concern about first-mover advantages among directory publishers is based on an arbitrary and unsupported choice of one of several different and opposing theoretical notions. For example, while it is conceivable that advertisers are so pleased with their incumbent directory advertising that considering a new alternative would seem unduly risky, it is also equally valid as a matter of theory that the risks perceived in dealing with a new alternative would be less as a result of the advertiser's experience with the medium. My Report cited some findings that might help to resolve this abstract debate on the subject.

Advertisers were not overwhelmingly happy with the value they experienced from advertising in Tele-Direct directories. And there are prominent examples of directory entrants gaining substantial penetration and revenues very quickly.

57. More fundamentally, it is important to recognize, as Professor Schwindt seems to neglect, that in a service business reputation, credibility, name recognition, and brand awareness are all elements of the most valuable business assets. They must generally be built up through investment, or extended from other applications, and it is their value that drives enterprises to perform well for their customers. Superior performance builds these assets, and protects those that exist from degradation of value. These are among the important mechanisms through which competition works in service industries, and it is a route to flawed competition analysis glibly to dismiss such important mechanisms as entry barriers. In particular, in the directory business, there is no evidence presented by Professor Schwindt that the crucial intangible assets are associated with first-mover advantages or incumbency advantages, rather than with entirely procompetitive investment in superior customer performance.

58. These remarks apply in particular to the trademarks and logos that belong to Tele-Direct. While such intangible assets do give customers some confidence in the service they can expect to receive, and thus build business in a fashion consonant with the assets' value, they are also always vulnerable to loss of value caused by disappointment of customers' expectations. It is this vulnerability that maintains incentives for customer-pleasing behaviour, and that creates a heavy responsibility for a business built on such a foundation. While it may be difficult for a less motivated or a less efficient entrant to succeed against a firm with such important assets, they need not be a barrier to the more efficient entrant, or one with a better idea of how to meet customers' demands. The prospect for an entrant of building its own valuable reputation based on its superior performance can be a powerful inducement for pro-competitive entry.

59. Professor Schwindt expresses concern about billing as a source of incumbent advantages. I think this concern is misplaced for two reasons. First, business experience suggests that there are many different approaches to billing that seem consistent with success in service businesses, so that it is hard to see purported billing advantages as a significant barrier to entry. Second, Tele-Direct pays a substantial fraction of its revenues to the telephone companies that cooperate with its billing. Professor Schwindt does not begin to attempt to show that the telephone company billing services provided to Tele-Direct are in any way a greater or consonant source of advantage as compared to the burden of Tele-Direct's financial obligation of payments to the telephone company.

60. Finally, Professor Schwindt claims that the U.S. experience leads to a concern that incumbents' strategic behaviour constitutes a source of entry barriers. The list of elements of such claimed strategic behaviour shows dangerous confusion between the workings of competition and fears of anti-competitive effects. These elements include adding features,

increasing advertising expenses, lowering prices, rescoping, special pricing programs, and "genuine attempts to improve the quality of their products and services." Professor Schwindt presents no evidence that these elements of competition, potentially of great value to consumers, are in the context he is purporting to analyze, a threat to consumers rather than a boon.

61. In short, the analysis of entry barriers presented by Professor Schwindt is weak in its economic logic, and bereft of factual evidence to support his claims. It would be a real mistake to base a finding of dominance, with concomitant implications for public policy, on such analysis.

#### V. The Conclusions of Professors Slade and Trebilcock on Tying

62. I have read the Report of Professor Slade and the Rebuttal of Professor Trebilcock. I disagree with the conclusions of Professor Slade on the subject of tying, and I agree with the points made by Professor Trebilcock in his rebuttal.

63. Overall, I find that the approach taken by Professor Slade to the fundamental issues involved in tying is inadequate as a matter of general public policy. Having concluded (incorrectly, in my view) that there is a tie based on a position of market power over the tying good, Professor Slade ended any further attempts at analysis, and merely asserted that injury to competition followed automatically. Thus, if her report were to set an example, subsequent tying cases would have no room for analyses of the efficiency or business rationale of the practice, and no need for a showing of harm to competition beyond the fact (assumed here for this purpose) of the tie itself. In my view, such an interpretation of competition law would be against the public interest in economic efficiency and consumer welfare.

