

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. 1985 c. C-34, as amended

COMPETITION TRIBUNAL TRIBUNAL DE LA CONCURRENCE		P R O D U I T
AUG 29 1995 <i>RA</i>		
REGISTRAR - REGISTRAIRE		
OTTAWA, ONT.		# 153

BETWEEN:

THE DIRECTOR OF INVESTIGATION AND RESEARCH

Applicant

COMPETITION TRIBUNAL
TRIBUNAL DE LA CONCURRENCE

- and -

File No. CT-94/3
 No. du dossier
See v Tele-Direct
 et R-175

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

Respondents

Exhibit No. R-175
 No. la pièce
 Filed Dec. 6/95; 10d05
 Déposée le
 Registrar Shagaci
 Greffier

- and -

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

Intervenors

AFFIDAVIT OF MICHAEL TREBILCOCK
FILED IN REBUTTAL

I, Michael Trebilcock, of the City of Toronto, in the Province of Ontario, MAKE OATH AND SAY AS FOLLOWS:

- I have reviewed the opinion of Professor Margaret Slade dated August 15, 1995, to be filed with the Competition Tribunal on behalf of the Director of Investigation and

Research of the Competition Policy Bureau, with respect to the Director's tying allegations in the above proceedings. I offer the following comments.

2. I note at pages 1 and 2 of her opinion that Professor Slade accepts that space and advertising services (including selling effort) are inputs or intermediate products that go into the production of directory advertising. However, having acknowledged this, she then fails in any way to relate the internal production of these inputs to the theory of the firm or theories of vertical integration. As I emphasize in my affidavit, vertical integration is pervasive in modern economies. In-house production of complementary inputs to a final product necessarily entail excluding the possibility of external or independent suppliers providing the inputs produced within the firm. If this constitutes an anti-competitive form of tying for purposes of s. 77 of the *Competition Act*, the potential for anti-competitive tying allegations is practically limitless in modern economies.

3. At page 7 of her opinion, Professor Slade indicates that she plans to discuss whether advertising space and advertising services can be provided separately or must be furnished as a package. As I emphasize in, my opinion, this is to ask the wrong question. I do not deny that technically the inputs can be separated - as indeed they presently are with respect to commissionable accounts - but the question is not whether technically they can be separated but whether it is efficient to contract out or to produce these inputs internally. Professor Slade implicitly acknowledges that this is the appropriate question when she states (at p.10) that "the decision concerning separateness must ultimately depend on economic

common sense. For example, it would be inefficient to treat left and right shoes as separate products" (even though technically they could be separated). However, nowhere in her opinion does Professor Slade address the comparable issue in the present proceedings of whether internal production or out-sourcing of these inputs for various classes of advertiser accounts is more efficient.

4. Professor Slade argues in the present context that advertiser clients should be able to decide whether to use an independent selling agent or not (pages 12 and 13). At page 8, Professor Slade further claims that it is standard for the advertising industry and the media to view the service and space functions as separate, citing the example of television stations that sell time (or pay a commission) to any accredited advertising agency. While this may be true of television stations, for many other retailing functions the selling function is routinely provided internally. For example, as I state in my affidavit at paragraph 37, major retailing chains like Eatons, Simpsons, The Bay, and Walmart routinely organize their selling functions internally by providing display space and sales staff. This is also obviously true of local new car dealerships and many other retailers. It is also true for a large range of display advertising in daily and weekly newspapers where commissions are not paid on most retail advertising. For example, the Toronto Star has an explicit policy of not paying commissions on retail advertising (see para. b of sample rate card attached hereto as Exhibit "A"). No one suggests that it should be a matter of objection either by consumers or potential sales intermediaries that customers are unable to hire independent sales intermediaries or that the latter in turn cannot demand a sale's commission from these

businesses for successful referrals. In fact, TeleDirect does choose to contract-out the provision of a variety of its inputs, including advertising selling and service functions for commissionable accounts, printing of its directories, and delivery of its directories. The explanation for when it does or does not find it appropriate to contract-out the provision of various inputs resides in a range of efficiency considerations which Professor Slade does not address, and cannot be explained by crude attempts to claim that Tele-Direct is attempting to monopolize its input markets, which even assuming market power in its output markets, makes no business or economic sense.

5. In developing her argument that space and services are two separate products, Professor Slade relies on a number of factors (at page 9). First, she rightly states that Tele-Direct pays commissions on some accounts, thus entailing a separation of space from services. However, the fact that space and services have been separated in some cases does not imply that it is efficient to separate them in all cases. For example, it appears to be common ground that small advertiser accounts can only be efficiently serviced through an internal sales force and that independent advertising agencies have neither the ability nor desire to service such accounts. Thus, there is no alternative but to provide space and services on a bundled basis for such accounts. In my earlier opinion, I also adduce reasons for why it is efficient to provide space and services on a bundled basis for larger local accounts but not for large national accounts. In all cases, space and services could be technically separated, but as I have emphasized, this is not the relevant question. Professor Slade also argues that Tele-Direct organizes its company into divisions and that there are two

Vice-Presidents in charge of sales and publishing respectively and thus the two functions are separated within Tele-Direct's own organization. This point does not refute the proposition that space and services have been vertically integrated within a single organization, with a hierarchy of decisionmaking that ensures integrated production functions, whatever organizational subdivisions may prove convenient for day-to-day operations. Professor Slade also claims that Tele-Direct has created an arms-length subsidiary, Tele-Direct (Media), which is a CMR specializing in providing advertising services for advertisers with commissionable accounts, which she claims again recognizes the separability of space and services. Again, I reemphasize the point that technical separability is not the issue, but rather whether it is efficient to integrate space and advertising services for some set of accounts and not others. Professor Slade also claims that Tele-Direct's subsidiary, NTD, provided advertising services in the U.S. market, but did not publish a U.S. directory, hence again suggesting the separability of space and advertising services. She does not acknowledge, however, that NTD operated in the U.S. market as an exclusive selling agency, an arrangement I refer to in my earlier opinion, which, as with the arrangements adopted by Tele-Direct in Canada, precludes independent advertising agencies from servicing selected advertisers and which has recently been upheld in similar circumstances to the present case by the U.S. Court of Appeals for the Fourth Circuit in Thompson Everett Inc. v. National Cable Advertising L.P. (June 27th, 1995). Finally, she claims that the separation of space and advertising services is common in the advertising industry, and it is standard for other media to pay commissions to accredited agencies. While this may be the case with

some media, such as television, as noted above it is not true of other media such as daily and weekly newspapers.

6. At pages 10 and 11, Professor Slade claims that Tele-Direct possesses market power in the provision of space, which is an essential input into directory advertising, and that by tying the provision of services to the purchase of space it has effectively extended its market power in the provision of space to the provision of advertising services, hence preventing independent advertising agencies from expanding their presence in the advertising services market. This view implicitly reflects an adoption of the leverage theory of tying, discussed in paragraph 31 of my opinion. Professor Slade, however, at no point acknowledges the extensive critiques of this theory, which point out that it is generally not possible for a firm, even assuming market power with respect to one product, to exploit profitably this market power a second time with respect to a complementary product.

7. At page 17, Professor Slade acknowledges that, with respect to the first remedy proposed by the Director for the alleged tying of advertising space and advertising services, i.e. unbundling of advertising space and advertising services by charging separate prices for these inputs, it will be difficult to establish marginal costs for these different inputs and therefore continuing regulatory oversight will probably be required. I address this issue in paragraphs 14 and 15 of my opinion and note there that these difficulties persuaded the U.K. Office of Fair Trading in its investigation of Yellow Pages advertising that unbundling was simply not a viable option - a view that was shared by most of the witnesses that

appeared before it. However, Professor Slade fails to recognize that the alternative remedy proposed by the Director - general commissionability of all advertising accounts - raises exactly the same issues of continuing regulatory oversight in fixing the commission rates - an issue that I address in paragraphs 16 and 23 of my opinion.

8. Professor Slade claims at pages 5 and 11 that profits of Tele-Direct are high - perhaps in the range of 38 to 40 percent of total assets - and that this is symptomatic of market power in the directory market. Measuring profitability by reference to return on assets in any service industry is totally inappropriate. For example, most independent advertising agencies, including intervenors in these proceedings, are likely to be found to possess market power by this measure, as would many other service firms such as law and accounting firms, that own very few assets. I note in this respect that Professor Richard Schwindt in a separate opinion filed on behalf of the Director does not invoke this measure of profitability as an indicia of market power. However, it should be emphasized that in my view the economic implications of the alleged "tying" of inputs in this case is independent of the question of whether Tele-Direct possesses market power in the directory advertising market (the output market). Even if it does, my opinion sets out reasons as to why it would be rational for Tele-Direct to employ exclusively an efficiency calculus in deciding whether or not to internally integrate the production of inputs into the production of directory advertising.

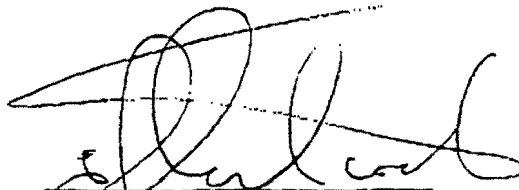
9. While Professor Slade argues at pages 12 and 15 of her opinion that Tele-Direct's alleged practice of tying impedes the entry of new directory advertising agencies and inhibits the expansion of existing agencies, thus in her view substantially lessening competition in terms of s.77 of the *Competition Act*, she also acknowledges at p.12 that entry into the advertising services market is potentially easy and economies of scale are relatively unimportant. Accepting as a logical fact that all forms of vertical integration foreclose a portion of the input market to independent suppliers, the question to be posed for the purpose of competition policy is not whether the number of independent suppliers is fewer with vertical integration than without (it obviously is), but whether vertical integration produces inefficiencies in the provision of directory advertising services. However, there are many organizations active in providing the same kinds of services that Professor Slade views as directory advertising services, including the sales staffs of independent directories, specialized advertising agencies, consultants, general advertising agencies, and in-house advertising agencies (see pages 8 and 9 of her opinion). There is no evidence of scale economies that would render ineffective the efforts of these various providers of directory advertising services to compete efficiently in the provision of non-integrated directory advertising services even if they remain foreclosed from providing advertising services related to the current range of Tele-Direct's vertically integrated advertising functions.

10. Professor Slade completely fails to address in her opinion the critical fact that almost all Yellow Pages Directory publishers, whether telco-affiliated or independent, organize their selling functions in a similar way to Tele-Direct, i.e. through heavy reliance

on an internal sales force, even where the directory publishers are very small and manifestly possess no market power in the directory space market (see paragraph 27 of my opinion). Any anti-competitive theory of tying in this case that cannot explain the vertical integration of advertising services by directory publishers that manifestly lack market power is critically deficient. Indeed, this fact is fatal to any attempt to argue that the internalization of selling functions is a manifestation of an effort by a firm with market power to leverage its market power from the space market to the advertising services market.

11. I make this affidavit pursuant to Rule 47(2) of the Competition Tribunal Rules.

SWORN BEFORE ME at the City of)
Toronto in the Municipality of)
Metropolitan Toronto this 25th)
day of August, 1995)


Michael Trebilcock


A Commissioner for Taking Affidavits

RED\35324\01\REBUTTAL.DOC

ELIZABETH WHITNEY TINKER
A Commissioner, etc., PROVINCE OF
ONTARIO, while a student-at-law.
Expires July 7, 1998.

THE TORONTO STAR

June 1995 ADVERTISING INCENTIVE PLAN FOR

Frequency

Savings for Retail Advertisers

Maximize your exposure with more insertions at reduced rates!

3 days - Sunday to Friday
or Saturday Life section
only \$3.46 per line, per day

*Here's how the 3-Day
Frequency Plan works:*

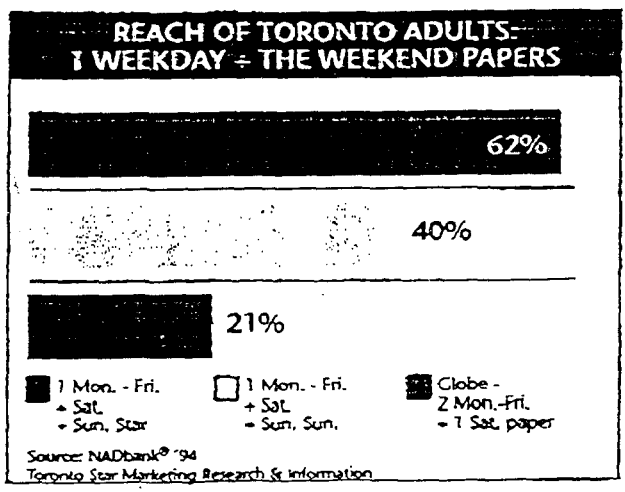
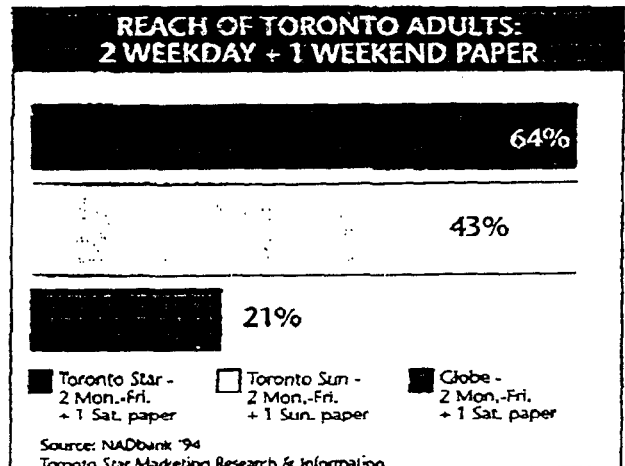
- You will receive 3 insertions within a 7-day span. On Saturday (Life section only)
- Your *maximum* ad size is 980 agate lines.
- The contents of each ad may change; however, the size must be consistent.
- Your line rate will be \$3.46 per line per day (*based on 3 insertions*)
- This plan is limited to retail advertisers.

This special line rate is actually 32% (\$1.62) *less than the lowest* weekday contract rate in The Toronto Star and 28% (\$1.36) *less than the lowest* Sunday contract rate.

Please note:

All terms and conditions detailed on our retail rate card apply. Rates effective June 1, 1995.

Each week, The Toronto Star reaches your consumers more successfully than the competition



Terms and Conditions

a.) Accounts are payable when rendered. Accounts are considered past due if payment is not made by the 20th of the month following billing. Payments in foreign currency must be made at the prevailing Canadian rate of exchange. The Publisher will require prepayment from Advertising agencies who indicate that their client(s) is responsible for payment of the advertisement or any kind of payment disclaimer is used or implied on Advertising insertion orders.

b.) Rates quoted are for retail advertising only. The Publisher reserves the right to classify all advertisements. No agency commissions are paid on retail advertising.

c.) The Publisher may increase advertising rates at any time and all contracts are accepted subject to this condition. The advertiser may cancel any contract without short rate penalty on notice within 15 days after higher rates are made effective by the Publisher.

d.) If publication of The Toronto Star is restricted or curtailed in any way, rates quoted here or in any contract and the size or location of any advertisement shall be subject to modification without notice by the Publisher.

e.) The Publisher reserves the right to revise, reject, discontinue or omit any advertisement, or to cancel any advertising contract, for reasons satisfactory to the Publisher without notice and without penalty to either party.

f.) If an error is made by The Toronto Star which in its judgement materially affects the value of an advertisement, a corrected advertisement will be inserted once upon demand without further charge. "Make good" insertions will not be granted on minor errors which in the Publisher's judgement do not lessen the value of the whole advertisement.

g.) The liability of the Publisher for damage arising out of errors in advertisements is limited to the amount paid for the space actually occupied by the portion of the advertisement in which the error occurred, whether such error is due to the negligence of the Publisher's employees or otherwise. The liability of the Publisher for damage arising out of non-insertion of any advertisement is limited to the amount received by the Publisher for such advertisement. The advertiser agrees to indemnify the Publisher for any losses or costs incurred by the Publisher as a result of publishing any advertisement which is libelous or misleading or otherwise subjects the Publisher to liability.

h.) The Publisher accepts no responsibility for loss of profit or consequential damages arising from the exercise of its rights set out in paragraph (e.), non-insertion of any advertisement or any error made in any advertisement whether such error is due to the negligence of the Publisher's employees or otherwise.

i.) Advertisers will be charged for space occupied from cut-off rule to cut-off rule, not exceeding space ordered.

j.) All materials produced by the Publisher will remain the property of the Publisher. The Publisher will not be responsible for the return of materials supplied by the advertiser unless return delivery instructions are received when the advertisement is placed.

k.) The printing of key codes used to track coupon redemption is not guaranteed.

l.) The Publisher may insert the word "advertisement" or "advt." above or below any copy.

m.) Contracts must be signed in order to obtain contract discounts. Open rates will be charged in absence of a contract. No contract will be accepted for a period longer than one year. Contingent orders will not be accepted.

n.) Press limitations, or other causes beyond its control, may require the Publisher to limit the availability of color, insert distribution and other special classifications on selected occasions during the year.

o.) Deadlines may vary dependent on printing schedules.

p.) The Publisher will not knowingly publish any advertisement which is illegal, misleading or offensive to its readers.

Member of:

- Canadian Daily Newspaper Association
- Newspaper Marketing Bureau
- Audit Bureau of Circulations
- Advertising Advisory Board
- Advertising Standards Council