Record - Public

THE COMPETITION TRIBUNAL

File No. CT-94/01

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

AND IN THE MATTER OF certain practices by The D & B Companies of Canada Ltd.

BETWEEN:

THE DIRECTOR OF INVESTIGATION AND RESEARCH

Applicant

- and -

THE D & B COMPANIES OF CANADA LTD.

Respondent

- and -

INFORMATION RESOURCES INC.

Intervenor

AFFIDAVIT OF DR. RALPH A. WINTER
SWORN OCTOBER 4, 1994

I, DR. RALPH A. WINTER, of the City of Toronto, in the Municipality of Metropolitan Toronto, MAKE OATH AND SAY AS FOLLOWS:

1. I hold the position of Professor of Economics at the University of Toronto. I have sworn an Affidavit in these proceedings dated September 20, 1994. Attached hereto as Exhibit "A" is a true copy of my Report in response to the Affidavits of Professor Frank Mathewson and Margaret E. Guerin-Calvert, filed on behalf of the Respondent in this matter.

SWORN BEFORE ME at Paris, France)
this 4th day of October, 1994.)

DR. RALPH A. WINTER

A Commissioner, etc.

Exhibit "A"

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PROFESSOR WINTER'S RESPONSE TO THE REPORTS OF NIELSEN'S EXPERTS

RESPONSE TO PROFESSOR MATHEWSON'S REPORT

Professor Mathewson and I agree on a number of issues in the Director's application and disagree on others. In this response to Professor Mathewson's report, I shall discuss his views on the six main issues raised in the report:

- The definition of the market in the Application
- Competition between Nielsen and IRI for the rights to scanner data
- The bargaining power of grocery retailers, supplying the scanner data
- The bargaining power of the buyers of Nielsen's market tracking services
- The evidence on price movements
- The explanation of exclusivity in Nielsen's contracts

1. Market Definition

Nielsen has, through its two expert witnesses, abandoned the argument advanced in its response that the relevant market in this application must include products beyond market tracking services. Professor Mathewson starts his analysis by examining the Canadian market for tracking services and his section 2.3 is "The Nature of the Product Market: Market Tracking Services".

This narrows the product market definition issue to a single question: Have scanner-based tracking services good substitutes based on other data sources? The market definition in the Application can be criticized successfully only with an affirmative answer to this question.

Professor Mathewson does not address the question directly. He notes that there are alternative data sources for tracking market variables, but does not argue that the alternative data sources are close substitutes for scanner-based services.

Professor Mathewson, in fact, recognizes that the data sources vary in their attributes and functions served:

> "The point is that data sources and needs are diverse. This permits business opportunities at various levels (geographically or trade level specific) in this industry both to collect data and to provide the decision support services that are demanded appropriate to the data at hand." (2.1.4)

I agree that the various data sources are diverse, rather than close substitutes for each other. Elsewhere in his report, as I discuss below, Professor Mathewson assumes that the functions of scanner data cannot be effectively duplicated by other data sources. In short, while he does not directly address the validity of the Director's market definition, Professor Mathewson's analysis supports its validity.

Both of Nielsen's experts agree that Canada is the relevant geographical market (2.1.1).

2. Competitive Bidding for the rights to Scanner Data

Professor Mathewson argues that since 1986, any potential competitor such as IRI could have bid on contracts with major grocery chains for scanner data (1.3 and Section 2.4). He does not attempt to connect the possibility of competitive bidding for contracts, however, to the issue of whether Nielsen's exclusivity restrictions violate Section 79 of the Competition Act.

This is appropriate, in my judgement. There is no connection. Bidding for the rights to the essential input, or competition "for the market", has not led to competition within the market. As I argue in my report, there is no reason to expect it to. More fundamentally, whether other firms could or could not have entered exclusive contracts with suppliers, they did not. Once the exclusivity contracts are struck and adhered to, Nielsen is protected against competition in the market for scanner-based tracking because no other firm has access to the essential input.

3. The Bargaining Power of Grocery Retailers

Professor Mathewson argues (at 1.2) that major grocery retailers, who supply the essential input of scanner data, are large and capable of negotiating favourable terms in their contracts with Nielsen.

I agree. Retailers are paid in some cases over for data that are virtually costless to provide. They do not have to be coerced into accepting these contracts. Because Nielsen and IRI have competed for the right to be a monopolist, a substantial share of the profits from monopoly flow upstream in the form of payments to retailers. The redistribution of rents from the prevention of competition, however, has no relevance for the application of Sections 78 and 79.

Nor is there any suggestion in the Director's Application that either Nielsen's control of the market for scanner-based tracking services or its anticompetive practices has been manifest in the coersion of retailers in the upstream market for scanner data. This is not the market of focus.

4. The Bargaining Power of Buyers

Professor Mathewson also argues that the buyers in the relevant market, manufacturers, are large and capable of negotiating favourable terms in their contracts with Nielsen. In support of this argument, he offers (at 2.2.4)

A countervailing-power defense of the prevention of competition among sellers may have some economic basis in a market with a single buyer. In a market with even two or three buyers, it has none. Furthermore, in Nutrasweet, the Tribunal explicitly rejected the countervailing power defense in a market with two very large buyers. The buyers' side of the relevant market in the current case is far less concentrated than in Nutrasweet, as Professor Mathewson's own evidence shows, and the countervailing power defense has no basis.

The sources of manufacturers' bargaining power offered by Professor Mathewson include the fact that "manufacturers could cut back on their demand for Nielsen's services" (2.2.6). I agree that

this is an option. Exchange is voluntary in a free market economy, even in markets that are monopolized. However, nothing in the economic principles underlying competition law assumes otherwise.

A second option offered for manufacturers is to influence favourably the terms and conditions that they receive in Canada through terms that they are accorded by Nielsen in other national markets (2.2.7). This is an economic argument that a firm with a monopoly in one market may be fully disciplined in its pricing, by competition in the provision of other products to the same buyers. I know of no economic basis for this proposition. As a factual matter, I understand that the opposite effect has occurred. IRI has been at a competitive disadvantage in the sales of its U.S. data to large multinational buyers because it cannot offer scanning data from both Canada and the U.S. Nielsen's monopoly in Canada has an anti-competitive impact beyond the relevant market in this case.

5. The Evidence on Price Movements

Professor Mathewson offers as one of his main conclusions the following:

> "The evidence is that during the period 1986 to the present the real price of the Nielsen market tracking service was constant or declined marginally and the quality of the product increased as, among other things, the scanning based data became more reliable and usable."

No economic theory allows us to infer from inflation rates in a market the extent of competition in the market. Monopoly is associated with high price *levels*, not high price *changes* over time. On its own, the evidence on inflation rates is irrelevant.

The evidence on price changes in the Canadian market for tracking services becomes meaningful, for inference about the competitiveness of the market, when it is combined with evidence on price changes in the U.S. market. This is because while the Canadian market has remained monopolized, the market structure in the U.S. has changed. IRI's market share in the U.S. has grown to roughly one-half. This natural experiment, with the U.S. market playing the role of a "control group", allows us to infer the impact of the prevention of competition in Canada through Nielsen's exclusivity restrictions.

In this regard, the evidence in the report of Professors Gould and Rosenfield and, I understand, from other witnesses, shows that prices for market tracking services have decreased substantially in the U.S. where there is competition, as compared to Canada where there is a monopoly. In short, the relevant pricing data does not support the hypothesis that Nielsen has priced competitively.

Note in addition, that in attributing the improved product quality to the increased reliability of scanning data, Professor Mathewson assumes that scanning data have no close substitutes among other data sources. On this we agree.

6. Professor Mathewson's Explanation of Exclusivity in this Market:

An analysis concluding that the role of a contractual restraint is not anticompetitive must, to be complete, include an explanation of why the restraint *is* used in the market and why this use is within the law.

Professor Mathewson presents his theory of why Nielsen used exclusivity restrictions at 2.4.2:

> "Confronted with the fact that IRI had initiated a bidding game based on exclusivity, it is reasonable to claim that Nielsen had little choice but to respond with exclusive contract proposal[s] of its own."

An anticompetitive practice cannot be defended legitimately on the grounds that it is the only profitable response to the use of the same practice by a rival, or even that it is necessary to survive in the market. Section 79 does not exempt an anticompetitive practice on grounds that more than one firm was using it or attempting to use it. The section offers no scope for "self-defense" arguments.

Finally, note that the statement once again recognizes that scanner data have no close substitutes in the production of marketing services. As Professor Mathewson states, "To produce national data, Nielsen would have had to replace the missing data with data from other sources. If this were grossly inferior, Nielsen would have had to abandon its attempt to produce national marketing tracking data services." Professor Mathewson's analysis assumes that there are no close substitutes for scanner data. For if scanner data were but one of many closely substitutable data sources, then Nielsen could have continued to compete in the market for national tracking services without scanner data, rather than being left with "little choice but to respond with exclusive contract proposals of its own".

RESPONSE TO THE REPORT OF MARGARET E. GUERIN-CALVERT

1. The Market Definition

Ms. Guerin-Calvert states the main conclusion of her report in paragraph 5:

> "I conclude that Nielsen's contracting practices with retailers in Canada have not foreclosed entry opportunities into competition for the sale of market tracking services to consumer packaged goods manufacturers in Canada; thus, they have not tended to lessen competition substantially in the sale of such services."

In reaching this conclusion, Ms. Guerin-Calvert simply adopts her own market definition: the provision of marketing services in general. This broad market definition appears to follow from a consideration of which products Nielsen offers.

I accept that there have been entry opportunities in the provision of some services outside of those based on scanner data. ISL is an example of a competitor in this broad business. The competitiveness of these markets, however, is irrelevant for this case.

Nor has the Director, in defining the market to be scanner-based products, chosen a small part of the Nielsen's business. Table 1 of my report, reproduced below,

The Application is about the prevention or lessening of competition in scanner-based tracking. The theme throughout Ms. Guerin-Calvert's report, that Nielsen offers a wide range of products and faces competition in the markets for some of these products, is beside the point.

To establish that the market definition in an application of Section 79 cannot be as narrow as scanner-based tracking, Ms. Guerin-Calvert would have to show that scanner-based tracking has close substitutes among services based on other sources. This would require a detailed examination of the specific functions provided by the scanner-based product. Like Professor Mathewson, Ms. Guerin-Calvert does not address this issue.

2. The Dynamics of the Relevant Market

Ms. Guerin-Calvert makes the observation (at 13 and 27) that for most of the period discussed in the Director's Application, 1986-1994, Nielsen did not produce the relevant product as defined by the Director. Nielsen's national market-tracking service, MarketTrack, was introduced only in 1992.

As a matter of economics, there is no reason to expect the consequences of anticompetitive acts to be contemporaneous with the acts themselves. In this market, Nielsen had substantial assets invested in traditional (non-scanning) market tracking technology as of 1986, and was the dominant supplier of market tracking services in Canada. In general, new innovations are often introduced not by a dominant firm in an industry, which has entire capital invested in traditional technology, but by new entrants.[1] It is clear that if an incumbent dominant firm can block the introduction of a new, superior technology through exclusionary contracts, it has the incentive to do so. It is equally clear that the incumbent dominant firm will then delay the introduction of the new innovation. The exclusionary contracts during the period prior to the introduction of the new product serve to protect the value of existing, traditional assets against the entrant's new technology. This is an example of a contractual restriction that economists term "naked exclusion".[2]

Naked exclusion is clearly anticompetitive, notwithstanding the fact (even, because of the fact) that the incumbent firm does not use the superior product or technology. The chronology of events in Canadian scanner-based market tracking, in which Nielsen purchased the exclusive rights to all supply of an essential input in 1986 but did not produce the national scanning product until 1992, is consistent with the anticompetitive effects of naked exclusion. Nielsen documents show that Nielsen did intend to offer a national market tracking service earlier than 1992, but in my judgement competition from IRI would have forced Nielsen to develop the service more quickly than it did.

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[1] The potential gain to an entrant from an innovation that dominates current technology is the entire monopoly profits; the gain to an incumbent monopolist is only the increase in monopoly profits in moving from the old technology to the new technology.

[2] This is the term adopted by Professors Thomas G. Krattenmaker and Steven C. Salop, in "Raising Rivals' Costs to Achieve Power over Price", *The Yale Law Journal* 96, No.2 (December 1986), to describe the purchase of exclusionary rights by a dominant firm which then does not use the input. The gain to the dominant firm arises solely from the exclusion of rivals, rather than from any enhanced supply; hence the term "naked" exclusion.

If the Director's Application were based solely on a claim that Nielsen's contracts lessened competition during the 1986-1991 period (for example, if the application were being brought in 1991), then the application would have to rely on the dynamic economic theory of anticompetitive exclusion that I outline above. In my judgement, this theory is realistic and such a hypothetical application would have some merit.

But the Director's application in fact does not stand or fall on the substantial lessening of competition during the 1986-91 period. For Section 79 to apply, it is enough that a firm have control of a *current* market and that it be engaging in acts that are *currently* anticompetitive. The Director's application states (at 1) that Nielsen has substantial or complete control of the supply of scanner-based tracking services in Canada, and that Nielsen has engaged in and continues to engage in a practice of anticompetitive acts.

In light of the actual wording of the Director's Application, the following statement in Ms. Guerin-Calvert's report is seriously misleading:

> "As of 1986, when the Director alleges that Nielsen's contracting practices had tended substantially to lessen competition in the provision of scanner-based market tracking services, Nielsen did not produce and sell a market tracking product based on scanner data to consumer packaged goods manufacturers" (paragraph 27)

The Director's Application contains no such allegation. Ms. Guerin-Calvert has in her report rewritten the Application before criticizing its market definition.

While I believe the Application could have been brought legitimately even as rewritten, this is beside the point. The Application as it stands does not require proof that Nielsen controlled a market from 1986-1991. The fact that eight years ago Nielsen did not offer a product in the market defined in the application, is irrelevant.

3. Retailers Bargaining Power

Ms. Guerin-Calvert's report develops, even more than Professor Mathewson's report, the issue of monopsonistic coersion in the market for rights to the data. Her report states:

> "The contracting outcome, however, was not an anticompetitive act or result. Rather it is the result of independent choices made by retailers. Nielsen does not have market power over the retailers such that it could force exclusives on each of them." (paragraph 19)

I accept that the retailers did not have to be coerced into accepting up to for the exclusive rights to data that cost them virtually nothing to produce. The high payments offered for the exclusive rights to data, however, are not evidence of pro-competitive effects of the exclusivity restrictions. To the contrary, the payments are evidence of substantial rents being earned from the prevention of competition. The payments represent a shift of these rents to the owners of the essential inputs.

4. The Possibility of "Niche" Entry

Both of Nielsen's expert witnesses argue that a firm could have entered into competition for some of Nielsen's scanner-based products without purchasing rights to data from the entire set of grocery distributors. Nielsen offers, for example, key account reports which individually depend only on the data from a single chain; and regional reports which depend upon the data from a region. A firm such as IRI could have entered as a competitor, the witnesses argue, by purchasing enough data to offer one of these products.

I have three responses to the argument that this "niche entry" was possible. First, there would be little manufacturer demand for the key account of a single retailer alone. A Nielsen witness, Mr. Churchill, said in discovery that he was unaware of any manufacturer that purchased only a key account. Manufacturers need substantially all major data sources for two reasons: 1) it gives them as complete a set of key accounts as possible, for decision-making and negotiating with individual retailers; and, 2) because of differences among grocery distributors in sales and distribution methods, missing even one large retailer would bias estimates of national and regional aggregate variables. Therefore if a supplier of market tracking services entered locally, manufacturers would need to purchase from both suppliers. This would involve the costs of integrating both sets of data and possibly software systems (in a market where the current trend is towards user-friendly systems that require very little expertise or computing input by the user). Is a configuration in which an entrant such as IRI bids successfully for the rights to one or two large chains, sustainable? No. The entrant will be outbid by Nielsen because of the gains to compatibility as well as the profit gains from any elimination of competition.

Not only these theoretical factors but the historical facts suggest that a single firm will win the bidding rights for all data sources when exclusivity is permitted. Whatever the technical feasibility of producing a marketing service based on a small set of data, a monopoly over scanner data tracking is the market outcome.

Second, as I show in my report, even if this is wrong, the market outcome involving exclusivity restrictions on the part of two firms still lessens competition compared to the market with no exclusivity.

Third, whatever the potential for such entry, it did not occur. Nielsen's exclusive contracts, once entered and adhered to, prevented the entry of any competitors - even local competitors - by tying up an essential input. The logic of the argument by Nielsen's witnesses is that if the exclusive contracts had not been struck, then the contracts would not have been anticompetitive. This is true but irrelevant to an assessment of the Director's application.