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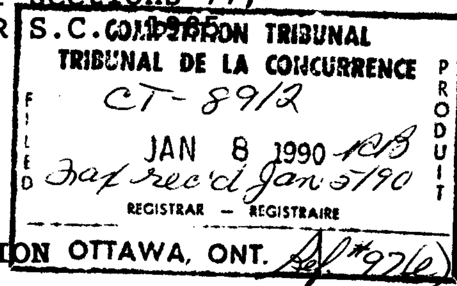
IN THE COMPETITION TRIBUNAL

IN THE MATTER OF an Application by the Director of Investigation and Research under sections 77, 78 and 79 of the Competition Act, R.S.C. 1985, c.C-34, as amended;



B E T W E E N:

THE DIRECTOR OF INVESTIGATION AND RESEARCH,

Applicant,

- and -

THE NUTRASWEET COMPANY

Respondent,

- and -

TOSOH CANADA LTD.

Intervenor

File No CT-89/2
Director NutraSweet
D-55-B
Feb. 9/90; 9h48
Registrar A. Leger

A F F I D A V I T

I, DONALD N. THOMPSON, of the City of Toronto, and the Province of Ontario, make oath and say as follows:

1. I have taught in the Graduate Programme in the Faculty of Administrative Studies at York University in Toronto since 1971, and have held the rank of Full Professor since 1973. I was formerly Chairman of the Marketing Department in the Faculty of Administrative Studies at York. I was a Visiting Professor at the London School of Economics in London, England

in the 1977-1978 academic year, and was Senior Visiting Fellow in Law and Business Administration at Harvard University in the 1970-71 academic year. I served as Director of Research and Chief Economist for the Royal Commission on Corporate Concentration from 1975 to 1977. I have also taught in the graduate faculties of the University of Toronto, the University of Alberta, and at the Roth School at Long Island University.

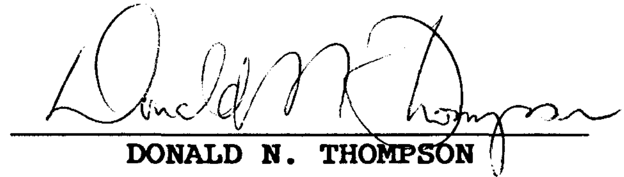
2. I teach in the areas of marketing, strategic planning, and economic regulation. My research is also in those areas. I have served as a consultant to a number of business corporations, Canadian government departments, and foreign governments, primarily in the areas of marketing and strategic planning.

3. I have authored, co-authored or edited seven books and about fifty articles in the areas of marketing, strategic planning and economic regulation.

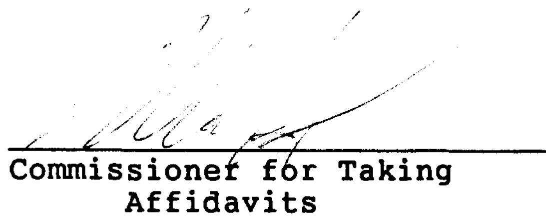
4. I have been retained by the Applicant in this action and asked to advise on the competitive implications of the marketing practices in Canada of the Respondent firm, The NutraSweet Company.

5. Attached hereto as Exhibit "A" to this my Affidavit is a true copy of the report prepared for the Applicant pursuant to the aforesaid request.

SWORN before me at the City of Toronto, in the Province of Ontario this 5th day of January, 1990)



DONALD N. THOMPSON



Commissioner for Taking Affidavits

Mark Halpern

EXHIBIT "A"

IN THE COMPETITION TRIBUNAL

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B E T W E E N:

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THE NUTRASWEET COMPANY

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TOSOH CANADA LTD.

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PUBLIC AFFIDAVIT EVIDENCE OF DONALD N. THOMPSON

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1. I, **DONALD N. THOMPSON**, have taught in the Graduate Programme in the Faculty of Administrative Studies at York University in Toronto since 1971, and have held the rank of Full Professor since 1973. I was formerly Chairman of the Marketing Department in the Faculty of Administrative Studies at York. I was a Visiting Professor at the London School of Economics in London, England in the 1977-1978 academic year, and was Senior Visiting Fellow in Law and Business

Administration at Harvard University in the 1970-71 academic year. I served as Director of Research and Chief Economist for the Royal Commission on Corporate Concentration from 1975 to 1977. I have also taught in the graduate faculties of the University of Toronto, the University of Alberta, and at the Roth School at Long Island University.

2. I have been retained by the Director of Investigation and Research (the "Director"), to advise on implications in Canadian markets of the marketing, distribution and pricing practices of the The NutraSweet Company ("NutraSweet") in the sale of the intense sweetener, aspartame, and to provide an opinion as to the competitive impact of those practices.

3. I have been provided with information from the Bureau of Competition Policy on the structure and practices found in the Canadian market for intense sweeteners. This material includes transcripts of interviews conducted by officers of the Bureau and their legal counsel, copies of contracts for the purchase of aspartame provided to the Bureau, confidential internal documents of industry participants, and publicly-available materials on the aspartame industry and the producers of other intense non-caloric sweeteners. I have had the opportunity to discuss industry practices at length with

officials of

4. My comments are divided into several categories:

(a) Background factors;

(b) Appropriate product market;

(c) Competitive effects of specific marketing practices; and

(d) Two pricing examples.

I. BACKGROUND FACTORS

5. The following are facts or assumptions which I have taken into consideration in reaching conclusions on NutraSweet's marketing practices.

6. NutraSweet will enjoy product patent protection on aspartame in the United States until the end of 1992. The Canadian patent expired in July of 1987. Process patents also exist on the various processes used by NutraSweet, HSC, and others, to produce aspartame.

7. HSC is capable of producing aspartame with a particle size, particle distribution, solubility, density, colour, and other quality factors acceptable to major customers. HSC can provide comparable warehousing, delivery service, technical services and support to customers (but not necessarily marketing support) as can NutraSweet.

8. The price level for aspartame in the United States has been in the range of two to two-and-a-half times as high as it is in Canada.

9. The NutraSweet Company is making a substantial effort to create brand recognition for the "NutraSweet" brand of aspartame among final consumers, rather than its actual customers, who are food manufacturers. Efforts to this end include use of the "NutraSweet" trademark and logo on cans and packages of products containing the sweetener, plus television and other promotion of the ingredient's trade name. The

apparent objective is to have the "NutraSweet" brand of the commodity chemical, aspartame, preferred to other aspartame manufacturers' because of its trademark identification, both prior to and following the date when the U.S. patent expires.

10. NutraSweet uses a variety of tradename, "logo display" and similar allowances to induce manufacturers using its product to display the "NutraSweet" trademark and logo on their cans and containers. A condition of receiving the allowance is that no aspartame, or other intense sweetener supplied by a company other than NutraSweet, may be blended with "NutraSweet" brand artificial sweetener. In other words, the incentive is paid not only for saying "this product contains NutraSweet brand aspartame", but for ensuring that "the product contains "NutraSweet" brand aspartame and no other sweetener". There may be minor exceptions to the practice described above, but these restrictions appear in virtually all NutraSweet's Canadian contracts.

11. The trademark, logo display and other allowances are calculated and paid based on how much aspartame is purchased from NutraSweet, rather than the number of advertising impressions created by the purchaser, or the amount of money spent by the purchaser on promoting the "NutraSweet" blend.

12. NutraSweet also offers many buyers advertising allowances for cooperative advertising.

13. NutraSweet offers supermarket buyers (such as) a direct rebate based on the quantity of "NutraSweet" brand aspartame purchased by their co-packers, rather than by themselves. The payment is apparently to encourage supermarket chains to ask co-packers to use "NutraSweet" brand aspartame exclusively.

14. NutraSweet has various "meeting competition" clauses in at least some of its contracts. One such provision is a "meet or release" clause. This permits customers to entertain competitive bids for the supply of aspartame in Canada, but allows NutraSweet the option of meeting any lower price offered by a competitor, or at its option releasing its customer from the contractual obligation to purchase the quantity of aspartame offered by the competitor. In the contract, so far as Canadian requirements are concerned, it seems that the clause may only be triggered by a bid for substantially all of aspartame requirements over a contract period.

15. NutraSweet offers customers in Canada discounted prices when faced with competing bids from TCL. Sometimes free goods are offered by NutraSweet as a form of price discount.

16. Some major contracts for the supply in Canada of "NutraSweet" brand aspartame are negotiated in the United States, as part of the negotiation of world-wide supply contracts. The and contracts for supply in Canada, which were contracted in the United States, together account for % or more of all NutraSweet's total sales in Canada. NutraSweet attempts to negotiate exclusive regional or world-wide supply contracts with its largest customers, such as

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17. No producer of aspartame in North America or Europe, except NutraSweet, presently has the production capacity to satisfy the entire current requirements of the largest North American buyers of aspartame, or to satisfy the total requirements of the 3 largest Canadian buyers.

18. The Canadian and U.S. markets for aspartame have large but declining growth rates when expressed as a percentage. Anticipated percentage growth rates in Europe, Japan and the rest of the world are much higher than those in North America.

19. To achieve competitive-cost production of aspartame compared to cost levels estimated for existing dedicated production facilities, it appears that a plant must be "dedicated" (single use), of substantial capacity, and operated at a high percentage of design capacity. Specifically, multi-use plants, very small plants, or plants operated at very low capacity utilization are unlikely to be cost-competitive compared to existing industry cost levels. These production characteristics produce the "chicken and egg" problem that a new entrant or expanding competitor cannot be cost competitive at low volumes, and cannot bid for high volume business without production capacity in place. Aspartame plants require substantial amounts of "front end" fixed capital investment prior to production start-up.

20. Several artificial sweeteners that are potentially substitutable for aspartame in some uses (Sucralose, Acesulfame-K, Alitame) are currently under development or testing by large multinational corporations. However, it is uncertain how long it might be before any one of these potential substitute sweeteners receives regulatory approval in Canada for use in carbonated soft drinks.

II. APPROPRIATE PRODUCT MARKET

21. When evaluating the implications of NutraSweet's marketing activities in Canada, the appropriate product market for consideration (at least from a marketing standpoint) is high-intensity calorie-reduced artificial sweeteners, including aspartame and artificial sweeteners which are substitutes for aspartame in aspartame's major uses.

22. Aspartame and related high-intensity calorie-reduced sweeteners constitute a distinct market from sugar or high-bulk sweetening agents, such as high fructose corn syrup, because they have very different attributes from those low-intensity sweeteners. The reason for aspartame's use in Canada is to provide an alternative sweetening agent for consumers who do not wish to consume sugar or a high-bulk sweetening agent such as high fructose corn syrup, because of their caloric content, or do not wish to consume sugar for medical reasons such as diabetes or tooth decay. The principal use of aspartame is in the production of calorie-reduced diet carbonated drinks. Sugar is not a substitute at all as a sweetener for the production of diet carbonated drinks.

23. Indeed, if sugar and aspartame did *not* have different attributes in the perception of buyers, one would expect the prices of the two products to equalize very quickly, or else the more expensive of the two products would disappear from the market. In fact, the comparative prices of sugar and aspartame in Canada have not shown any relationship and, speaking generally, sugar has remained considerably lower priced in Canada than the price of aspartame.

24. Because aspartame is the only high-intensity sweetener in Canada approved by the federal government for use in carbonated beverages (the carbonated beverage industry being the principal user of aspartame), it is probably fair to conclude that until other high-intensity sweeteners gain regulatory approval for use in carbonated beverages and are accepted as functional substitutes by the beverage industry, the appropriate product market for consideration here should include only aspartame.

III. SPECIFIC PRACTICES

A. Use of "NutraSweet" Brand Name on Other-Branded Packaging

25. NutraSweet's "branded ingredient" strategy of inducing users of its ingredient to affix the "NutraSweet" logo and brand name to their own branded product is very unusual and possibly unique. I know of no other significant ingredient producer in the world which has attempted such a strategy, and certainly no other ingredient producer which has succceeded in a "branded ingredient" strategy for a consumer good. The strategy is in NutraSweet's interest, but not (and certainly not in the initial stages) in the interest of the customer of NutraSweet (the food processor). The "branded ingredient" strategy almost certainly could be imposed on buyers only because of NutraSweet's dominant position in the supply market, and the need of buyers for an aspartame-type of calorie-reduced sweeteners.

B. The "Teflon" Strategy

26. The strategy of "branded ingredients" is often called a "Teflon" strategy, after a practice used over several decades by Dupont of having makers of cookware and other items include

the "Teflon" brandname with their own on final products. The strategy used by NutraSweet is in fact very different from this, and should not in any way be compared to strategies used by Dupont or other makers of fibers or coatings. Dupont's "Teflon" strategy is different for a number of reasons.

27. Dupont over a number of years used the strategy referred to above for nylon (which is a fibre, not a final product); "Teflon" (a permanent, non-stick, non-toxic coating material); "Silverstone" (which is a more modern version of "Teflon"); "Stainmaster" (a stain repellent coating for carpets); "Lycra" (a fibre); "Spandex" (a fibre); and other products.

28. The strategy is based on the fact that each new "ingredient", for example "Teflon", is superior to comparable ingredients and costs more, but the difference is not immediately visible or obvious to potential buyers of the final good. The maker of cookware is often a smaller, less well-known firm with a less well-known tradename, which cannot afford to advertise the superior product attributes of the cookware product widely or frequently enough to justify its higher price.

29. Cookware, like many of the other products for which Dupont supplies "ingredients", is usually purchased by consumers infrequently, and at fairly high unit cost, so that the buyer only searches for product information at quite long intervals. Dupont itself then advertises the virtues of a "Teflon", and has the dealer, either voluntarily or in return for a cooperative advertising or display payment, include Dupont's "Teflon" name on the branded cookware.

30. The important features here are that the cookware manufacturer's tradename is far less well-known than the "Teflon" name, and so the manufacturer "piggy-backs" on the ingredient name; the supplier, Dupont, is far bigger and has more resources than most of its customers, and the "ingredient", in this case "Teflon", has superior attributes to other competing ingredients. "Teflon" also may be more costly, and the higher cost of the final product must be justified with promotion of its improved attributes.

31. The NutraSweet strategy is quite different. Its important features are that the "NutraSweet" name is less well-known than those of its larger customers such as Coke and Pepsi (and was far less well-known at the inception of the strategy), so NutraSweet is "piggy-backing" on its customers' trade names, rather than the other way around. NutraSweet is

far smaller and has fewer promotional resources than its largest customers; and, its "ingredient" is essentially the same as that of competing aspartame sweeteners. Thus, NutraSweet does not have to justify a higher cost for products containing its artificial sweetener in contrast with Dupont's experience in selling its innovative coating and fabric products.

32. Products containing NutraSweet also tend to be lower-unit cost, and more frequently purchased, so less initial effort is required to get the customer to try the product, and less "reminder advertising" is necessary to keep the ingredient name before the potential buyer.

33. The NutraSweet strategy of making companies the size and sophistication of not only pay for an ingredient, but also advertise the ingredient tradename and logo to the public (and to their own disadvantage), is perhaps unique in the western world. A consumer package goods company's marketing mission is, after all, to promote their own logo, not someone else's. There are real downside risks to a marketer in promoting someone else's tradename or logo in conjunction with his own product. Each promotion of NutraSweet makes it more difficult and expensive for a producer to switch to an equivalent sweetener sometime in the future. The

practice is so contrary to the best interest of the food processor, that again, the most likely conclusion is that it could have been imposed only through the dominant position of NutraSweet, and through its patent-protected position in the United States market.

C. Advertising Directly to Ultimate Customers

34. The NutraSweet strategy of advertising a branded commodity ingredient directly to ultimate consumers, rather than to its own customers, is also very unusual. In a market where virtually everyone who uses an intense, calorie-reduced sweetener in carbonated beverages already uses NutraSweet, why would an ingredient producer promote the "NutraSweet" name and logo rather than that of the final customer product? Even NutraSweet would probably agree that consumers shop for a "Diet Coke" or "Diet Pepsi", not for a "NutraSweet drink". The probable answer is that in advertising directly to ultimate consumers, NutraSweet is raising the potential cost to its own customers of switching to another aspartame product. It is certainly illustrating its ability to become an advertising competitor, rather than just an ex-supplier, to any processor who switches supply, quite possibly in the role of joining with one or more remaining NutraSweet customers who would advertise -- "the only diet cola(s) on the market containing genuine

"NutraSweet"...". This would certainly act as a deterrent to a company like Coca Cola or PepsiCo developing their own high-intensity, calorie-reduced sweetener or switching suppliers.

35. While there may be nothing wrong *per se* with advertising a branded commodity ingredient directly to ultimate consumers, when done by the dominant supplier who formerly was patent-protected and when done in conjunction with other NutraSweet marketing practices, the cumulative effect is to deter new entry or the expansion of existing competitors.

D. Separate Contracts For Ingredient Purchase and Trademark and Logo Display

36. The two distinct "contracts" for ingredient purchase and for trademark display are not separable in that the buyer cannot receive payment for displaying the NutraSweet trade name and logo without also agreeing to purchase the product, and to use it exclusively in the soft drink, pudding, chewing gum, or other foodstuff produced. These two contracts constitute a unique form of "tying arrangement" (in marketing terms at least). I am unaware of any other major consumer goods company which ties exclusive product supply and advertising allowances

together in this way. The practical effect of this practice is that the manufacturer is being "paid" for not using a rival's product.

E. Payment of Tradename and Logo Display Allowances Not Related to Promotional Results Achieved By Customer

37. The practice of paying tradename and logo display allowances through a discount from "gross" price, and based on the volume of "NutraSweet" brand aspartame purchased, rather than the number of advertising impressions created or the amount spent promoting the NutraSweet product, is very unusual. The tradename and logo display allowances paid are clearly much greater than the one-time cost of putting the name or logo on the retail product, and amount to a large fraction of the ingredient price of the aspartame. The display allowances which NutraSweet pays "per 1000 viewers" are certainly much higher than for any comparable form of print advertising.

38. The idea of simply receiving an advertising allowance without any need to measure or justify the results of the advertising actually undertaken, would certainly appeal to food processors. But it makes little sense for NutraSweet, given the company's interest in effective advertising, that it would

structure its allowance payments in this way. Assuming NutraSweet is a rational company, the most likely explanation is that it was buying something other than the delivery of advertising impressions. Again, the most reasonable conclusion is that it was buying the fidelity of the buyer, by offering an inducement for not using anyone else's aspartame.

39. The tie-in of ingredient purchase and trademark and logo display of the "NutraSweet" name and logo create a very substantial barrier to entry to other suppliers of aspartame (or substitutes) by creating substantial costs of switching for customers who are currently using NutraSweet exclusively. A purchaser of NutraSweet which decides to purchase and use any quantity of aspartame from a company other than NutraSweet, faces a cost of purchasing new dies to remove the NutraSweet name and logo from all future containers. There is also a one-time but nevertheless important scheduling problem in delaying using the second supplier's aspartame while the "old" inventory of cans or cartons is used up.

F. Payment to Wholesalers or Retailers to Induce Suppliers Purchase Behaviour

40. The practice by NutraSweet of offering an inducement to wholesalers or retailers (such as   ) to encourage their co-packers to use "NutraSweet" brand aspartame

exclusively may be unique. It is my understanding that the payment is not in the form of an advertising allowance or logo display allowance, but is simply a rebate (perhaps unknown to the co-packer), per-unit purchased by the co-packer which is payable to the retailer or wholesaler and not to the co-packer.

41. I know of no similar practice by ingredient suppliers for other processed food products. The payment appears not to be related to use of the "NutraSweet" tradename or logo on packaging (the packaging design being controlled by the retailer), but rather a rebate to induce the retailer to put pressure on the food processor to direct its purchasing in a certain way.

42. Such a payment is certainly not in the best interest of the co-packer (who is the NutraSweet "customer"), which may explain why the rebate may be a secret, and why it is not found very often. The retailer will willingly accept "free money" in return for exerting a little moral suasion on the co-packer, but he understands that the practice is not necessarily in his long run interest if it has the effect of increasing the co-packer's costs, which then in time get passed back to the retailer. A more interesting question is why NutraSweet would offer such a rebate to the retailer, rather than directly to the co-packer. The only situation I know of where such

payments occur is in "kickbacks", where the recipient of the funds holds great power, and will exert that power for a smaller payment of money than would the person whose behaviour is being changed.

G. "Meeting Competition" Clauses

43. A formal "meeting competition" clause (as compared to the more common implicit ones) allows a supplier the option of retaining a customer's business, even when a rival supplier offers a lower price, by matching that price rather than having to beat it. Generally "meeting competition" clauses provide total market transparency to the company that offers them -- the ability to know the lowest price that a competitor is offering at any point of time. This is particularly important to NutraSweet when the "meeting competition" clause relates to offers for the customer's entire business in the country.

44. A supplier which always meets every lower price brought to his attention under a formal "meeting competition" clause also goes far in deterring competitors from being motivated to make such offers. Most economists are of the opinion that formal "meeting competition" clauses are primarily information exchange devices used by competing firms to monitor price cutting.

45. The real impact of the "meeting competition" clause in this situation would seem to be an entry-deterring one -- to reinforce the anti-competitive effects of the exclusive dealing provisions in NutraSweet's supply agreements. A new entrant to the supply of aspartame, or an existing firm expanding in Canada, has to produce and compete on a substantial commercial scale in order to achieve competitive production cost levels. The requirement that customers permit NutraSweet to match any offering price by a new or existing competitor prevents the possibility of that entrant building a substantial market share through secret price discounting. This sort of secret, "buy into the market" entry strategy, which is commonly used in most other markets, is made unlikely here by the "meeting competition" clause -- and made impossible if NutraSweet wants it to be impossible.

H. Supply Contracts Covering Many Countries

46. NutraSweet's practice of negotiating central contracts with multinational customers covering many countries is not unique, but certainly uncommon. One can query why a central purchaser would want to negotiate prices and delivery terms for a number of countries, when supply conditions, demand conditions, cost factors such as tariff rates, etc. differ by

country, rather than let its subsidiary in each country negotiate its own best terms, based on conditions in that area.

47. The most likely answer, given that the United States market is patent protected and represents about % of the world market, is that the central purchaser feels coerced into multi-country negotiation, perhaps in the belief that it will get better average world-wide prices, or better terms (i.e., better assured delivery in the United States), through such multinational negotiation.

48. Whatever the motivation for multi-national negotation, the impact of the practice in this industry is that, given the existence of product patent protection in the United States, only NutraSweet has the legal capacity to compete for world-wide supply contracts. If a substantial majority of world demand for NutraSweet is found in the United States (i.e., approximately %), and if NutraSweet in the U.S. either requires or induces the signing of world-wide supply contracts, then the net effect is to deter or perhaps prevent competition in the rest of the world by other existing suppliers of aspartame, or to deter potential competition by new entrants. The result of the practice is to extend the patent-created monopoly held by NutraSweet in the U.S. to non-U.S. markets.

49. It is most uncommon to find companies the size of Coca Cola, PepsiCo and General Foods using a single source for any major input or ingredient other than secret-formula ingredients. It is virtually never in the best interest of a manufacturer or processor to rely on a single supplier of any major input of a commodity type. The reasons for a company seeking to establish multiple suppliers include: better assurance of supply in times of shortage or labour problems, better assurance of acceptable quality, and the likelihood of competitive price that comes from ~~have~~ having competing suppliers. Why then would major companies rely on a single supplier of aspartame not only in the United States (where they have no option because of NutraSweet's patent protection), but also in Canada, where they do have an option?

50. The answer appears to be a combination of the patent-protected position of NutraSweet in the United States and the multi-national contracts that sprang from it, plus, the price structure of NutraSweet supply contracts in Canada, notably the presence of large fidelity rebates.

51 Recall that the rebate structure in Canada has the result of being a reward for fidelity; it forces buyers to purchase their entire supply of aspartame from NutraSweet in order to get a net price competitive with that offered to their

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PURSUANT TO THE DIRECTION OF THE
PRESIDING MEMBER
Suzanne Lagé
REGISTRY OFFICER

direct competitors who purchase exclusively from NutraSweet. A major customer for aspartame cannot purchase its entire requirement of aspartame from a supplier other than NutraSweet, because no other supplier presently has the capacity to supply its total requirements. And the customer cannot purchase partial requirements from another supplier, because it will then pay substantially more under the standard NutraSweet supply agreement in terms of its total average cost of aspartame as a result of using a second supplier. The arithmetic of this "always higher" price is shown below. The presence of the U.S. patent protection plus the Canadian rebate structure forces exclusive dealing on most NutraSweet customers, and raises substantial barriers to new entry or to competitor's expansion in Canada.

IV. TWO PRICING EXAMPLES

A. Relationship Between U.S. Price and Canadian Price Discounting

52. It is possible to illustrate how all the aspects of pricing in the United States and Canada come together to make it difficult or impossible for a competitor such as TCL to meet Canadian prices offered by NutraSweet. For example, assume that NutraSweet can sell in the United States, where it has

product patent protection, and in Canada, where it does not, and that TCL can sell only in Canada. Assume further that United States sales are 95% of combined North American (United States plus Canada) unit sales.

Sales in the United States are 95% of total North American unit sales. At $10 per unit, net return to NutraSweet from United States sales is $10 unit.

Sales in Canada are 5% of total North American unit sales. At say $5 per unit, net return to NutraSweet from ~~United States~~ Canadian sales is $5 unit.

Net return to Canadian competitor of NutraSweet selling at same price in Canada is $5 unit.

Net return to NutraSweet per unit from all North American sales, United States plus Canada, is [(.95 X 10) + (.05 X 5)] $9.75 unit.

Now if NutraSweet faces competition in Canada, and has to lower its Canadian price through discounts or rebates to $4 per unit, then we have:

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Suzanne Lanyi
REGISTRY OFFICER

Net return to NutraSweet per unit from all North American sales, United States plus Canada is [(.95 X 10) + (.05 X 4)] $9.70 unit.

Net return to NutraSweet from Canadian sales is $4 unit.

Net return to Canadian competitor of NutraSweet selling at same price is $4 unit.

NutraSweet's revenue from North American sales has dropped $.05 per unit on average, from $9.75 to $9.70 - a percentage drop of .05%.

NutraSweet's competitor in Canada has also had to drop its price from $5 to $4 to compete. This is a percentage drop of 20%.

53. The example can be extended to illustrate how NutraSweet can set almost any price in Canada without altering its total average net return from North American sales very much. If NutraSweet were to reduce its Canadian price from $5 to $1 per unit, then compared to the original case:

Net return to NutraSweet per unit from all North American sales, United States plus Canada, is [(.95 X 10) + (.05 X 1)] $9.55 unit.

Net return to NutraSweet from Canadian sales is $1 unit.

Net return to Canadian competitor of NutraSweet selling at same price is $1 unit.

NutraSweet's revenue from North American sales has dropped .20 per unit on average, from $9.75 to $9.55 - a percentage drop of 2.1%.

NutraSweet's competitor in Canada has also had to drop its price from $5 to $1 to compete. This is a drop of 80%.

54. It can readily be seen how NutraSweet can undercut any Canadian selling price of its competitor, while having little effect on its average North American unit return from sales. The strategy might be profitable for NutraSweet if it were able, by deterring a competitor's Canadian sales, to prevent the development of a viable, Canadian-based competitor which would compete for United States sales on the expiration of NutraSweet's United States product patent.

55. NutraSweet's price cutting in Canada may produce for its competitor a classic "chicken-and-egg" problem. The competitor cannot build up volume in Canada, and thus cannot reasonably build a large scale plant. Without a large scale plant, it cannot credibly hope to bid for large-scale Canadian business, or for large scale United States business, following expiration of the U.S. product patent. It cannot even hope to build a large scale plant and break even while waiting to enter the United States market because to attempt to sell any quantity in Canada can result either in sales very much below cost, or in no sales at all.

56. However, the more important result of the illustration is the observation that NutraSweet's North American unit return can be maintained at approximately the same level even when the Canadian price is dropped significantly because competitors are unable to bid down the United States price in return. It is NutraSweet's patent-protected status in the United States which grants it the ability to cut prices to almost any degree in Canada.

B. Price Impact of Using Tradename and Logo Display Discount

57. Using the same sort of analysis as above, it is easy to show the price and profit impact of NutraSweet's use of a significant tradename and logo display discount. Consider customers which currently purchase all their Canadian requirements of aspartame from NutraSweet. Assume that their cost per unit purchased is $5 if they agree to purchase all their requirements from NutraSweet, and have the NutraSweet logo and tradename on each container of calorie-reduced product they sell and in their advertising. Assume that their cost is $7 per unit purchased if they purchase only part of their requirements from NutraSweet, and do not have the tradename or logo on the container or in their advertising. If NutraSweet's Canadian competitor attempts to sell aspartame for $7 per unit, it clearly will not be successful because NutraSweet is offering the same product at a net, after display allowance, price of $5 per unit. If NutraSweet's Canadian competitor attempts to sell aspartame for $5 per unit, it still will not be successful. In part, this is because NutraSweet is selling aspartame, plus a well-recognized trade name, plus tie-in advertising, all for $5. But there is also another reason the competitor will not be successful. To understand why assume the competitor tried to sell at $4.50 per unit. If the competitor tried to take the customer's total business at that price, NutraSweet could easily match the new offer because its

total North American receipts would drop only very marginally. (Indeed, under some contracts NutraSweet would be informed of the lower price offer and given the chance to match it).

58. A prospective competitor of NutraSweet might try to establish a "second supplier" or smaller share position in the aspartame market in Canada. This is a reasonable entry strategy in most industries because almost any buyer would want some assurance over time of product quality and delivery capabilities of a new supplier before committing to a very high percentage of their total purchase volume. And almost any buyer would wish to have a second supplier available to put pressure on its principal supplier to offer competitive terms and service. However, the new supplier is very likely to fail in trying to get a small, "second supplier" share because of the structure of NutraSweet's pricing. The reason is as follows. Assume that the new supplier wanted to provide 20% of the buyer's requirements at the lower price. The buyer will now lose the "NutraSweet" tradename and logo promotional discounts. The buyer's cost will be as follows: (a) 80% of volume from NutraSweet, at $7 per unit; and (b) 20% of volume from competitor at $4.50 per unit. The blended price for 100% of supply is $6.50 per unit, well above the original NutraSweet price of $5.00 per unit. Indeed, if the new competitor decided to give the buyer 20% of his requirements free of cost, as a

way of establishing product quality and delivery capabilities, the buyer would still turn him down. The reason is that the blended price, with 20% of the aspartame supply free for competitive bids, would still be $5.60 per unit. Indeed, in this example the competitor would have to give the buyer 28.6% of its aspartame requirements free for the blended price to be such that the buyer would break even compared with its offer from NutraSweet.

59. The point is that a competitor which aspires to "second supplier" status cannot compete by matching the NutraSweet price of $5 per unit, or even by charging $4 or $3 per unit. The competitor probably would have to charge a price well below production cost, _and_ have enough production capacity to satisfy the buyer, in order to induce that buyer to change its current reliance on NutraSweet as a sole supplier. The problem for the competitor exists not because of the quality of the competitor's aspartame, and not because of the customer's inertia. It exists because of the pricing and rebate structure which has been adopted by NutraSweet.

60. Applying the analysis in the example to actual contract prices will produce the same result. NutraSweet's gross pricing and trademark and logo display allowance figures appear to vary by customer and perhaps by contract, but for

illustration one can use the pricing structure set out in the agreement between and NutraSweet with respect to the purchase and supply of "NutraSweet" blend aspartame, effective as of August 1, .

61. The contract terms are set out

For 1988, the pricing structure is set out as follows:

	Gross Pricing	Trademark Display Allowance	Net Price
1988			

Note: All pricing in U.S. funds.

62. If were to purchase its total requirements from NutraSweet, and display the NutraSweet logo and trademark, its net price per pound is $ per pound. If were to purchase 80% of its total requirements from NutraSweet, and 20% from TCL at say, $ per pound, it would lose its Trademark Display Allowance, and revert to the Nutrasweet "Gross Pricing" price of $ per

pound. Its blended price from NutraSweet and TCL would be: [(.80 X $) + (.20 X $)> = $ per pound, well above the current NutraSweet net price of $ per pound.

63. If TCL were to offer a loss-leader, "buy-in" price of $ per pound to for 20% of its requirements, the blended price to would be:

[(.80 X $) + (.20 X $) = $ per pound, still well above the current NutraSweet net price of $ per pound.

64. TCL could make one further effort, offering to provide 20% of requirements free for a year, to prove their quality and service levels. would still reject the offer . Even with 20% free goods, blended price is:

[(.80 X $) + (.20 X 0)] = $ per pound, still above the current NutraSweet net price of $ per pound.

65. TCL cannot, under this type of pricing, reasonably aspire to a "second supplier" status, which is the normal entry strategy for a newcomer supplier.

66. TCL also cannot hope to become a sole supplier to the 3 largest customers in Canada because it does not have the production capacity to meet their needs. And it cannot economically build the capacity to serve the Canadian market because it knows that NutraSweet can lower its Canadian price to any level required to hold the and accounts; this is because a decrease in the Canadian price will have minimal impact on NutraSweet's blended North American price.

67. Indeed the only exception to the gross price/net price examples above is a company that refuses to display the ingredient's name and logo on its own container, and thus will always reject an advertising rebate. However, such a customer may still be beyond the reach of a competitor, who knows that NutraSweet can lower its price in Canada to any level required to win the account because of its higher United States price.

V. CONCLUSION

68. It is my opinion that the combination of NutraSweet's marketing and pricing practices described above, has the overall impact of strongly deterring and perhaps preventing the new entry of potential suppliers of aspartame, and of strongly deterring and perhaps preventing the expansion of existing suppliers such as TCL. The practices make it extremely

difficult for a newcomer or an existing firm to gain a presence in the Canadian market using the normal "second source" strategy to build a customer base.

69. The combination of NutraSweet's patent protected, high-price position in the United States, and its established willingness to cut prices to retain business in Canada, makes it extremely risky for a newcomer or an existing firm to undertake the only other available strategy, which is to make the large capital investment in capacity and marketing necessary to attempt to be a sole supplier to major buyers of aspartame. Unlike almost any other market situation in Canada, a newcomer or expanding firm is forced to compete for all of a customer's business, or none. Indeed, if world-wide supply contracts are the norm, a newcomer or expanding firm may be forced to bid for all of a customer's available world-wide business, or none.

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