CT-2022-002

THE COMPETITION TRIBUNAL

IN THE MATTER OF the *Competition Act*, R.S.C. 1985, c. C-34;

AND IN THE MATTER OF the proposed acquisition by Rogers Communications Inc. of Shaw Communications Inc.;

AND IN THE MATTER OF an application by the Commissioner of Competition for an Order pursuant to section 92 of the *Competition Act*.

BETWEEN:

COMMISSIONER OF COMPETITION

Applicant

and

ROGERS COMMUNICATIONS INC. AND SHAW COMMUNICATIONS INC.

Respondents

and

VIDEOTRON LTD.

Intervenor

BOOK OF AUTHORITIES
(For the Commissioner's Closing Argument)

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Eleanor R. Dawson, David Stratas, Judith Woods JJ.A.

Heard: June 25-26, 2020
Judgment: September 10, 2020
Docket: A-456-19, A-457-19

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Subject: Constitutional; Property; Public; Tax — Miscellaneous

APPEAL by large telephone and cable companies from decision of Canadian Radio-television and Telecommunications Commission, setting rates they could charge for aggregate wholesale high-speed access services provided to competitors.

***Eleanor R. Dawson J.A.*:**

1. Introduction

1 High-speed Internet is a resource vital to modern communications and participation in the digital economy.

2 In Canada, Internet services are provided to retail customers by large telephone and cable companies or by independent Internet service providers. Small and medium sized independent Internet service providers that do not own their own wireless networks do not possess the required infrastructure to provide high-speed Internet access (HSA) directly to end-users. Therefore, to foster competition, large cable and telephone companies are required to make available parts of their respective networks to independent Internet service providers. These leased parts are referred to as wholesale services and are used by the independent Internet service providers, sometimes referred to as "competitors", to provide high-speed Internet services to their retail customers.

3 The Canadian Radio-television and Telecommunications Commission does not regulate the provision of Internet services to retail customers because the number of service providers is sufficient to bring competition, pricing discipline, innovation and consumer choice to the retail Internet services market. However, the CRTC does regulate the provision of wholesale high-speed access services by large telephone and cable companies to the competitors. In particular, the CRTC sets the rates that the large telephone and cable companies are permitted to charge competitors for wholesale high-speed access services.

4 On August 15, 2019, the CRTC issued *Follow-up to Telecom Orders 2016-396 [*Telecom Order CRTC 2016-396, Re *(October 6, 2016), 2016-396 (C.R.T.C.)] and 2016-448 - [*Bragg Communications Inc., Re *(November 10, 2016), 2016-448 (C.R.T.C.)] hereinafter* 2016-448 *Final rates for aggregated wholesale high-speed access services* (15 August 2019), Telecom Order CRTC 2019-288 (TO 2019-288) [*Telecom Order CRTC 2019-288, Re* (August 15, 2019), 2019-288 (C.R.T.C.)] which set final rates that the large telephone and cable companies may charge for aggregated wholesale high-speed access services provided to competitors. The order provided that the final rates would be applied retroactively.

5 Bell Canada, MTS Inc., and Bell MTS, large telephone companies sometimes referred to as incumbent local exchange carriers or ILECs, sought and obtained leave to appeal TO 2019-288 to this Court. Bragg Communications Incorporated, carrying on business as Eastlink, Cogeco Communications Inc., Rogers Communications Canada Inc., Shaw Cablesystems G.P. and Videotron Limited, large cable carriers referred to in these reasons as the Cable Carriers, also sought and obtained leave to appeal the order to this Court.

6 Here, a brief procedural comment is warranted. On September 27, 2019, orders issued staying TO 2019-288 pending this Court's determination of the motions for leave to appeal. On November 22, 2019, the leave applications were granted and orders issued staying TO 2019-288 until the issuance of the Court's final judgments on the appeals. TO 2019-288 therefore remains stayed until the issuance of the judgments that accompany these reasons. Subsequently, the appeals were consolidated, case managed and set for an early hearing which took place by videoconference. In accordance with the consolidation order, a copy of these reasons shall be placed on each Court file.

7 On this consolidated appeal the telephone companies argue that the CRTC "erred in law or jurisdiction" by:

i. failing to exercise its powers with a view to implementing the Canadian telecommunications policy objectives set out in section 7 of the *Telecommunications Act*, S.C. 1993, c. 38 (Act) and in accordance with a direction given to the CRTC by the Governor in Council, all as required by section 47 of the Act. Particular emphasis is placed on what is asserted to be a statutory reasons requirement imposed by paragraph 1(*b*)(i) of the direction issued by the Governor in Council;

ii. failing to exercise its powers with a view to ensuring that the telephone companies charge "just and reasonable" rates in accordance with section 27 of the Act, and as required by section 47 of the Act; and

iii. imposing an unconstitutional tax, contrary to section 53 of the *Constitution Act, 1867*.

8 For their part, the Cable Carriers argue the CRTC committed "one or more legal or jurisdictional errors, either in issuing TO 2019-288 or during the rate-setting proceeding that culminated in the issuance of that Order". More particularly, the Cable Carriers argue that the CRTC:

(a) failed to consider relevant and cogent evidence submitted by the Cable Carriers;

(b) made decisions on the basis of no evidence, irrelevant evidence or irrelevant considerations, including by preferring its own unsubstantiated "expectations" over the Cable Carriers' evidence, even though that evidence directly contradicted such "expectations";

(c) acted arbitrarily by treating the available evidence in an inconsistent and *ad hoc* fashion, including by (i) endorsing and applying outdated third-party data (from 2011 or earlier) in lieu of company-specific information, while (ii) rejecting without explanation more up-to-date data (from 2016 and 2017) provided by the same third party, and then (iii) criticizing the Cable Carriers for not submitting the very types of company-specific information that the CRTC had previously rejected;

(d) breached core principles of natural justice and procedural fairness by adopting unorthodox and unexpected methodologies that changed the "rules of the game" in a manner that defeated the Cable Carriers' reasonable expectations, without giving the Cable Carriers either timely notice of its intention to do so or an adequate opportunity to meaningfully respond;

(e) disregarded established principles and rate-setting decisions on which the Cable Carriers had reasonably relied on a number of issues, while simultaneously fettering improperly its discretion by adhering to outdated or inapplicable assumptions and guidelines on other issues; and

(f) disregarded a binding Direction issued by Cabinet in 2006 ... and ignored impermissibly the mandatory requirements imposed by sections 7, 27 and 47 of the *Telecommunications Act*.

(memorandum of fact and law, paragraph 4, footnotes and emphasis deleted)

9 The respondents represent, or are, independent Internet service providers that purchase wholesale high-speed access services. They submit that all of the asserted grounds of appeal should be dismissed on their merits. Additionally, they submit that the appellants:

i. rely on post-decision evidence that is inadmissible;

ii. raise grounds of appeal that are not questions of law or jurisdiction and so are outside the scope of the limited right of appeal conferred by subsection 64(1) of the Act; and,

iii. advance a new, unconstitutional tax argument that should not be heard by this Court at first instance.

10 Before turning to consider the issues raised on this appeal it is necessary to situate the impugned order in its proper context. Situating the order in its context requires consideration of the legislative framework in which the decision was made and the prior decisions of the Commission that led to and informed TO 2019-288 — what has been referred to as its policy pedigree.

2. The context in which TO 2019-288 was made and is to be considered by this Court

i. The legislative framework

11 The *Telecommunications Act* sets out the legislative framework that governs the telecommunications industry in Canada. The provisions described immediately below are central to the appellants' argument that the CRTC impermissibly ignored mandatory requirements imposed upon it by the Act.

12 The Act's guiding objectives are enumerated in section 7. Pursuant to subsection 47(*a*), the CRTC must perform its duties with a view to implementing these objectives. Additionally, section 8 of the Act authorizes the Governor in Council "by order" to "issue to the Commission directions of general application on broad policy matters with respect to the Canadian telecommunications policy objectives." An order made under section 8 is binding on the Commission (subsection 11(1); see also subsection 47(*b*)).

13 The Governor in Council has given directions to the CRTC that were binding upon it at the time it issued the decision under appeal: *Order Issuing a Direction to the CRTC on Implementing the Canadian Telecommunications Policy Objectives*, S.O.R./2006-355 (Cabinet Direction). Section 1 of the direction requires the CRTC, when exercising its powers and performing its duties under the Act, to "implement the Canadian telecommunications policy objectives set out in section 7" of the Act in accordance with a number of enumerated criteria. Of particular relevance to this appeal are three obligations:

(i) the obligation when relying on regulation to "use measures that are efficient and proportionate to their purpose and that interfere with the operation of competitive market forces to the minimum extent necessary to meet the policy objectives" (paragraph 1(*a*)(ii));

(ii) the obligation when relying on regulation to use measures that "if they are of an economic nature, neither deter economically efficient competitive entry into the market nor promote economically inefficient entry" (paragraph 1(*b*)(ii)); and,

(iii) the obligation when relying on regulation relating to regimes for access to networks to use measures that "ensure the technological and competitive neutrality of those arrangements or regimes, to the greatest extent possible, to enable competition from new technologies and not to artificially favour either Canadian carriers or resellers" (paragraph 1(*b*)(iv)).

14 Paragraph 1(*b*)(i) of the Cabinet Direction requires the Commission, when relying on regulation, to "specify the telecommunications policy objective that is advanced by those measures and demonstrate their compliance with" the Cabinet Direction. The appellants assert this provision creates a reasons requirement.

15 Subsection 47(*a*) of the Act also requires the Commission to perform its duties with a view to ensuring that Canadian carriers provide telecommunications services and charge rates in accordance with section 27 of the Act. Section 27 requires every rate charged by Canadian carriers to be "just and reasonable". The power to determine and approve just and reasonable rates is a central responsibility of the Commission.

16 To ensure that rates are just and reasonable the Act grants the Commission broad powers to, amongst other things, set and regulate rates for telecommunications services (sections 24 and 25). The Commission may also "determine any matter and make any order relating to the rates, tariffs or telecommunications services of Canadian carriers" (subsection 32(*g*)).

17 Subsection 27(3) empowers the Commission to "determine in any case, as a question of fact, whether a Canadian carrier has complied with" specific provisions of the Act including sections 24, 25, and 27. Subsection 27(5) permits the Commission to "adopt any method or technique that it considers appropriate, whether based on a carrier's return on its rate base or otherwise" when determining whether a rate is just and reasonable. The Commission also has the authority under subsection 37(1) to require a Canadian carrier "to adopt any method of identifying the costs of providing telecommunications services and to adopt any accounting method or system of accounts for the purposes of the administration" of the Act.

18 The Commission's decisions may be challenged in a number of ways. The following provisions are of particular relevance to the respondents' argument that the appellants raise grounds of appeal that are outside the scope of the limited right of appeal conferred by subsection 64(1) of the Act.

19 Subsection 64(1) of the Act permits, with leave of the Court, an appeal to this Court on "any question of law or of jurisdiction". The Commission may determine any question of law or fact, and "its determination on a question of fact is binding and conclusive" (subsection 52(1)). On an appeal to this Court, the Court "may draw any inference that is not inconsistent with the findings of fact made by the Commission and that is necessary for determining a question of law or jurisdiction" (subsection 64(5)).

20 Other avenues of redress exist.

21 The Commission "may, on application or on its own motion, review and rescind or vary any decision made by it" (section 62).

22 Within one year of a decision being made by the Commission, "the Governor in Council may, on petition in writing ... or on the Governor in Council's own motion, by order, vary or rescind the decision or refer it back to the Commission for reconsideration of all or a portion of it." (subsection 12(1)).

23 Significantly, neither section 62 nor subsection 12(1) circumscribe the types of questions that may be raised before the CRTC or the Governor in Council. This stands in contradistinction to the prescription in subsection 64(1) that limits this Court to reviewing questions of law or jurisdiction.

24 In addition to bringing these appeals, the appellants have filed applications with the CRTC asking that the Commission review and vary the order under appeal. The appellants have also filed separate petitions to the Governor in Council seeking the rescission of TO 2019-288. During the hearing, counsel advised that decisions on these requests are outstanding.

25 While this decision was under reserve, counsel for the appellants advised that the Governor in Council had rendered a decision with respect to the petitions filed by the appellants. We were directed to *Order to decline to vary, rescind or refer back for reconsideration Telecom Order CRTC 2019-288*, P.C. 2020-0553. Counsel sought and received permission to file brief, written submissions on Order in Council P.C. 2020-0553. The Order in Council is discussed below when considering the appellants' submissions that the Commission failed to exercise its powers with a view to implementing telecommunications policy objectives and the Cabinet Direction, and this failure was an error in law or jurisdiction.

ii. TO 2019-288's policy pedigree

26 TO 2019-288 did not spring into existence in a factual vacuum; it had antecedents. As this Court has noted, CRTC decisions fit into a "continuum" (*Société Radio-Canada c. Métromédia CMR Montréal Inc.*1999 CanLII 8947(1999), 254 N.R. 266 (Fed. C.A.), at paragraph 14). Indeed, TO 2019-288 is entitled *Follow-up to* Telecom Order CRTC 2016-396, Re *and* 2016-448 - *Final rates for aggregated wholesale high-speed access services*.

27 The decision expressly incorporates as "Related documents" a number of prior decisions of the CRTC including Telecom Regulatory Policies CRTC 2010-632, 2011-703 and 2015-326, Telecom Decisions CRTC 2013-73 [2013 CarswellNat 11720 (C.R.T.C.)], 2013-76 [2013 CarswellNat 12068 (C.R.T.C.)] and 2016-117 [2016 CarswellNat 7468 (C.R.T.C.)] and *Telecom Order CRTC 2016-396, Re* and *2016-448*, discussed and fully cited below. As counsel for the Cable Carriers acknowledged in oral argument, the reasons of the Commission in TO 2019-288 are not to be read in isolation. A reader, and a reviewing court, ought to go beyond the Commission's reasons and read the related documents in order to fairly understand the reasoning of the Commission. Put another way, the related documents are inextricably linked to the decision under appeal.

28 The decision does not reference as a related document *Disposition of review and vary applications with respect to wholesale high-speed access services: Introductory statement* (21 February 2013), Telecom Regulatory Policy CRTC 2013-70 (TRP 2013-70). In this introductory statement, the Commission frames a series of decisions on wholesale high-speed access services issued contemporaneously with it, including Telecom Decisions CRTC 2013-73 and 2013-76. These decisions, specifically listed by the Commission as related documents in TO 2019-288, should be read in the light of TRP 2013-70.

29 A brief review of these policies and orders and Telecom Decision CRTC 2016-117 (TD 2016-117) will situate TO 2019-288.

30 *Wholesale high-speed access services proceeding* (30 August 2010), Telecom Regulatory Policy CRTC 2010-632 (TRP 2010-632) is an early policy statement issued by the CRTC on wholesale high-speed access services. The decision followed what the Commission described to be "a comprehensive public proceeding" commenced in May 2009, to consider whether incumbent local exchange carriers and Cable Carriers should be required to offer certain high-speed access facilities as wholesale services to competitors for resale. The Commission reviewed the evolution of Internet services from low-speed dial-up services to higher speed Internet services facilitated by the construction of more fibre facilities in access networks. The Commission "indicated its intention to apply its essential services framework for wholesale services in this proceeding on a forward-looking basis to provide appropriate incentives for continued investment in broadband infrastructure, encourage competition and innovation, and expand consumer choices."

31 The Commission went on to describe its determinations to be in accordance with the Act, including subsection 27(2), and to be made with a view to implementing the policy objectives found in subsections 7(*a*), (*b*), (*c*), (*f*), and (*h*) of the Act. The Commission also stated that its determinations were in accordance with the Cabinet Direction (TRP 2010-632, paragraphs 26

and 27). The Commission returned to a discussion of the policy objectives advanced by its decision at paragraphs 143 to 149 of its reasons (as quoted later in these reasons at paragraph 193). The Commission ended its decision by directing the major incumbent local exchange carriers and the Cable Carriers to file proposed tariffs with supporting Phase II cost studies, and by reciting the policy objectives advanced by its determinations.

32 Here, it is helpful to provide a brief explanation about Phase II costing principles. Phase II costing principles, or simply Phase II costing, is the costing methodology used by the CRTC when conducting rate-setting proceedings. This methodology has been used, with various modifications, since 1979 for a variety of rate-setting functions performed by the CRTC. In brief, regulated Carriers are required to file Phase II costing manuals which are used to prepare cost studies that are submitted to the CRTC. The CRTC then uses these cost studies, as well as other information and considerations, to set rates. Rates developed pursuant to this methodology are based on the projected, actual costs that a regulated carrier will incur when providing a telecommunications service over a defined future study period, plus a reasonable markup. The markup recognizes overhead and other fixed costs and the need to provide an incentive for continued investment in new network infrastructure (see, for example, TRP 2011-703, paragraph 82 and footnote 30).

33 TRP 2010-632 was followed a few months later by *Billing practices for wholesale residential high-speed access services* (15 November 2011), Telecom Regulatory Policy CRTC 2011-703 (TRP 2011-703) where the Commission reconsidered how large telephone and cable companies should charge competitors for access to, and use of, their HSA wholesale services. The Commission found two billing models to be acceptable: a capacity-based billing model and a flat rate model. The Commission decided that rates for either model should be based on each of the individual, large cable and telephone companies' costs to provide the service plus a reasonable markup; further, the markups should be comparable for all cable and telephone companies. The Commission also addressed other important policy issues: the rate principles to be applied to the selected billing models and the reasonableness of the costs submitted by the network providers. When considering the reasonableness of the costs submitted by the network providers the Commission examined various issues associated with the Phase II cost studies that had been filed, including such things as annual capital unit cost changes (which will be discussed in more detail below). After discussing the implementation of the tariffs set by it establishing final wholesale rates, the Commission reviewed the extent to which its decision complied with the Cabinet Direction. Portions of this analysis are set out at paragraph 194 below.

34 TRP 2011-703 essentially settled the basic form and structure of the wholesale rates at issue in this appeal. The Commission noted that it was important to "ensure that retail Internet service competition is sufficient to protect consumers' interests" and that the services "provided by the independent service providers bring pricing discipline, innovation, and consumer choice to the retail Internet service market."

35 The Commission further clarified billing models and costing issues in TRP 2013-70. The Commission affirmed that it "sought to ensure that there is a competitive wholesale market that accurately compensates each incumbent for the costs incurred to make those wholesale services available to the independent service providers and, at the same time, to allow for effective and efficient competition to the benefit of Canadians." (TRP 2013-703, paragraph 14).

36 In the eight decisions issued with TRP 2013-70, the Commission sought to simplify the implementation of the new wholesale high-speed access service billing models, make adjustments to the wholesale high-speed access service rates to reflect cost adjustments and create a uniform pricing approach for business and residential wholesale high-speed access services. In associated orders, the Commission found errors in the service costs upon which rates set in TRP 2011-703 and TRP 2011-704 were based, and adjusted the 2011 rate accordingly. In some cases it was necessary to apply the rate adjustments retroactively "to ensure that the rates are at all times just and reasonable and in furtherance of the policy objectives set out in the Act." (TD 2013-73, paragraphs 106 to 110, TD 2013-76, paragraph 46).

37 TRP 2013-70 was followed by *Review of wholesale wireline services and associated policies* (22 July 2015), Telecom Regulatory Policy CRTC 2015-326 (TRP 2015-326). This policy is the most recent decision mandating access to the high-speed access services of the large telephone and cable companies. The decision followed a public proceeding conducted to review wholesale wireline services and associated policies. The Commission stated that as part of this proceeding it had "reviewed the existing wholesale services framework, various wholesale wireline services, and the approach it uses to set the

rates for wholesale services to determine whether changes to the existing regulatory landscape are appropriate" (TRP 2015-326, preamble, paragraph 2). The Commission adjusted its mandating criteria for wholesale services and set out the rationale behind its determination to mandate the provision of certain wholesale high-speed access services, stating at paragraph 3:

> Over the years, the Commission has established various policies, rules, and regulations to govern the provision of wholesale services. These regulatory measures are necessary because incumbent carriers have had considerable advantages over competitors. Without wholesale regulation, fewer competitive service options would be available to Canadians.

The Commission also determined the costing methodology to be applied to wholesale services. Rates for wholesale services would continue to be based upon the use of incremental costing supplemented by an approved markup (*i.e*. Phase II costing principles). Alternative costing approaches were rejected because, among other reasons, no evidence suggested that alternative approaches would improve regulatory efficiency (TRP 2015-326, paragraphs 233 to 241).

38 Before leaving TRP 2015-326 I will deal with the Cable Carriers' submission, made in reply argument, that this decision is irrelevant to TO 2019-288 because TRP 2015-326 phased out the mandated provision of aggregated HSA services and TO 2019-288 set final rates for those services.

39 TRP 2015-326 is not irrelevant to the decision at issue. In TRP 2015-326 the Commission determined that aggregated wholesale HSA services would "no longer be mandated for the incumbent carriers under certain conditions and subject to an appropriate transition plan." (TRP 2015-326, paragraph 143). "Incumbent carriers are expected to continue to file tariffs regarding the introduction of or modifications to the provision of aggregated wholesale HSA services until such services have been phased out within their respective serving territories." (TRP 2015-326, paragraph 155). The final rates for aggregated wholesale HSA services set in TO 2019-288 are integral to the transition plan.

40 In *Review of costing inputs and the application process for wholesale high-speed access services* (31 March 2016), Telecom Decision CRTC 2016-117 (TD 2016-117) the Commission made its determinations with two particular objectives in mind: i) to establish a streamlined tariff application process, and ii) to ensure that the inputs to wholesale high-speed access service providers' cost models remained appropriate. To meet the first objective, the Commission adopted a simplified cost-based approach for rate-setting referred to as "speed-banding". More will be said about speed-banding below. To meet the second objective, the Commission made determinations with respect to some components of cost studies. Of relevance to this appeal are determinations made with respect to the annual traffic growth assumption (necessary because the annual growth of Internet traffic had increased significantly since TRPs 2011-703 and 2011-704) and the annual capital unit cost change assumption. More will also be said below about these cost components.

41 The Commission also changed the study period from the then current ten-year period to a shorter five-year study period. This reflected the fact that wholesale HSA service speeds were rapidly changing; many service speed offerings might not have a life span of more than five years. Finally, the Commission converted the then current wholesale rates paid by competitors into interim rates. The Commission's determination that changes were necessary to certain costing assumptions demonstrated to it that "current wholesale HSA service rates are likely not just and reasonable." The HSA service providers were required to submit new cost studies. The Commission stated it would assess whether rates should be set retroactively when the new cost studies were submitted (TD 2016-117, paragraph 105).

42 Generally, Telecom Orders apply established policies to the facts found in the proceeding. They are the practical application of the policy framework set out in TRPs to specific fact situations. Two orders are of particular relevance. After the issuance of TD 2016-117, the Commission considered the new cost studies submitted by the parties and issued *Telecom Order CRTC 2016-396, Re* and *2016-448*. These orders established new interim rates. These interim rates were lower than the rates previously paid by competitors.

43 In *Tariff notice applications concerning aggregated wholesale high-speed access services - Revised interim rates* (6 October 2016), *Telecom Order CRTC 2016-396, Re* (TO 2016-396) the Commission observed, at paragraph 19, that some of the proposed costs submitted by wholesale HSA service providers were "not reasonable due to deviations from Phase II

costing principles, the lack of pertinent costing details, including descriptions of input data variables, and modelling assumptions without supporting rationale. Accordingly, the Commission concludes that the proposed monthly rates for certain wholesale HSA service providers are, on a *prima facie* basis, not based on reasonable costs." Therefore, the Commission set revised, lowered interim rates for aggregated wholesale HSA.

44 In *Bragg Communications Inc., Re, operating as Eastlink - Revised interim rates for aggregated wholesale high-speed access service* (10 November 2016), *2016-448* (TO 2016-448) the Commission concluded, for similar reasons, that "Eastlink's proposed monthly rates are, on a *prima facie* basis, not reasonable" (paragraph 13).

45 In response, new proposed wholesale rates based on updated cost studies were submitted by the telephone and cable companies. This culminated in the issuance of the order under appeal that established final wholesale rates that were lower than the interim rates set in 2016. The rates applied retroactively to March 31, 2016 for Bell Canada, Bell MTS, Cogeco, Eastlink, Sasktel, TCI and Videotron, and to January 31, 2017 for Shaw (TO 2019-288, paragraphs 331 and 332).

46 It is relevant to end this portion of the reasons with the observation that aside from the present appeal none of the policies, decisions and orders described above were appealed.

47 Having situated the appeal in its statutory and historical context, I turn to consider the proper scope of the appeal.

3. Do the appellants raise grounds of appeal that are not questions of law or jurisdiction properly before this Court?

48 In *Canadian National Railway v. Emerson Milling Inc.*, 2017 FCA 79, [2018] 2 F.C.R. 573 (F.C.A.), this Court considered the scope of the statutory appeal authorized under subsection 41(1) of the *Canada Transportation Act*, S.C. 1996, c. 10 (CTA). Subsection 41(1), like subsection 64(1) of the *Telecommunications Act*, permits an appeal to this Court, with leave, on questions of law or jurisdiction. There are other important similarities between the Acts and the limited right of appeal each grants:

i. Both Acts deal with highly specialized, expert regulatory bodies.

ii. Findings of the Canada Transportation Agency on questions of fact, like those of the CRTC, are binding and conclusive (CTA, section 31).

iii. The Agency, like the CRTC, may review, rescind or vary any decision or order made by it (CTA, section 32).

iv. The Governor in Council may also vary or rescind any decision, order, rule or regulation of the Agency (CTA, section 40), in the same manner as it may review decisions of the CRTC.

49 Looking at the text, context and purpose of subsection 41(1) of the CTA, this Court concluded in *Emerson Milling Inc.* that a question of jurisdiction "includes at least issues of procedural fairness, even if those issues are factually suffused" (*Emerson Milling Inc.*, paragraph 19). As to what constitutes a question of law, this Court found that the standard of "extricable questions of law or legal principle" is the applicable standard for determining whether a question of mixed fact and law is a "question of law" appealable under subsection 41(1) of the CTA (*Emerson Milling Inc.*, paragraph 26).

50 In my view, the Court's analysis and conclusion in *Emerson Milling Inc.* are equally apposite to appeals under subsection 64(1) of the *Telecommunications Act*.

51 In *Emerson Milling Inc.* this Court also recognized that the mere say-so of a party that a "legal test" is implicated is insufficient to found an appeal. Grounds of appeal may be expressed in an artful way to make them appear to raise legal questions when they do not. Accordingly, what is required is to look at the substance of what is raised, not the form. The true subject-matter of an appeal may be identified by construing the notice of appeal. As well, an appellant's memorandum of fact and law may be useful in providing a realistic appreciation of the appeal's essential character (*Emerson Milling Inc.*, paragraphs 29 and 30).

52 With this background, I turn to the grounds of appeal presented by the appellants in this case. To summarize briefly, these grounds of appeal are: i) the Commission breached the principles of procedural fairness and engaged in arbitrary

decision-making; ii) the Commission failed to comply with a statutory reasons requirement; iii) the Commission imposed an unconstitutional tax; iv) the Commission failed to exercise its powers with a view to ensuring that the appellants' rates are "just and reasonable"; and, v) the Commission failed to exercise its powers with a view to implementing the Canadian telecommunications policy objectives set out in section 7 of the Act and the Cabinet Direction.

i. Proper grounds of appeal

53 I am satisfied the first three of the profferred grounds of appeal at least on the surface raise questions of law or jurisdiction.

54 This is so because the allegation of breach of procedural fairness was characterized to be a question of jurisdiction in *Emerson Milling Inc.*; the related issue described by the Cable Carriers to be "arbitrary decision-making" (discussed in more detail below) may, as a matter of law, rise to the level of an extricable question of law if, for example, a decision-maker renders a decision in the absence of any evidence (see, for example, *Telus Communications Inc. v. Canadian Radio-Television & Telecommunications Commission*, 2004 FCA 365, [2005] 2 F.C.R. 388 (F.C.A.), at paragraphs 40 to 43). The remaining two issues of a statutory reasons requirement and an unconstitutional tax also raise extricable questions of law.

ii. Improper grounds of appeal

55 The remaining two profferred grounds of appeal are more problematic: the ground that the CRTC failed to exercise its powers with a view to ensuring that the appellants' rates are "just and reasonable" and the ground that it failed to exercise its powers with a view to implementing the Canadian telecommunications policy objectives set out in section 7 of the Act and the Cabinet Direction. Each will be considered in turn.

a) Whether the rates are just and reasonable is not a question of law or jurisdiction

56 As explained above, subsection 47(*a*) of the Act requires the Commission to exercise its powers and perform its duties with a view to ensuring that the rates it sets are "just and reasonable". The appellants argue that:

• A just and reasonable rate must allow a carrier to recover its costs, and the final rates set in the decision do not allow the carriers to recover their costs.

• Nowhere in the reasons does the CRTC advert to the importance of setting rates that ensure a return on investment.

• This error is an error of jurisdiction.

57 I begin consideration of this point by noting that the Cable Carriers do not cite any evidence in support of their submission that the final rates are insufficient to cover their costs (memorandum of fact and law, paragraph 91). The evidence Bell relies upon to argue that the actual cost of providing wholesale HSA services is substantially higher than the CRTC rate is new evidence, found in the affidavit of its Vice-President Regulatory Law. In his affidavit, the officer swore that:

> 28. In short, the process we employed closely mirrors the approach used by the CRTC in reaching the Decision, except that we used Bell's actual capital costs, from Bell's financial records, rather than the theoretical assumed capital costs used in Phase II Costing. Using this methodology, we determined that the per-subscriber per-month cost of FTTN access is **substantially higher** than the $14.78 rate ordered by the CRTC in the Decision.
>
> 29. The Decision thus orders Bell to provide wholesale FTTN Access at **below cost**.
>
> (emphasis in original)

58 The respondents object that this evidence was not before the Commission, and is improperly placed before this Court.

59 I agree.

60 In *Bell Canada v. 7262591 Canada Ltd.*, 2016 FCA 123, 17 Admin. L.R. (6th) 175 (F.C.A.), this Court discussed the purpose of the general rule against allowing new evidence on a statutory appeal:

> [11] The purpose of the general rule is two-fold:
>
> • *To respect the role of the administrative decision-maker*. The administrative decision-maker is the merits decider. It decides what evidence or information it should rely upon, it considers that evidence and information, and it makes findings of fact. That is not the role of the reviewing court. See *Bernard*, *Access Copyright* and *Delios*, all above.
>
> • *To further the role of the reviewing court*. The reviewing court must assess the administrative decision-maker's decision against the evidence and information the administrative decision-maker took into account. If certain of that evidence and information is withheld from the reviewing court, the review may be artificial and lead to inaccurate outcomes. See the discussion in *Canadian Copyright Licensing Agency (Access Copyright) v. Alberta*, 2015 FCA 268at paras. 13-14.

61 I am satisfied that admitting Bell's new evidence about its asserted cost of providing service would violate the CRTC's role as the fact finder and decider of the merits. The cost of providing service was an issue squarely before the Commission.

62 Further, accepting the evidence would not facilitate this Court's review of the CRTC's decision against the evidence before it. As will be seen below when considering the allegations of breach of procedural fairness and arbitrary decision-making, there were instances when the appellants declined to put company-specific evidence before the Commission. It would be particularly inappropriate in this circumstance for this Court to now rely upon evidence that Bell did not put before the Commission.

63 Contrary to the submissions of the Cable Carriers, the affidavit evidence provided by the appellants is generally not profferred to provide general background information to assist the Court or to shed light on the factors identified in *Baker v. Canada (Minister of Citizenship & Immigration)*, [1999] 2 S.C.R. 817, 174 D.L.R. (4th) 193 (S.C.C.). The evidence I have rejected about Bell's asserted costs is intended to add new evidence directly relevant to the merits of the appeal.

64 The result is that the appellants' argument that the Commission committed a jurisdictional error by setting rates that are not just and reasonable is unsupported by an evidentiary basis. However, in any event, I am satisfied that the question of whether the rates in question are just and reasonable is a question of fact — not a question of law or jurisdiction. I reach this conclusion for the following reasons.

65 For ease of reference I set out subsections 27(1), (3) and (5) of the Act:

> **27.**(1) Every rate charged by a Canadian carrier for a telecommunications service shall be just and reasonable.
>
> . . .
>
> (3) The Commission may determine in any case, <u>as a question of fact</u>, whether a Canadian carrier has complied with this section or section 25 or 29, or with any decision made under section 24, 25, 29, 34 or 40.
>
> . . .
>
> (5) In determining whether a rate is just and reasonable, the Commission may adopt any method or technique that it considers appropriate, whether based on a carrier's return on its rate base or otherwise.
>
> (underlining added)
>
> **27.**(1) Tous les tarifs doivent être justes et raisonnables.
>
> [...]

(3) Le Conseil peut déterminer, comme question de fait, si l'entreprise canadienne s'est ou non conformée aux dispositions du présent article ou des articles 25 ou 29 ou à toute décision prise au titre des articles 24, 25, 29, 34 ou 40.

[...]

(5) Pour déterminer si les tarifs de l'entreprise canadienne sont justes et raisonnables, le Conseil peut utiliser la méthode ou la technique qu'il estime appropriée, qu'elle soit ou non fondée sur le taux de rendement par rapport à la base tarifaire de l'entreprise.

(soulignements ajoutés)

66 Reading subsection 27(1) in conjunction with subsection (3) demonstrates that whether rates are "just and reasonable" under the statute is a factually suffused question of mixed law and fact. This type of question cannot be entertained under subsection 64(1) of the Act.

67 This view is reinforced by subsection 27(5). The Commission may adopt any method or technique that it considers appropriate to determine whether a rate is just and reasonable. The Commission enjoys considerable deference in determining the factors to be considered and the methodology that may be adopted for assessing whether rates are just and reasonable (*Bell Canada v. Canadian Radio-Television & Telecommunications Commission*, 2009 SCC 40, [2009] 2 S.C.R. 764 (S.C.C.), at paragraphs 40 and 41). As the CRTC is empowered to choose the method for setting rates, the appellants' arguments are necessarily an assault on the methods selected by the CRTC and its assessment of the evidence. The chosen methods of calculating rates and the CRTC's findings of fact are not subject to appeal under subsection 64(1).

68 This conclusion is demonstrated in the grounds of appeal set out in the notice of appeal filed on behalf of the large telephone companies. At paragraph 17 it is asserted that:

The CRTC's reasoning process contains several fundamental legal errors that are hallmarks of an irrational decision. The CRTC considered irrelevant factors like outdated data, ignored relevant factors like current data, and adopted methodologies that are contrary to its own earlier decisions. It greatly underestimated the costs of Bell's services. It thus erred in law by unreasonably applying its statutory rate-setting power to these facts.

(underlining added)

69 Challenges to the Commission's choice of methodologies and its assessment of evidence relevant to the selected methodologies are not matters of law or jurisdiction properly before this Court. The appellants' avenues for redress on these points lies with the Commission itself and the Governor in Council.

b) The Commission's consideration of policy objectives is not a question of law or jurisdiction

70 I reach a similar conclusion with respect to the appellants' argument that the Commission failed to implement or even consider the policy objectives enumerated in section 7 of the Act, thus committing a jurisdictional error.

71 The appellants argue that:

• Section 47 requires the Commission to exercise its powers with a view to implementing the Act's policy objectives and the Cabinet Direction.

• The Commission failed to do so. The decision not only fails to implement the policy objectives but is directly contrary to the geographic and competitive goals of the policy.

• This error deprived the Commission of jurisdiction.

72 I begin consideration of these submissions by observing that the appellants again point to inadmissible, new evidence to support their submissions. Such inadmissible evidence includes adverse commentary on the decision at issue (for example, the TD Securities Equity Research report, appeal book, tab 136T) and the appellants' own post-decision statements (for example, Cogeco's, Eastlink's, Rogers', Shaw's, Videotron's and Bell's parent company's post-decision announcements). As discussed above beginning at paragraph 60, this new evidence is inadmissible in this proceeding. Receiving this evidence would not respect the differing roles of this reviewing Court and the CRTC.

73 This said, I am satisfied that the appellants' argument that the Commission failed to implement or consider the policy objectives enumerated in section 7 of the Act again is not a question of law or jurisdiction properly before the Court.

74 In *Bell Aliant*, at paragraph 43, the Supreme Court quoted with approval the following passage from the reasons of Justice Sharlow, writing for this Court in the decision then under appeal:

> Because of the combined operation of section 47 and section 7 of the *Telecommunications Act* ..., the CRTC's rating jurisdiction is not limited to considerations that have traditionally been considered relevant to ensuring a fair price for consumers and a fair rate of return to the provider of telecommunication services. Section 47 of the *Telecommunications Act* expressly requires the CRTC to consider, as well, the policy objectives listed in section 7 of the *Telecommunications Act*. What that means, in my view, is that in rating decisions under the *Telecommunications Act*, the CRTC is entitled to consider any or all of the policy objectives listed in section 7.
>
> (underlining added)

75 During oral argument, counsel for the telephone companies conceded that the Commission:

• was not obliged to advance all of the policy objectives enumerated in section 7 of the Act;

• did advance some of the objectives articulated in section 7; and,

• the manner in which the Commission chose to balance policy objectives is not a question of law or jurisdiction.

76 In my view, these proper concessions, coupled with the broad authority of the Commission to consider any or all policy objectives, is fatal to the appellants' assertion that the Commission's treatment of the policy objectives raises questions of law or jurisdiction. Again, any disagreement with the Commission's policy choices is a matter to be pursued with the Commission or the Governor in Council — not this Court.

77 Indeed, in Order in Council P.C. 2020-0553 the Governor in Council considered "that the final rates set by [TO 2019-288] do not, in all instances, appropriately balance the objectives of the wholesale services framework recognized in Order in Council P.C. 2016-332 ... and that they will, in some instances, undermine investment in high-quality networks". This said, the Governor in Council found it premature to vary or refer TO 2019-288 back to the Commission because the Commission has already launched a public proceeding to consider the appellants' applications asking that it review and vary the decision.

78 As the issue of the CRTC's treatment of policy objectives is not properly before this Court it is unnecessary to consider the supplementary written submissions filed by the parties.

4. The issues to be decided

79 Having found the two grounds of appeal discussed above are not questions of law or jurisdiction, and therefore fall outside the scope of subsection 64(1), the remaining issues to be determined are:

i. Did the CRTC breach the principles of procedural fairness or engage in arbitrary decision-making?

ii. Do the reasons of the CRTC fail to comply with a statutory reasons requirement?

iii. Did the CRTC impose an unconstitutional tax?

5. The standards of review to be applied to the issues

80 In *Canada (Minister of Citizenship and Immigration) v. Vavilov*, 2019 SCC 65, 441 D.L.R. (4th) 1 (S.C.C.), the Supreme Court held that where Parliament has provided for an appeal from an administrative decision-maker to a court, the reviewing court is to apply appellate standards of review. Thus, questions of law, including questions concerning the scope of a decision-maker's authority, are reviewable on the standard of correctness (*Vavilov*, paragraph 37).

81 In light of this, the parties all agree that the standard of review for questions of law and jurisdiction is correctness. It follows that the issues of whether the CRTC failed to comply with a statutory reasons requirement and imposed an unconstitutional tax are reviewable on the standard of correctness.

82 The Cable Carriers acknowledge some divergence in the jurisprudence as to how allegations of procedural fairness are to be reviewed (memorandum of fact and law, footnote 94). In my view, in this case it is unnecessary to resolve any uncertainty in the law. For the reasons articulated below, even on the non-deferential standard of correctness the appellants have failed to demonstrate procedural unfairness.

83 I now turn to the application of these standards to the three issues properly before the Court.

6. Did the CRTC breach the principles of procedural fairness or err in law or jurisdiction by engaging in arbitrary decision-making?

i. The nature of the asserted errors of law and jurisdiction

84 As explained at the outset of these reasons, in their notice of appeal and memorandum of fact and law the Cable Carriers assert that the CRTC breached the principles of procedural fairness, impermissibly fettered its discretion, or acted arbitrarily with respect to the following costing factors: the productivity factor, upstream traffic growth rates, the attribution of segmentation fibre costs to Internet services, speed-banding, unrecovered costs, working fill factors, segmentation fibre facilities, coaxial cable facilities and annual development costs.

85 The telephone companies also argue briefly in their memorandum of fact and law that the CRTC ignored relevant factors, relied on irrelevant factors and made findings with no evidence. They allege the same error with respect to the productivity factor as the Cable Carriers assert. Other examples of alleged breaches of procedural fairness were briefly listed but were not well-developed by the telephone companies (memorandum of fact and law, paragraphs 87 to 92).

86 In oral argument the Cable Carriers characterized the asserted errors to be errors of law or jurisdiction falling within two categories: breaches of the duty of fairness and arbitrary decision-making.

87 Three elements of the duty of fairness were said to be breached by the CRTC: i) the right to have the rates determined by a fair, impartial and open-minded decision-maker; ii) the right to know the case the Cable Carriers had to meet and to put forward their case fully and fairly; and, iii) the right to receive reasons that met the requirements of the Act and the Cabinet Direction. The appellants also claim the Commission acted arbitrarily by making findings which were not supported by any evidence or which were made without regard to the relevant evidence actually adduced by the Cable Carriers.

88 After setting out in oral argument the applicable legal frameworks in which breaches of the duty of fairness and arbitrary decision-making are to be considered, the Cable Carriers orally argued that unfairness and arbitrariness were generally present in five cost factors addressed by the CRTC: the productivity factor, upstream traffic growth rates, the attribution of segmentation costs to Internet services, speed-banding and unrecovered costs. The Cable Carriers relied upon their memorandum of fact and law with respect to the remaining cost factors (listed in paragraph 84 above) which were also characterized to be additional examples of breaches of the duty of fairness or arbitrary decision-making. The Bell appellants made no oral submissions on this issue but adopted the submissions of the Cable Carriers.

89 In the oral argument of the five cost factors, the Cable Carriers did not maintain a clear distinction between their "fairness" arguments and their "arbitrariness" arguments. Their submissions delved deeply into the technical record and the CRTC's findings, often only loosely tethered to a legally protected right that could be asserted on these appeals.

90 In my view, nothing turns on the failure to maintain a clear distinction. I have reviewed in detail the submissions made orally and in writing with respect to the nine errors asserted by the Cable Carriers. For the reasons set out below I see no breach of procedural fairness, arbitrary decision-making or disregard of any legitimate expectation as to the conduct of the rate-setting process. The parties knew the issues that were in play and were afforded the opportunity to adduce evidence and make submissions on those issues. The parties' real complaint is that the Commission rejected their submissions.

91 I begin my analysis with the five specific errors that were argued orally and will then conclude with the four remaining asserted errors described in the Cable Carrier's memorandum of fact and law. The issue of the adequacy of the Commission's reasons is dealt with separately below.

ii. The productivity factor

92 The productivity factor, or the annual unit cost change assumption, is used to estimate reductions in per-unit equipment costs due to increases in equipment capacity over the study period (TO 2019-288, paragraph 9; TD 2016-117, paragraph 41). This costing factor is meant to reflect ongoing improvements in productivity that carriers can expect to realize in providing service as a result of communications technology becoming more productive over time (affidavit Lee Bragg, appeal book, tab 137, paragraph 70). The higher the absolute value of the productivity factor, the lower the associated wholesale rates.

93 In TD 2016-117, the CRTC established an annual productivity factor of minus 26.4%. The Cable Carriers assert that this was based on data "from a comprehensive Report published in 2011 by the Dell'Oro Group, an independent market analysis and research firm for the telecommunications industry." (memorandum of fact and law, paragraph 22). At that time, the CRTC is said to have described the Dell'Oro Group as a "reliable source of data from which to determine a revised annual unit cost" (TD 2016-117, paragraph 58 referring to a report which relied upon the Dell'Oro Group data). Subsequent to TD 2016-117, the Dell'Oro Group published updated productivity factors in reports issued in 2016 and 2017. During the rate-setting process that led to the decision at issue, Rogers proposed a productivity factor of minus 9% based on the Dell'Oro Group's 2017 report; four other Cable Carriers proposed a productivity factor of minus 17% based on the Group's 2016 report.

a) The appellants' submissions

94 The Cable Carriers argue that in TO 2019-288 the CRTC refused to consider this updated information. Instead, they submit that the CRTC "adhered rigidly to the minus 26.4% productivity factor that it had established previously ... based on data from the now-seriously outdated 2011 Dell'Oro Group Report." The Cable Carriers submit that the CRTC provided no meaningful explanation "for preferring obsolete data" and unjustifiably criticized the Cable Carriers for relying on the updated data, stating that the Cable Carriers had "selectively chosen data from third-party reports ... instead of relying on company-specific information." (memorandum of fact and law, paragraphs 24 to 25; TO 2019-288, paragraph 21).

b) Context

95 I begin by providing some important context, particularly the Commission's earlier decision in TD 2016-117. In this decision the Commission cited the argument advanced by the Canadian Network Operators Consortium Inc. (CNOC) that unit costs had been declining more rapidly than accounted for by the Commission's then current assumed productivity rate of minus 10%, and that a rate of minus 26.4% was appropriate. CNOC relied upon two reports to demonstrate this point. One of the reports was a report prepared by J. Scott Marcus, referred to as the Scott Report (TD 2016-117, paragraph 48). The Commission determined that the Scott Report constituted a reliable source of data from which to determine a revised productivity factor (TD 2016-117, paragraph 58). The Commission determined that the productivity factor should be changed to minus 26.4% (TD 2016-117, paragraph 63). While the Scott Report was prepared using data from the Dell'Oro Group, it is not accurate to state that the Commission's determination of the productivity factor was based on the report of the Dell'Oro Group.

96 As explained above, the Commission concluded its reasons in TD 2016-117 by reiterating that it had modified the rate-setting approach, adopted new assumptions for annual traffic growth and annual unit cost change, and changed the length of the study period for cost studies. The nature and scope of these changes indicated to the Commission that current wholesale HSA service rates were likely not just and reasonable (TD 2016-117, paragraph 104). Therefore, the Commission made interim all wholesale HSA service rates that were then approved on a final basis. All wholesale HSA service providers were directed to file new tariff applications reflecting the Commission's determinations (TD 2016-117, paragraphs 105 and 106).

97 On March 31, 2016 (the same day TD 2016-117 was issued) the Commission wrote to wholesale HSA service providers advising that the cost studies to be filed pursuant to TD 2016-117 were "to contain the detailed cost information outlined in the Commission staff letter dated 13 September 2013." Both the September 13, 2013 letter and the detailed cost information requirements were attached to the Commission's letter of March 31, 2016.

98 The cost studies submitted in response to TD 2016-117 were considered by the Commission in TO 2016-396 and TO 2016-448. At paragraphs 21 and 22 of TO 2016-396 the Commission referred to its letter of March 31, 2016 and expressed "significant concern that most wholesale HSA service providers chose to disregard Commission staff's guidance, the [Regulatory Economic Studies] Manual, and relevant past Commission determinations." To ensure that the interim rates were based on proper costing principles and reasonable costs the Commission made adjustments to the proposed costs before it, including adjustments to the annual unit cost change assumption for two carriers. The adjustments applied an annual unit cost change assumption of minus 26.4% (TO 2016-396, paragraph 23 and Appendix 2). The Commission approved monthly rates on an interim basis. The establishment of final rates was to be based on a full review and assessment of the relevant cost inputs and costing methodologies (TO 2016-396, paragraph 26).

99 Parenthetically, I note that the reference to a "Manual" is a reference to regulatory manuals prepared by telecommunications service providers and approved by the CRTC. The various manuals describe the basic framework for conducting regulatory economic studies and contain general and company-specific information and procedures to be used in calculating the incumbents' service costs. While originally developed for use by the ILECs, the manuals have been consistently applied to the Cable Carriers (see, for example, *Regulatory Economic Studies Manuals - Follow-up proceeding to Telecom Decision 2008-14* (25 August 2008), Telecom Order CRTC 2008-237, (TO 2008-237), paragraph 1, footnote 1).

100 In respect of "Productivity Improvement Factors", the Manual notes that a regulatory economic study must reflect the impact of productivity changes over the study period in recognition of anticipated operational process improvements. When a company has information about the productivity associated with a particular cost element, this specific level of productivity is to be used and identified in a regulatory economic study. When a company has insufficient information about the productivity associated with a particular cost element, the company may use its corporate average productivity improvement factors.

101 On December 16, 2016, after the issuance of TO 2016-396, the Commission again wrote wholesale HSA service providers advising that in "order for the Commission to approve the wholesale HSA service tariff applications on a final basis, it is necessary for the companies to refile cost studies in the context of their related tariff applications." Such cost studies were to abide by the principles and methodologies outlined in the Manual, abide by previous applicable Commission determinations and include all of the information in the prescribed format as identified in the Commission's letter of March 31, 2016. Any request for deviation from a past Commission determination contained in those items was to be accompanied by a detailed rationale for the request, with supporting evidence. In the absence of supporting rationale and evidence, "Commission staff will be guided by the Commission's adjustments identified in Telecom Order CRTC 2016-396."

102 On March 2, 2018, the Commission wrote wholesale HSA service providers requesting responses to attached requests for information. For example, Rogers was contacted with respect to its proposed annual capital unit cost change assumption which differed from the minus 26.4% annual capital unit cost change assumption approved by the Commission. Rogers was requested to explain "with supporting rationale why the company has not relied on company-specific information to estimate and propose the annual capital unit cost change assumption". If Rogers intended to propose a company-specific annual capital cost unit change assumption, it was to provide actual company-specific information.

103 Rogers responded that its opposition to the annual capital unit cost change assumption of minus 26.4% was based upon "the very data used to inform the Commission's original decision". Rogers advised that it had purchased a recent version of what it referred to as the data set entitled the "2017 Dell'Oro" Report. Rogers restated its opinion that an assumption that the annual capital unit cost change of minus 26.4% was inappropriate. Rogers did not respond to the request that it provide company-specific information to support a proposed company-specific annual capital unit cost change assumption. It simply repeated why it proposed an annual capital cost change assumption which differed from minus 26.4% and insisted that the CRTC accept the information it had provided.

c) The Commission's reasons

104 With this extensive background I now turn to the Commission's reasons; the material parts are found at paragraphs 21 and 24:

> 21. The Commission notes that the ILECs (with the exception of SaskTel and TCI) and cable carriers have selectively chosen data from third-party reports (i.e. the Dell'Oro Router Reports) to estimate company-specific annual capital unit cost change assumptions for use in their cost studies, instead of relying on company-specific information. Given that the wholesale HSA service providers are sophisticated network operators, it is reasonable to expect that they have detailed company-specific equipment prices and capacities for traffic-driven equipment that they acquire on an annual basis. Accordingly, the Commission determines that the approach adopted by these ILECs and cable carriers is not appropriate since it is not consistent with the general use of company-specific data in regulatory cost studies.
>
> . . .
>
> 24. In light of the above, the Commission determines that the previously approved annual capital unit cost change assumption of minus 26.4% continues to be a reasonable estimate for the annual capital unit cost change assumption for all traffic-driven equipment and should be applied accordingly to all wholesale HSA service providers' cost studies.

d) Analysis

105 As stated previously in these reasons, the issue before this Court is not the correctness or reasonableness of a productivity factor of minus 26.4%. The sole issues are whether the Cable Carriers' right to procedural fairness was breached when the Commission selected this productivity factor or whether the Commission arbitrarily, without explanation, preferred obsolete data.

106 The Cable Carriers have not demonstrated any procedural unfairness or arbitrariness. In circumstances where:

> i. in TD 2016-117 the Commission commented on the lack of evidence supporting proposed productivity factors (TD 2016-117, paragraph 53);
>
> ii. the Commission then sought detailed cost information in the cost studies to be filed in response to TD 2016-117;
>
> iii. the Commission expressed significant concern in TO 2016-396 at the lack of proper costing information, notwithstanding staff guidance and the provisions of the Manual, and continued to apply a productivity factor of minus 26.4%;
>
> iv. the Manual requires company-specific information about the impact of productivity changes;
>
> v. the Commission provided further guidance in its letter of December 16, 2016 as to the specific information required in the cost studies and stated that any request for a deviation from a past Commission determination was to include a detailed rationale for the deviation and supporting evidence; and
>
> vi. the Commission again requested company-specific information in its information request of March 2, 2018;

there is no procedural unfairness or arbitrariness.

107 The Commission sought company-specific information, and gave clear and fair warning of the consequence that would follow from a failure to provide such information or a rationale for a deviation that was accompanied by supporting evidence. Reading the reasons in the light of the record, the explanation for the Commission's use of a productivity factor of minus 26.4% is clear. It wished company-specific information, not third-party data.

108 As the record shows, the Cable Carriers had the opportunity to submit the requested information. The choice to require company-specific information may not have been what the Cable Carriers wanted, but the CRTC may select any method it considers appropriate when setting rates (Act, subsection 27(5)).

109 The Cable Carriers chose not to provide the requested information and now complain that they were not accorded fair process. This argument has no merit; the Cable Carriers were given a fair process, which they chose not to follow. In substance, the Cable Carriers object to the reasonableness of the productivity factor determined by the Commission. This is not a question of law or jurisdiction properly before the Court.

iii. Upstream traffic growth rates

110 Growth rates in peak period Internet traffic are used to forecast peak period traffic; in turn, peak period traffic is used to estimate the facilities that will be required to provide service over a study period (TO 2019-288, paragraph 162). Lower growth traffic rates produce lower wholesale rates.

a) The appellants' submissions

111 The Cable Carriers submit that in TD 2016-117, the CRTC directed them to use: i) a growth rate for the first two years of the study period that reflected historical levels of Internet traffic; and, ii) a growth rate of 32% for the remainder of the study period. They say that both Rogers and Cogeco followed "this mandated approach in preparing their cost studies." However, they submit that in the decision under appeal the CRTC "declined to follow the approach that it had previously and specifically prescribed." (memorandum of fact and law, paragraphs 54 and 55). Instead, the CRTC selected the growth rate from the most recent year in which historical data was available and applied that rate over the entirety of the study period.

112 The Cable Carriers say that by relying on what they assert is the lowest annual growth rate experienced by these companies over the past five years, the CRTC artificially depressed the wholesale rates payable by resellers to Rogers and Cogeco. They submit that the CRTC provided no notice to the Cable Carriers of its intention to abandon the approach it had "mandated" only three years earlier. In their submission, the CRTC ignored the evidence it had directed would be determinative while at the same time denying Rogers and Cogeco the opportunity to file additional evidence or make submissions on the issue (memorandum of fact and law, paragraphs 55 and 56). They say that they had a legitimate expectation that the Commission would follow its previous methodology.

b) Context

113 Again, I begin my analysis with TD 2016-117. In this decision the Commission:

> i. described its approach, set out in TD 2006-77 and in TRPs 2011-703 and 2011-704, in which it applied to the first two years of a study period traffic growth rates per retail end-user consistent with historical levels, followed by a constant annual growth rate assumption for the remaining period of the cost study. Most recently, a constant growth rate of 20% had been applied by the Commission (TD 2016-117, paragraphs 27, 28 and 39);
>
> ii. explained that both wholesale HSA service providers and the Internet service providers agreed that annual Internet traffic had been growing at a rate greater then the Commission's then current annual traffic growth assumption of 20%. However, the Internet traffic growth rate estimates submitted to the CRTC varied considerably, with the highest estimate being more than double the lowest estimate (TD 2016-117, paragraph 29);

iii. noted that both Shaw and CNOC referred to the Cisco Systems, Inc. Visual Networking Index White Paper which provided a growth forecast for Internet traffic in Canada, and which indicated that peak period Internet traffic would grow, from 2014 to 2019, at a compound annual growth rate of 32% (TD 2016-117, paragraphs 30 and 31);

iv. noted that no intervener refuted the validity of the Cisco White Paper (TD 2016-117, paragraph 37);

v. found that the Cisco White Paper used sound methodology and provided a proper and principled basis for determining a Canada-wide Internet traffic growth forecast (TD 2016-117, paragraph 38); and,

vi. determined that in the cost studies to be submitted in support of proposed new wholesale HSA service rates, all wholesale HSA service providers were to include, in the first two years of the study period, annual traffic growth rates per retail end-user consistent with historical levels, followed by a constant growth rate of 32% for each of the remaining years of the study period (TD 2016-117, paragraph 40).

114 I pause here to make two observations. First, the parties' submissions and the Commission's determination was premised on the view that the annual growth rate of Internet traffic had increased significantly (see, particularly, the fourth paragraph of the preamble to TD 2016-117) so that the assumption of 20% annual traffic growth was no longer appropriate. Based on the evidence, the CRTC updated the assumed rate of growth but did not revisit the structure of its formula. Second, contrary to the submissions of the Cable Carriers, in this decision the CRTC neither set rates nor mandated any particular rate outcome.

115 Rogers and Cogeco state that they followed the Commission's direction when preparing and submitting their cost studies in support of proposed new wholesale HSA service rates.

116 However, contrary to the Commission's understanding at the time of TD 2016-117, Rogers' and Cogeco's historical annual peak period upstream traffic growth rates had been declining, not increasing.

c) The Commission's reasons

117 Faced with that fact, in TO 2019-288 the Commission concluded that it was not reasonable to expect that annual peak period upstream traffic would increase over the cost study period to the levels proposed by Rogers and Cogeco. In light of the actual declining growth rates, "and having regard to the record before it", the Commission applied the most recent year's values from Rogers' and Cogeco's respective historical annual peak period upstream traffic growth rates as the growth rate to be applied in each year of their cost studies (TO 2019-288, paragraph 168).

d) Analysis

118 Again, I see no procedural unfairness. The 32% growth rate set in TD 2016-117 was a substantive finding of the CRTC, which was revised in TO 2019-288 in the face of new evidence. As the doctrine of legitimate expectation protects procedural, not substantive expectations (*Agraira v. Canada (Minister of Public Safety and Emergency Preparedness)*, 2013 SCC 36, [2013] 2 S.C.R. 559 (S.C.C.), at paragraph 97), neither Rogers nor Cogeco could have any enforceable reasonable expectation that rates would be set on the basis of an assumed 32% annual growth rate.

119 Further, both Rogers and Cogeco must be assumed to have understood the express premise of TD 2016-117 and to have known that their historical annual peak period upstream traffic growth rates had been declining. Armed with that knowledge they were able to make informed submissions to the Commission on an appropriate rate. The fact that the Commission rejected those submissions does not amount to a breach of procedural fairness.

iv. Attribution of segmentation costs

120 Segmentation facilities include segmentation fibre and optical nodes. These facilities transport various services such as Internet and television (TO 2019-288, paragraph 119) and voice calling. In *Cogeco Cable Canada Inc., Re* (21 December 2006), Telecom Decision CRTC 2006-77 (TD 2006-77), [(December 21, 2006), 2006-77 (C.R.T.C.)] the Commission determined

that 75% of the proposed all-carrier node segmentation capital costs would be attributed to wholesale HSA and retail Internet services. This recognized that these facilities were used for other Cable Carrier services, not just Internet services (TO 2019-288, paragraph 136; TD 2006-77, paragraphs 92 and 93). The Commission reached this decision notwithstanding the submissions of the Cable Carriers that high-speed Internet access was the sole driver of node segmentation (TD 2006-77, paragraphs 84 to 88, 90 to 91).

121 In the rate-setting hearing under review, the Cable Carriers again argued that incremental segmentation costs are dedicated exclusively to managing peak Internet traffic volumes. Therefore, they proposed that 100% of the cost associated with segmentation fibre facilities be attributed to Internet services. The CRTC rejected this argument:

> 136. In Telecom Decision 2006-77, the Commission determined that 75% of the proposed all-carrier node segmentation capital costs would be causal to the wholesale HSA and retail Internet services, in recognition of the use of these investments for other cable carrier services such as television and voice.
>
> 137. The Commission remains of the view that these facilities are used to provision a variety of services; therefore, it would not be appropriate to attribute 100% of the costs of these facilities to retail Internet and wholesale HSA services.
>
> 138. In the absence of any evidence, and given that future services are expected to benefit from segmentation facility investments over the cost study period, the Commission determines that an attribution factor of 75% continues to be appropriate.

a) The appellants' submissions

122 The Cable Carriers argue that the Commission reached this conclusion in the absence of any evidence supporting its stated "expectation", and without support in the Manual for the application of such an approach. They submit the Commission had no basis for this 75% attribution of segmentation costs as segmentation facilities are deployed to satisfy demand for new services or increasing demand for existing services and there was no evidence of increasing demand for non-Internet services. The Cable Carriers also argue that in stating that it adopted this approach "in the absence of any evidence" the Commission demonstrated that it disregarded the evidence of the Cable Carriers.

123 In oral argument the Cable Carriers referred only to the submissions to the Commission by Shaw and Rogers.

b) Context

124 In response to an information request from the Commission, Shaw confirmed that its video and voice services also use the facilities associated with optical nodes. It submitted, however, that peak Internet traffic is the cost driver for the major network components, including node segmentation related costs. It submitted that no other traffic on its network reached a level that required Shaw to undertake node splits to alleviate traffic congestion. As a result, Shaw only included in its cost study the incremental causal costs related to Internet service for node segmentation related costs.

125 In response to a similar request for information, Rogers confirmed that its optical node carries radio frequency signals for Internet, television and Rogers home phone services. Plans to add other services were said to be underway. In the submission of Rogers, even if other services benefit from the facilities, costs should not be attributed to these other services unless they cause advancement of the facilities.

126 Thus, both Shaw and Rogers acknowledged that their segmentation equipment and facilities were used by services other than Internet services. Notwithstanding, they argued that no other traffic had reached a level that required them to undertake node splits to alleviate traffic congestion so all segmentation costs should be attributed to Internet services. They elected not to provide evidence of any incremental cost for other services.

c) The Commission's reasons

127 Having received the Cable Carriers' evidence and submissions, the Commission remained of the view that because the facilities were used to provide a variety of services it would not be appropriate to attribute 100% of the cost of these facilities to retail Internet and wholesale HSA services. In the absence of any evidence about any incremental cost for other services the Commission determined that the attribution factor of 75% continued to be appropriate.

d) Analysis

128 I see no procedural unfairness. The Cable Carriers were aware of the issue, filed their evidence, offered their submissions and replied to requests for information. Their complaint is with the Commission's decision not to attribute 100% of the cost of segmentation facilities to Internet services, not with the fairness of the Commission's process.

v. Speed-Banding

129 To understand the speed-banding issue one must understand that the cost model for wholesale HSA services is based upon two broad categories of costs: access costs and usage costs. Access costs consist of costs associated with end users' access to the network. These costs do not vary with changes in usage levels. Usage costs consist of costs incurred to move data through a wholesale HSA service provider's network. These costs do vary with changes in usage levels. Coaxial cable costs are an example of access costs; optical node costs are an example of usage costs (TO 2019-288, paragraph 139; TD 2016-117, paragraph 77).

130 In TD 2016-117 the Commission considered whether usage-sensitive equipment should be assigned to the traffic-driven portion of cost models. The Commission determined:

> 85. The large cable companies have some costs for usage-sensitive equipment in the access portion of their cost models (e.g. the CMTS chassis) that are traffic-driven. <u>These usage-sensitive costs can be identified and removed from the access portion of cost models and assigned to the traffic-driven portion</u>, whether the wholesale HSA service provider is using the CBB model or the flat rate model. <u>This reassignment of costs would aid in the creation of speed-bands</u> by reducing variability in the access costs between the various service speeds within a speed-band.
>
> 86. In light of the above, the <u>Commission determines that wholesale HSA service providers must ensure that all equipment costs accounted for in the access portion of their cost models include costs only for non-usage-sensitive equipment</u>.
>
> (underlining added)

131 To understand the speed-banding issue one must also understand that in the decision at issue the Commission was considering whether segmentation fibre facilities should be accounted for in the access or usage portion of the cost model (*Review of costing inputs and application process for wholesale high-speed access services* (28 May 2015), Telecom Notice of Consultation CRTC 2015-225, paragraph 19; TD 2016-117, paragraph 77). It was this determination that gave rise to what is referred to as the speed-banding issue. With this background, I turn to speed-banding.

132 In TD 2016-117 one of the Commission's key determinations was whether to adopt either the "fixed access" approach or the "speed-banding" approach to rate-setting. The Commission described the "fixed access" approach to involve the creation of a fixed access rate that would apply to all service speeds. The fixed access rate would recover both speed-dependent and speed-independent access costs for all service speeds. The Commission described the "speed-banding" approach to further break down access costs into two access rate components. The first component would consist of a speed-independent, fixed, weighted-average access rate that would apply to all service speed offerings. The second rate component would consist of a speed-dependent access rate per speed-band uniformly applied to all service speeds falling within a given speed-band. Each speed-band would be determined based on service speeds that have similar costs (TD 2016-117, paragraph 12).

133 In TD 2016-117, the Commission determined that rate-setting for all wholesale HSA services would be done in accordance with the speed-banding approach. It did not establish how the various costs would be allocated to different rate components.

a) The appellants' submissions

134 The Cable Carriers say that they relied on this determination and proposed wholesale rates based on the speed-banding approach.

135 The Cable Carriers acknowledge that during the course of the rate-setting proceeding the Commission asked the Cable Carriers to comment on the appropriateness of moving segmentation costs from the "access" rate component of wholesale rates to the "capacity" (or usage) rate component. They responded that this adjustment would be a "radical change in the pricing approach of access services" that would be impossible to reconcile with speed-banding (memorandum of fact and law, paragraph 37). Moreover, they asserted that such a change would require new costing models based on the discredited "fixed access approach". They identified the connection between segmentation fibre facilities and speed-banding, however they did not provide revised proposed rates associated with segmentation fibre costs in the traffic-driven portion of the cost model.

136 Notwithstanding their submissions, the Cable Carriers assert that the CRTC gave them no notice of its intention to abandon speed-banding and gave them no opportunity to file such new costing models based on a fixed access approach. Instead, the Cable Carriers say that the Commission simply imposed a single access rate to be applied across all speeds offered by each Cable Carrier. The Cable Carriers assert that in doing so the Commission: i) ignored their evidence establishing the greater cost of providing higher-speed Internet service independent of the usage; ii) disregarded its own explicit direction to use the speed-banding approach and thereby disregarded the legitimate expectation of the Cable Carriers as to how the rate-setting process would be conducted; and, iii) gave no consideration to the fact that the entirety of the Cable Carriers' cost studies had been premised on the Commission's previous direction to apply speed-banding.

137 Again, I see no error of law or jurisdiction.

b) Context

138 In paragraph 85 of TD 2016-117, quoted above, the CRTC foreshadowed its requirement that usage-sensitive costs be identified and removed from the access portion of the cost models and assigned to the usage-driven portion. The speed-banding approach was premised on the adoption of two access rate components — one consisting of speed-independent costs, the other consisting of speed-dependent costs. In the decision at issue the Commission did not reverse its previous policy. Instead, with the benefit of a full record, it found that most speed-dependent costs were better characterized as usage costs (TO 2019-288, paragraphs 156 to 161). Applying its previous policy to the finding, the Commission reassigned those costs to the usage portion of the model. The impact on speed-banding was a foreseeable consequence of that determination.

139 Further, the Commission specifically solicited submissions from the parties on this issue. In a request for information issued on March 2, 2018 the Commission referenced TD 2016-117 and observed that the addition of fibre facilities to support node segmentation generally occurs as additional facilities are required to meet rising Internet demand. The Commission went on to ask that the parties comment "on the appropriateness of including the costs associated with segmentation fibre in the access portion of the cost model as opposed to the traffic [or usage] driven portion" and were asked to "provide revised proposed rates and cost information using the baseline cost study that includes the costs associated with segmentation fibre and any other usage-sensitive equipment in the traffic driven portion of the cost model", using a specified format.

140 Accordingly, contrary to the submission of the Cable Carriers, new costing models were solicited.

c) Analysis

141 We were not taken to any evidence to suggest that the Cable Carriers provided such cost studies. Indeed, in its Aggregated Final Comments, Rogers simply argued extensively that its method of including certain node segmentation costs in the access portion of the cost model remained appropriate. In response to the information request Cogeco similarly replied that it remained of the view that "it is appropriate to include the costs associated with segmentation fibre in the access portion rather than in the traffic driven portion of Cogeco's proposed cost model." (appeal book, tab 112C.1(I), question 6).

142 The Cable Carriers knew this issue was in play and were given the opportunity to file new costing models. There was no procedural unfairness. The doctrine of legitimate expectations does not protect a substantive expectation that the CRTC would continue to set access rates that vary across speed-bands.

vi. Unrecovered costs

143 As explained above, in TD 2016-117 the CRTC changed the study period from the then current ten year term to a shorter period of five years. The Commission wrote:

> 76. These changes to the study period are to take place immediately, and not after the expiration of the current ten-year study period. When service rates are revisited prior to the end of an original study period, service providers may be unable to recover certain costs that they would have otherwise expected to recover. It is appropriate for service providers to be able to recover these costs. Unrecovered costs that are causal to a service can be recovered according to the methodology outlined in Appendix E-1 of the large telephone companies' Regulatory Economic Studies Manuals, which were approved in Telecom Order 2008-237. For all other unrecovered costs, the Commission requests wholesale HSA service providers to identify and justify the amount, with supporting rationale, and to propose a way to recover these costs.

144 During the rate-setting hearing at issue, Rogers submitted evidence of two categories of unrecovered costs, totalling $52.3 million. The first category of unrecovered costs reflected costs that had not been recovered due to the Commission's decision to update wholesale HSA rates prior to the end of the original study period (Changed Study Period Unrecovered Costs). The Commission had originally approved final rates based on a ten-year cost study that Rogers asserted would have had to run its course in order for cable companies to fully recover their costs. The Commission's decision to truncate that period was said to result in unrecovered costs. Rogers quantified these costs in the amount of $30.1 million. The second category of unrecovered costs were costs that were not recovered due to the difference between interim rates in place since 2012 and what Rogers submitted were the true costs of providing the services (Interim Rates Unrecovered Costs). These costs were quantified in the amount of $22.2 million.

145 At paragraph 38 of its reasons in TO 2019-288, the Commission acknowledged that revisiting wholesale HSA rates prior to the end of the period captured by the original cost study might result in unrecovered costs. This said, the Commission rejected Rogers' claim for unrecovered costs stating:

> 45. RCCI's proposed unrecovered costs were estimated based on interim rates. Given that the rates for the speed tiers for which the company has proposed unrecovered costs were (i) approved on an interim basis, (ii) under review, and (iii) not approved on a final basis, the question of unrecovered costs does not arise. The difference between the interim rates and final rates is resolved through retroactivity. In view of the above, the Commission determines that RCCI's proposed unrecovered costs are not appropriate.

146 On this basis, the Commission excluded Rogers' proposed unrecovered costs from its cost studies.

a) The appellants' submissions

147 Rogers submits that these reasons addressed only the Interim Rates Unrecovered Costs and that no reasons were provided for rejecting the Changed Study Period Unrecovered Costs. It further submits that the Commission's reasons for rejecting the Interim Rates Unrecovered Costs ignored the fact that these costs related to interim rates in place between 2012 and 2016 so that retroactive rates for the period from 2016 to the present cannot address those earlier unrecovered costs.

b) Analysis

148 I see no error of law or jurisdiction.

149 In the rate-setting process at issue, Rogers submitted proposed rates for consideration by the Commission based upon its revised cost study. Included in its proposed rates was Rogers' claim for unrecovered costs. Rogers' proposed rates were

higher than the interim rates set in 2016. In TO 2019-288 the CRTC not only rejected the higher rates proposed by Rogers, but found that the interim rates set in 2016 were not just and reasonable; the Commission set rates that were lower than the then existing interim rates and made such rates retroactive in order to ensure that wholesale HSA service providers applied just and reasonable rates.

150 Read in this light, the Commission's reasons disposed of both parts of Rogers' unrecovered costs claim. Rogers' cost study was rejected because the CRTC found it overestimated how much it actually cost Rogers to provide wholesale HSA services. The embedded claim for unrecovered costs failed when the Commission approved a lower rate than that proposed.

151 There is no valid claim for breach of procedural fairness or arbitrariness. Rogers' real complaint is with the quantum of the tariff approved by the Commission; a complaint that is outside the scope of this Court's reviewing function.

vii. Working fill factors (WFF)

152 As the CRTC explained in TO 2019-288:

> 47. The working fill factor (WFF) is a measure of the utilization of a shared facility and is used to recognize the non-working capacity and to apportion the cost of non-working capacity to the per-unit cost of the working capacity.
>
> 48. Working capacity is the capacity that is available to provide service to customers making use of the relevant facility. This includes all units that are potentially revenue generating, while non-working unit capacity is all other remaining units (e.g. units required for maintenance).

153 The WFF represents the point at which network equipment must be upgraded to handle increased usage. As a "higher WFF implies that a carrier can operate at a much higher capacity before additional costs" must be incurred to upgrade network capacity, a higher WFF produces lower wholesale rates (affidavit Lee Bragg, appeal book, tab 137, paragraph 59).

154 In *Review of the use of company-specific working fill factors and the recovery of past introduction costs not fully recovered* (14 May 2009), Telecom Regulatory Policy CRTC 2009-274 (TRP 2009-274) the Commission determined that companies could propose a company-specific WFF for a particular facility for use in a cost study so long as the company met five enumerated conditions. The Commission also determined that when a company-specific proposed WFF did not meet the enumerated conditions, the Commission-mandated WFFs are to be used (TRP 2009-274; TO 2019-288, paragraphs 49 and 50). For the purpose of this appeal, the relevant condition is the first enumerated condition: the company must satisfy a common definition of the WFF.

155 Throughout the rate-setting proceedings now under review by this Court, the appellants proposed company-specific WFFs. The CRTC found these proposals did not satisfy the relevant conditions and so it rejected them (TO 2019-288, paragraphs 66 to 67, 97).

a) The appellants' submissions

156 The Cable Carriers allege two errors of law with respect to the WFF. First, they allege the CRTC improperly fettered its discretion by following outdated Manuals when the Cable Carriers provided "superior" information. Second, they allege that the CRTC made decisions without evidence based on irrelevant considerations while ignoring relevant evidence. In addition to these errors of law the Cable Carriers also assert that the CRTC breached an explicit undertaking that it would rely on a report from a third-party research and development group (CableLabs Report).

b) Analysis

157 I begin by rejecting the notion that the Commission fettered its discretion. An administrative decision-maker fetters the exercise of their discretion by relying exclusively on an administrative policy without regard to the law (*Stemijon Investments Ltd. v. Canada (Attorney General)*, 2011 FCA 299, 425 N.R. 341 (F.C.A.), at paragraphs 24 and 60). This is not what the Commission did in this case. The Commission did not treat its former determinations as being legally binding; rather, it asked the

parties to explain and support their proposed departure from the determination established in TRP 2009-274 (see, for example, CRTC Request for Information, appeal book, tab 109D, pages 7, 12 to 13, 18, 31, 37 to 38 and 50).

158 I next reject the notion that the CTRC in effect closed its eyes to the evidence. In their responses to a request for information, the appellants asked the CRTC to make a departure from the manner in which it calculated WFF.

159 The appellants submitted that WFF should be based on the "average operational utilization level of the entire access network at steady state". In TRP 2009-274 the Commission defined the company-specific measured WFF to be a function of "working units" and defined "working units" to be those units that are expected to provide service to an end-user (TRP 2009-274, paragraph 22). Instead, in the present case the appellants defined "working units" to be those units used at the moment of measurement. In the view of the Commission, this approach resulted in an underestimation of working units because it did not take into account all working units that could provide service to a customer (TO 2019-288, paragraph 67). It follows that the Commission found the proposed company-specific measured WWFs were not appropriate for use in cost studies. Those WWFs did not satisfy the first enumerated condition for the use of a company-specific WFF. This was a determination open to the Commission. The CRTC did not close its eyes to the evidence.

160 To the extent that the Cable Carriers now complain that it was inappropriate for the CRTC to impose the conditions set in TRP 2009-274 because that policy was designed for ILECs, this is an argument they ought to have advanced before the CRTC. It is too late to raise it on this appeal (*A.T.A. v. Alberta (Information & Privacy Commissioner)*, 2011 SCC 61, [2011] 3 S.C.R. 654 (S.C.C.), at paragraphs 22 to 26).

161 Finally, I reject the submission that the CRTC breached an explicit undertaking that it would rely upon the CableLabs Report. This undertaking is said to have been made by the CRTC in *Bragg Communications Incorporated, operating as Eastlink - Application to review and vary or stay* 2016-448 *regarding wholesale high-speed access service interim rates* (25 May 2017), Telecom Decision CRTC 2017-167 (TD 2017-167) [2017 CarswellNat 4546 (C.R.T.C.)] where it wrote:

> 18. With respect to the CableLabs report filed by Eastlink in support of the application, this report was filed with the Commission after Telecom Order 2016-448 was issued, and thus could not have been considered in the proceeding that led to that order. However, the Commission will consider it in determining the final rates for Eastlink's TPIA service.

162 Context is important. As described above when dealing with the policy pedigree of the decision at issue, after finding that existing wholesale HSA service rates were not just and reasonable in TD 2016-117, the CRTC set revised interim rates for Eastlink in TO 2016-448. The interim rates were lower than the previous rates. The Commission expressed concern that Eastlink had deviated from the established Phase II capacity costing methodology and specifically expressed concern with the working fill factor (TD 2016-117, paragraph 12).

163 Eastlink then applied for a stay, review and variation of the interim rates under section 62 of the Act. In its application, Eastlink made a similar argument to the one raised in this appeal and presented the CableLabs Report as evidence. The CableLabs Report was new evidence that had not been before the CRTC when it set the interim rates under review.

164 In TD 2017-167 the CRTC dismissed Eastlink's application for reconsideration. It commented, at paragraph 17, that Eastlink had the opportunity to submit evidence supporting its proposal before interim rates were set but failed to do so. In this circumstance, it would have been improper for the CRTC to consider the CableLabs Report at that time. It was in this context that the Commission stated that it would consider the report when determining final rates.

165 The Commission's meaning was clear. Eastlink had failed to provide evidence to support its company-specific WFFs during the interim rate-setting process and filing such evidence as part of its application to review and vary did not remedy that failure. This said, the report could be filed as part of the final rate-setting process. In saying this the CRTC made no comment on the contents of the report. The CRTC did not make a binding commitment or undertaking to adopt the CableLabs Report in the final rate-setting order.

166 In its report, CableLabs used the definition of WFF proposed by the appellants but rejected by the Commission (see Report, appeal book, tab 119A(I), paragraph 52). The Commission rejected the CableLabs Report because it relied on an improper definition of WFF.

viii. Segmentation fibre facilities

167 Segmentation facilities transport various services, such as television and Internet, to end-users.

168 The Cable Carriers submitted that the Commission should abandon the technology cost factor methodology set out in the Regulatory Studies Manual at section 3-43 to be used to estimate segmentation fibre facility costs. Instead, the Cable Carriers advocated use of the replacement cost approach (TO 2019-288, paragraphs 120 and 124).

169 The Commission rejected the request of the Cable Carriers:

> 130. The Commission considers that the use of this approach, as proposed, is not appropriate, given that fibre facilities are shared among different services. As per the Manual, a cost factor approach is an appropriate method to use to estimate the costs for such facilities.
>
> 131. With respect to the capacity of segmentation fibre facilities, the Commission is of the view that once they are deployed to a given node, no further augmentation of the deployed fibre facilities is required since the fibre's capacity to serve a given node is, in practice, not subject to exhaustion. Accordingly, the capacity of a given segmentation fibre facility to provision an optical node cannot be said to be limited.

170 During the course of the rate-setting proceeding the CRTC sought submissions about the appropriateness of estimating the costs for segmentation fibre facilities using the technology cost factor in place of the Cable Carriers' proposed approach (March 2, 2018 Request for Information, appeal book, tab 109D, pages 24, 33, 43-44, and 54). The Commission received and considered the submissions it received in response.

171 The Cable Carriers' assertion that the Commission ignored evidence is unfounded. Their real complaint is with how the CRTC interpreted and applied the facts before it.

ix. Coaxial cable facilities

172 In *Terms and rates approved for large cable carriers' high speed access service* (21 August 2000), Order CRTC 2000-789 (Order 2000-789), the Commission determined that it is appropriate to use a proxy monthly cost of $0.152 per channel, per subscriber, to estimate the cost associated with coaxial cable facilities. This rate was meant to reflect the relevant cost categories of depreciation, operating expenses and rate of return. In the rate-setting proceeding at issue, the Cable Carriers submitted that the use of this proxy was no longer appropriate because the information and data used to calculate the proxy was outdated.

173 The Commission's analysis and conclusions are set out in paragraphs 112 through 116 of its reasons:

> 112. The capacity costing approach is generally used when the use of existing shared facilities results in the advancement of future relief of facilities.
>
> 113. With respect to existing coaxial facilities, there is no cost of advancement. This is due to the fact that when wholesale HSA and retail Internet services make use of the facilities, relief is provided by segmenting the facilities. Accordingly, the Commission considers that it is not appropriate to use the capacity costing approach to estimate the costs of existing coaxial facilities.
>
> 114. With regard to the cable carriers' concerns regarding the use of outdated cost information in the proxy approach, the Commission considers that updated cost information should be used to reflect the forward-looking, company-specific costs for existing coaxial facilities.

> 115. With respect to estimating existing coaxial facility costs, the Commission determines that, subject to what follows, it is reasonable to include forward-looking coaxial facility costs associated with the same cost categories as before. The cable carriers provided the depreciation and operating expenses for coaxial facility costs, and the Commission has used these amounts to estimate the coaxial facility costs. The Commission determines, however, that it is not appropriate to include a specific category to account for a rate of return given that the after-tax weighted average cost of capital (AT-WACC) takes into consideration the rate of return.
>
> 116. With respect to estimating new coaxial facility costs, the Commission determines that it is appropriate to do so based on an average cost for provisioning coaxial facilities per new home passed during the cost study period.

a) The appellants' submissions

174 The Cable Carriers state that the relevant Manuals mandate the use of the "capacity costing" methodology to estimate costs associated with shared facilities such as coaxial cable facilities. They complain, however, that the CRTC rejected the use of the capacity costing approach for determining the cost associated with their coaxial cable facilities. Instead, they submit that the Commission "applied a novel and unwarranted methodology that involved estimating these costs based on depreciation and operating expenses." (memorandum of fact and law, paragraph 42). Moreover, the CRTC did not request submissions concerning the appropriateness of using the information solicited from them to estimate the costs associated with their coaxial cable facilities.

175 This submission fails to distinguish between the Commission's determinations with respect to existing and new coaxial facilities.

b) Context

176 At paragraph 112 of its reasons the CRTC confirmed that capacity costing is generally used when the use of existing shared facilities results in the advancement of future relief of facilities. However, in the case of existing coaxial facilities the Commission determined that there was no cost advancement because while segmentation requires the addition of an optical node along with fibre facilities, no additional coaxial facilities are required.

177 The Commission did not reject the application of capacity costing to new coaxial facilities (TO 2019-288, paragraph 113 and footnote 20).

c) Analysis

178 As to the assertion that the Commission applied a "novel and unwarranted methodology", the Commission confirmed that it included depreciation and operating expense amounts provided by the Cable Carriers to estimate coaxial facility costs. The Commission did not include an allowance for a rate of return because, in its view, another calculation takes into account the rate of return (TO 2019-288, paragraph 115). This does not constitute a "novel and unwarranted methodology". The duplicative element of rate of return was simply removed from the relevant cost categories considered when estimating the cost associated with coaxial cable facilities.

179 The Cable Carriers have not demonstrated any breach of procedural fairness.

x. Annual development costs

180 In the rate-setting proceeding below, Rogers sought annual development costs associated with its aggregated wholesale HSA service and annual development costs associated with its wholesale HSA and retail Internet services (TO 2019-288, paragraph 181). At paragraphs 182 and 183 of its decision, the CRTC disallowed most of these costs for the following reasons:

> 182. With respect to annual development costs causal to aggregated wholesale HSA service, development costs are normally incurred only at the beginning of the study period. The Commission considers that RCCI did not provide sufficient

> evidence to support ongoing development costs. Accordingly, the Commission has excluded RCCI's development costs from year two and beyond in its cost studies.
>
> 183. With respect to the separate annual development costs associated with its wholesale HSA and retail Internet services, RCCI did not provide evidence that these initiatives are causal to the provisioning of wholesale HSA service. Therefore, the Commission has excluded these development costs from RCCI's cost studies.

a) The appellants' submissions

181 Rogers now argues that the relevant Manual only requires the provision of detailed supporting evidence in respect of items that account for 20% or more of the total cost sought to be recovered through a proposed rate and the proposed annual development costs represented less than 5% of its total estimated costs. Rogers further complains that the CRTC did not give notice that it required additional evidence supporting Rogers' proposal to recover annual development costs.

b) Context

182 The applicable Regulatory Economic Studies Manual does state that detailed cost information is required for key reporting cost categories only. One exemplar of a key reporting cost category is expressed to be cost categories whose cost is equal to or greater than 20% of the total service cost. However, in *Regulatory Policy - Review of certain Phase II costing issues* (21 February 2008), *Telecom Decision CRTC 2008-14* [2008 CarswellNat 7192 (C.R.T.C.)] (TD 2008-14) the Commission determined that expenses associated with development activities that are not causal to a service are fixed common expenses and are to be excluded from regulatory economic studies (Appendix 1, paragraph 13). Rogers has not established that the quantum of the development costs relieves it from the initial burden of proving that the costs were causal to the provision of services and not a fixed common expense.

c) Analysis

183 I see no breach of procedural fairness in requiring Rogers to demonstrate that claimed costs were causal to the provision of a service.

xi. Conclusion on procedural fairness and arbitrary decision-making

184 The appellants have not demonstrated any error of law or jurisdiction arising out of any breach of procedural fairness or arbitrary decision-making. Their concerns center in largest part on the methods chosen by the Commission and the Commission's conclusions when it applied those methods to the evidence before it. The Commission may adopt and apply any method it considers appropriate for determining rates (Act, subsection 27(5); *Bell Canada v. Canadian Radio-Television & Telecommunications Commission*, 2009 SCC 40, [2009] 2 S.C.R. 764 (S.C.C.), at paragraph 40; *Ontario (Energy Board) v. Ontario Power Generation Inc.*, 2015 SCC 44, [2015] 3 S.C.R. 147 (S.C.C.), at paragraph 81). The proper avenue of recourse lies with the Commission itself by way of a request for reconsideration or by way of an appeal to the Governor in Council.

7. Do the reasons of the CRTC fail to comply with a legislative reasons requirement?

185 Paragraph 1(*b*)(i) of the Cabinet Direction provides:

> 1 In exercising its powers and performing its duties under the *Telecommunications Act*, the ... Commission ... shall implement the Canadian telecommunications policy objectives set out in section 7 of that Act, in accordance with the following:
>
> > . . .
> >
> > (b) the Commission, when relying on regulation, should use measures that satisfy the following criteria, namely, those that

> (i) specify the telecommunications policy objective that is advanced by those measures and demonstrate their compliance with this Order, ...

(underlining added)

186 The appellants assert that:

• This provision imposes a further jurisdictional limit on the Commission. It is an independent jurisdictional error for the CRTC to give reasons that do not comply with the mandatory obligation to specify the objectives advanced by regulatory measures and demonstrate compliance with the Cabinet Direction.

• The Commission's reasons are noncompliant in that they: i) devote only a single sentence to the telecommunications policy objectives the decision purports to advance; ii) fail to explain how the decision will advance these objectives; iii) make no effort to explain how the decision can be reconciled with the numerous policy objectives it will undermine; and, iv) do not demonstrate how or why the asserted policy objectives will be advanced.

• In order to demonstrate that the regulatory measures imposed by it complied with the Cabinet Direction, the Commission was obliged to explain how the measures: i) were efficient and proportionate to their purpose and interfered with the operation of competitive market forces only to the minimum extent necessary; ii) neither deterred economically efficient competitive entry into the market nor promoted economically inefficient entry; and, iii) ensured the technological and competitive neutrality of the wholesale network access regime, to the greatest extent possible, so as to enable competition from new technologies and not artificially favour either Canadian carriers or their competitors.

187 The respondents argue that:

• Neither the Cabinet Direction nor the Act requires the Commission to enumerate policy objectives in every decision — the use of the word "should" in paragraph 1(*b*)(i) of the Cabinet Direction simply encourages the Commission to specify the objective and demonstrate compliance but does not require it.

• In any event, the Commission's decision properly advances telecommunications policy objectives.

188 The Court received competing submissions as to whether the Cabinet Direction imposed a mandatory, as opposed to a directory or permissive requirement. In my view, it is unnecessary to resolve this question. Assuming, without deciding, that the Commission was subject to a mandatory requirement to give reasons explaining its implementation of the telecommunications policy objectives set out in section 7 of the Act and show compliance with the Cabinet Direction, it did so. The reasons of the Commission properly read in light of its policy pedigree, the substantial record before the Commission and the submissions of the parties fulfilled any mandatory requirement. The reasons satisfactorily address the policy objectives and the arguments and issues raised by the parties. I reach this conclusion for the following reasons.

189 To begin, I accept that the exercise of rate-setting consists of two distinct steps.

190 First, the Commission must determine if there is a need to deviate from market forces and, if so, what regulatory measures are necessary. This step is consistent with the direction set out in paragraph 1(*a*)(i) of the Cabinet Direction that when implementing Canadian telecommunications policy objectives the Commission "should ... rely on market forces to the maximum extent feasible". This step primarily involves a policy function.

191 The second step in the process is to determine the rates to be set. This is primarily a fact-finding function.

192 I reviewed TO 2019-288's policy pedigree in some detail above. The decisions that make up the pedigree show that the Commission was mindful throughout of its obligation to perform its duties with a view to implementing the policy objectives enumerated in section 7 of the Act and in accordance with the Cabinet Direction. Two of the Commission's TRPs are particularly relevant to the appellants' submissions.

193 In TRP 2010-632 the CRTC required ILECs and Cable Carriers to offer certain high-speed access facilities as new wholesale services to competitors. The decision shows a focus on the use of market forces when possible and a focus on the three Cabinet obligations of proportionality, efficiency and neutrality. This is particularly evident at paragraphs 143 to 149 of the decision:

> 143. The Commission's determinations in this decision are based on the requirements of the Act, the Order in Council, and the Governor in Council's Policy Direction.
>
> 144. The regulatory measures under consideration in this decision are of an economic nature and deal with network access regimes. Therefore, subparagraphs 1(*b*)(ii) and (iv), paragraph 1(*a*), and subparagraph 1(*b*)(i) of the Policy Direction apply to the Commission's determinations.
>
> 145. Consistent with paragraph 1(*a*) of the Policy Direction, in all cases where the Commission has imposed regulatory requirements on the incumbents, it has done so because market forces cannot be relied upon to achieve the telecommunications policy objectives set out in section 7 of the Act, and it has adopted measures that are efficient and proportionate to their purpose.
>
> 146. The Commission considers that the policy objectives set out in paragraphs 7(*a*), (*b*), (*c*), (*f*), and (*h*) of the Act are advanced by the regulatory measures established in this decision. The Commission considers that the objective in paragraph 7(*f*) of the Act - to foster increased reliance on market forces and ensure that regulation, where required, is efficient and effective - is of particular relevance. The determinations in this decision aim to ensure that retail Internet service markets will remain competitive and continue to deliver high-quality services and respond to users' economic and social requirements.
>
> 147. To ensure that competition in retail Internet service markets, notably in the residential market, remains sufficient to protect the interests of users as service speeds increase, the Commission has modified the basis upon which ILECs may charge wholesale customers for the provision of new higher speed options for aggregated ADSL access services. It has also concluded that a speed-matching requirement is necessary for the ILECs' existing aggregated ADSL access services. The Commission has further concluded that changes to the cable carriers' TPIA services are required. Consistent with its finding in the essential services decision, the Commission considers that the provision of these wholesale services, as modified by this decision, neither deter economically efficient competitive entry into retail Internet service markets nor promote economically inefficient entry.
>
> 148. The Commission has also addressed the matter of equity for the incumbents' relevant wholesale obligations. It considers that its determinations in this decision ensure the technological and competitive neutrality of these obligations to the greatest extent possible, consistent with subparagraph 1(*b*)(iv) of the Policy Direction.
>
> 149. In applying the essential services framework on a forward-looking basis in this decision, the Commission has adopted a cohesive, forward-looking regulatory approach that provides appropriate incentives for continued investment in broadband infrastructure, promotes retail service competition, ensures equity for the incumbents' respective wholesale obligations, and does not unduly impair the ILECs' abilities to offer new converged services.
>
> (underlining added, footnotes omitted)

194 Thereafter, the Commission issued TRP 2011-703. As explained above, in this decision the Commission considered how large telephone and cable companies should charge competitors for access to, and use of, their HSA wholesale services. The Commission explained how rate-setting policy furthers the obligations set out in the Act and the Cabinet Direction:

> 194. The regulatory measures under consideration in this decision are of an economic nature and deal with network access regimes. Therefore, subparagraph 1(*a*)(ii) and subparagraphs 1(*b*)(i), (ii), and (iv) of the Policy Direction apply to the Commission's decisions. Consistent with subparagraph 1(*a*)(ii) of the Policy Direction, in all cases where the Commission

has imposed regulatory requirements on the incumbents, it has adopted measures that are efficient and proportionate to their purpose. In this regard, the Commission has approved billing models that are consistent with how the network providers plan and build their own networks and thus can be implemented with limited billing system changes.

195. Consistent with subparagraph 1(*b*)(i) of the Policy Direction, the Commission considers that the policy objectives set out in paragraphs 7(*a*), (*b*), (*c*), (*f*), and (*h*) of the Act are advanced by the regulatory measures established in this decision. The Commission also considers that the objective in paragraph 7(*c*) of the Act - to enhance the efficiency and competitiveness, at the national and international levels, of Canadian telecommunications - is of particular relevance. This decision ensures that the retail Internet service market will remain competitive, thus allowing the delivery of high-quality services and responding to retail customers' economic and social requirements.

196. To ensure that competition in retail residential Internet service markets remains sufficient to protect the interests of retail customers as service speeds increase, the Commission has approved billing models that significantly increase flexibility as compared to a per-customer wholesale UBB model. These approved models enable independent service providers to design and price their retail services in the manner they find most appropriate for their retail customers. Consistent with its findings in the essential services decision (Telecom Decision 2008-17), the Commission considers that the provision of wholesale high-speed access services, according to the billing models and at the rates established in this decision, neither deters economically efficient competitive entry into retail Internet service markets nor promotes economically inefficient entry.

(underlining added, footnotes omitted)

195 In light of these TRPs, and the other decisions reviewed above, it is understandable that the Commission did not see the need to further elaborate upon its application of the policy objectives that apply generally to the provision of wholesale HSA services.

196 This said, I accept that at the second step of the rate-setting process more is involved than simple math. Issues touching upon telecommunications policy objectives must also be decided at the second step of the process. However, again I am satisfied that the Commission's reasons are adequate. The Commission was plainly alive to the policy objectives the appellants sought to advance and it responded to those submissions.

197 To illustrate, the appellants, including Bell, made submissions expressly referencing the Cabinet Direction and the potential for the rate-setting decision to undermine the policy objectives set out in section 7 of the Act. Bell argued that substantial rate cuts, and any retroactive adjustment, would undermine its network and infrastructure investments. In its May 18, 2018 response to a request for information Bell submitted to the CRTC that:

... [T]o have the Commission change the rates, especially the wholesale rates, part way through the 10-year period that the related costs were based on, will deprive us of the opportunity to recover our up-front costs. It is a departure from the basic arrangement, under which we invest and the Commission gives as a reasonable opportunity to recover that investment.

This is especially the case with a risk of retroactivity. We estimate that the cumulative financial impact of the adjustments based on the RF1s the Commission is asking just on GAS-FTTN access and GAS-CBB from April 2016 until the end of this year would be over #, let alone the impact on a going forward basis. To put the estimated impact of retroactivity into perspective, we recently-announced our investment of more than $100 million to fully fund deployment of our all-fibre optic network to approximately 60,000 homes and business locations throughout the city of Oshawa, Ontario (one of many important FTTP deployments that we are currently moving forward with). There can be no doubt that even a one-time # retroactive adjustment would prevent us from funding, regardless of the strength of the business case, the next Oshawa.

(underlining added)

198 Bell argues that, notwithstanding its submissions, the Commission chose to reduce wholesale HSA rates retroactively and dramatically without any explanation as to why doing so would "promote innovation, competitiveness or access to high speed networks for rural Canadians." (memorandum of fact and law, paragraph 68).

199 Contrary to Bell's submission, the Commission understood and directed its mind to the policy arguments advanced by Bell. At paragraph 316 of TO 2019-288 the Commission summarized the arguments in the following terms:

> Bell Canada submitted that the rates will have been interim for approximately two years by the time the Commission issues a decision on the final rates, and that during that time, industry participants were making investment and marketing decisions based on the interim rates and their individual expectations of how rates may evolve over time.

200 However, on its appreciation of the evidentiary record the Commission rejected Bell's submission for the following reasons:

> 327. In Telecom Decision 2016-117, the Commission adopted a simplified cost-based approach to setting wholesale HSA service rates and made determinations that affected certain components of the cost studies used in setting those rates. In recognition of these changes, the Commission (i) directed the wholesale HSA service providers to file revised cost studies for their wholesale HSA services that incorporated these changes, and (ii) made interim, as of the date of that decision, all wholesale HSA service rates that had previously been approved on a final basis.
>
> 328. In addition, the Commission stated, in both Telecom Decision 2016-117 and Telecom Order 2016-396, that it would assess the extent to which, if at all, retroactive rates would apply when it set wholesale HSA service rates on a final basis.
>
> 329. <u>The Commission considers that to the extent that the interim rates for aggregated wholesale HSA services were based on inappropriate costs and assumptions, those rates are not just and reasonable. Consequently, retroactive application of the final rates is necessary to ensure that wholesale HSA service providers use just and reasonable rates</u>.
>
> 330. The Commission considers, however, that it would not be appropriate to apply rates for the aggregated wholesale HSA services resulting from this proceeding retroactively to a date that is earlier than those captured by the study periods that have informed this proceeding. This is due to the fact that the cost studies submitted in support of the proposed rates, and upon which the Commission is establishing tariffed rates, are based on assumptions that reflect the technologies, costs, and demand for the services over the study period.
>
> 331. In light of the above, the Commission determines that the final rates for aggregated wholesale HSA services should apply retroactively as of 31 March 2016 for Bell Canada, Bell MTS, Cogeco, Eastlink, SaskTel, TCI, and Videotron.
>
> (underlining added)

201 The reasons of the Commission were adequate. Bell's submission that the reasons did not address policy objectives could not succeed in light of the Commission's conclusion that the existing, interim rates were based upon "inappropriate costs and assumptions" that had resulted in rates that were not just and reasonable.

202 A second illustration relates to the Commission's determination about whether a supplementary markup should be maintained. By way of background, as previously explained, when the Commission establishes a rate for a wholesale service it typically adds a percentage markup to the cost of the service. The markup is intended to contribute to the recovery of the carrier's fixed and common costs. In TRP 2010-632, the Commission recognized that significant up-front investment was required to construct the facilities that the ILECs used to provide new higher-speed wholesale service options over fibre facilities (referred to as FTTN facilities). Therefore, the rate for those services included, in addition to the markup that would otherwise be applied, a supplementary markup of 10%.

203 In the present case, Bell advanced policy-based arguments as to why the supplementary markup should be maintained. In TO 2019-288, the Commission summarized the arguments as follows:

> 288. Bell Canada and SaskTel submitted that eliminating the supplementary markup for aggregated FTTN services would be contrary to the Commission's determination in Telecom Regulatory Policy 2015-326. They added that reducing the rates for aggregated FTTN services would discourage the migration from those services to next-generation technologies, to the detriment of investment in those technologies.
>
> 289. Bell Canada added that the rollout of retail and wholesale FTTN services was predicated on the rates approved by the Commission in Telecom Regulatory Policy 2010-632. Investments in plant and equipment were based on a 10-year period, and the terms and conditions approved by the Commission to be in effect during that period. In granting the supplementary 10% markup on the wholesale use of Bell Canada's FTTN plant and facilities, the Commission noted that the cost of capital used in the company's cost studies for aggregated FTTN services was significantly lower than the cost of capital used by the cable carriers in their cost studies. The supplementary markup of 10% applied to Bell Canada's services was also intended to equalize these costs of capital.
>
> 290. Bell Canada submitted that, given that (i) the above considerations apply to both the transport and the access components, and (ii) these components are tightly integrated, the supplementary markup of 10% should continue to apply to both the transport and the access components.
>
> (underlining added)

204 The Commission rejected these arguments for the following reasons:

> 306. In Telecom Regulatory Policy 2010-632, the Commission recognized that significant upfront investment was required to construct the facilities that ILECs use to provision new higher-speed wholesale service options over fibre facilities (i.e. FTTN facilities). Therefore, the rates for these service options include, in addition to the markup on costs that would otherwise be used, a supplementary markup of 10%.
>
> 307. The Commission considers that the ILECs' focus has shifted from expanding their FTTN networks to growing their FTTP footprints as much as possible, given the important benefits associated with higher speeds and long-term service reliability. In this regard, the Commission notes that the ILECs' volume of new FTTN builds has become minimal and is dropping significantly each year, particularly when compared to new FTTP builds.
>
> 308. In light of this, the Commission considers that the rationale set out in Telecom Regulatory Policy 2010-632, in which the Commission considered that the investment risk associated with the construction of FTTN facilities is greater than the risk associated with other ILEC facilities, is no longer supported. Consequently, the Commission considers that the 10% supplementary markup that has applied to both the access and the transport components of aggregated wholesale HSA services should not be maintained.
>
> (underlining added)

205 Again, the reasons of the Commission are adequate. The reasons explain and demonstrate that Bell's policy argument was not supported by the evidentiary record.

206 To conclude on this point, the Commission was aware of the policy concerns identified by the appellants. I am satisfied that it engaged with those concerns and addressed them adequately in its reasons.

207 I would add, however, that in the event some genuine doubt exists as to whether some policy concern was adequately addressed by the Commission, the appellants may seek further clarification from the Commission in the Commission's pending, public proceeding to review TO 2019-288. The Commission's decision will be informed by Order in Council P.C. 2020-0553.

8. Did the CRTC impose an unconstitutional tax?

208 The Bell appellants rely upon their written submissions to argue that the retroactive payments constitute a tax, which the CRTC is not empowered to levy. In their submission, the retroactive payments that they are required to pay to the competitors are an unconstitutional and *ultra vires* tax because the payments meet all of the four criteria applied in *620 Connaught Ltd. v. Canada (Attorney General)*, 2008 SCC 7, [2008] 1 S.C.R. 131 (S.C.C.), at paragraph 22, to determine whether a levy is a tax as opposed to a regulatory charge.

209 The respondents submit that Bell is precluded from raising this issue on this appeal because it did not raise the issue before the Commission. In the alternative, and in any event, the respondents submit that the retroactive payments are not a tax. Rather, the retroactive payments effect a correction for an unjust enrichment that accrued to the appellants as a consequence of the application of rates that were not just and reasonable.

210 I begin my analysis by noting that Parliament authorized the Commission "to determine any question of law" (subsection 52(1) of the Act). This includes constitutional issues. The appellants well-knew that an issue before the Commission was whether final rates should be set retroactively; they have provided no explanation as to why the unconstitutional tax issue was not raised before the Commission.

211 In *Forest Ethics Advocacy Assn. v. National Energy Board*, 2014 FCA 245, [2015] 4 F.C.R. 75 (F.C.A.) this Court considered whether a constitutional issue not raised before the National Energy Board could be raised for the first time on judicial review. The Court found it could not, for the following reasons:

> 43. <u>The approach of placing the constitutional issues before the Board at first instance respects the fundamental difference between an administrative decision-maker and a reviewing court</u>: here, the Board and this Court. Parliament has assigned the responsibility of determining the merits of factual and legal issues - including the merits of constitutional issues - to the Board, not this Court. Evidentiary records are built before the Board, not this Court. As a general rule, this Court is restricted to reviewing the Board's decisions through the lens of the standard of review using the evidentiary record developed before the Board and passed to it. See generally *Association of Universities and Colleges of Canada v. Canadian Copyright Licensing Agency (Access Copyright)*, 2012 FCA 22, 428 N.R. 297.
>
> 44. <u>Were it otherwise, if administrative decision-makers could be bypassed on issues such as this, they would never be able to weigh in</u>. On a judicial review, administrative decision-makers do not have full participatory rights as parties or interveners. They cannot make submissions to the reviewing court with a view to bolstering or supplementing their reasons. They face real restrictions on the submissions they can make. See generally *Canada (Attorney General) v. Quadrini*, 2010 FCA 246, [2012] 2 F.C.R. 3at paragraphs 16-17. As a result, often their only opportunity to supply relevant information bearing upon the issue - such as factual appreciations, insights from specialization and policy understandings - is in their reasons.
>
> 45. <u>If administrative decision-makers could be bypassed on issues such as this, those appreciations, insights and understandings would never be placed before the reviewing court. In constitutional matters, this is most serious. Constitutional issues should only be decided on the basis of a full, rich factual record</u>: *Mackay v. Manitoba*, [1989] 2 S.C.R. 357 at pages 361-363. Within an important regulatory sector such as this, a record is neither full nor rich if the insights of the regulator are missing.
>
> 46. <u>The Supreme Court has strongly endorsed the need for constitutional issues to be placed first before an administrative decision-maker who can hear them</u>: *Okwuobi v. Lester B. Pearson School Board*; *Casimir v. Quebec (Attorney General)*; *Zorrilla v. Quebec (Attorney General)*, 2005 SCC 16, [2005] 1 S.C.R. 257at paragraphs 38-40. <u>Where, as here, an administrative decision-maker can hear and decide constitutional issues, that jurisdiction should not be bypassed by raising the constitutional issues for the first time on judicial review</u>. Parliament's grant of jurisdiction to the Board to decide such issues must be respected.
>
> (underlining added)

212 In my view, these considerations are equally apposite to this statutory appeal, based as it is on the record before the Commission. The Bell appellants ought not to be permitted to raise this issue for the first time on appeal.

9. Conclusion and costs

213 For the above reasons, I would dismiss the appeals and order the appellants to pay the costs of the appeals to each of the Canadian Network Operators Consortium Inc. and Teksavvy Solutions Inc.

214 As for the quantum of the costs, if not agreed I would direct that the costs be assessed at the mid-point of Column V of the table to Tariff B. While Rule 407 provides that unless otherwise ordered, costs are to be assessed in accordance with Column III, this award reflects the number and complexity of the issues, a good number of dubious merit, which the appellants chose to put in play. The award also reflects the fact that the appellants succeeded on none of these issues.

***David Stratas J.A.*:**

I agree.

***Judith Woods J.A.*:**

I agree.

Appeal dismissed.

2006 CAF 233, 2006 FCA 233
Federal Court of Appeal

Canada (Commissioner of Competition) v. Canada Pipe Co.

2006 CarswellNat 1763, 2006 CarswellNat 4554, 2006 CAF 233, 2006 FCA 233, 268 D.L.R. (4th) 193, 350 N.R. 291, 49 C.P.R. (4th) 241

Commissioner of Competition, Appellant and Canada Pipe Company Ltd./Tuyauteries CanadaLtée, Respondent

A. Desjardins J.A., G. Létourneau J.A., J.D.D. Pelletier J.A.

Heard: February 7-8, 2006
Judgment: June 23, 2006
Docket: A-106-05

Proceedings: reversing *Canada (Commissioner of Competition) v. Canada Pipe Co.* (2005), 2005 Comp. Trib. 3, 40 C.P.R. (4th) 453, 2005 CarswellNat 2348 (Competition Trib.)

Counsel: Mr. Randall Hofley, Ms Leslie Milton, for Appellant
Mr. Kent Thomson, Mr. James Doris, Mr. Charles Tingley, for Respondent

***A. Desjardins J.A.*:**

1 This is an appeal from a decision of the Competition Tribunal ("Tribunal"), dated February 3, 2005, dismissing the application by the Commissioner of Competition ("Commissioner" or appellant) under sections 77 and 79 of the *Competition Act* (reported as 2005 Comp. Trib. 3). The Commissioner sought an order against Canada Pipe Company Ltd. ("Canada Pipe" or respondent), to prohibit the respondent from engaging in the practice of several purported anti-competitive acts leading to an abuse of dominant position under section 79, as well as to prohibit the respondent from continuing to engage in the practice of exclusive dealing under section 77. This case also involves a cross-appeal by Canada Pipe, which is dealt with in separate reasons.

2 This is the first time this Court has the opportunity to consider the tests for exclusive dealing and abuse of dominant position established respectively by sections 77 and 79 of the *Act*. Both of these provisions, generally speaking, authorize the Tribunal to make orders prohibiting a dominant firm from engaging in conduct that has had, is having or is likely to have the effect of substantially lessening competition. While the *Act* has been in force since 1986, and the Tribunal has elaborated its perspective on the requirements of sections 77 and 79 in several cases, these provisions have not to date been interpreted by any Canadian court.

3 The conduct at issue in this case consists of a "loyalty rebate" program offered by the respondent and known as the Stocking Distributor Program (SDP). Under the SDP, distributors of the respondent's cast iron drain, waste and vent (DWV) products obtain significant rebates and discounts in return for stocking only cast iron products produced by the respondent. These distributors are free to stock other companies' DWV products which are not made of cast iron.

4 According to the Commissioner, Canada Pipe is a dominant firm with respect to the product markets relevant in this case. Furthermore, the Commissioner asserts, the SDP constitutes both a practice of exclusive dealing with exclusionary effects and a practice of anti-competitive acts, and it is likely to have the effect of substantially lessening competition in the markets for DWV products by impeding the entry and expansion of competitors. The respondent contends, by contrast, that it exercises no market power in relation to the relevant product markets, when the latter are properly defined. Moreover, according to the respondent,

the SDP is neither exclusionary nor anti-competitive, but rather is a voluntary, non-exclusive, incentive-based program which encourages competition between DWV distributors, is compatible with competition on the merits between suppliers and is supported by valid business justifications.

5 The Tribunal dismissed the Commissioner's application, based upon the following findings. With respect to the alleged abuse of dominant position under section 79, the Tribunal held that: (i) there are three relevant product markets, and six geographic markets, and the respondent substantially controls all these markets; (ii) the Stocking Distributor Program (SDP) is a practice, but does not qualify as an "anti-competitive act"; and (iii) the Commissioner had not demonstrated that the SDP had substantially lessened or prevented competition. With respect to the allegation of exclusive dealing contrary to section 77, the Tribunal found that: (i) the SDP can be characterized as a practice of exclusive dealing; (ii) the respondent is a major supplier of the products in the relevant markets; and (iii) there was insufficient evidence to establish that the SDP had impeded entry or expansion of firms, or that it is having any other exclusionary effect on the market, or that it has caused or is likely to cause a substantial lessening of competition.

6 The Commissioner appeals from the Tribunal's decision.

7 Broadly stated, the appeal challenges two aspects of the Tribunal's conclusions: first, the finding with respect to substantial lessening of competition for the purposes of both sections 77 and 79, and second, the finding concerning exclusionary effects under section 77 or anti-competitive acts under section 79. The cross-appeal by Canada Pipe, which concerns the Tribunal's conclusions as to the definition of the relevant product markets and the issue of market power for the purpose of paragraph 79(1)(a), is discussed in separate reasons, as stated earlier.

8 In order to facilitate the reading of these reasons, I include the following table of contents:

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IV. Analysis	[25]
(A) For the purposes of paragraph 79(1)(*c*), did the Tribunal err in its determination with respect to whether the SDP has had, is having or is likely to have the effect of preventing or lessening competition substantially?	[29]
(1) The legal test under paragraph 79(1)(*c*)	[35]
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(B) For the purposes of paragraph 79(1)(*b*), did the Tribunal err in its determination with respect to whether the SDP constitutes an "anti-competitive act"?	[59]
(1) The legal test under paragraph 79(1)(*b*)	[63]
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(C) For the purposes of subsection 77(2), did the Tribunal err in its determination with respect to whether the SDP has the result that competition is or is likely to be lessened substantially?	[93]
(D) For the purposes of subsection 77(2), did the Tribunal err in its determination with respect to whether the SDP is likely to impede entry or expansion of a firm or a product in a market or have any other exclusionary effect in a market?	[96]
V. Conclusion	[100]

I. Facts

9 The respondent is a Canadian company based in Hamilton, Ontario, which produces and sells through its Bibby Ste-Croix division ("Bibby") cast iron drain, waste and vent (DWV) products. DWV products are used in a wide variety of structures

to carry waste and drain water, and to vent plumbing systems. There are three components to a cast iron DWV system: pipe, fittings and mechanical joint (MJ) couplings (collectively, "DWV products").

10 There are currently two domestic manufacturers of cast iron DWV products: Bibby and Vandem Industries ("Vandem"). Bibby manufactures cast iron DWV pipe and fittings, and imports MJ couplings from its sister companies in the United States. Vandem, which was founded in 1997 (according to the Tribunal; the respondent claims it was 1999, but little turns on this fact) by two former officers of Bibby, manufactures DWV pipe and imports fittings and couplings. The only Canadian manufacturer of MJ couplings is Rollee Industrial Products (1987) Ltd., but it is not a major player. In addition, there are a limited number of other Canadian importers of cast iron DWV products, who generally import from the United States and the Far East (mainly China and India). Imports of cast iron DWV products for all of Canada, including imports by Bibby and Vandem, represented 5% of total sales in 2002. The respondent is the only company in Canada that manufactures and sells a full range of cast iron DWV products.

11 Distributors buy DWV products from the suppliers (either manufacturers or importers), and in turn sell to the building, mechanical or plumbing contractors involved in construction or renovation projects. Distributors generally carry DWV pipe and fittings made of various materials; cast iron DWV products usually represent only a small proportion of their inventory and sales. In Canada, there are three major distributors, all with national presence: Wolseley Canada Inc., EMCO Ltd, and Crane Supply. There are also small distributors, some of whom are members of buying groups in order to improve their bargaining power and obtain volume discount advantages.

12 Contractors buy DWV products from distributors for construction projects upon which they bid. The bidding process is highly competitive, and contractors will try to obtain the best price possible in order to make their bids attractive. Although contractors may have some leeway in deciding what material to use in construction they will generally buy the type of DWV product that has been specified by the architect or mechanical engineer.

13 The SDP was introduced by Bibby in January 1998. In contrast to the volume-based rebate programs typical in the industry, the SDP is premised on exclusivity, not the volume of purchases. Under the SDP, distributors of Bibby's DWV products obtain quarterly and yearly rebates as well as significant point-of-purchase discounts, in return for stocking only Bibby-supplied cast-iron DWV products. These distributors are free to stock other companies' DWV products which are not made of cast iron, but must purchase all three cast iron DWV products exclusively from the respondent. There are no signed contracts for the SDP: distributors can join at any time, and receive the quarterly and yearly rebates for each completed calendar quarter or year. Distributors who choose not to participate in the SDP are permitted to purchase products from Bibby, albeit at higher prices. There are no restrictions on the resale of cast iron DWV products purchased by distributors who participate in the SDP.

14 The SDP discounts consist of point-of-sale discounts (for example, 55% of list price for stocking distributors, compared to 94% for non-stocking distributors), as well as quarterly and annual rebates (in 2002, the quarterly rebates were 7, 15 and 9 percent on pipe, fittings and MJ couplings respectively, and the annual rebate was 4 percent for all products). The point-of-sale discount and the rebates vary from one region to another. Any distributor can participate in the SDP, so long as a threshold minimum purchase is made; once this threshold is met, the rebates and discounts are the same for the given region, regardless of the size of the distributor's purchase. As a result, the SDP allows small- and medium-sized distributors to access the same prices as large distributors. The discount is applied at the time of purchase, so long as the distributor has committed to participating in the program, and is not reimbursable even if the distributor leaves the program. Except for losing the rebates, there are therefore no penalties attached to opting out of the SDP.

II. Legislative Framework

15 Three legislative provisions govern the issues to be decided in this appeal, namely sections 77, 78 and 79 of the *Act*. These sections set out the various elements that must be proven by the Commissioner to establish exclusive dealing and abuse of dominant position, and provide some relevant statutory definitions.

16 With respect to an alleged abuse of dominant position, the requisite elements for an order are described in subsection 79(1):

Prohibition where abuse of dominant position

79. (1) Where, on application by the Commissioner, the Tribunal finds that

(a) one or more persons substantially or completely control, throughout Canada or any area thereof, a class or species of business,

(b) that person or those persons have engaged in or are engaging in a practice of anti-competitive acts, and

(c) the practice has had, is having or is likely to have the effect of preventing or lessening competition substantially in a market,

the Tribunal may make an order prohibiting all or any of those persons from engaging in that practice.

Ordonnance d'interdiction dans les cas d'abus de position dominante

79. (1) Lorsque, à la suite d'une demande du commissaire, il conclut à l'existence de la situation suivante:

a) une ou plusieurs personnes contrôlent sensiblement ou complètement une catégorie ou espèce d'entreprises à la grandeur du Canada ou d'une de ses régions;

b) cette personne ou ces personnes se livrent ou se sont livrées à une pratique d'agissements anti-concurrentiels;

c) la pratique a, a eu ou aura vraisemblablement pour effet d'empêcher ou de diminuer sensiblement la concurrence dans un marché,

le Tribunal peut rendre une ordonnance interdisant à ces personnes ou à l'une ou l'autre d'entre elles de se livrer à une telle pratique.

17 Subsection 79(4) further specifies that possible superior competitive performance must be considered in making the requisite determination under subsection 79(1) concerning competition:

Superior competitive performance

79. (4) In determining, for the purposes of subsection (1), whether a practice has had, is having or is likely to have the effect of preventing or lessening competition substantially in a market, the Tribunal shall consider whether the practice is a result of superior competitive performance.

Efficience économique supérieure

79. (4) Pour l'application du paragraphe (1), lorsque le Tribunal décide de la question de savoir si une pratique a eu, a ou aura vraisemblablement pour effet d'empêcher ou de diminuer sensiblement la concurrence dans un marché, il doit évaluer si la pratique résulte du rendement concurrentiel supérieur.

18 The term "anti-competitive act", which is a requisite element pursuant to paragraph 79(1)(*b*), is not defined in the *Act*. However, section 78 provides, under the heading "Definition", a non-exhaustive illustrative list of eleven anti-competitive acts:

Definition of "anti-competitive act"

78. (1) For the purposes of section 79, "anti-competitive act", without restricting the generality of the term, includes any of the following acts:

(a) squeezing, by a vertically integrated supplier, of the margin available to an unintegrated customer who competes with the supplier, for the purpose of impeding or preventing the customer's entry into, or expansion in, a market;

(b) acquisition by a supplier of a customer who would otherwise be available to a competitor of the supplier, or acquisition by a customer of a supplier who would otherwise be available to a competitor of the customer, for the purpose of impeding or preventing the competitor's entry into, or eliminating the competitor from, a market;

(c) freight equalization on the plant of a competitor for the purpose of impeding or preventing the competitor's entry into, or eliminating the competitor from, a market;

(d) use of fighting brands introduced selectively on a temporary basis to discipline or eliminate a competitor;

(e) pre-emption of scarce facilities or resources required by a competitor for the operation of a business, with the object of withholding the facilities or resources from a market;

(f) buying up of products to prevent the erosion of existing price levels;

(g) adoption of product specifications that are incompatible with products produced by any other person and are designed to prevent his entry into, or to eliminate him from, a market;

(h) requiring or inducing a supplier to sell only or primarily to certain customers, or to refrain from selling to a competitor, with the object of preventing a competitor's entry into, or expansion in, a market;

(i) selling articles at a price lower than the acquisition cost for the purpose of disciplining or eliminating a competitor;

(j) acts or conduct of a person operating a domestic service, as defined in subsection 55(1) of the *Canada Transportation Act*, that are specified under paragraph (2)(*a*); and

(k) the denial by a person operating a domestic service, as defined in subsection 55(1) of the *Canada Transportation Act*, of access on reasonable commercial terms to facilities or services that are essential to the operation in a market of an air service, as defined in that subsection, or refusal by such a person to supply such facilities or services on such terms.

Définition de « agissement anti-concurrentiel »

78. (1) Pour l'application de l'article 79, « agissement anti-concurrentiel » s'entend notamment des agissements suivants:

a) la compression, par un fournisseur intégré verticalement, de la marge bénéficiaire accessible à un client non intégré qui est en concurrence avec ce fournisseur, dans les cas où cette compression a pour but d'empêcher l'entrée ou la participation accrue du client dans un marché ou encore de faire obstacle à cette entrée ou à cette participation accrue;

b) l'acquisition par un fournisseur d'un client qui serait par ailleurs accessible à un concurrent du fournisseur, ou l'acquisition par un client d'un fournisseur qui serait par ailleurs accessible à un concurrent du client, dans le but d'empêcher ce concurrent d'entrer dans un marché, dans le but de faire obstacle à cette entrée ou encore dans le but de l'éliminer d'un marché;

c) la péréquation du fret en utilisant comme base l'établissement d'un concurrent dans le but d'empêcher son entrée dans un marché ou d'y faire obstacle ou encore de l'éliminer d'un marché;

d) l'utilisation sélective et temporaire de marques de combat destinées à mettre au pas ou à éliminer un concurrent;

e) la préemption d'installations ou de ressources rares nécessaires à un concurrent pour l'exploitation d'une entreprise, dans le but de retenir ces installations ou ces ressources hors d'un marché;

f) l'achat de produits dans le but d'empêcher l'érosion des structures de prix existantes;

g) l'adoption, pour des produits, de normes incompatibles avec les produits fabriqués par une autre personne et destinées à empêcher l'entrée de cette dernière dans un marché ou à l'éliminer d'un marché;

h) le fait d'inciter un fournisseur à ne vendre uniquement ou principalement qu'à certains clients, ou à ne pas vendre à un concurrent ou encore le fait d'exiger l'une ou l'autre de ces attitudes de la part de ce fournisseur, afin d'empêcher l'entrée ou la participation accrue d'un concurrent dans un marché;

i) le fait de vendre des articles à un prix inférieur au coût d'acquisition de ces articles dans le but de discipliner ou d'éliminer un concurrent;

j) à l'égard des exploitants d'un service intérieur, au sens du paragraphe 55(1) de la *Loi sur les transports au Canada*, les agissements précisés à l'alinéa (2)*a*);

k) le fait pour l'exploitant d'un service intérieur, au sens du paragraphe 55(1) de la *Loi sur les transports au Canada*, de ne pas donner accès, à des conditions raisonnables dans l'industrie, à des installations ou services essentiels à l'exploitation dans un marché d'un service aérien, au sens de ce paragraphe, ou de refuser de fournir ces installations ou services à de telles conditions.

19 With respect to exclusive dealing, a statutory definition is provided in sub-section 77(1):

Definitions

77. (1) For the purposes of this section,

"exclusive dealing" means

(a) any practice whereby a supplier of a product, as a condition of supplying the product to a customer, requires that customer to

(i) deal only or primarily in products supplied by or designated by the supplier or the supplier's nominee, or

(ii) refrain from dealing in a specified class or kind of product except as supplied by the supplier or the nominee, and

(b) any practice whereby a supplier of a product induces a customer to meet a condition set out in subparagraph (*a*)(i) or (ii) by offering to supply the product to the customer on more favourable terms or conditions if the customer agrees to meet the condition set out in either of those subparagraphs;

Définition

77. (1) Les définitions qui suivent s'appliquent au présent article.

« exclusivité »

a) Toute pratique par laquelle le fournisseur d'un produit exige d'un client, comme condition à ce qu'il lui fournisse ce produit, que ce client:

(i) soit fasse, seulement ou à titre principal, le commerce de produits fournis ou indiqués par le fournisseur ou la personne qu'il désigne,

(ii) soit s'abstienne de faire le commerce d'une catégorie ou sorte spécifiée de produits, sauf ceux qui sont fournis par le fournisseur ou la personne qu'il désigne;

b) toute pratique par laquelle le fournisseur d'un produit incite un client à se conformer à une condition énoncée au sous-alinéa *a*)(i) ou (ii) en offrant de lui fournir le produit selon des modalités et conditions plus favorables s'il convient de se conformer à une condition énoncée à l'un ou l'autre de ces sous-alinéas.

20 Sub-section 77(2) sets out the elements required to be proven for an order to issue with respect to a practice of exclusive dealing:

Exclusive dealing or tied selling

77. (2) Where, on application by the Commissioner or a person granted leave under section 103.1, the Tribunal finds that exclusive dealing or tied selling, because it is engaged in by a major supplier of a product in a market or because it is widespread in a market, is likely to

(a) impede entry into or expansion of a firm in a market,

(b) impede introduction of a product into or expansion of sales of a product in a market, or

(c) have any other exclusionary effect in a market, with the result that competition is or is likely to be lessened substantially, the Tribunal may make an order directed to all or any of the suppliers against whom an order is sought prohibiting them from continuing to engage in that exclusive dealing or tied selling and containing any other requirement that, in its opinion, is necessary to overcome the effects thereof in the market or to restore or stimulate competition in the market.

Exclusivité ou ventes liées

77. (2) Lorsque le Tribunal, à la suite d'une demande du commissaire ou d'une personne autorisée en vertu de l'article 103.1, conclut que l'exclusivité ou les ventes liées, parce que pratiquées par un fournisseur important d'un produit sur un marché ou très répandues sur un marché, auront vraisemblablement:

a) soit pour effet de faire obstacle à l'entrée ou au développement d'une firme sur un marché;

b) soit pour effet de faire obstacle au lancement d'un produit sur un marché ou à l'expansion des ventes d'un produit sur un marché;

c) soit sur un marché quelque autre effet tendant à exclure, et qu'en conséquence la concurrence est ou sera vraisemblablement réduite sensiblement, le Tribunal peut, par ordonnance, interdire à l'ensemble ou à l'un quelconque des fournisseurs contre lesquels une ordonnance est demandée de pratiquer désormais l'exclusivité ou les ventes liées et prescrire toute autre mesure nécessaire, à son avis, pour supprimer les effets de ces activités sur le marché en question ou pour y rétablir ou y favoriser la concurrence.

21 A parallel structure and logic is readily apparent between the requisite elements for exclusive dealing under ss.77(2) and abuse of dominant position under ss.79(1). First, both provisions require an initial determination that the firm in question occupies a position of dominance: subsection 77(2) refers to a "major supplier of a product in a market", while paragraph 79(1)(*a*) requires that "one or more persons substantially or completely control... a class or species of business". Second, both provisions call for the identification of a particular type of conduct, namely a practice of exclusive dealing with an exclusionary effect in the case of ss.77(2), and a practice of anti-competitive acts in the case of ss.79(1). Third, both provisions require a finding of actual or likely substantial lessening of competition.

22 While I would not conclude that the legal tests applicable under these two provisions would necessarily produce identical results in all cases, this parallel structure suggests that an overlapping analysis is to be expected.

III. Issues

23 This appeal raises the following four issues:

(A) For the purposes of paragraph 79(1)(*c*), did the Tribunal err in its determination with respect to whether the SDP has had, is having or is likely to have the effect of preventing or lessening competition substantially?

(B) For the purposes of paragraph 79(1)(*b*), did the Tribunal err in its determination with respect to whether the SDP constitutes an "anti-competitive act"?

(C) For the purposes of subsection 77(2), did the Tribunal err in its determination with respect to whether the SDP has the result that competition is or is likely to be lessened substantially?

(D) For the purposes of subsection 77(2), did the Tribunal err in its determination with respect to whether the SDP is likely to impede entry or expansion of a firm or a product in a market or have any other exclusionary effect in a market?

24 I will address each of these issues in turn. As the analysis of each issue depends heavily upon the Tribunal's particular findings and approach, I will summarize the Tribunal's decision in the context of my analysis of each question.

IV. Analysis

25 Before proceeding to an analysis of the issues listed above, a preliminary observation concerning analytic methodology and evidentiary limitations in the competition law context might be helpful. Each of the legislative provisions governing this appeal define a series of elements that must be proven in order to ground the particular order that is sought; if any of these elements is not established, the Commissioner's application must fail. Both section 77 and section 79 specify three distinct elements, and each of these elements is at issue in the appeal or cross-appeal in this case.

26 The multi-element structures of sections 77 and 79 suggest that the applicable legal tests consist of several discrete sub-tests, each corresponding to a different requisite element. Indeed, this interpretation appears necessary to give effect to the "well-accepted principle of statutory interpretation that no legislative provision should be interpreted so as to render it mere surplusage" (*R. v. Proulx*, [2000] 1 S.C.R. 61 (S.C.C.) at para. 28; see also *Rizzo & Rizzo Shoes Ltd., Re*, [1998] 1 S.C.R. 27 (S.C.C.) at para. 27). Each statutory element must give rise to a distinct legal test, for otherwise the interpretation risks rendering a portion of the statute meaningless or redundant.

27 The difficulty arises, however, when the necessary distinct sub-tests are examined in light of the available evidence in a given case. In the abuse of dominance context, the economic concepts upon which the legal tests are based often cannot be readily extracted from the available evidence. For example, in many cases the foundational concept of market power cannot be established directly; instead, one must look to relevant indirect indicators. However, these indirect indicators are often relevant with respect to more than one element. As a result, the same evidence - for example, concerning barriers to entry, or market share - is potentially and unavoidably relied upon at several points in the analysis, in respect of different requisite elements. In its first abuse of dominance case, *Canada (Director of Investigation & Research) v. NutraSweet Co.* (1990), 32 C.P.R. (3d) 1 (Competition Trib.) [*NutraSweet*], the Competition Tribunal noted that this difficulty "is pervasive in competition law because the relevant factors in the different statutory elements are rarely distinct and it is impossible not to draw on common factors whenever required" (p. 28).

28 However, it is important that the correct approach to the overlapping use of supporting evidence in the competition context be properly understood, so as to avoid the interpretive danger of impermissible erosion or conflation of the discrete underlying statutory tests. Although a particular piece of supporting evidence may be employed as an indirect indicator in respect of more than one element, the elements themselves must remain conceptually distinct. I will return to this point in my analysis of the questions at issue in the appeal at bar.

(A) For the purposes of paragraph 79(1)(c), did the Tribunal err in its determination with respect to whether the SDP has had, is having or is likely to have the effect of preventing or lessening competition substantially?

29 I begin my analysis with the issue of substantial lessening of competition for the purposes of paragraph 79(1)(*c*), for it is on this question that I am most clearly convinced that this Court's intervention is required. My conclusion in this regard follows directly from an interpretation of the governing statutory language. In short, I have concluded that the Tribunal erred in law in its analytic approach with respect to the legal test applicable under paragraph 79(1)(*c*).

30 Before this Court, the appellant argued that the Tribunal erred in law in its interpretation of paragraph 79(1)(*c*) and failed to apply the correct legal test. The appellant argued that the statutory language - and in particular the use of the relative concept "lessening" - mandates an assessment of the effect of the impugned practice on competition in the relevant markets, which can only be properly accomplished by comparing the competitiveness of the relevant markets in the presence and absence of the impugned practice. The appellant submitted that the correct legal test for assessing competitive effects therefore involves a "but for" analysis: would markets - in the past, present or future - be substantially more competitive *but for* the impugned practice? Or, in other words, *but for* the impugned practice, would markets be characterized by greater price competition, choice, service or innovation than exists in the presence of this practice? The Tribunal thus erred, the appellant contended, in that its assessment of substantial lessening of competition focussed virtually exclusively on the narrow question of whether the SDP prevented entry or switching of suppliers, or in other words, whether a substantial level of competition continued to exist in the relevant market. Rather, the Tribunal should have considered the broader question of whether the SDP impeded or hindered the competition that would otherwise exist if the program were absent from the market.

31 In response, the respondent submitted two main arguments challenging the Commissioner's proposed "but for" test. First, the respondent argued that the "but for" test was a "novel approach", which the Commissioner had never before advocated before the Tribunal, either in this case or in prior proceedings under section 79. As a result, the respondent contended, the appellant is precluded from introducing this new argument at the appellate level. In this regard, the respondent cited this Court's comments in *Gravel & Lake Services Ltd. v. Bay Ocean Management Inc.* (2002), 298 N.R. 369, 2002 FCA 465 (Fed. C.A.) at para. 8, *SMX Shopping Centre Ltd. v. R.* (2003), 314 N.R. 365, 2003 FCA 479 (F.C.A.) at para. 32, and *Naguib v. R.* (2004), 317 N.R. 88, 2004 FCA 40 (F.C.A.) at para. 7 for the proposition that a new argument may not be raised for the first time on appeal if the responding party would be prejudiced by having had no opportunity to adduce evidence that could, if accepted, defeat the argument. In this case, the respondent maintained that the record contains little or no evidence to establish the likely characteristics of the necessary hypothetical "but for" market. Moreover, Canada Pipe would have argued its case very differently had it had notice at the Tribunal level of the Commissioner's new "but for" test; in particular, it would have retained experts to model the hypothetical comparator markets that would exist "but for" the SDP.

32 Second, or in the alternative, the respondent asserted that the Tribunal adopted the correct, well-established approach in its determination under paragraph 79(1)(*c*), and properly considered all relevant factors. The Tribunal reached its conclusion by carefully exercising its considerable expertise in appraising and weighing the relevant factors, and the respondent argued that since its conclusion on this question of mixed law and fact was not unreasonable, this Court should not interfere.

33 Although initially appealing, the respondent's first argument cannot be sustained, for several reasons. The legal principle cited by the respondent, with respect to the impropriety of an appellate court considering an entirely new argument which had not been raised below and in relation to which additional evidence is required, is indeed well-established: see, for example, *"Tordenskjold" (The) v. "Euphemia" (The)* (1908), 41 S.C.R. 154 (S.C.C.); *Perka v. R.*, [1984] 2 S.C.R. 232 (S.C.C.), at 240; *R. v. Keegstra*, [1995] 2 S.C.R. 381 (S.C.C.) at para. 26; *Bell ExpressVu Ltd. Partnership v. Rex*, [2002] 2 S.C.R. 559 (S.C.C.) at para. 58. However, this principle is inapplicable in the instant case, for the appellant's argument is not in fact "entirely new" (*Perka* , *supra* at 240). As I explain further below, although the Competition Tribunal has not used the "but for" wording in its previous cases, this wording appears in *Enforcement Guidelines on the Abuse of Dominance Provisions* issued by the appellant, and the substance of this legal test has been articulated and applied by the Tribunal in prior decisions. The respondent thus had ample notice of this argument. Moreover, the primary concern underlying the general prohibition - namely, that the evidentiary record is insufficient to support the new argument (*Keegstra* , *supra* at para. 26) - also does not apply in this case, for the Commissioner bears the burden of establishing each statutory element; if insufficient evidence exists to meet the "but for" test, no order will issue.

34 As to the respondent's second argument, I am not persuaded that the Tribunal's error with respect to its determination under paragraph 79(1)(*c*) is one of mixed law and fact. The appellant's argument calls for an exercise of statutory interpretation, to determine whether the statutory language indeed mandates a particular analytic approach. As the Supreme Court of Canada noted in *Canada (Director of Investigation & Research) v. Southam Inc.*, [1997] 1 S.C.R. 748 (S.C.C.) at para. 36 [*Southam*], questions of statutory interpretation "are generally questions of law", as such questions have "the potential to apply widely to many cases". In the case at bar, the Tribunal's actual appraisal and weighting of different factors - that is, the question of mixed law and fact - is a secondary question, arising only once it has been determined whether the correct legal test was applied. While the Tribunal has economics and competition law expertise in relation to the determinations of fact and mixed law and fact required for the *application* of the correct legal test, this is not sufficient to displace the expertise of this Court with respect to statutory interpretation itself. As this Court has previously determined - and indeed, the parties do not dispute - the Tribunal's conclusions on questions of law are to be reviewed on the standard of correctness: *Canada (Commissioner of Competition) v. Superior Propane Inc.*, [2001] 3 F.C. 185 (Fed. C.A.) at para. 88 [*Superior Propane*].

(1) The legal test under paragraph 79(1)(c)

35 In light of the appellant's argument, I must consider the correct statutory interpretation of paragraph 79(1)(*c*), which, for convenience's sake, I set out again:

> 79. (1) Where, on application by the Commissioner, the Tribunal finds that
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> . . .
>
> > (c) the practice has had, is having or is likely to have the effect of preventing or lessening competition substantially in a market,
>
> 79. (1) Lorsque, à la suite d'une demande du commissaire, il conclut à l'existence de la situation suivante:
>
> . . .
>
> > c) la pratique a, a eu ou aura vraisemblablement pour effet d'empêcher ou de diminuer sensiblement la concurrence dans un marché,

36 Two aspects of the scope of paragraph 79(1)(*c*) are immediately evident from the wording. First, the effect on competition is to be assessed by reference to up to three different time frames: actual effects in the past or present, and likely effects in the future. Second, the effect on competition which must be proven to ground an order prohibiting an abuse of dominance is one of substantial preventing or lessening. The requisite assessment is thus a relative one: it is not the absolute level of competition in a market which must be substantial, but rather the preventing or lessening of competition that results from the impugned practice must be substantial.

37 The test mandated by paragraph 79(1)(*c*) is not whether the relevant markets would or did attain a certain level of competitiveness in the absence of the impugned practice, or whether the level of competitiveness observed in the presence of the impugned practice is "high enough" or otherwise acceptable. These are absolute evaluations, while the statutory language of "effect of preventing or lessening... substantially" clearly demands a relative and comparative assessment. In order to achieve the inquiry dictated by the statutory language of paragraph 79(1)(*c*), the Tribunal must compare the level of competitiveness in the presence of the impugned practice with that which would exist in the absence of the practice, and then determine whether the preventing or lessening of competition, if any, is "substantial". This comparison must be done with reference to actual effects in the past and present, as well as likely future effects. Only through such a comparative approach can the Tribunal determine, as the statutory provision requires, whether the impugned practice "has had, is having or is likely to have the effect of preventing or lessening competition substantially".

38 The comparative interpretation described above is in my view equivalent to the "but for" test proposed by the appellant. Apart from its arguments concerning the evidentiary difficulties involved in the application of such a test at the appeal stage in

this case, the respondent did not advance any reasons of principle or statutory interpretation as to why this approach to paragraph 79(1)(*c*) is incorrect or inappropriate. I would therefore endorse the formulation of the legal test proposed by the appellant: the question that must be assessed for the purposes of paragraph 79(1)(*c*) is, would the relevant markets - in the past, present or future - be substantially more competitive but for the impugned practice of anti-competitive acts?

39 It is important to note that the "but for" wording appears in the *Enforcement Guidelines on the Abuse of Dominance Provisions* issued by the appellant, which *Guidelines* are expressly intended to "help the general public, business people and their legal and economic advisors to better understand... the general approach taken by the Competition Bureau to enforce these provisions" (see Competition Bureau, *Enforcement Guidelines on the Abuse of Dominance Provisions* (Industry Canada: Ottawa, 2001) at page 5). In describing the Commissioner's approach to assessing the effects of anti-competitive acts for the purposes of paragraph 79(1)(*c*), the *Guidelines* employ the "but for" wording (see page 19).

40 The expression "but for" has also appeared in American antitrust jurisprudence. In *Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039 (U.S. C.A. 8th Cir. 2000), at 1055, the Court referred to the difficulty of constructing a hypothetical market:

> Notwithstanding the complex nature of the conduct at issue, Dr. Hall was required to construct a hypothetical market, a <u>"but for" market, free of the restraints and conduct alleged to be anticompetitive</u>. The difficulty of such a task has long been recognized by courts in antitrust cases.

41 In substance, the "but for" interpretation of paragraph 79(1)(*c*) is also accordant with the Tribunal's interpretations in earlier abuse of dominance cases. Although the "but for" wording does not appear in the statutory provision or in previous Tribunal decisions, this legal test does not, as the respondent alleges, "amount[...] to an attempt by the Commissioner to re-write the Act at the appellate stage of this proceeding" (respondent's Memorandum of Fact and Law, para. 102). Rather, the "but for" test reflects the plain meaning of the statutory language of paragraph 79(1)(*c*), and corresponds to the Tribunal's analysis in its previous decisions with respect to this provision.

42 The Tribunal's use of a comparative and relative test for paragraph 79(1)(*c*) is evident in its descriptions, in previous abuse of dominance cases, of the appropriate analytic approach for determining whether there exists an actual or likely substantial lessening of competition. In *Canada (Director of Investigation & Research) v. Laidlaw Waste Systems Ltd.* (1992), 40 C.P.R. (3d) 289 (Competition Trib.) [*Laidlaw*], the Tribunal specifically endorsed an assessment based upon comparison of the competitiveness of the relevant markets with and without the impugned practice (at p. 344-346):

> Laidlaw argues that the Director has not demonstrated that there has been any substantial lessening of competition in the relevant markets. It is argued that no analysis has been done of the state of competition in the markets before Laidlaw entered compared to what exists now... It is not just the number of competitors and comparative market shares which are relevant in considering whether a substantial lessening of competition has occurred... <u>[T]he substantial lessening which is to be assessed need not necessarily be proved by weighing the competitiveness of the market in the past with its competitiveness at present. Substantial lessening can also be assessed by reference to the competitiveness of the market in the presence of the anti-competitive acts and its likely competitiveness in their absence.</u>
>
> [Emphasis added.]

Similarly, in *Canada (Director of Investigation & Research) v. D & B Co. of Canada* (1995), 64 C.P.R. (3d) 216 (Competition Trib.) [*D & B*], the Tribunal described as follows the appropriate approach to assessing the existence of a substantial lessening of competition (at p. 267):

> First, we must establish what the conditions of entry would be without the exclusives [the impugned practice of anti-competitive acts] and, then, determine how the anti-competitive acts altered the prospects for economically feasible entry.

The correspondence between these formulations and the "but for" test described above is readily apparent.

43 The Tribunal's previous abuse of dominance decisions also highlight the centrality of *relative* comparison in the test mandated by paragraph 79(1)(*c*). The test for substantial lessening of competition articulated by the Tribunal in *NutraSweet*, *supra*, *Laidlaw*, *supra*, and *D & B*, *supra*, in all cases depends upon this relative comparative aspect:

> The factors to be considered in deciding whether competition has been or is likely to be substantially lessened are similar to those that were discussed in concluding that NSC [NutraSweet Co.] has market power [that is, market share and entry barriers]. In essence, the question to be decided is whether the anti-competitive acts engaged in by NSC preserve or add to NSC's market power. The issue with respect to the contract terms associated with exclusivity and the use of the United States patent as leverage in competing for Canadian customers is the degree to which these anti-competitive acts add to the entry barriers into the Canadian market and, additionally therefore, into the industry.
>
> (*NutraSweet*, *supra* at p. 47, emphasis added)
>
> There is no reason to doubt that based solely on the economics of lift-on-board service that these should be highly competitive markets. The evidence shows, however, that the effect of the contracts is to make entry sufficiently difficult so that it no longer effectively polices the market. The evidence demonstrates that a new firm can acquire a certain number of customers but that it cannot establish a customer base with sufficient rapidity to make entry attractive. In the markets in question there is no doubt that acquisition practices of Laidlaw buttressed by the creation of artificial barriers to entry through the contracts have resulted in a substantial lessening of competition.
>
> (*Laidlaw*, *supra* at p. 347-348, emphasis added)
>
> The central issue to be decided in determining whether the Director has satisfied this third element [of sub-section 79(1)] is the effect of the exclusives with retailers and the long-term contracts with customers on the conditions of entry into the market. Or, to paraphrase the words of the tribunal in *Nutrasweet*, in essence, the question to be decided is whether the anti-competitive acts engaged in by Nielsen [D & B] preserve or add to Nielsen's market power.
>
> (*D & B*, *supra* at p. 266-267, emphasis added).
>
> Clearly, the assessment envisaged and undertaken by the Tribunal in all these cases was not merely an absolute evaluation of the level of competition in the relevant markets, but rather a relative comparison: did the impugned practice result in a *preventing or lessening* of competition as compared to the conditions governing in the absence of the practice, and was this lessening of a degree sufficient to be considered *substantial*?

44 Based upon the plain meaning of the statutory language, and supported by the interpretation advanced by the Tribunal in its earlier cases, I conclude therefore that paragraph 79(1)(*c*) mandates an approach that properly accentuates these comparative and relative aspects, and enables this analysis to be undertaken in respect of each of the three specified time frames (past, present and future). As I have explained, the "but for" test is one such approach. I must emphasize, however, as the Tribunal rightly implied in the passage from *Laidlaw* quoted in paragraph 39 above, that the "but for" test is not necessarily the only correct approach. I therefore expressly leave open the possibility that the Tribunal might in a future abuse of dominance case find evidence corresponding to a different test sufficient to discharge the burden placed upon the Commissioner by virtue of paragraph 79(1)(*c*). However, as the "but for" test describes an approach that corresponds to the requirements mandated by the statutory language of paragraph 79(1)(*c*), it is one that the Tribunal must consider in all cases - although it may in future cases choose to consider other appropriate tests as well.

(2) Application of the statutory test for paragraph 79(1)(c)

45 In practice, the application of the "but for" test, and in particular, determination of the appropriate methodology in any given case, is a matter for which the Tribunal is better qualified than this Court. This Court should not attempt to prescribe in the abstract the "correct" methodology, for "[s]uch a task is beyond the limits of the Court's competence" (*Superior Propane*, supra at para. 159). As the Supreme Court of Canada observed in *Southam*, *supra* at para. 52, for the questions of mixed law

and fact involved in the application of the legal tests set out in the *Competition Act*, "what is required in the end is an assessment of the economic significance of the evidence; and to this task an economist is almost by definition better suited than is a judge".

46 As suggested by the parties in the case at bar, application of the "but for" test could conceivably involve the construction of a hypothetical comparator model, a market identical to reality in all respects except that the impugned practice is absent. In appropriate circumstances, the "but for" test might also be applied by comparing the competitiveness of the market across time, and treating the market conditions before and after the introduction of the impugned practice as proxies for the market with and without the practice. However, I would not want to be seen to suggest that any particular type of evidence would necessarily be required. Ultimately, the Commissioner bears the burden of proof for each requisite element, and the Tribunal must be convinced on the balance of probabilities. The evidence required to meet this burden can only be determined by the Tribunal on a case-by-case basis.

47 The *Act* does, however, provide some guidelines which should be borne in mind in undertaking the assessment mandated by paragraph 79(1)(*c*). In this regard, I would adopt *mutatis mutandis* the advice provided by Evans JA in *Superior Propane*, *supra* with respect to the methodology appropriate for determining the anti-competitive "effects" of a merger under section 96 of the *Act*:

> Whatever standard is selected (and, for all I know, the same standard may not be equally apposite for all mergers) must be more reflective than the total surplus standard [the methodology adopted by the Tribunal in that case] of the different objectives of the *Competition Act*. It should also be sufficiently flexible in its application to enable the Tribunal fully to assess the particular fact situation before it.
>
> Similarly, whatever methodology the Tribunal chooses in any given case in its application of the "but for" analysis required under paragraph 79(1)(*c*) must be sufficiently flexible to allow a full assessment of all factors relevant in the particular fact situation at issue, and must be reflective of the different objectives of the *Act*.

48 In *Superior Propane*, *supra*, at paras. 104-112, this Court looked to the purposes provision of the *Act*, section 1.1, to inform its analysis of the meaning of the word "effects" in section 96. Similarly, for the purposes of paragraph 79(1)(*c*), in undertaking its assessment of whether there is an actual or likely substantial preventing or lessening of competition, the Tribunal must ensure that the methodology chosen to apply the "but for" test reflects the multiple purposes or objectives set out in section 1.1. Four different purposes are described in section 1.1:

> **Purpose of Act**
>
> 1.1 The purpose of this Act is to maintain and encourage competition in Canada in order to promote the efficiency and adaptability of the Canadian economy, in order to expand opportunities for Canadian participation in world markets while at the same time recognizing the role of foreign competition in Canada, in order to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the Canadian economy and in order to provide consumers with competitive prices and product choices.
>
> **Objet**
>
> 1.1 La présente loi a pour objet de préserver et de favoriser la concurrence au Canada dans le but de stimuler l'adaptabilité et l'efficience de l'économie canadienne, d'améliorer les chances de participation canadienne aux marchés mondiaux tout en tenant simultanément compte du rôle de la concurrence étrangère au Canada, d'assurer à la petite et à la moyenne entreprise une chance honnête de participer à l'économie canadienne, de même que dans le but d'assurer aux consommateurs des prix compétitifs et un choix dans les produits.

All of these purposes must be reflected in the methodology adopted by the Tribunal to assess the existence of an actual or likely substantial lessening of competition for the purposes of paragraph 79(1)(*c*).

(3) The Tribunal's paragraph 79(1)(c) decision

49 Having articulated the legal test for paragraph 79(1)(*c*), I turn now to an analysis of what the Tribunal actually did in the case at bar. The Tribunal's analysis directly concerning paragraph 79(1)(*c*) is brief, and I will therefore quote it in its entirety:

> 263 The Tribunal, as stated above, is satisfied that Bibby does exercise market control. This can be traced to a number of factors and specifically to the fact that Bibby is the only Canadian supplier able to supply full product lines. The SDP is certainly an instrument that helps Bibby market its products, but the Tribunal is not satisfied that the SDP has been shown to be a practice of anti-competitive acts. If, however, the Tribunal has erred in this assessment, the Tribunal is also of the view that the SDP has not been shown to be a practice that has substantially lessened or prevented competition, for the reasons that follow.
>
> 264 The Tribunal has accepted the Commissioner's submission that there are three distinct product markets, and six geographic markets. Therefore, the Commissioner has the onus of establishing a substantial lessening or prevention of competition in eighteen separate markets. Yet the Commissioner has not established to the Tribunal's satisfaction that the SDP has led to substantial lessening or prevention of competition in any of these markets.
>
> 265 In Western Canada and in Ontario, which represent approximately 75 percent of Bibby's market, there is significant evidence of competitive pricing, notwithstanding the SDP. This competitive pricing is due to imports and to the emergence of a new manufacturer. Although imports still represent a relatively small portion of the cast iron DWV markets, they have been steadily increasing and have had a noticeable impact on prices of cast iron DWV products. In addition, a new competing manufacturer has emerged for the first time in thirty years and has succeeded in capturing 10 percent of the market in Canada within four years, while the SDP was in effect. There is clearly effective entry in the market by Vandem, as evidenced by the lowering of prices for cast iron DWV products in Ontario. As discussed earlier, in these reasons, its viability remains to be determined. It is the Tribunal's view, however, that the evidence shows that a number of factors, unrelated to the SDP, will bear on Vandem's future. In consequence, the Tribunal is of the view that the SDP has not brought about a substantial lessening or prevention of competition for the Ontario and Western markets.
>
> 266 The Tribunal acknowledges that for Quebec and the Maritimes, which represent 25 percent of the market, prices appear not to have been constrained by competition. This, however, does not necessarily lead to a conclusion that the SDP has caused the lack of competition. The data provided by the Commissioner relate only to the period of time when the SDP was operating. Dr. Ross based his arguments concerning market power on pricing information covering the period of January 1998 to September 2003. The Tribunal has no historical data which would allow it to measure the state of competition before and after the SDP came into effect. Canada Pipe bought the assets of Canada's only manufacturer of cast iron DWV products, the Gooding foundries, a well-established player with no significant rivals. As well, Bibby has been and continues to be the only producer of a full line of products. The Tribunal therefore finds that there is insufficient evidence for it to conclude that the SDP is responsible for a substantial lessening or prevention of competition.

50 The Tribunal's substantive analysis for the purpose of paragraph 79(1)(*c*) is contained in two paragraphs, 265 and 266. Paragraph 265 considers the evidence with respect to the geographic markets of Western Canada and Ontario, and paragraph 266 considers that with respect to Quebec and the Maritimes. The Tribunal's stated reasons for concluding that substantial lessening of competition had not been established are very different for the two geographic groupings. In both cases, however, the Tribunal's reasoning evinces errors of law.

51 For Western Canada and Ontario, the reasons show that the Tribunal's conclusion was based upon its appreciation of three main factors: the existence of competitive pricing, the increasing presence of imported cast iron DWV products, and the effective entry of a new cast iron DWV manufacturer, Vandem. The Tribunal emphasized that these significant features have been observed "notwithstanding the SDP" and "while the SDP was in effect" (para. 265), and thus concluded that the SDP had not brought about a substantial lessening or prevention of competition in Western Canada or Ontario.

52 The occurrence of entry, both by importers and a new manufacturer, was evidently the key consideration in the Tribunal's analysis with respect to the absence of substantial lessening of competition. In the context of its direct analysis of paragraph

79(1)(*c*), the Tribunal's explanation of its use, for the purposes of paragraph 79(1)(*c*), of the evidence concerning entry is very brief: it merely noted that "a new competing manufacturer has emerged for the first time in thirty years and has succeeded in capturing 10 percent of the market in Canada within four years, while the SDP was in effect", and concluded that "[t]here is clearly effective entry in the market by Vandem" (para. 265). The Tribunal also noted the "steadily increasing" presence of imports, which "although still represent[ing] a relatively small portion of the cast iron DWV markets", are said to "have had a noticeable impact on prices" (para. 265).

53 This analysis of the occurrence of entry in the Western Canada and Ontario markets provides no indication that the Tribunal considered expressly whether the SDP was responsible for a *substantial increase* in the difficulty of gaining entry in the market, and hence a *substantial lessening* of competition. The occurrence of entry and the consequent existence of a certain level of competition relate to an absolute evaluation of the state of the market in the presence of the SDP, which is neither an equivalent of nor a substitute for the relative and comparative assessment that is required by the statutory language of paragraph 79(1)(*c*). The fact that entry has been observed in the presence of the SDP, and that barriers to entry are therefore not total, does not by itself address the question of whether, in the absence of the SDP, there would be substantially more competition in the relevant markets, in the past, present or future. In short, the Tribunal's analysis with respect to these geographic markets does not address the "but for" question.

54 The Tribunal provided different reasoning for its conclusion in this regard concerning the Quebec and Maritimes markets (at para. 266). In these geographic markets, the Tribunal acknowledged that competitive pricing is absent, but cautioned that this "does not necessarily lead to a conclusion that the SDP has caused the lack of competition", as the Commissioner had not led any evidence concerning the period before the SDP was in effect. Without "historical data which would allow it to measure the state of competition before and after the SDP came into effect", and in light of other markets considerations (Canada Pipe's acquisition of the assets of another cast iron DWV manufacturer, and Bibby's status as the only full-line supplier), the Tribunal concluded that "there is insufficient evidence for it to conclude that the SDP is responsible for a substantial lessening or prevention of competition" (para. 266).

55 The legal error inherent in this portion of the Tribunal's paragraph 79(1)(*c*) analysis is manifest. As the Tribunal itself recognized in *Laidlaw*, *supra*, substantial lessening "need not necessarily be proved by weighing the competitiveness of the market in the past with its competitiveness as present", for "substantial lessening can also be assessed by reference to the competitiveness of the market in the presence of the anti-competitive acts and its likely competitiveness in their absence" (p. 346). For the purposes of paragraph 79(1)(*c*), it is insufficient to conclude that the Commissioner had not met her burden because no historical data was provided, for the Tribunal was required to also consider whether the evidence on record demonstrated that the SDP had the effect of substantially lessening competition in the past, present or future, as compared to the markets' *likely* competitiveness in the absence of the practice. The failure to consider this possibility in this case constitutes an error of law.

56 Can it be argued, as the respondent suggests, that the Tribunal implicitly took into account the relative and comparative considerations required under paragraph 79(1)(*c*)? In this vein, it could be argued that the Tribunal's paragraph 79(1)(*c*) reasoning depends implicitly upon its analysis undertaken in earlier sections of its decision, for the purposes of its determinations under paragraphs 79(1)(*a*) and (*b*), of the evidence concerning entry conditions and the effects of the SDP (paras. 141-156, and 204-254 and 260-261, respectively).

57 However, the Tribunal's treatment in these earlier sections of its decision of the evidence concerning entry and effects reinforces my conclusion that it erred in law in its paragraph 79(1)(*c*) analysis. In general, this earlier analysis treats the question of entry in an absolute sense, and appears to be guided by such questions as, has entry been prevented completely, or is a certain level of competition observed in the presence of the SDP. The evidence of actual entry is explicitly accorded a dominant and even preeminent role in the Tribunal's analysis (see, for example, paras. 149, 156 and 161). Throughout the Tribunal's decision, evidence concerning entry or the effects of the SDP is considered against the standard of "prevention" in an absolute sense, rather than a more relative standard such as that implied by the words "impeding" or "lessening" (see paras. 150, 155, 207, 225-226, 237, 241, 245, 254-255, 260-261). The decision does employ the words "impede" or "lessening" at several points (see paras. 2, 6, 53, 113, 162, 263-266, 280, 282), but these occur when the Tribunal is citing the text of the statutory provisions or paraphrasing the Commissioner's submissions, and not in the context of the Tribunal's own conclusions or analysis. In short, these earlier

sections of the decision provide little if any support for the argument that the Tribunal implicitly took into account the relative and comparative considerations required under paragraph 79(1)(*c*). To the contrary, a careful reading of the Tribunal's reasons indicates that the analysis throughout was conducted from the narrow, absolute perspective of preventing entry and competition, and not from the broader, relative and comparative perspective of "impeding" or "lessening".

(4) Conclusion with respect to paragraph 79(1)(c)

58 In summary, the Tribunal should have turned its mind to the question of whether, in each of the relevant markets, competitiveness was substantially lessened in the presence of the SDP, as compared to the likely state of competition in the absence of this practice. In other words, the Tribunal should have considered whether, without the SDP, the relevant product market would be substantially more competitive. Proper examination of this question might include the following considerations: whether entry or expansion might be substantially faster, more frequent or more significant without the SDP; whether switching between products and suppliers might be substantially more frequent; whether prices might be substantially lower; and whether the quality of products might be substantially greater. In this regard, identification of the occurrence of entry, or reference to evidence of competition subsisting in the presence of the impugned practice, is insufficient. I conclude therefore that the Tribunal erred in law in its analysis, for the purposes of paragraph 79(1)(*c*), as to whether the SDP has had, is having or is likely to have the effect of preventing or lessening competition substantially in the relevant markets.

(B) For the purposes of paragraph 79(1)(b), did the Tribunal err in its determination with respect to whether the SDP constitutes an "anti-competitive act"?

59 The statutory test for an abuse of dominant position set out in section 79 is a conjunctive one: each of the three distinct elements must be found if an order is to issue. The Tribunal found that the market control element required under paragraph 79(1)(*a*) was established, and this finding, which is the subject of the cross-appeal, is upheld by this Court in separate reasons. This Court must also determine whether the Tribunal erred in its findings with respect to paragraph 79(1)(*b*).

60 Paragraph 79(1)(*b*) calls for a determination as to whether the respondent, through the SDP, "ha[s] engaged in or [is] engaging in a practice of anti-competitive acts". The Tribunal had no difficulty recognizing the SDP as a "practice". It wrote, at para. 171, that the term entails more than an isolated act but may be one occurrence that is sustained and systemic, or that has had a lasting impact on competition. It explained at para. 200 of its reasons that the SDP is structured, organized and applied throughout Canada, albeit with some variations in the multiplier and rebates in the different regions and that the various components of the program add up to a practice. The respondent does not appear to contest this particular finding. The dispute arises with respect to whether the SDP can be characterized as composed of "anti-competitive acts" (« agissements anti-concurrentiels »).

61 The Commissioner argued that while the Tribunal stated the correct legal test for anti-competitive acts, which was established in previous Tribunal decisions, this was not the test that it ultimately applied in its analysis of the SDP. The Tribunal erred in law, the Commissioner asserts, by requiring proof of a link between the SDP and a decrease in competition, and by improperly extending the scope of the valid business justification doctrine. As a result, according to the Commissioner, the approach to paragraph 79(1)(*b*) adopted by the Tribunal conflated the discrete statutory tests established by paragraphs 79(1)(*b*) and 79(1)(*c*).

62 This question is further complicated in the case at bar by the fact that this appeal represents the first time that a court has considered the legal test applicable for the purposes of paragraph 79(1)(*b*). The Tribunal has considered, in prior abuse of dominance cases, the legal test and analytic methodology applicable in ascertaining the existence of an "anti-competitive act". The Tribunal's jurisprudence on these questions cannot by itself be determinative in the current case, as its views on questions of law are not binding on this Court. The Tribunal's jurisprudence may however be indicative of what makes sense and what has been working in the past - if, at the same time, it corresponds to the wording of the Act.

(1) The legal test under paragraph 79(1)(b)

63 The *Act* does not provide an express definition of "anti-competitive act". Section 78 provides a list of eleven anti-competitive acts, expressly "without restricting the generality of the term". These examples are thus illustrative only, and indeed the Tribunal has recognized in its previous decisions that conduct not specifically mentioned in section 78 can constitute an anti-competitive act (*Nutrasweet*, *supra* at p. 34; *Laidlaw*, *supra* at p. 331-332; *D & B*, *supra* at p. 257; *Canada (Director of Investigation & Research) v. Tele-Direct (Publications) Inc.* (1997), 73 C.P.R. (3d) 1 (Competition Trib.), at 180 [*Tele-Direct (Publications) Inc.*]). While clearly non-exhaustive, the illustrative list in section 78 provides direction as to the type of conduct that is intended to be captured by paragraph 79(1)(*b*): reasoning by analogy, a non-enumerated anti-competitive act will exhibit the shared essential characteristics of the examples listed in section 78.

64 In *Nutrasweet*, *supra*, the Tribunal applied this interpretive approach to paragraph 79(1)(*b*), and suggested (at p. 34) the following working definition of "anti-competitive act":

> A number of the acts [mentioned in section 78] share common features but... only one feature is common to all: an anti-competitive act must be performed for a purpose, and evidence of this purpose is a necessary ingredient. The purpose common to all acts, save that found in paragraph 78(*f*), is an intended negative effect on a competitor that is predatory, exclusionary or disciplinary.
>
> (Emphasis added.)

65 I adopt the above definition, which is very close in substance to the core characteristic of the enumerated list of section 78, save at paragraph 78(*f*). This exception was noted by the Tribunal in *Nutrasweet*, *supra*.

66 Two aspects of this definition should be noted. First, an anti-competitive act is identified by reference to its *purpose*. Second, the requisite purpose is an *intended predatory, exclusionary or disciplinary negative effect on a competitor*. I will elaborate on each of these aspects in turn.

67 First, the meaning of the term *purpose* deserves some comment. As the Tribunal observed in *Tele-Direct (Publications) Inc.* , *supra* at p. 180, "'purpose' is used in this context in a broader sense than merely subjective intent on the part of the respondent... it might be more apt to speak of the *overall character* of the act in question" (emphasis added). In order to apply paragraph 79(1)(*b*), the purpose or character of the impugned conduct must therefore be determined. Relevant factors to be considered and weighed to determine this overarching "purpose" include the reasonably foreseeable or expected objective effects of the act (from which intention may be deemed, as I explain further below), any business justification, and any evidence of subjective intent, if available (see *Tele-Direct (Publications) Inc.* , *supra* at p. 180).

68 The second aspect describes the *type of purpose* required in the context of paragraph 79(1)(*b*): to be considered "anti-competitive" under paragraph 79(1)(*b*), an act must have an intended predatory, exclusionary or disciplinary negative effect on a competitor. The paragraph 79(1)(*b*) inquiry is thus focused upon the intended effects of the act *on a competitor*. As a result, some types of effects on competit*ion* in the market might be irrelevant for the purposes of paragraph 79(1)(*b*), if these effects do not manifest through a negative effect on a competitor. It is important to recognize that "anti-competitive" therefore has a restricted meaning within the context of paragraph 79(1)(*b*). While, for the *Act* as a whole, "competition" has many facets as enumerated in section 1.1, for the particular purposes of paragraph 79(1)(*b*), "anti-competitive" refers to an act whose purpose is a negative effect on a competit*or*.

69 Adopting this interpretive approach to section 79, it is conceivable that a practice might be found to be composed of anti-competitive acts within the meaning of paragraph 79(1)(*b*), but at the same time, for the purposes of paragraph 79(1)(*c*), be held not to have the effect of preventing or lessening competition substantially in the market in question.

70 A final comment should be made with respect to the evidence required to establish an anti-competitive purpose within the meaning of paragraph 79(1)(*b*). It is clear from the legislative history of paragraph 79(1)(*b*) that evidence of subjective intent, although certainly probative if available, is not required in order to find that a given act is anti-competitive within the meaning

of paragraph 79(1)(*b*). When Bill C-91, which eventually became the *Competition Act*, was first introduced in Parliament in December 1985, the text of paragraph (*b*) of the abuse of dominance provision (then section 51) read as follows:

> 51. (1) Where, on application by the Commissioner, the Tribunal finds that
>
> . . .
>
> > (b) that person or those persons have engaged in or are engaging in a practice of anti-competitive acts, <u>and the object of the practice is to lessen competition,</u> and
>
> 51. (1) Lorsque le Tribunal, à la suite d'une demande du directeur, conclut:
>
> . . .
>
> > b) que cette personne ou ces personnes se livrent ou se sont livrées à une practique d'agissements anti-concurrentiels <u>dont le but est de réduire la concurrence,</u> et

Perceived problems with the subjective intent requirement implied by the latter part of the proposed paragraph (*b*) were frequently raised in testimony before the House of Commons Legislative Committee on Bill C-91 (see Canada, House of Commons, *Minutes of Proceedings and Evidence of the Legislative Committee on Bill C-91*, First session of 33 rd Parliament, 1986 at pages 2:8-9, 3:7-9, 3:17, 5:13, 5:15, 5:63-64, 6:9-10; 9:20-21; note also the contrary view expressed at 4:55-56, 6:57-58; 7:55-57, 7:60-63 [*Minutes of Committee on Bill C-91*]). In response, the reference to "the object of the practice" was deleted in paragraph (*b*), in order to remove any subjective intent requirement from the statutory test for abuse of dominant position (see *Minutes of Committee on Bill C-91*, *supra* at pages 11:3 and 11:32-33).

71 On the basis of this legislative history, I would endorse the following comment by the Tribunal in *Laidlaw*, *supra* at p. 342, with respect to the proper role of evidence concerning subjective intent within paragraph 79(1)(*b*):

> Proof of subjective intention on the part of a respondent is not necessary in order to find that a practice of anti-competitive acts has occurred. Such intention is almost impossible of proof in many cases involving corporate entities unless one stumbles upon what is known as a "smoking gun". (A document which makes it clear that the purpose of the conduct in question was to exclude competitors from the market.) Section 79 of the Act provides for a civil proceeding and civil remedies. In that context corporate actors and individuals are deemed to intend the effects of their actions.

72 Proof of the intended nature of the negative effect on a competitor can thus be established directly through evidence of subjective intent, or indirectly by reference to the reasonably foreseeable consequences of the acts themselves and the circumstances surrounding their commission, or both.

73 Even though evidence of subjective intent is neither required nor determinative, intention remains an important ingredient of paragraph 79(1)(*b*). In particular, intention is relevant in the sense that while a respondent cannot disavow responsibility for the reasonably foreseeable consequences of its acts, a respondent might nevertheless be able to establish that such consequences should not, in the context of the paragraph 79(1)(*b*) inquiry, be considered the intended "purpose" or "overall character" of the acts in question. In appropriate circumstances, proof of a valid business justification for the conduct in question can overcome the deemed intention arising from the actual or foreseeable effects of the conduct, by showing that such anti-competitive effects are not in fact the overriding purpose of the conduct in question. In essence, a valid business justification provides an alternative explanation as to why the impugned act was performed. To be relevant in the context of paragraph 79(1)(*b*), a business justification must be a credible efficiency or pro-competitive rationale for the conduct in question, attributable to the respondent, which relates to and counterbalances the anti-competitive effects and/or subjective intent of the acts. The appropriate application of the valid business justification doctrine in the context of paragraph 79(1)(*b*) will be further considered below, in my discussion of the Tribunal's analysis in the case at bar.

(2) The Tribunal's paragraph 79(1)(b) decision

74 In the case at bar, it would appear that the Tribunal correctly articulated the legal test. At para. 171 of its reasons, at the outset of its review of the Tribunal's definition of "anti-competitive acts" in its previous cases, the Tribunal stated:

> 171 ... In order to determine whether acts are anti-competitive, the Tribunal must consider the nature and purpose of the acts in question, as well as the impact they have or may have on the relevant market. [Note: *Nielsen* at 257; *Laidlaw* at 333; *Nutrasweet* at 34] In both *Tele-Direct* and *Laidlaw*, the Tribunal assessed the alleged anti-competitive practices by taking into account what effect they had had on competitors.
>
> [Emphasis added]

In the course of quoting a longer passage from *Tele-Direct (Publications) Inc.* , the Tribunal reproduced (at para. 178) the key sentence from *Nutrasweet*, *supra* at p. 34, to the effect that the feature common to anti-competitive acts is that they are all performed for a "purpose", namely "an intended negative effect on a competitor that is predatory, exclusionary or disciplinary". This formulation was also repeated in the concluding section of the Tribunal's decision (at para. 284).

75 However, despite this correct articulation of the test, the Tribunal's analysis of the salient features of the applicable legal test is a cause for concern. At the end of the portion of its paragraph 79(1)(*b*) analysis entitled "The Law", the Tribunal summarized as follows its understanding of key aspects of the legal test (at para. 191):

> The Tribunal [in *Tele-Direct*] has stated that there must be a link between the impugned practice and a decrease in competition. Moreover, if a practice does not appear to have an exclusionary effect or cause detriment to the consumer, it cannot be said to be anti-competitive.
>
> [Emphasis added.]

76 This statement is incorrect, in at least two respects.

77 First, for the purposes of paragraph 79(1)(*b*), a link need not be proven between the impugned practice and a decrease in competit*ion*. Quite simply, such a causal link is not part of the legal test for an anti-competitive act. Moreover, an emphasis upon evidence of this type runs the risk of obscuring the correct focus of the paragraph 79(1)(*b*) test. An anti-competitive act is one whose purpose is an intended negative effect on a competit*or* that is predatory, exclusionary or disciplinary. The focus of analysis is thus on the act itself, to discern its purpose. The questions as to whether a decrease in competit*ion* in the market is evident, or whether any such decrease can be causally attributed to the impugned practice, are not directly relevant for this task. Certainly, such findings are not requisite elements of the test for an anti-competitive act.

78 Obviously, if an act is to be found anti-competitive, there must be evidence linking the impugned practice to the requisite intended negative effect *on a competitor*: the practice must be found to cause or at least contribute to the intended negative effect. Such a negative effect on a competitor must also be found to be the "purpose" of the practice in question, and to this end, all relevant factors must be taken into account and weighed to determine if the requisite purpose is established. One must remember, however, that in the context of paragraph 79(1)(*b*), evidentiary factors are relevant only insofar as they shed light upon the paragraph 79(1)(*b*) statutory test, that is upon the *purpose of the act vis-à-vis competitors*. Evidence concerning other types of effects of the impugned act that are not related to competitors - while perhaps pertinent in respect of the paragraph 79(1)(*c*) assessment of competition - are not directly relevant for paragraph 79(1)(*b*). Similarly, evidence concerning the general competitive state and structure of the relevant market, and whether such features can be causally attributed to the impugned act, are not the direct focus of the paragraph 79(1)(*b*) analysis, and are more properly considered under paragraph 79(1)(*c*). In short, paragraph 79(1)(*b*) simply concerns whether the act displays the requisite intended effect on competit*ors*; it is not directly concerned with the state of competit*ion* in the market or the general causes thereof. In directing itself to the contrary, and requiring proof of a causal link between the impugned act and a decrease in competition, the Tribunal erred.

79 Second, the Tribunal appears mistakenly to suggest in the above-quoted passage that the impugned practice's effects on the consumer should or could be considered within the paragraph 79(1)(*b*) analysis. However, contrary to what the Tribunal

implies in the above quotation, "detriment to the consumer" is not a relevant independent consideration for the purposes of paragraph 79(1)(*b*), as evidence of this type does not relate directly to whether an act has the requisite defining characteristic of an intended negative effect on a competitor. The effect of an act on consumers may in some circumstances be relevant in assessing the credibility and weight of a proffered business justification, as I explain further below. Otherwise, however, such evidence is largely irrelevant for the purposes of the paragraph 79(1)(*b*) assessment, and is more appropriately considered under paragraph 79(1)(*c*). To the extent that the Tribunal suggests in the above-quoted sentence that "detriment to the consumer" is an independently relevant consideration for the purposes of paragraph 79(1)(*b*), the Tribunal therefore erred.

80 The Tribunal thus embarked on its paragraph 79(1)(*b*) analysis from an incorrect foundation: it erroneously believed itself obliged to consider factors which are not relevant in the correct legal test. The Supreme Court stated in *Southam*, *supra* at para. 41 that "[i]f the Tribunal did ignore items of evidence that the law requires it to consider, then the Tribunal erred in law". Logically, this statement can be extended to encompass the situation of the case at bar: if the Tribunal considered items of evidence that the law requires it not to consider, then the Tribunal also erred in law. Moreover, these irrelevant factors may well have played a decisive role in this case: according to the Tribunal's own articulation, evidence of a link between the practice and a decrease in competition was considered to be *required* for the purposes of paragraph 79(1)(*b*). Thus, to the extent that the Tribunal misdirected itself as to the applicable legal test, and as a consequence considered irrelevant factors in making its paragraph 79(1)(*b*) determination, the Tribunal committed a reversible error of law.

81 The Tribunal's erroneous interpretation of the paragraph 79(1)(*b*) test played a significant role in its analysis of the SDP. It is clear that in concluding that the SDP was not anti-competitive, the Tribunal relied heavily upon its mistaken understanding that a demonstrable link must exist between the impugned act and a decrease in competition. Indeed, the Tribunal expressly stated that this factor was "the most striking" basis for its conclusion:

> 261 The most striking argument against the alleged anti-competitive effect of the SDP is the fact that it has not prevented entry nor competition in certain regions. The SDP has not prevented an increase in imports, nor has it prevented the emergence, for the first time in thirty years, of a new manufacturer of cast iron DWV products. For a practice to be found anti-competitive, it must have a negative effect on competition. As was stated in *Tele-Direct*, there has to be a link between the practice and its alleged anti-competitive effect. In the instant case, the link has not been established to the Tribunal's satisfaction. The Tribunal recognizes that entry may be difficult, but this appears unrelated to the SDP. Several other factors come into play: Bibby is a known manufacturer that offers a complete line of products; the market is not a growth market, thus limiting investment potential. Yet, it has been possible for competitors to match Bibby's price and offer a reliable supply, to the point of making it an interesting proposition for distributors or contractors to change suppliers. This has occurred, notwithstanding the SDP, as illustrated by new entrants such as Sierra and Vandem, and by new arrangements such as Wolseley's change of suppliers.

82 As this passage shows, the Tribunal's incorrect assumption that a link to a reduction in competition was required under paragraph 79(1)(*b*) critically influenced its reasoning. Instead of enquiring as to whether the SDP's purpose was an intended negative effect on competitors, the Tribunal asked whether there was evidence of a decrease in competition in the relevant market, in the abstract, and whether the identified competitive problems could be causally attributed to the SDP and hence be considered its "effects". This approach, of focussing on the general state of competition in the market rather than on the purpose of the impugned act, led the Tribunal to adopt an unwarrantedly and incorrectly narrow test for paragraph 79(1)(*b*): essentially, the Tribunal's reasoning would imply that unless an impugned act *prevents* entry of competitors or otherwise *prevents* competition, or unless it is the (predominant) *cause* of the uncompetitive attributes observed in the market, the act cannot be considered anti-competitive. This result is clearly incorrect.

83 In my view, the Tribunal's error of law with respect to paragraph 79(1)(*b*) is partly attributable to a conflation of the legal test for paragraph 79(1)(*c*) with that applicable for paragraph 79(1)(*b*). As I mentioned above at the outset of my analysis, the multi-element structure of section 79 suggests that upon proper interpretation, each statutory element must give rise to a distinct legal test. To repeat, paragraph 79(1)(*b*) relates to whether the impugned act exhibits the requisite anti-competitive purpose vis-à-vis competitors, while paragraph 79(1)(*c*) concerns the broader state of competition, and whether the practice has the effect of substantially lessening competition in the relevant market. A particular indirect evidentiary indicator may serve subtly different

- yet importantly distinct - purposes in regards to paragraph 79(1)(*b*) as compared to paragraph 79(1)(*c*). Since paragraph 79(1)(*b*) focuses on whether the impugned act was performed for a particular purpose with respect to competitors, the relevant factors - that is, evidence concerning its foreseeable effects on competitors, business justifications for its adoption, and subjective intent - are to be interpreted in this particular light. By contrast, paragraph 79(1)(*c*) mandates an assessment of the substantiality of the practice's actual or likely effects on competition in the relevant market(s), a task that proceeds from the vantage point of the market as a whole and invites consideration of a wider range of effects of the practice in question. The approach adopted by the Tribunal in this case does not properly recognize or maintain these important conceptual distinctions between the statutory elements of paragraph 79(1)(*b*) and 79(1)(*c*).

(3) The valid business justification and paragraph 79(1)(b)

84 The Tribunal's conflation of the legal tests for paragraph 79(1)(*b*) and 79(1)(*c*) is also apparent in its discussion of the business justification arguments proffered by the respondent. The Tribunal noted two business justifications suggested by the respondent: first, that the SDP's uniform rebate structure encourages competition, by creating a level playing field between small and large distributors; and second, that the SDP makes possible the high-volume sales necessary to enable Bibby to maintain a full line of products.

85 The Tribunal rejected the first business justification proposed by the respondent, but was persuaded by the second. With respect to the first justification, the Tribunal concluded (at para. 209) that although the creation of equitable opportunities for small- and medium-sized enterprises to participate in the Canadian economy is an objective of the *Act* set out in section 1.1, this is not a relevant consideration for the purposes of section 79:

> While the Tribunal acknowledges this to be an enunciated purpose of the Act, the Tribunal is of the view that this purpose is unrelated to the issue of abuse of dominance. Competition between distributors is not at issue. Rather, the case is about competition between Bibby and other suppliers of cast iron DWV products. The equitable characteristics of the SDP as it relates to distributors have little to do with whether Bibby is exercising its market power in a way that precludes competition between suppliers of the product. In consequence, this argument of business justification must fail.

86 The Tribunal was persuaded, however, by the second business justification put forward by the respondent. It explained its reasoning as follows (at paras. 212 and 259):

> High volume sales are also important to a business which is volume-driven, as Mr. Leonard, General Manager of Bibby, explained. Bibby argues that it needs the sales to ensure efficiencies and to lower its cost of production; the Commissioner did not challenge this assertion. The rebate structure provided for in the SDP does encourage distributors to deal with Bibby for all three products if they choose Bibby to supply one of them and in consequence Bibby's sales are increased. As was stated in *Laidlaw*, the self-interest justification is not sufficient. However, in this case, the Tribunal accepts, based on Mr. Leonard's evidence, that high volumes allow Bibby to maintain in inventory smaller, less profitable but nevertheless important products. As a result, items that are used less often remain available in the market. This availability serves the interests of distributors and contractors, whether or not they belong to the SDP, and ultimately benefits the consumer.
>
> The respondent's business argument that Bibby needs to sell a certain volume in all three products to be able to maintain full production of all product lines is valid. There are certainly recognizable advantages in having a reliable source able to manufacture and supply a full line of cast iron pipe DWV products for the Canadian market.

87 This analysis is problematic, as the Tribunal appears to have lost sight of the role of the valid business justification doctrine *within paragraph 79(1)(b)*, and instead seems to grant it an independent role. A business justification for an impugned act is properly relevant only insofar as it is pertinent and probative in relation to the determination required by paragraph 79(1)(*b*), namely the determination as to whether the purpose for which the act was performed was a predatory, exclusionary or disciplinary negative effect on a competitor. As I explained above in the discussion of the intentionality aspect of the paragraph 79(1)(*b*) test, a valid business justification can, in appropriate circumstances, overcome the deemed intention arising from the actual or foreseeable negative effects of the conduct on competitors, by demonstrating that such anti-competitive effects are

not in fact the overriding purpose of the conduct in question. In this way, a valid business justification essentially provides an alternative explanation as to why the impugned act was performed, which in the right circumstances might be sufficient to counterbalance the evidence of negative effects on competitors or subjective intent in this vein.

88 The valid business justification doctrine is not an absolute defence for paragraph 79(1)(*b*). Rather, a business justification is properly employed to counterbalance or neutralize other evidence of an anti-competitive purpose, prior to making a determination under 79(1)(*b*). As the Tribunal observed in *D & B*, *supra*, a business justification proffered by a respondent must therefore be "weigh[ed]... in light of any anti-competitive effects to establish the overriding purpose" of the impugned act (at p. 262, also quoted in *Tele-Direct (Publications) Inc.* , *supra* at p. 180). In *D & B*, *supra*, the Tribunal properly emphasized this balancing exercise (at p. 265):

> Proof of the existence of a business motive for long-term contracts [the impugned conduct] that was unrelated to an anti-competitive purpose would undoubtedly be relevant to an evaluation of an allegation of anti-competitive acts. The mere proof of some legitimate business purpose would be, however, hardly sufficient to support a finding that there is no anti-competitive act. All known factors must be taken into account in assessing the nature and purpose of the acts alleged to be anti-competitive.

89 In the case at bar, the Commissioner argued that the business justification accepted by the Tribunal is actually a self-interest argument based on selling more product, and therefore cannot qualify as a business justification for the purposes of paragraph 79(1)(*b*). The respondent countered that this was a mischaracterization of the Tribunal's reasons, as in its view the business justification actually accepted by the Tribunal related to the maintenance of a full product line and the consequent benefits for consumers: according to the respondent, "it is crystal clear from the Tribunal's reasons that the Tribunal accepted the SDP's business purpose on the basis of its benefits to *customers* and *end consumers*, rather than Canada Pipe" (Respondent's Memorandum of Fact and Law at para. 83, original emphasis).

90 In my view, the respondent's interpretation of the Tribunal's reasons with respect to the second business justification is apt. However, this reasoning, which relies solely upon consumer welfare benefits to establish the business justification, is at the core of the Tribunal's error. Simply stated, improved consumer welfare is on its own insufficient to establish a valid business justification for the purposes of paragraph 79(1)(*b*). A valid business justification must provide a credible efficiency or pro-competitive explanation, unrelated to an anti-competitive purpose, for why the dominant firm engaged in the conduct alleged to be anti-competitive. The business justification must therefore be attributable to the respondent, for it is the latter's allegedly anti-competitive conduct which is sought to be explained.

91 In the case at bar, the Tribunal's reasons do not establish the requisite efficiency-related link between the SDP and the respondent, and hence do not supply a legitimate explanation for the latter's choice to engage in the impugned conduct, unrelated to an anti-competitive purpose. Without such a link, self-interest remains as the only justification for the SDP which is attributable to the respondent for the purposes of paragraph 79(1)(*b*). The Tribunal thus erred in concluding, on the basis of the reasoning provided in its decision, that the respondent had established a valid business justification for the SDP. While this error may not ultimately have been determinative, in that a valid business justification is at most a factor to be balanced within the paragraph 79(1)(*b*) determination, it may well have played an important supporting role in the Tribunal's decision with respect to paragraph 79(1)(*b*).

(4) Conclusion with respect to paragraph 79(1)(b)

92 In sum, the aspects of the Tribunal's decision discussed above admittedly represent short extracts of a long and complex analysis. However, the identified errors suggest a basic misapprehension and misapplication of the legal test for paragraph 79(1)(*b*), and a troubling conflation between paragraphs 79(1)(*b*) and (*c*). Thus, at the very least, the extracts highlighted above render suspect the Tribunal's analysis of the relevant factors in the context of paragraph 79(1)(*b*). I can only conclude that the matter should be returned to the Tribunal for a reconsideration of its paragraph 79(1)(*b*) determination in light of the correct legal test.

(C) For the purposes of subsection 77(2), did the Tribunal err in its determination with respect to whether the SDP has the result that competition is or is likely to be lessened substantially?

93 As I described above at paragraph 21 of these reasons, there is a parallel structure and logic between the requisite statutory elements for exclusive dealing under subsection 77(2) and abuse of dominant position under subsection 79(1). The parties did not present separate arguments with respect to the substantial lessening of competition element of subsection 77(2), and instead simply referred the Court to their arguments concerning this element in the context of section 79. This same approach was adopted by the Tribunal, which concluded, "[f]or the same reasons... as in our analysis under section 79," that the Commissioner had failed to establish that the exclusive dealing practice has lessened competition substantially (para. 282).

94 In *Nutrasweet*, *supra*, the Tribunal observed that "the fundamental test of substantial lessening of competition is the same in both sections of the Act [section 79 and subsection 77(2)]" (p. 56). The similarity between this element in section 79 and subsection 77(2) is indeed strong, in that both provisions employ the key concepts of substantial lessening and competition. However, the two provisions also contain some differences in wording. In particular, the scope of section 79 appears to include events of the past, which are not expressly included for the purposes of subsection 77(2): paragraph 79(1)(*c*) encompasses three time frames ("has had, is having or is likely to have"), while subsection 77(2) refers to only two ("is or is likely to").

95 For the purposes of this appeal, I need not consider whether the differences in wording between paragraph 79(1)(*c*) and subsection 77(2) might in particular cases properly yield substantively different results with respect to the substantial lessening of competition element. In the case at bar, it is clear that the Tribunal simply adopted the same legal test and analysis in respect of the substantial lessening of competition element for both section 79 and subsection 77(2). To the extent that the Tribunal erred in law in the context of paragraph 79(1)(*c*) in its interpretation of the test for substantial lessening of competition, the same errors of law apply with respect to subsection 77(2).

(D) For the purposes of subsection 77(2), did the Tribunal err in its determination with respect to whether the SDP is likely to impede entry or expansion of a firm or a product in a market or have any other exclusionary effect in a market?

96 The parallel structure of subsection 77(2) and 79(1) is also apparent in comparing the second elements required by the two statutory provisions: both provisions call for the identification of a particular type of impugned conduct, namely a practice of exclusive dealing with an exclusionary effect in the case of subsection 77(2), and a practice of anti-competitive acts in the case of paragraph 79(1)(*b*). The parties did not present separate arguments concerning this element of subsection 77(2), but rather appear to have assimilated this element into their arguments concerning section 79.

97 The Tribunal was satisfied that the SDP was a practice of exclusive dealing according to the statutory definition provided in paragraph 77(1)(*b*) (para. 279). However, the Tribunal concluded that an exclusionary effect had not been established, based on its analysis under section 79:

> 281 We have concluded under section 79 that the SDP is not an anti-competitive practice because we found insufficient evidence to show that the SDP in itself had an exclusionary effect...
>
> 282 For the same reasons therefore as in our analysis under section 79, we find that the Commissioner has failed to establish that the exclusive dealing practice impedes or is likely to impede entry of a new competitor or have any exclusionary effect...

98 For the purposes of this appeal, I need not decide the precise scope or nature of the similarity between the statutory element of subsection 77(2) concerning exclusionary effects, and paragraph 79(1)(*b*). There may well be differences between the two provisions, which could prove pertinent in a future case. However, it is sufficient in the circumstances of this case to note that the exclusionary effects required under subsection 77(2) are clearly of a relative nature, as indicated by use of the word "impede" in paragraph 77(2)(*a*) and (*b*), rather than a more categorical verb, such as "prevent". I have already considered in detail the Tribunal's treatment of the evidence concerning barriers to entry and the effects of the SDP, and it is unnecessary to repeat this analysis here. My conclusion, stated above at paragraph 58, is equally applicable for the purposes of the Tribunal's determination with respect to the exclusionary effects element of subsection 77(2): the Tribunal's analysis of the evidence concerning barriers

to entry and the effects of the SDP was conducted from the narrow perspective of prevention, and not the broader perspective implied by the word "impede". The adoption of this unduly narrow perspective constitutes reversible error.

99 Moreover, it should be noted that like subsection 79(1), subsection 77(2) establishes distinct statutory elements, each of which must be established before an order prohibiting exclusive dealing can issue. These distinct statutory elements must not be conflated: the existence of the various exclusionary effects described in paragraph 77(2)(*a*), (*b*) and (*c*) must be considered separately from the question of whether there has been a substantial lessening of competition. Since the Tribunal relied, for the purpose of its subsection 77(2) determination concerning exclusionary effects, upon its erroneous paragraph 79(1)(*b*) reasoning, its conclusion in this regard cannot stand.

V. Conclusion

100 For the above reasons, I would allow the appeal with costs, I would set aside the Tribunal's decision in this regard, and I would refer the matter back to the Tribunal for a redetermination in accordance with these reasons and on the basis of the evidence currently on record.

***G. Létourneau J.A.*:**

I agree.

***J.D.D. Pelletier J.A.*:**

I agree.

Appeal allowed.

2001 Trib. conc. 34, 2001 Comp. Trib. 34
Competition Tribunal

Canada (Commissioner of Competition) v. Canadian Waste Services Holdings Inc.

2001 CarswellNat 3896, 2001 CarswellNat 7043, 2001 Trib. conc. 34, 2001 Comp. Trib. 34, [2001] C.C.T.D. No. 32, 15 C.P.R. (4th) 5

In the Matter of the Competition Act, R.S.C. 1985, c. C-34

In the Matter of an application by the Commissioner of Competition under section 92 of the Competition Act

In the Matter of the acquisition by Canadian Waste Services Inc. of certain assets of Browning-Ferris Industries Ltd., a company engaged in the solid waste business

The Commissioner of Competition, (applicant) and Canadian Waste Services Holdings Inc. Canadian Waste Services Inc. Waste Management, Inc., (respondents) and The Corporation of the Municipality of Chatham-Kent, (intervenor)

McKeown J., Schwartz Member, Solursh Member

Heard: June 20, 2001
Heard: June 22, 2001
Judgment: October 3, 2001
Docket: CT2000002

Proceedings: additional reasons to *Canada (Commissioner of Competition) v. Canadian Waste Services Holdings Inc.* ((2001)), 2001 Comp. Trib. 3, 2001 CarswellNat 3987, [2001] C.C.T.D. No. 3, 11 C.P.R. (4th) 425 ((Competition Trib.))

Counsel: *Donald Houston et al*, for Commissioner of Competition
Lawson A.W. Hunter, for Canadian Waste Services Holdings Inc., Canadian Waste Services Inc., Waste Management Inc.

Subject: Intellectual Property; Property; Corporate and Commercial

Related Abridgment Classifications

Commercial law
VI Trade and commerce
VI.5 Competition and combines legislation
VI.5.d Abuse of dominant position (monopolies) and mergers
Commercial law
VI Trade and commerce
VI.5 Competition and combines legislation
VI.5.g Investigation and prosecution
VI.5.g.vi Evidence
Commercial law
VI Trade and commerce
VI.5 Competition and combines legislation
VI.5.g Investigation and prosecution
VI.5.g.x Appeals

Headnote

Trade and commerce --- Competition and combines legislation — Investigation and prosecution — Orders — Miscellaneous orders

Table of Authorities

Statutes considered:

Clayton Act, 1993, 15 U.S.C. 18 (U.S.C. 1993)

Generally — referred to

Competition Act, R.S.C. 1985, c. C-34

Generally — referred to

s. 92 — considered

s. 92(1) — referred to

s. 92(1)(e) — referred to

s. 92(1)(e)(i) — considered

s. 92(1)(e)(ii) — referred to

s. 92(1)(e)(iii) — considered

s. 93 — referred to

ss. 94-96 — referred to

Interpretation Act, R.S.C. 1985, c. I-21

s. 12 — referred to

Decision of the Board:

I. Introduction

1 These reasons and decision are issued pursuant to the Tribunal's Reasons and Order of March 28, 2001 (the "Reasons"), and the remedy hearing that took place on June 20, 21 and 22, 2001. In its earlier decision, the Tribunal found that the acquisition of the Ridge Landfill ("Ridge") by Canadian Waste Services Inc. ("CWS") would likely substantially prevent and lessen competition for the disposal of institutional, commercial and industrial waste ("ICI Waste") in two Southern Ontario markets: the Greater Toronto Area ("GTA") and the Chatham-Kent area (Reasons, paragraphs 204, 205, 224 and 234). As requested by the parties, the Tribunal ordered that counsel appear for a further hearing on an appropriate remedy.

2 The relevant background information is provided in the Reasons of March 28, 2001. For present purposes it is sufficient to note that the application brought by the Commissioner of Competition (the "Commissioner") arose from the acquisition by CWS on March 31, 2000, of parts of the solid waste business of Browning-Ferris Industries, Inc. in Canada through the acquisition of certain assets and shares held by the latter. As part of this merger, CWS acquired the Ridge located in Blenheim, Ontario. Prior to this acquisition, the respondents already owned or controlled six landfill facilities in Southern Ontario. The Commissioner alleged in the application that the merger was likely to prevent and lessen competition substantially in the disposal of ICI Waste in the GTA and the Chatham-Kent area due mainly to high barriers to entry and to the lack of effective remaining competition. The Tribunal found that if CWS would have been permitted to keep the Ridge, it would have controlled over 70 percent of the Southern Ontario landfill capacity for ICI Waste from the GTA in 2002 and 100 percent of the capacity for this type of waste from the Municipality of Chatham-Kent ("Chatham-Kent").

3 The issue at this stage of the proceedings is to determine which remedy should be ordered by the Tribunal to eliminate, in all likelihood, the substantial prevention and lessening of competition. When deciding the appropriate remedy, the Tribunal must be satisfied that it is available and effective in restoring competition to the point at which it can no longer be said to be substantially less than it was before the merger.

4 Two alternative orders were put forward by the parties and argued before the Tribunal at the remedy hearing. The Commissioner submits that the divestiture of the Ridge is the only effective remedy. The respondents propose that one or more Disposal Capacity Agreements ("DCAs") at the Ridge in an aggregate maximum amount of 163,000 tonnes will eliminate any substantial prevention or lessening of competition found by the Tribunal for the disposal of ICI Waste from the GTA and the disposal of ICI Waste from Chatham-Kent.

5 The new evidence introduced at this hearing consisted of the affidavit and rebuttal affidavit of Michael R. Baye, the Commissioner's expert, and the affidavit and the rebuttal affidavit of Christopher Vellturo, the respondents' expert. Both provided their opinions regarding the appropriate remedy. While Professor Baye appeared on behalf of the Commissioner in the hearing regarding the allegation of a substantial prevention and substantial lessening of competition in this case, Dr. Vellturo appeared for the first time at the stage of the remedy hearing.

6 No issue was raised before the Tribunal as to whether the divestiture of the Ridge would be an effective remedy. The Commissioner's proposal is very straightforward. However, the availability and the effectiveness of the respondents' proposed remedy is in dispute. The respondents' proposal is more complex and is set out in their draft remedial order.

7 Both the Commissioner's draft divestiture order and the respondents' draft remedial order were filed as confidential documents. However, it is necessary to refer to the contents of these documents in order to meaningfully discuss the respondents' proposal. The following is a summary of the arguments advanced by the parties and by the intervenor.

II. Remedies Proposed by the Parties

A. Commissioner

8 The Commissioner submits that divestiture of the Ridge is appropriate to remedy the substantial lessening and prevention of competition for ICI Waste from the GTA and Chatham-Kent for the following reasons: 1) it is available to the Tribunal under section 92 of the *Competition Act*, R.S.C. 1985, c. C-34 (the "Act"); 2) it is effective because it creates competition to CWS landfills; and, 3) it is proportionate because it is an asset which formed a part of the merger.

(1) Divestiture of the Ridge Landfill

(a) Availability of remedies

9 The Commissioner submits that the proposed remedy must be available under the Act. He argues that paragraph 92(1)(e) of the Act sets out the remedies available to the Tribunal once a finding has been made that the merger substantially prevents and lessens competition.

10 The Commissioner argues that absent the consent of both parties, the Tribunal's authority is limited to the "blunt instruments" of dissolution or divestiture. Further, the Commissioner argues that the "airspace agreements" proposed by CWS are not available remedies because they do not constitute a dissolution of the merger or a divestiture of assets or shares as dictated by paragraph 92(1)(e) of the Act.

(b) Effectiveness of remedies

11 It is the Commissioner's submission that the proposed remedy must be effective and that each party bears the onus of showing that the remedy they propose meets that requirement.

12 According to the Commissioner, the Tribunal's findings make divestiture of the Ridge the appropriate remedy for the following reasons: 1) the Tribunal found that CWS's acquisition of the Ridge substantially prevents and lessens competition; 2) the Ridge is a vigorous and effective competitor in the ICI Waste disposal market; 3) it will discipline the Tipping Fees CWS charges for ICI Waste from the GTA and Chatham-Kent; 4) the Ridge is the closest competitor to CWS's landfills; and, 5) it constrains the exercise of market power by CWS.

13 The Tribunal found in its Reasons, at paragraph 136, that if the Ridge remains independent, the Ridge and CWS's Warwick landfill will be each other's closest competitors. In that respect, the Commissioner submits that divestiture of the Ridge would maintain competition among the Ridge and CWS landfills that are similar distances from the GTA such as the Warwick and the Richmond landfills.

14 Moreover, the Commissioner suggests that divestiture of the Ridge is a proportionate remedy to the Tribunal's finding that the merger substantially prevents and lessens competition because: 1) it directly addresses the Tribunal's concerns; 2) CWS will enjoy as much disposal space as it did pre-merger; 3) the Ridge represents only part of a larger transaction that was allowed to proceed; and, 4) even after divestiture, CWS will retain ownership and control of nearly 50 percent of the Southern Ontario capacity for ICI Waste from the GTA.

15 He relies on his expert, Professor Baye, who concludes that divestiture of the Ridge does not suffer from the shortcomings identified in the airspace agreements proposed by the respondents and would ensure that a landfill that is geographically and economically positioned to compete with other CWS landfills for ICI Waste remains independent.

16 The Commissioner points out that even CWS's new expert in this case, Dr. Christopher Vellturo acknowledges that the divestiture of the Ridge would be an effective remedy and that CWS has proposed divestiture of the Ridge as the alternative remedy in its draft order (CWS's Draft Remedial Order, under cover of June 5, 2001, at paragraphs 11-14, Joint Book of Pleadings, Tab 10. Expert affidavit of Christopher Vellturo (May 24, 2001): exhibit 424).

17 While Dr. Vellturo, the respondents' expert, maintains that full divestiture of the Ridge would impose a social cost of reduced efficiency, the Commissioner points out that there is no evidence from which the Tribunal could find that divestiture of the Ridge is excessive. Further, there is no evidence of any efficiencies arising from this merger nor any evidence of a business rationale for the merger.

18 In response, the respondents submit that the combined divestitures required to discipline both a price increase and to ensure that an anticipated price decrease is not prevented with respect to ICI Waste from the GTA and Chatham-Kent are relatively small. It is their position that requiring a full divestiture of the Ridge would go beyond the purpose of section 92 of the Act and would unnecessarily punish the respondents. They rely on Dr. Vellturo's conclusions and submit that requiring a full divestiture of the Ridge to alleviate the competitive harm found by the Tribunal would be a far more drastic remedy than what is necessary to eliminate the substantial lessening and prevention of competition found by the Tribunal.

B. Respondents

(1) Airspace agreements

19 The respondents propose that a sale to one or more third parties of the right to dispose of a specified volume of waste on an annual and daily basis at the Ridge will be sufficient to eliminate the substantial lessening and prevention of competition found by the Tribunal. Counsel for the respondents filed a draft remedial order including a draft DCA.

20 More specifically, they argue that one or more airspace agreements for the divestiture of a maximum of 155,647 tonnes (assuming the maximum price increases) of capacity at the Ridge will eliminate any likely substantial lessening or prevention of competition in the disposal of ICI Waste from the GTA, and a divestiture of a maximum of 7,154 tonnes of capacity at the Ridge will eliminate any likely substantial lessening or prevention of competition in the disposal of ICI Waste from the region of Chatham-Kent, resulting from the acquisition of the landfill by the respondents. Adding these tonnages, the maximum tonnage to be divested through airspace agreements is approximately 163,000 tonnes.

21 Further, they propose that the DCAs commence on January 1, 2003, or such other date as the Tribunal finds appropriate in the circumstances. The respondents propose that the DCAs terminate in 2010 or 2011 or at such other time as deemed appropriate by the Tribunal. With respect to the tipping fee to be charged, they propose that the per tonne disposal fee to be paid by the purchaser of the rights under the DCAs be set at the marginal cost of the Ridge.

22 The respondents submit that the only limitation on any prospective purchaser of these rights is that it be an arm's length third party with the expressed intention of carrying on the business of waste disposal in the province of Ontario and that it has the managerial, operational and financial capability to engage in the business of waste disposal services.

(a) Availability of remedies

23 As stated above, the remedy proposed by the respondents contemplates the sale of the right to dispose of waste at the Ridge for a specified period of time. The respondents argue that these rights constitute an asset for the purposes of subparagraph 92(1)(e)(ii) of the Act. Hence, they submit that the Tribunal clearly has the jurisdiction to order the remedy proposed by the respondents by virtue of paragraph 92(1)(e) of the Act.

24 The respondents argue that the rights under the airspace agreement have economic value to the owner. They submit that the case law supports a similarly broad definition of the word asset. In *Philips v. 707739 Alberta Ltd.* (2000), 77 Alta L.R. (3d) 302 at 332 (Alta.Q.B.), the term asset was found to mean "any owned physical object (tangible) or right (intangible) having economic value to its owner(...)" Further, they rely on *A.G. Canada v. Gordon*, [1925] 1 D.L.R. 654 (Ont. Sup. Ct.), where the expression "assets" was found to be "(...)frequently used and is well understood as including all kinds of property."

25 They rely on the definition of "asset" found in The Dictionary of Canadian Law, Second Edition:

> 1. Any real or personal property or legal or equitable interest therein including money, accounts receivable or inventory.

In addition, they refer to Black's Law Dictionary with Pronunciations, (Sixth Edition) which provides that assets are:

> Property of all kinds, real and personal, tangible and intangible, including, *inter alia*, for certain purposes, patents and causes of action which belong to any person including a corporation and the estate of a decedent. The entire property of a person, association, corporation, or estate that is applicable or subject to the payment of his or her or its debts.

26 They also suggest that an examination of certain definitions of assets from an accounting perspective illustrates that the agreements proposed by the respondents are clearly assets:

> Assets are economic resources controlled by an entity as a result of past transactions or events from which future economic benefits may be obtained.
>
> Assets have three essential characteristics:
>
> > (a) they embody a future benefit that involves a capacity, singly or in combination with other assets, in the case of profit oriented enterprises, to contribute directly or indirectly to future net cash flows,...;
> >
> > (b) the entity can control access to the benefit; and
> >
> > (c) the transaction or event giving rise to the entity's right to, or control of, the benefit has already occurred. (CICA Handbook-Accounting, Canadian Institute of Chartered Accountants March 1999.)

27 The respondents referred the Tribunal to another accounting text that defines asset as:

> ...anything of use to future operations of the enterprise, the beneficial interest in which runs to the enterprise. Assets may be monetary or nonmonetary, tangible or intangible, owned or not owned. So long as they can make a contribution to future operations of the company and the company has the right to so use them without additional cost in excess of the anticipated amount of that contribution, they constitute assets and are so treated in accounting. (S. Davidson and R. L. Weil, Handbook of Modern Accounting 2nd Ed., McGraw-Hill Book Company, 1977, p.1-6.)

28 Further, the respondents submit that section 12 of the *Interpretation Act*, R.S.C. 1985, c. I-21, provides that "[e] very enactment is deemed remedial, and shall be given such fair, large and liberal construction and interpretation as best ensures

the attainment of its objects." They argue that the Commissioner's interpretation would not best ensure the attainment of the objectives of the Act. To restrict the definition of assets would lead to overly harsh remedies that go beyond what is necessary to achieve the purposes of the Act.

29 The Commissioner has also alleged that the proposed remedy of the respondents does not constitute a "disposal" for the purposes of subparagraph 92(1)(e)(ii) of the Act. Black's Law Dictionary with Pronunciations (Sixth Edition) defines disposal as:

> Sale, pledge, giving away, use, consumption or any other disposition of a thing. To exercise control over; to direct or assign for a use; to pass over into the control of someone else; to alienate, bestow, or part with.

30 The respondents submit that a narrow interpretation of the words "asset" and "disposal" will not serve the purpose of subparagraph 92(1)(e)(ii) of the Act which is to provide the Tribunal with the authority to order a remedy which eliminates the substantial lessening or prevention of competition. It is the respondents' position that the proposed remedy of a divestiture of airspace clearly contemplates the disposal of an asset for the purposes of subparagraph 92(1)(e)(ii) of the Act and that the Tribunal clearly has the jurisdiction to order the proposed remedy.

(b) Effectiveness of remedies

31 The respondents submit that, as illustrated in Dr. Vellturo's expert report, the "combined divestitures" required to discipline both a price increase and to ensure that any anticipated price decrease is not thwarted with respect to ICI Waste from the GTA and Chatham-Kent are relatively small. Hence, they submit that a DCA in an aggregate maximum amount of approximately 163,000 tonnes will eliminate any substantial prevention or lessening of competition found by the Tribunal for the disposal of ICI Waste from the GTA and the disposal of ICI Waste from Chatham-Kent. The effectiveness of the remedy proposed by the respondents is assessed in detail below under the section entitled "Proposed Airspace Agreements", starting at paragraph 54.

C. Intervenor

32 The Corporation of the Municipality of Chatham-Kent, the sole intervenor in this case, has maintained the position throughout the hearing of neither supporting nor opposing either the respondents or the Commissioner on the merits.

33 At the remedy stage, the intervenor took the position that the Host Community Agreement ("Agreement"), entered into between Chatham-Kent and Browning-Ferris Industries Ltd. ("BFIL") in relation to the Ridge, should be be included in the list of assets of the Ridge to any order that the Tribunal will make. At the hearing, the respondents and the Commissioner consented to the request of Chatham-Kent that the Agreement be included as an asset of the Ridge (transcript at 2325, 22 June, 2001).

III. Test to be Applied to Determine Appropriate Remedy

34 The issue at this stage of the proceedings is to determine which remedy should be ordered by the Tribunal to eliminate, in all likelihood, the substantial prevention and lessening of competition. The remedy must be available and effective. Subsection 92(1) of the Act sets out the Tribunal's jurisdiction to order a remedy upon a finding that a merger prevents or lessens, or is likely to prevent or lessen competition substantially. Specifically, paragraph 92(1)(e) provides:

> The Tribunal may, subject to sections 94 to 96.
>
> (e) in the case of a completed merger, order any party to the merger or any other person
>
> > (i) to dissolve the merger in such manner as the Tribunal directs,
> >
> > (ii) to dispose of assets or shares designated by the Tribunal in such manner as the Tribunal directs, or
> >
> > (iii) in addition to or in lieu of the action referred to in subparagraph (i) or (ii), with the consent of the person against whom the order is directed and the Commissioner, to take any other action, or

35 The Supreme Court of Canada set out the test to be applied in determining an appropriate remedy to a substantial lessening or prevention of competition in *Director of Investigation and Research v. Southam Inc.*, [1997] 71 C.P.R. (3d) 417 (SCC) at 445-446:

> The evil to which the drafters of the *Competition Act* addressed themselves is substantial lessening of competition. See *Competition Act*, s. 92(1). It hardly needs arguing that *the appropriate remedy for a substantial lessening of competition is to restore competition to the point at which it can no longer be said to be substantially less than it was before the merger*(...)
>
> (Emphasis added)

Further, the Supreme Court stated at page 446:

> (...) If the choice is between a remedy that goes farther than is strictly necessary to restore competition to an acceptable level and a remedy that does not go far enough even to reach the acceptable level, then surely the former option must be preferred. At the very least, a remedy must be effective. If the least intrusive of the possible effective remedies overshoots the mark, that is perhaps unfortunate but, from a legal point of view, such a remedy is not defective(...)

A. Availability of the Proposed Remedies Under the Act

(1) Proposed "airspace agreements" are not a "dissolution" of the merger

36 When the Tribunal makes a finding that a merger prevents or lessens competition substantially, the Tribunal may choose, as an appropriate remedy, to "dissolve" the merger pursuant to subparagraph 92(1)(e)(i) of the Act. The term "dissolve" undoubtedly connotes the undoing, separation or destruction of something. Such an interpretation is common to the everyday use of the term "dissolve", and the meaning attributed to it in some federal statutes. For instance, corporations that are dissolved cease to exist; Parliament is dissolved before an election; and marriages that end in divorce are "dissolved".

37 When a merger is dissolved, the merger no longer exists and the parties are separated as before the merger. In this case, the merger consists of CWS's acquisition of a substantial portion of the assets and business of BFIL, one of which is the Ridge. The Tribunal is of the view that the remedy proposed by CWS does not dissolve the merger since CWS would retain ownership and control of all of its Ontario landfills and would have an ongoing contractual relationship with the contractor for airspace.

(2) Proposed "airspace agreements" are not a "disposal of assets or shares

38 Further, pursuant to subparagraph 92(e)(ii) of the Act, the Tribunal may order a party to "dispose of assets or shares". The disposition of assets or shares contemplates the transfer of ownership over property. In *Harman v. Gray-Campbell Ltd.*, [1925] 2 D.L.R. 904 at 908 (Sask.C.A.) the Court of Appeal states:

> The words "dispose of" are giving [sic] the following meaning in Murray's New English Dictionary :-"(b) To put or get off one's hands; to get rid of; and (c) To make over or part with by way of sale or bargain"; and in Bouvier's Law Dictionary :-"To alienate or direct the ownership of."

39 The respondents are not proposing to dispose of assets or shares but rather, to enter into an ongoing contractual relationship for the supply of disposal services at a landfill. The proposed "airspace agreements" are contracts that CWS proposes to enter into. The disposal services that would be contracted are not pre-existing assets that could be divested. They are new rights that CWS proposes to create.

40 While CWS describes its proposed remedy as a "divestiture" of "airspace", its draft DCA does not, on its face, purport to "sell" either "airspace" or disposal "capacity". It merely creates a contractual right to deliver an amount of waste to a landfill.

41 CWS's draft "airspace agreements" do not transfer ownership over property or even create an interest in property. Rather, they expressly negate the possibility that they create any proprietary interest in the following terms. Section 9 of CWS's draft DCA (Joint Book of Pleadings, Tab 10) states:

> (...)Hauler shall have a limited, non-exclusive license to enter the Facility for the limited purpose of, and only to the extent necessary for (i) off-loading Acceptable Waste at the location and in the manner directed by CWS, and (ii) removing or causing to be removed, Non-Conforming Waste(...)
>
> Except for the limited, non-exclusive license granted by CWS to the Hauler in Subsection 9(1) above, *Hauler acknowledges, agrees and confirms that it has no interest or rights whatsoever in respect of the Facility*.
>
> (emphasis added)

42 One of the characteristics of an asset is that it can be bought and sold. However, section 17 of CWS's draft DCA (Joint Book of Pleadings, Tab 10) states that the proposed "airspace agreements" would not be transferable without the consent of CWS:

> Hauler may not assign, transfer or otherwise vest in any other Person any of its rights or obligations under this Agreement without the prior written consent of CWS(...)

43 Under the proposed "airspace agreements", CWS would keep ownership and control of 70 percent of the capacity for the disposal of ICI Waste in the GTA and 100 percent of the capacity for the disposal of ICI Waste in Chatham-Kent (expert affidavit of Michael Baye, (May 23, 2001): exhibit 421, paragraph 13).

44 The airspace agreements are not a "disposal" of assets. Rather, they are the creation of a disposal right on the part of the contracting party. They are agreements between CWS and a hauler that provides the hauler, over a period of time, a right to dispose of certain amounts of waste at the Ridge and a limited right of access to the facility. It does not have for effect of disposing of any part of the Ridge. It does not provide the contracting party any right in the Ridge. It simply gives the contracting party the right to dispose of some amount of waste at the Ridge over some period of time. The term "dispose of" connotes "getting rid of" some thing that is owned, as opposed to creating some right of access.

45 Further, the Tribunal can only order divestiture of assets that are acquired as part of the merger, or that one of the parties to the merger may already have. That does not mean that, post-merger, creating a contract or entering into a contract to create a right constitutes the disposal of that right. In the Tribunal's view, the creation of a contract, post-merger, to provide a service to somebody does not constitute disposal of an asset.

46 In *Director of Investigation and Research v. Air Canada et al.* (1993), 49 C.P.R. (3d) 417, the Federal Court of Appeal confirmed that, in a contested proceeding as opposed to a consent proceeding, the authority of the Tribunal is limited to the "blunt instruments" of dissolution or divestiture. Anything beyond that can only be done, as is shown in subparagraph 92(1)(e)(iii) of the Act, on a consent basis. The Court stated at page 430:

> Section 92(1)(e)(iii) by contrast allows the consent of the parties to expand the type of order that the Tribunal can make in merger cases. The power of the Tribunal to make the expanded order, however, is conditioned by and dependent upon the consent.
>
> Without consent, the Tribunal is limited to ordering the dissolution of the merger (subpara. (i)) or the divestiture of assets or shares (subpara. (ii)). These are important and even drastic powers, but in the hands of either the Director or the Tribunal, they constitute a rather blunt instrument for the implementation of Canada's competition policy. Indeed, it is the very bluntness of that instrument and the all-or-nothing nature of the orders that can be given under subparas. (i) and (ii) which no doubt give subpara. (iii) its vitality and increase its utility(...)

47 Unlike dissolution or divestiture, the proposed "airspace agreements" involve behavioural components, since they create an ongoing contractual relationship involving mutual promises to be performed over a period of time. The proposed "airspace

agreements" constitute a behavioural remedy and not a disposition of assets as suggested by the respondents. The Tribunal cannot order behavioural remedies under subparagraph 92(1)(e)(iii) of the Act, absent consent of both the respondent and the Commissioner.

48 In *Director of Investigation and Research v. Southam Inc.* (1992), 47 C.P.R. (3d) 240 (C.T.) at 250-251, the Tribunal held that it did not have authority to order proposed service contracts in aid of a proposed divestiture of assets without the consent of the Commissioner:

> The Director's first objection to the respondents' proposal is that it would require the tribunal to exceed its jurisdiction, since the proposed order would go beyond the dissolution of the merger or the divestiture of shares or assets as contemplated in s. 92(1)(e)(i) and (ii). In his view, the terms that would require the respondents to offer such agreements to a purchaser fall within s. 92(1)(e)(iii). The tribunal can only make an order under that subparagraph on the consent of the parties. As previously stated, the Director does not consent. The respondents are of the view that the tribunal has considerable latitude in ordering the disposition of assets under s. 92(1)(e)(ii) "in such a manner as the Tribunal directs" and could issue the suggested order. The tribunal does not agree that requiring the respondents to provide would-be purchasers with an option to contract for services from the North Shore News or LMPL can be considered to fall within the terms it may place on the disposition of assets pursuant to s. 92(1)(e)(ii).

49 Further at page 252, the Tribunal states:

> Without adopting any particular characterization such as "tame competitor", the tribunal agrees that a remedy that depends, for its possible success, on supply contracts between the only competitors in the market is somewhat suspect. While the nature of the proposed remedy necessarily precludes a detailed assessment of its terms and conditions, the tribunal considers that the small accommodations and goodwill that are required to make a long-run supply relationship work would not create the kind of climate that is desirable and necessary to restore the competitive situation disrupted by the merger(...)

50 The Tribunal is of the view that the same reasoning applies in this case.

B. Effectiveness of the Proposed Remedies

51 The Commissioner and the respondents submitted expert economic evidence regarding the effectiveness of each of their proposed remedies. The Tribunal assesses that evidence below.

(1) Proposed "Airspace Agreements"

52 The respondents' remedy is to require CWS to enter into agreements with third parties to dispose of ICI Waste at the Ridge. In these agreements, CWS would sell, for an unspecified up-front payment to be negotiated, rights to dispose of such waste at the Ridge at this landfill's marginal cost of disposal. The third-party purchasers of these rights could be haulers or transfer stations that seek to dispose of ICI Waste from the GTA or from Chatham-Kent at the Ridge. Third parties might also be entities in the business of selling disposal services at the Ridge to haulers and transfer stations of that ICI Waste.

53 During the term of these airspace agreements, CWS would continue to wholly-own the Ridge landfill and operate all aspects of waste disposal there. The respondents propose specific dates for the term of the airspace agreements and they indicate that the Tribunal may wish to establish different dates based on its assessment of the onset and termination of the condition of excess capacity.

54 The respondents' expert, Dr. Vellturo, uses the critical sales loss procedure to assess remedies for the substantial prevention and lessening of competition found by the Tribunal regarding the disposal of ICI Waste generated in the GTA and in Chatham-Kent. As a result of his critical sales loss analysis, he finds that relatively small reductions in waste volumes at the Ridge are required (2,400 tonnes -163,000 tonnes) to eliminate the substantial lessening and prevention of competition found by the Tribunal with respect to both the GTA and Chatham-Kent allegations. He concludes that airspace agreements covering

such volumes are the appropriate remedy and that the total divestiture of the Ridge landfill sought by the Commissioner is unnecessary.

55 Dr. Vellturo also states that total divestiture would prevent the attainment of efficiencies that would result from the acquisition of the Ridge by CWS, and on this basis he criticizes the Commissioner's proposed remedy as inappropriate (expert affidavit of Christopher Vellturo (June 13, 2001): exhibit 426).

56 The Commissioner's economic expert, Professor Baye, opines that the airspace agreements are insufficient to alleviate the substantial lessening and prevention of competition. He concludes that they would likely lead to collusion, and would create a "trivial non-competitive fringe" of third parties with too little volumes to compete with CWS at the Ridge; he is also critical of Dr. Vellturo's critical sales loss analysis. His criticisms are directed mainly to Dr. Vellturo's analysis of the remedy regarding the GTA allegations (expert affidavit of Michael Baye (June 13, 2001): exhibit 422).

57 As Dr. Vellturo's analysis of remedies for the GTA requires him to a undertake a spatial competition analysis, his assessment is more complicated than that for Chatham-Kent. In order to focus on the critical sales loss procedure, the Tribunal first addresses the remedies Dr. Vellturo advances for Chatham-Kent.

(a) Critical Sales Loss Analysis

58 In his expert report, Dr. Vellturo defines the critical sales loss procedure as follows:

> The critical loss required to ensure that a firm would not have an incentive to raise price is determined by solving for the minimum volume loss that would render a price increase (or, correspondingly, a failure to decrease price) unprofitable to the firm. (expert report of Christopher Vellturo (May 24, 2001): exhibit 423, at page 6, item 2)

59 Dr. Vellturo illustrates the procedure by positing a firm with a current output of 100 units, marginal cost of $2/unit and selling price of $5/unit. Accordingly, gross profit per unit (or margin) is $3 and gross profit is $3 × 100 units = $300 in the *status quo*. The firm determines whether to increase the price by 10 percent to $5.50 by considering the impact on gross profit. If the firm expects the price increase to reduce sales by 10 units, the gross profit per unit increases to $3.50 and gross profit will increase to $315; hence, the increase will be profitable as compared to the *status quo*. However, if the firm expects a loss in sales of 20 units, gross profit will be $280 and the increase will be unprofitable (transcript at 1988 and 1989 (21 June, 2001)).

60 In this example, the critical sales loss for a 10 percent price increase is that loss in unit sales that maintains gross profit at $300. With elementary algebra, the critical sales loss is found to be approximately 14 units. The firm will raise the price by 10 percent if the expected sales loss is less than 14 units, and it will not raise the price by 10 percent if the expected sales loss is greater than 14 units. Accordingly, as long as the firm can produce and sell at least 86 units after the price increase, that increase will be profitable as compared to the *status quo* (transcript at 1989 and 1990 (21 June, 2001)).

61 The magnitude of the critical sales loss depends on the particular price increase being considered and the margin in the status quo. The critical sales loss procedure calls for a comparison of the loss of unit sales that the firm expects to result from a posited price increase with the critical sales loss. If the expected loss of unit sales is less than the critical sales loss, the price increase is profitable.

62 The Tribunal notes that in this procedure, the marginal cost is presumed to be constant. In Dr. Vellturo's example, whether the firm's output is 100 units, 86 units, or some other figure, the increase in the firm's total cost due to the additional unit of output remains $2. As a broad indication or rule of thumb, this presumption is the usual one, although it should be refutable in a particular fact situation, particularly in situations involving large changes in output and/or price.

63 The Tribunal notes that Dr. Velluro uses critical sales loss analysis to examine the competitive effect of the transaction directly. However, the critical sales loss procedure is also used to delineate relevant markets and is an alternative to the hypothetical monopolist approach. In the hypothetical monopolist approach, the key question is whether demand is so elastic

that even a monopolist would not raise price by at least a small but significant and non-transitory amount. If demand is that elastic, a relevant market has not been identified and the candidate market must be expanded to include another product.

64 The critical sales loss procedure delineates a market by asking whether a monopoly could increase the price by up to a given amount and be no worse off in terms of profit than before the price increase. If the monopoly would lose so much business that the price increase would not be profitable in this sense, then a relevant market has not been identified.

65 While the two procedures share certain features, the hypothetical monopolist approach is consistent with conventional profit-maximization while the critical sales loss approach is not. Moreover, the hypothetical monopolist approach requires knowledge of, or an explicit assumption about, the demand curve while the latter does not. While there is debate in the American antitrust literature whether one procedure is to be preferred for delineating relevant markets, it appears that both procedures are widely used. The Tribunal relied heavily on the hypothetical monopolist approach when it decided the relevant market at the hearing on the merits.

66 The Tribunal also observes that the lost sales volume that makes a 10 percent price increase unprofitable also makes any lesser price increase unprofitable. However, that critical sales loss does not indicate that even larger price increases of 20 percent, 50 percent or even 100 percent would also be unprofitable. Thus, a small price increase may be unprofitable based on a critical sales loss analysis but a larger increase may be profitable.

(b) Critical Sales Loss Analysis for Chatham-Kent

67 In evaluating the airspace remedies proposed in regard to the disposal of ICI Waste from the GTA and to the disposal of ICI Waste from Chatham-Kent, Dr. Vellturo writes:

> The appropriate remedy for the competitive harm envisioned by the Tribunal...is to require divestitures that provide third parties with the right to dispose of ICI volumes. Sufficient volumes would be divested so that the amount of ICI volume that the Respondents stand to lose following a unilateral price increase (or a failure to decrease price from current market levels) would render the price increase unprofitable.
>
> . . .
>
> If third parties did control such volumes, any unilateral price increase by the Respondents would result in the loss of volumes at least equal to the critical loss. Customers would dispose of their ICI waste with the third party who controlled the divested volume rather than with the Respondents. By design, this third party would be able to serve sufficient volume that the Respondents would face lower profits by having implemented the price increase. As a result, the Respondents would not implement the price increase in the first instance, since it would not be in their profit-maximizing interest to do so. (expert report of Christopher Vellturo (May 24, 2001): exhibit 423, at pages 6-7)

68 As shown in Table 6 of Dr. Vellturo's expert report, he uses the total volume of ICI Waste from Chatham-Kent disposed of at the Ridge and Gore landfills per year. Using the pre-merger tipping fee at the Gore landfill and marginal cost at the Ridge, he calculates the gross profit per tonne and finds the post-acquisition, total gross profits at those landfills are $900,676 absent any decline in tipping fees due to expansion of capacity. This calculation assumes that both landfills would charge the same tipping fee for local ICI Waste and incur the same marginal cost.

69 As the Tribunal noted in its decision, the annual permitted capacity at the Ridge will expand from 220,000 tonnes in 1999 to 680,000 tonnes in 2002. Accordingly, the capacity of landfills in Chatham-Kent to accept local ICI Waste will rise dramatically until the Gore closes. In Table 6 of his expert report, Dr. Vellturo examines three scenarios in which post-expansion price decreases of 5 percent, 10 percent, and 15 percent are thwarted by CWS after the acquisition of the Ridge. He analyzes these scenarios by asking what price increases would be needed to restore the original price and finds that increases of 5.3 percent, 11.1 percent and 17.6 percent would be needed respectively.

70 In the first scenario, Dr. Vellturo hypothesizes that the expansion of capacity would lead to a 5 percent decline in tipping fees. Accordingly, gross profit per tonne would decline and total gross profit would then be $842,988. Absent a remedy, CWS would thwart this decline by restoring the tipping fee through an increase of approximately 5.3 percent in the post-expansion price. In so doing, it would, or could expect to, lose volumes.

71 He determines the annual disposal tonnage that would make CWS's gross profit from the Ridge and Gore sites following its price increase equal to the post-expansion level of $842,988. Since the price increase restores the profit margin per tonne, the critical annual volume is found to be approximately 35, 000 tonnes. If CWS's annual disposal tonnages exceed this level, the price increase would be profitable and hence would be imposed unilaterally.

72 Accordingly, the critical sales loss is 2,384 tonnes. By taking slightly more than 2,384 tonnes of capacity out of CWS's control, Dr. Vellturo concludes that it would not be profitable for CWS to thwart the hypothesized 5 percent decline in tipping fees for ICI Waste from Chatham-Kent. In his testimony, Dr. Vellturo states that the tonnage required to be taken away is 2,500 tonnes (transcript at 2029, lines 19-21 (21 June, 2001)).

73 On this basis, he concludes that the remedy for the substantial prevention and lessening of competition in the disposal of ICI Waste from Chatham-Kent is the divestiture, through airspace agreements to third parties, of 2,500 tonnes, in the event of a 5 percent decline in tipping fees due to capacity expansion. The respondents indicate that the airspace agreements would cover space at the Ridge.

74 He repeats this analysis for hypothesized price declines of 10 percent and 15 percent. The required price increases needed to thwart these declines are 11.1 percent and 17.6 percent respectively, and the required divestitures are minimally 4,770 tonnes and 7,154 tonnes respectively.

(c) Tribunal's Assessment of Chatham-Kent Analysis

75 The Commissioner's case regarding the Chatham-Kent allegation is premised on the assessment that, following its acquisition of the Ridge, CWS would be able to prevent the decline in tipping fees on locally-generated ICI Waste that excess capacity would bring about. The Tribunal accepted this position (Reasons, paragraph 205).

76 According to Dr. Vellturo's analysis, CWS would, post-merger, stand to lose volumes of such waste, but increase gross profits if it were to raise the tipping fee, or equivalently if it failed to decrease the tipping fee, in response to excess capacity in Chatham-Kent. He regards either action as an effective increase in the tipping fee. His remedy, premised on the critical sales loss analysis, is to remove business volumes equal to the critical sales loss so as to make the effective price increase unprofitable.

77 However, it is not clear to the Tribunal that, absent a remedy, CWS would lose any volume of locally-generated ICI Waste. First, the only capacity-expansion in Chatham-Kent will occur at the Ridge itself.

78 Second, in its decision, the Tribunal noted that since the Gore landfill is owned by CWS, the acquisition of the Ridge by CWS would prevent competition between them. The Tribunal also found that there is no effective remaining competition and little prospect of entry, and that CWS will control 100 percent of the Chatham-Kent disposal market for ICI Waste. It appears to the Tribunal that in this situation of inelastic demand, a remedy would have to remove very large volumes to make a small effective price increase unprofitable. While Dr. Vellturo's critical sales loss for a 5.3 percent price increase is 2,384 tonnes, this is only 6.4 percent of tonnages of locally-generated ICI Waste delivered to the Ridge and Gore landfills and nothing in the record indicates that CWS would lose, or expects to lose, even that amount of business.

79 These considerations lead the Tribunal to doubt the effectiveness of airspace agreements in constraining any anti-competitive pricing policy of CWS in respect of ICI Waste generated in Chatham-Kent following the acquisition of the Ridge.

80 However, even accepting Dr. Vellturo's critical sales loss analysis, on his figures, the gross profit per tonne at the lowest tipping fee at the Gore for local ICI Waste exceeds 70 percent of price and exceeds 300 percent of marginal cost at the Ridge. It appears to the Tribunal that there is considerable room for tipping fees to fall much farther than the 5 to 15 percent range that

he analyzes, even if they do not fall to marginal cost. Accordingly, the Tribunal is of the view that Dr. Vellturo's critical sales loss estimates and remedies regarding Chatham-Kent are very likely too low.

81 In this regard, the Tribunal notes that while Dr. Vellturo's remedies are designed to make the complete thwarting of price declines of 5 percent, 10 percent and 15 percent unprofitable, it cannot be concluded that a larger increase would not be profitable. Moreover, he does not predict a particular price decline for locally-generated ICI Waste in Chatham-Kent. He states only that, in that event of a decline in the 5 to 15 percent range, the remedies are the divestitures of airspace that he has found.

82 Dr. Vellturo does not address how many different competitors need to be established in Chatham-Kent by airspace agreements. Professor Baye is concerned, in the GTA context, that the divestitures of airspace suggested by Dr. Vellturo would, at best, create a non-competitive fringe. Given the competitive situation in Chatham-Kent, the Tribunal shares this concern.

83 Since Dr. Vellturo does not indicate which price decline might be expected, he puts the onus on the Tribunal to do so and to select from among his various remedies. In the Tribunal's view, this is inadequate. The Tribunal did not identify a specific price decline in its reasons regarding the Chatham-Kent allegation because no specific percentage decline was advocated or contested in the hearing on the merits. The Tribunal concluded that excess capacity at the Ridge would lead to greater competition and lower tipping fees for ICI Waste from Chatham-Kent and that the acquisition of the Ridge by CWS would prevent such competition from occurring (Reasons, paragraph 205).

84 Without expert opinion evidence and rebuttal evidence thereon, the Tribunal has no basis for adopting a particular price decline and consequential remedy that Dr. Vellturo has advanced.

85 In view of its previous findings that, after the acquisition of the Ridge, CWS would control all of the disposal capacity for locally-generated ICI Waste in Chatham-Kent and that there would be no effective competition to CWS for the disposal of such waste, and in light of its concern about the critical sales loss methodology, and in light of the limited range of price changes that Dr. Vellturo has analyzed, the Tribunal is not satisfied that the remedies analyzed by Dr. Vellturo for Chatham-Kent would be effective.

(d) Critical Sales Loss Analysis for GTA

86 Dr. Vellturo employs a spatial analysis of competition of disposal of ICI Waste from the GTA in the expected environment of substantial excess capacity. His procedure allocates ICI Waste from the GTA to a landfill in Southern Ontario based on its distance from the GTA, and its effective price per tonne, which is its minimum tipping fee plus the transportation cost per tonne from the GTA. In this framework, which he asserts is broadly similar to the analysis submitted by the Commissioner and accepted by the Tribunal, the last landfill to receive ICI Waste from the GTA is the "last active landfill". It sets its tipping fee in relation to that charged by the next distant landfill, the "marginal landfill", to the extent that the latter has excess capacity. The price charged by a landfill is the tipping fee that makes the transfer station indifferent between disposing there and hauling it to the next distant landfill. Accordingly, the tipping fee at the marginal landfill determines the tipping fees charged by all landfills closer to the GTA.

87 Having established the tipping fees at each landfill, Dr. Vellturo allocates ICI Waste from the GTA to those landfills according to their distance from the GTA. He finds that the last active landfill is GreenLane, whose minimum tipping fee is just below that of the marginal landfill, the Essex-Windsor Solid Waste Authority. Dr. Vellturo concludes that since the marginal landfill is not owned by CWS, then whether or not CWS acquires the Ridge it will not be able to influence prices for ICI Waste from the GTA in Southern Ontario. On this basis, he cannot conclude that post-expansion prices will be lower than those currently prevailing and he opines:

> As a result, no remedy is needed in order to prevent the realization of assumed decreases in price that are less than 5 [percent] below currently prevailing prices, since Green Lane [sic] will continue to have sufficient excess capacity to discipline the Respondents from seeking such price increases (or correspondingly, failing to decrease price). (expert affidavit of Christopher Vellturo (May 24, 2001): exhibit 423, at p.8)

88 During his examination and cross-examination, Dr. Vellturo restates and clarifies his opinion. It is that the model of spatial competition that the Tribunal has accepted does not, in his formulation using data from the record, lead to a forecast of declining tipping fees. Accordingly, the only price decline that could be expected is a small one.

89 Using the critical sales loss procedure, Dr. Vellturo determines the volumes of waste capacity that, if taken out of CWS's control, would make it unprofitable for it to thwart small price decreases of 5 percent, 10 percent and 15 percent that might be expected absent its acquisition of the Ridge. To thwart these declines, CWS would have to raise the post-acquisition price by 5.3 percent, 11.1 percent and 17.6 percent respectively.

90 Assuming a 5 percent price decrease, Dr. Vellturo finds that no divestiture of any volume is needed to make the thwarting thereof unprofitable. For decreases of 10 percent and 15 percent, he estimates that divestiture of 53,225 tonnes and 155,647 tonnes would suffice.

91 In his rebuttal report, Dr. Vellturo conditions his conclusions by noting that all such volumes be divested at the Ridge and that the divested volumes must be done at CWS's marginal cost at the Ridge. He concludes that airspace agreements covering these volumes would accomplish the goal of eliminating the substantial lessening and prevention of competition that results from the acquisition of the Ridge in respect of ICI Waste from the GTA (expert rebuttal affidavit of Christopher Vellturo (June 13, 2001): exhibit 426).

(e) Tribunal's Assessment of GTA Analysis

92 It appears to the Tribunal that Dr. Vellturo agrees with the Tribunal's conclusion from Professor Baye's evidence, that each landfill accepting ICI Waste from the GTA views demand as highly elastic. Even a small increase in its tipping fee would lead to a significant loss of business to competing landfills. Thus, in the Tribunal's view, the relatively small critical sales volumes found by Dr. Vellturo are not surprising. His estimate of gross profit per tonne at the Ridge is high: exceeding approximately 70 percent of sales and exceeding approximately 300 percent of cost. This means that even small reductions in output (i.e. tonnes disposed) will reduce gross profit significantly at the Ridge. CWS would not willingly impose such losses on itself and would hence refrain from small price increases that occasion large volume reductions. As a result, the critical sales loss volumes are small.

93 However, the Tribunal cannot conclude that CWS views large price increases in the same way. As the Tribunal observed in its decision, after it acquires the Ridge, CWS would own 70 percent of total disposal capacity available for ICI Waste from the GTA after 2002. Moreover, it would own 85.8 percent of the excess capacity available for such waste. The Tribunal found that CWS would be able to affect the level of tipping fees in the relevant geographic market. In light of Dr. Vellturo's analysis, the Tribunal's concern is heightened by the evidence that the marginal and last active landfills have been weak competitors for ICI Waste from the GTA.

94 The Tribunal accepted the evidence that the GreenLane site (i.e. the last active landfill) was not competitive on tipping fees; hence it received little ICI Waste from the GTA. As the Tribunal noted in its decision, GreenLane's high tipping fee is due, at least in part, to the significant community host fee that it must pay on every tonne of waste it receives (Reasons, paragraph 149). There is no indication on the record to suggest that GreenLane's pricing would change.

95 Moreover, Essex-Windsor (i.e. the marginal landfill) had received no ICI Waste from the GTA in 1999 due to restrictions on its service area, though its board of directors had since authorized 100,000 tonnes of annual capacity to be marketed outside the municipality. As a result, there is no tipping fee for such waste in the record. To complete his analysis, Dr. Vellturo needed to make an assumption about the tipping fee that Essex-Windsor would have charged had it been able to accept such waste:

> Remember, the Essex-Windsor price I have here is an imputed price based on historical information (transcript at 2057, lines 9-11 (21 June, 2001)).

Thus, it appears to the Tribunal that a critical part of his analysis, the tipping fee that Essex-Windsor would have charged, and would have constrained the tipping fee at GreenLane, is a construct not based on actual tipping fee evidence for Essex-Windsor.

96 Moreover, he implicitly assumes that while some Essex-Windsor capacity would be offered to transfer stations in the GTA seeking to dispose of ICI Waste, Essex-Windsor would receive none. In this regard, the practice of price discrimination may be relevant, but, by referring only to the lowest tipping fee charged by a landfill, Dr. Vellturo's allocation procedure does not take this practice into account. Given the widespread practice of price discrimination by landfills seeking to obtain ICI Waste from the GTA, the Tribunal is reluctant to conclude without better evidence that Essex-Windsor would not receive any such waste.

97 As the last active landfill and marginal landfill respectively, the GreenLane and the Essex-Windsor landfills are crucial to Dr. Vellturo's analysis of remedies. In the Tribunal's view, there is insufficient evidence on the record for it to be confident that these sites would exert the discipline that he attributes to them.

98 Professor Baye criticized the airspace remedy in the GTA context as likely to create a competitively insignificant fringe of parties that would collude with, rather than compete with, CWS. The respondents argue that any such collusion would be short-lived in light of the benefits a party would derive from cheating on any implicit agreement on price by even a very small amount. The Tribunal notes that airspace rights at the Ridge would place the parties and CWS literally side-by-side, and CWS would be able to observe the conduct of parties easily. Professor Baye notes that CWS would be able to disrupt the operations of the parties at the Ridge by requiring unnecessary inspections and tests of waste delivered to the Ridge. As a result, the Tribunal is concerned that CWS has the ability to punish any deviations from an implied collusive agreement.

99 Dr. Vellturo noted that, to be effective, a collusive agreement would require the cooperation of other landfills, specifically GreenLane and Walker, that have disparate interests. Having noted its concern about the competitiveness of GreenLane above, the Tribunal also refers to its decision wherein it noted that the Walker landfill is already at capacity, and that a significant amount of the volume of waste received at the Walker landfill is brought in by CWS (Reasons, paragraph 148). It is not clear to the Tribunal that Walker's interests would diverge in a collusive environment.

100 The Commissioner notes that while the proposed airspace agreements makes provision for compensation in the event of disproportionate inspections by CWS, the administration of this contractual provision is itself problematic and could potentially lead to dispute resolution by the Tribunal. Third party rights must be clear in any order. The Tribunal does not favor ongoing monitoring particularly when, as in the case before it, there is a clear structural remedy which will be effective, that is the divestiture of the Ridge. The proposed airspace agreements could not detail the amount of compensation to be awarded in a variety of circumstances. CWS would have an incentive to oppose compensation or reasonable compensation given that these agreements are designed to be unprofitable for CWS. There is reason to doubt the effectiveness of the airspace agreements.

101 Similar concerns arise with respect to the provision of the airspace agreement that allows CWS to adjust price terms in the event of an unforeseen change in applicable law. Although the provision calls for the fair application of any such increase to all users of the facility, it places the Tribunal in the position of deciding whether the price adjustment was reasonable and fairly applied. Again, the Tribunal is reluctant to place itself in such a position. The force majeure clause and the restriction on assignment raise similar concerns.

102 These contractual considerations, in conjunction with CWS's market share and the lack of effective remaining competition and entry, and its concerns with Dr. Vellturo's emphasis on GreenLane and Essex-Windsor sites, lead the Tribunal to believe that airspace agreements will not likely be effective remedies.

(2) Divestiture of the Ridge

103 The Commissioner advocates that the only effective remedy is the total divestiture of the Ridge by CWS, and relies on the opinion evidence of Professor Baye. Professor Baye based his analysis of the remedy on the theory of spatial competition that he introduced at the hearing on the merits.

104 In his expert report, Professor Baye noted that any effective remedy must maintain vigorous competition among the Ridge, Warwick and Richmond landfills, all of which are similar distance from the GTA. While the divestiture of any one of these landfills could, in his opinion, remedy the anti-competitive effects of the transaction on the disposal of ICI Waste from

the GTA, he concludes that the divestiture of the Ridge is the appropriate remedy. He notes, *inter alia*, that unlike the Warwick or Richmond sites, the Ridge is not part of the CWS infrastructure and that divestiture of either of these other sites would not address the anti-competitive concern regarding the disposal of locally-generated ICI Waste in Chatham-Kent; hence another remedy would be required to address that concern (expert affidavit of Michael Baye (May 23, 2001): exhibit 421).

105 In his expert rebuttal report, Dr. Vellturo suggests that total divestiture of the Ridge is excessive in light of the statutory goal of eliminating the substantial lessening or prevention of competition. In this connection, he states that Professor Baye's analysis of competition among similarly situated landfills is incorrect and that the airspace remedy restores such competition. In addition, he concludes that full divestiture of the Ridge will result in the loss of potential pro-competitive operational efficiencies (expert rebuttal affidavit of Christopher Velluturo (June 13, 2001): exhibit 426).

106 With regard to efficiencies, Dr. Vellturo, relying on his experience, states that logistics savings are available to an operator who reallocates waste streams optimally when expanding its network of landfills. In addition, such expansion offers opportunities for specialization of facilities, hence creating additional operational efficiencies. Finally, a larger landfill network creates greater incentives for the owner or operator to consider investments in new technologies or procedures because the payout to such developments can be enjoyed across a greater range of facilities. He concludes that a full divestiture would impose the social cost of reduced efficiency without any corresponding benefit in restoring competition.

(3) Tribunal's Assessment

107 There is no issue about the effectiveness of divestiture of the Ridge as a remedy. There are, however, significant concerns about the effectiveness of these airspace agreements. CWS had the burden of establishing that these agreements would be effective to remedy the anti-competitive effects the Tribunal has found.

108 As noted above, the Tribunal is not convinced that the airspace agreements proposed by the respondents, and analyzed by Dr. Vellturo, constitute an effective remedy. Moreover, in its decision, the Tribunal accepted that the Ridge competes with Warwick and Richmond landfills for ICI Waste from the GTA and that the present transaction prevents such competition (Reasons, paragraph 204).

109 Regarding gains in efficiency, the Tribunal observes that no evidence of such gains from the present transaction was presented at the hearing on the merits; indeed, such gains were not even alleged. Accordingly, the Tribunal regards Dr. Vellturo's efficiency claims as speculative.

110 As stated above, the remedy proposed by the respondents is not available under the Act. Since the Tribunal has found that the divestiture of the Ridge is an available and effective remedy and complies with the provisions of the Act, the Tribunal is not obliged to consider alternative submissions. However, the Tribunal is of the view that even if these airspace agreements constituted a remedy available under the Act, contractual arrangements of that nature would be of some concern. Indeed, once there has been a finding that a merger is likely to substantially prevent or lessen competition, a remedy that permanently constrains that market power should be preferred over behavioural remedies that last over a limited period of time and require continuous monitoring of performance. This is not to say that, in cases where both the respondents and the Commissioner consent, behavioural remedies cannot be effective. However, the Tribunal notes that enforcing the remedy proposed by the respondents would have the potential of being cumbersome and time-consuming and that monitoring such order would involve the Commissioner in commercial conduct more than would the administration of the divestiture order.

111 In *United States v. E.I. Du Pont de Nemours et al.*, 366 U.S. 316 (1961), the court rejected Du Pont's proposed behavioural remedy under which Du Pont would retain the shares whose purchase gave rise to the violation, but would "pass through" the voting rights to Du Pont shareholders. The Supreme Court held, at page 6 (QL) paragraph 24, that divestiture is the appropriate remedy for mergers that violate the *Clayton Act* (15 U.S.C.):

> Divestiture or dissolution has traditionally been the remedy for Sherman Act violations whose heart is intercorporate combination and control [...]. Divestiture has been called the most important of antitrust remedies. It is simple, relatively easy to administer, and sure. It should always be in the forefront of a court's mind when a violation of [s] 7 has been found.

112 Similarly, in *Community Publishers Inc. et al. v. NAT et al.*, 892 F. Supp. 1146 at 1176 (West. Dist. Ark., 1995) at 36 (QL), the United States District Court rejected a form of permanent hold separate order proposed by NAT.

113 Further, as noted in Table 1 of its decision, the Tribunal found that CWS would own 70 percent of the available capacity for ICI Waste from the GTA if it did not divest the Ridge landfill, and 48 percent if it did. The Tribunal also accepted Professor Baye's estimates that CWS would control 85.8 percent of total excess capacity if it did not divest the Ridge, and 63.6 percent if it did (Reasons, paragraph 196). When these shares of capacity are considered in light of the various factors stated in section 93 of the Act, the Tribunal does not accept that the total divestiture of the Ridge constitutes an excessive remedy.

114 Divestiture of the Ridge is the appropriate remedy to deal with the problem that the Tribunal has found and it is likely to be effective. It is neither excessive nor disproportionate. Indeed, in this case, the Commissioner is not asking the Tribunal to either dissolve a merger or order divestiture which goes beyond the specific assets which are the root of the problem. It is not, for instance, the situation that occurred in the *Southam* case (referred to above at paragraph 48), where the divestiture proposed by the Commissioner went beyond what was necessary to address the anti-competitive effects, but was nevertheless ordered because no other effective remedy was available. In this case, CWS will enjoy as much disposal space as it did pre-merger. Furthermore, the Ridge is only part of a larger transaction that was allowed by the Commissioner to proceed. Even after divestiture, CWS will retain ownership and control of nearly 50 percent of the Southern Ontario capacity for ICI Waste from the GTA. There is no evidence of hardship or anything of that nature that arises out of proposed divestiture. The Commissioner's remedy clearly meets the test of eliminating the substantial prevention and lessening of competition resulting from the acquisition of the Ridge.

115 The Tribunal notes that the draft divestiture order incorporates terms and conditions with respect to the sale of the Ridge that are necessary and reasonable, including a deadline for effecting the sale and provision for the appointment of a trustee in default of a sale within that time limit. The draft divestiture order proposed by the Commissioner provides that CWS would have 90 days to divest the Ridge, failing which it would pass into the hands of a trustee for sale. The respondents argue that 90 days is too short a period of time.

116 The Commissioner suggests that Deloitte & Touche be the trustee, in the event that a trustee is required. The reason for this is that Deloitte & Touche has been the monitor under the Consent Interim Order dated April 28, 2000. The Tribunal accepts counsel for the Commissioner's suggestion that Deloitte & Touche be the trustee. The respondents did not raise any objection in that regard following the remedy hearing. The Tribunal notes that the draft divestiture order contains usual terms expected to be found in a divestiture order.

IV. Order

117 For these reasons, the Tribunal orders that the respondents divest the Ridge in accordance with the divestiture order attached hereto.

Decision of the Board:

118 WHEREAS the Tribunal has determined that the acquisition by Canadian Waste Services Inc. of the Ridge Landfill is likely to result in a substantial lessening and substantial prevention of competition in the disposal of industrial, commercial and institutional waste ("ICI Waste") from the Greater Toronto Area ("GTA") as well as for the disposal of ICI Waste from the Chatham-Kent Area;

119 AND WHEREAS the Tribunal has determined that the respondents are required to divest the Ridge Landfill;

120 UPON HEARING counsel for the parties and for the intervenor with respect to the terms of the divestiture;

121 AND FURTHER TO the Reasons and Order dated March 28, 2001, and the Reasons and decision regarding the remedy dated October 3, 2001:

THE TRIBUNAL ORDERS THAT:

Definitions

122 For the purposes of this order:

(a) definitions used in the Notice of Application and Statement of Grounds and Material Facts dated April 26, 2000, the Interim Consent Order dated April 28, 2000, the Statement of Agreed Facts dated October 2, 2000, and the Supplementary Statement of Agreed Facts dated November 20, 2000, shall apply herein except where otherwise defined in this order;

(b) "Ridge Landfill" shall mean the Ridge Landfill facility at Blenheim, Ontario, together with all associated business, shares and assets, including the Host Community Agreement entered into between the Municipality of Chatham-Kent and Browning-Ferris Industries Ltd.;

(c) "Purchaser" shall mean the person or entity who purchases the Ridge Landfill in accordance with the procedure for divestiture set out in this order.

Application

123 The provisions of this order shall apply to the respondents and to:

(a) each division, subsidiary or other person controlled by the respondents and each officer, director, employee, agent or other person acting for or on behalf of the respondents with respect to any of the matters referred to in this order;

(b) the respondents' successors and assigns;

(c) the Trustee;

(d) Hugh Thomas Consulting Ltd. as independent manager of the Ridge pursuant to the Interim Consent Order, and each employee, agent or other person acting for or on behalf of Hugh Thomas Consulting Ltd. with respect to any matter referred to in this order; and

(e) Deloitte & Touche Inc. as monitor pursuant to the Interim Consent Order, and each employee, agent or other person acting for or on behalf of Deloitte & Touche Inc. with respect to any matter referred to in this order.

Divestiture of the Ridge Landfill

124 The respondents shall promptly commence their efforts to divest, and shall use best efforts to complete the divestiture of the Ridge Landfill within 180 days from the date of this order, in accordance with the procedure for divestiture set out herein.

125 If the divestiture of the Ridge Landfill is not completed within 180 days from the date of this order or such further time as specified by the Tribunal, the divestiture shall be carried out by a trustee in accordance with the procedure for a Trustee Sale set out herein.

126 The respondents shall not, without the consent of the Commissioner, provide financing for all or any part of the divestiture under this order which would permit the respondents to influence or control directly or indirectly the operations of Ridge Landfill after the divestiture.

Divestiture Procedure

127 The divestiture of the Ridge Landfill shall be completed on the following terms:

(a) by sale, assignment, transfer, sale of shares or other disposition necessary to ensure that, by completion of the divestiture, the respondents have, directly or indirectly, no remaining title, right or interest in the Ridge Landfill;

(b) by way of disposition of the Ridge Landfill for use as a going concern;

(c) to a Purchaser who is at arm's length to each of the respondents and meet the following objective criteria:

(i) the Purchaser shall effect the purchase with the expressed intention of carrying on the business and competing effectively in the market for the disposal of ICI Waste from the GTA as well as the disposal of solid waste from the Chatham-Kent area; and

(ii) the Purchaser shall have the managerial, operational and financial capability to compete effectively in the market for the disposal of ICI Waste from the GTA as well as the disposal of solid waste from the Chatham-Kent area;

(iii) the Purchaser shall have agreed to accept the assignment of and assume the obligations set out in the Host Community Agreement entered into between the Municipality of Chatham-Kent and Browning-Ferris Industries Ltd.

(d) by way of a commercially reasonable public tender, bidding or other procedure instituted in a manner to allow a fair opportunity for one or more *bona fide* prospective purchasers to obtain notice of the prospective divestiture and to make an offer to acquire the Ridge Landfill; and

(e) on usual commercial terms for transactions of the size and nature of those contemplated in this order.

128 Any person making a *bona fide* inquiry of the respondents or their agent regarding the possible purchase by that person or its principal of the Ridge Landfill shall be notified that the divestiture is being made pursuant to this order and provided with a copy of this order. Any *bona fide* prospective Purchaser shall be furnished, subject to the execution of a customary confidentiality agreement, with all pertinent information regarding the Ridge Landfill. Such information shall be provided to the Commissioner upon written request. Any *bona fide* prospective Purchaser shall be permitted, subject to the execution of a customary confidentiality agreement, to make such inspection of the Ridge Landfill and of all financial, operational or other documents and information as may be relevant to the divestiture.

129 The respondents may request that the Commissioner review a preliminary list of proposed Purchasers. The Commissioner shall, within eight business days after the request, communicate to the respondents any objection to a person on the list. Failure to object to a person pursuant to this paragraph does not prejudice the right of the Commissioner to refuse to approve the eventual proposed Purchaser.

130 The respondents shall, within three business days after a request by the Commissioner, provide the Commissioner with a written report on the progress of their efforts to accomplish the divestiture. The report shall include a description of contacts, negotiations and offers regarding the business to be divested and the identity of all parties contacted and prospective Purchasers who have come forward, all with reasonable detail.

131 The respondents may, with the consent of the Commissioner, have a further 60 days to complete the divestiture if:

(a) the respondents have entered into a binding agreement to divest the Ridge Landfill to a Purchaser within 180 days of the date of this order; and

(b) the respondents and the Purchaser require more time to complete the divestiture transaction.

Trustee Sale

132 If the respondents have not completed the divestiture within 180 days or such further time as ordered by the Tribunal, Deloitte & Touche Inc., the monitor of the Ridge Landfill pursuant to the Interim Consent Order, shall be appointed as Trustee.

133 If Deloitte & Touche Inc. is unable or unwilling to act as Trustee, another person agreed to by the parties shall be appointed as Trustee. Should the parties fail to agree on the appointment of such other person, the Tribunal, on the application of the Commissioner, shall appoint the Trustee.

134 The respondents shall transfer to the Trustee the authority to dispose of the Ridge Landfill.

135 The Trustee shall carry out the sale of the Ridge Landfill on the following terms (the "Trustee Sale"):

(a) after the appointment of the Trustee becomes effective, only the Trustee shall have the right to effect the divestiture of the Ridge Landfill, subject to the approval of the purchaser by the Commissioner;

(b) the Trustee shall have the full power and authority to effect the Trustee Sale and shall use all reasonable efforts to do so;

(c) the Ridge Landfill shall be sold by the Trustee within 90 days of the Trustee's appointment at the most favourable price and on the most favourable terms and conditions available;

(d) the Trustee Sale shall be accomplished in accordance with paragraphs 10 and 11 of this order;

(e) the respondents shall use their best efforts to assist the Trustee in accomplishing the Trustee Sale. In connection therewith, the Trustee shall have full and complete access as is reasonable in the circumstances, subject to an appropriate confidentiality agreement, to the personnel, books, records and facilities of the respondents relating to the Ridge Landfill and the respondents shall take no action to interfere with or impede the Trustee's accomplishment of the Trustee Sale;

(f) after appointment, the Trustee shall, every 30 days, file written reports with the respondents and the Commissioner setting out the Trustee's efforts to sell the Ridge Landfill. The reports shall include a description of contacts, negotiations and offers regarding the business to be divested and the identity of all parties contacted and prospective Purchasers who have come forward, all with reasonable detail;

(g) all expenses and fees reasonably and properly incurred by the Trustee in the course of the Trustee Sale shall be paid by the respondents and the proceeds of the Trustee Sale shall be paid to the respondents;

(h) the Trustee shall promptly notify the respondents and the Commissioner of any negotiations with a prospective purchaser that, in the opinion of the Trustee, may lead to a Trustee Sale; and

(i) on application by either the Commissioner or the respondents, the Tribunal may confer any other power on the Trustee that it deems appropriate.

136 The respondents may not object to the Trustee Sale on any grounds other than the Trustee's malfeasance, gross misconduct or breach of this order and any such objection shall be made in accordance with the provisions of paragraph 25.

137 If the Trustee has not accomplished the Trustee Sale within 60 days of its appointment, the Trustee shall promptly file with the Tribunal, on a confidential basis, and shall at the same time provide a copy to the Commissioner and the respondents, a report setting forth:

(a) the Trustee's efforts to accomplish the required divestiture;

(b) the reasons, in the Trustee's judgement, why the required divestiture has not been accomplished; and

(c) the Trustee's recommendations.

138 After receiving the report of the Trustee, the Commissioner or respondents may apply to the Tribunal for any further order to carry out the purpose of the divestiture.

Commissioner's Approval

139 The divestiture of the Ridge Landfill by the respondents or the Trustee is subject to the approval of the Commissioner, who shall take into account the competitive impact of the acquisition by the proposed Purchaser, and which shall be based on

the criteria outlined in paragraph 10 and shall be obtained in accordance with the notification procedure set out in paragraphs 23 to 29.

Notification

140 The respondents or the Trustee, whichever is then responsible for effecting the divestiture of the Ridge Landfill, shall give a written notice ("Divestiture Notice") to the Commissioner of any proposed divestiture or Trustee Sale. If the Trustee is responsible, the Trustee shall similarly notify the respondents. The Divestiture Notice shall include:

(a) the identity of the proposed Purchaser;

(b) the details of the proposed transaction, including the proposed agreement;

(c) information concerning whether the proposed Purchaser would satisfy the terms of paragraph 10(c);

(d) an update to the last report provided pursuant to paragraphs 13 and 18(f); and

(e) the agreement of the proposed Purchaser that it will respond within seven days of a request by the Commissioner for additional information regarding the proposed divestiture or Trustee Sale.

141 Within seven days after receipt of the Divestiture Notice, the Commissioner, and in the case of a Trustee Sale, the respondents, may request additional information concerning the proposed divestiture or Trustee Sale, the proposed Purchaser or any other potential purchaser. The respondents, the Trustee or the proposed Purchaser, as the case may be, shall provide the additional information within seven days of the receipt of the request, unless the Commissioner agrees in writing to extend the time.

142 Within 15 days after receipt of the Divestiture Notice or, if additional information is requested by the Commissioner or the respondents within the time specified in paragraph 24, within 15 days after receipt of the additional information, the Commissioner shall notify the respondents, and, in the case of a Trustee Sale, the Commissioner or the respondents shall notify the Trustee, in writing, of any objections they may have to the proposed divestiture or Trustee Sale on the ground that it does not conform to the terms of this order, and the reasons for the objections.

143 Where the Commissioner or the respondents object to any of the terms of the proposed divestiture or Trustee Sale pursuant to paragraph 25, the proposed divestiture shall not be completed without the approval of the Tribunal.

144 If the Commissioner fails to object within the period set out in paragraph 25 and on the grounds set out in paragraph 22, or if the Commissioner notifies the respondents and the Trustee, if there is one, in writing that he does not object, then the divestiture of the Ridge Landfill shall be completed, subject to paragraph 26.

145 If the respondents fail to object within the period set out in paragraph 25, then the divestiture of the Ridge Landfill shall be completed, subject to paragraph 26.

146 The respondents or the Trustee, as the case may be, shall notify the Commissioner forthwith after the divestiture of the Ridge Landfill, required by this order, has been completed.

Continuation of Interim Consent Order

147 The terms of the Interim Consent Order dated April 28, 2000, are hereby continued until the completion of the divestiture or Trustee Sale as defined in paragraph 33 below, of the Ridge Landfill by the Purchaser from the respondents.

Notice

148 Notices and reports required to be given pursuant to any of the terms of this order shall be considered given if dispatched by personal delivery, registered mail or facsimile transmission to the parties listed in Schedule A.

149 Any such notice or other document shall, if delivered or transmitted by facsimile, be deemed to have been given and received on the business day next following the date of sending, and if mailed, be deemed to have been given and received on the third business day following the date of mailing.

Completion of divestiture

150 The divestiture or Trustee Sale shall be considered to be completed when all right, title and interest of the respondents in the Ridge Landfill has been conveyed to a Purchaser in accordance with the terms of this order.

Statement by Commissioner

151 Once divestiture or Trustee Sale has taken place in accordance with this order, the Commissioner shall file with the Registrar of the Tribunal a statement identifying the purchaser and setting out the date on which the divestiture or Trustee Sale was accomplished.

Post Divestiture

152 Following divestiture by the respondents or the Trustee Sale, none of the respondents, their affiliates, their agents or representatives shall acquire the Ridge Landfill, any interest therein, or any part of the business of the Ridge Landfill for a period of 10 years.

Confidentiality

153 The Commissioner, the respondents and the Trustee, if any, shall keep confidential among the Commissioner, the respondents and the Trustee, if any, and their respective advisors, the identities of all prospective Purchasers and all persons expressing an interest in purchasing the business to be divested or sold, as well as the details of their offers and expressions of interest.

Jurisdiction

154 Either the respondents or the Commissioner may apply to the Tribunal at any stage of the divestiture or Trustee Sale for directions or such other order as may be appropriate.

155 The Tribunal shall retain jurisdiction in this matter for the purpose of addressing any matters in this order where specific reference is made to the Tribunal, for purposes of variation and for any other purposes provided for in the *Competition Act*.

APPENDIX"A" — Service List

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André Brantz

W. Michael G. Osborne

Josée Gravelle

For the respondents:

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Canadian Waste Services Inc.

Waste Management, Inc.

Lawson A. W. Hunter, Q.C.

Shawn C. D. Neylan

Danielle K. Royal

For the intervenor:

The Corporation of the Municipality of Chatham-Kent

Brian Knott

Anthony Fleming

2022 Comp. Trib. 18
Competition Tribunal

Canada (Commissioner of Competition) v. Parrish & Heimbecker, Limited

2022 CarswellNat 4872, 2022 Comp. Trib. 18

IN THE MATTER OF an application by the Commissioner of Competition for one or more orders pursuant to section 92 of the Competition Act, RSC 1985, c C-34 as amended

Commissioner of Competition (Applicant) and Parrish & Heimbecker, Limited (Respondent)

Denis Gascon J. Chair, Andrew D. Little J. Member, Ramaz Samrout Member

Heard: January 6, 2021; January 7, 2021; January 11, 2021; January 12, 2021; January 13, 2021; January 14, 2021; January 15, 2021; January 19, 2021; January 20, 2021; January 21, 2021; January 25, 2021; February 3, 2021; February 4, 2021
Judgment: October 31, 2022
Docket: CT-2019-005

Counsel: Jonathan Hood, Ellé Nekiar, for Applicant, Commissioner of Competition
Robert S. Russell Davit Akman Denes Rothschild Moshe Grunfeld, Joshua Abaki, Carolyn Wong, for Respondent, Parrish & Heimbecker, Limited

***Denis Gascon J. Chair, Andrew D. Little J. Member, Ramaz Samrout Member*:**

I. EXECUTIVE SUMMARY

1 On December 19, 2019, the Commissioner of Competition ("*Commissioner*") filed a Notice of Application ("*Application*") against the Respondent Parrish & Heimbecker, Limited ("*P&H*"), pursuant to section 92 of the Competition Act, RSC 1985, c C-34 ("Act"), following the acquisition by P&H of 10 primary grain elevators ("*Elevators*") located in Western Canada ("*Transaction*"). Prior to the Transaction, these 10 Elevators were owned and operated by Louis Dreyfus Company Canada ULC ("*LDC*"), one of P&H's competitors in the grain business. In his Application, the Commissioner challenges the acquisition by P&H of one of these Elevators, namely, the LDC Elevator located on the Trans-Canada Highway in Virden, Manitoba ("*Virden Elevator*"), near the Manitoba-Saskatchewan border.

2 The Commissioner claims that by acquiring the Virden Elevator ("*Virden Acquisition*" or "*Acquisition*"), P&H causes or is likely to cause a substantial reduction of competition in the supply of grain handling services ("*GHS*") for wheat and canola for those farms that benefited from competition between the Virden Elevator and the nearby elevator owned by P&H and located in Moosomin, Saskatchewan, also on the Trans-Canada Highway ("*Moosomin Elevator*"). The Virden Acquisition is the only portion of the Transaction challenged by the Commissioner in this Application.

3 The Commissioner's Application alleges that the anti-competitive effects caused by the Virden Acquisition require a remedy under section 92 of the Act. The Commissioner submits that farms in the area which had previously benefited from the competition between P&H and LDC are likely to pay materially more to obtain GHS from the Moosomin and Virden Elevators, and will thus receive less money for their wheat and canola. The Commissioner maintains that canola crushing plants ("*Crushers*") and more distant Elevators are not sufficient to constrain an exercise of market power by P&H, due to higher transportation costs for farms to deliver their grain to these competitors.

4 P&H disputes the Commissioner's position. P&H submits that the Commissioner's Application improperly defines both the relevant product market and the relevant geographic market affected by the Virden Acquisition. According to P&H, the relevant product market is the purchase of wheat or canola from the farms, as P&H does not supply GHS. As to the relevant geographic

market, P&H submits that it is much broader than the Commissioner alleges since the purchase prices set by the Moosomin and Virden Elevators are influenced by rival Elevators and Crushers located far beyond the respective individual draw areas of these two Elevators. P&H contends that in the face of vigorous and effective competition from competing Elevators, as well as from canola Crushers and other direct purchasers of wheat and canola, P&H's control of the Virden Elevator gives it neither the ability nor the incentive to exercise monopsony power in any properly defined market. Hence, says P&H, the Virden Acquisition does not lessen competition substantially in any relevant market, and is not likely to do so. Moreover, P&H argues that in any event, the efficiencies that the Virden Acquisition is likely to bring about will be greater than, and will offset, the effects of any alleged lessening or prevention of competition.

5 For the reasons that follow, the Tribunal will dismiss the Application brought by the Commissioner. The Commissioner has failed to establish, on a balance of probabilities, that the elements of section 92 have been satisfied.

6 The Tribunal [1] first concludes that in the circumstances of this case, the relevant product is not the sale of GHS to farms, as alleged by the Commissioner, but the purchase of wheat and canola by P&H. The definition of the relevant product market was a fundamental point of disagreement between the parties, and was highly influential in the Tribunal's overall analysis. The Tribunal finds that the Commissioner's proposed product market is not grounded in commercial reality and in the evidence. Moreover, in this case, the "value-added" approach to product market definition advanced by the Commissioner fails on the facts, from a precedential and legal standpoint, and from a conceptual and economic perspective. Turning to the geographic market, the Tribunal is of the view that the relevant geographic market for the purchase of wheat is more likely than not to be comprised of at least the Virden, Moosomin, Fairlight, Whitewood, Oakner, Elva, and Shoal Lake Elevators. As to the relevant geographic market for the purchase of canola, it includes at least the Moosomin, Virden, Fairlight, Oakner, Whitewood, Brandon (Richardson), Melville, Souris East, Shoal Lake, and Elva Elevators, as well as the Crushers at Harrowby, Yorkton (LDC), Velva, and Yorkton (Richardson). These relevant markets are somewhat closer to the geographic markets proposed by the Commissioner but are larger than the narrow "corridor of concern" between the Moosomin and Virden Elevators that he originally identified (discussed below).

7 The Tribunal also finds that the Commissioner has not established that the Acquisition lessens competition substantially in any relevant market, or is likely to do so. The Tribunal reaches that conclusion after finding that the Virden Acquisition does not materially reduce, and is not likely to reduce materially, the degree of price or non-price competition in the purchase of wheat and canola in the relevant geographic markets, relative to the degree that would likely have existed in the absence of the merger. In particular, the evidence shows that the price effects of the Acquisition are immaterial for the purchase of both wheat and canola, that several effective remaining competitors will remain to constrain P&H's ability to exercise market power, and that the post-merger market shares are below the 35% safe harbour threshold. The Tribunal finds that the Virden Acquisition causes *some* lessening of competition for the purchase of wheat, but the evidence does not allow it to conclude that such lessening reaches the substantiality level required by section 92.

8 In light of those conclusions, the Tribunal does not need to determine the issue of efficiencies claimed by P&H. However, considering the extensive submissions made by the parties on efficiencies and the nature of the issues raised, the Tribunal addresses the matter. The Tribunal concludes that P&H has not proven, with clear and convincing evidence, that the Virden Acquisition is likely to bring about cognizable gains in efficiency. As a result, P&H would not have met its burden of demonstrating, on a balance of probabilities, that its claimed gains in efficiency would be greater than, and would offset, the anti-competitive effects of any lessening of competition resulting from the Acquisition.

II. INTRODUCTION AND OVERVIEW

A. The parties

9 The Commissioner is the public official appointed by the Governor in Council under section 7 of the Act and is responsible for the enforcement and administration of the Act.

10 P&H is a private, family-owned Canadian agribusiness headquartered in Winnipeg, Manitoba. P&H buys many varieties of grain, including wheat and canola, from farms and sells them to customers located in Canada, Europe, Asia, and South America. P&H has vertically integrated operations spanning across Canada in grain trading, handling, and merchandising, as well as in crop inputs retail, flour milling, and feed mills. It employs over 1,500 people with customers in 24 countries. Prior to the Transaction, P&H owned 19 Elevators in Western Canada. It also has ownership interests in a number of export terminals at Canadian ports located near Vancouver, British Columbia and in Thunder Bay, Ontario.

B. The Transaction

11 Pursuant to an asset purchase agreement dated September 3, 2019, P&H agreed to purchase from LDC 10 Elevators and related assets in Western Canada, including the Virden Elevator. On December 10, 2019, P&H and LDC closed the Transaction, bringing the total number of Elevators owned by P&H to 29. The grain volumes purchased through the former LDC Elevators in the last full crop year when they were owned and operated by LDC was 1.6 million metric tonnes ("*MT*").

12 The Transaction is part of P&H's growth strategy. P&H claims that it will improve its efficiency and effectiveness in competing with other grain companies in Western Canada.

C. The merger provisions of the Act

13 A merger is defined by section 91 of the Act as referring to the acquisition or establishment, by one or more persons, of "control over or significant interest in the whole or a part of a business of a competitor, supplier, customer, or other person." It is not disputed that the Transaction is a merger covered by the Act.

14 Mergers, along with matters such as restrictive trade practices, are reviewable by the Tribunal under Part VIII of the Act if they have anti-competitive effects (Tervita Corp v Canada (Commissioner of Competition), 2015 SCC 3 (" at para 43). With respect to mergers, section 92 identifies these anti-competitive effects as either substantially lessening competition or substantially preventing competition. More specifically, subsection 92(1) allows the Tribunal to intervene with respect to a merger or proposed merger if it finds that the merger prevents or lessens, or is likely to prevent or lessen, competition substantially "(*a*) in a trade, industry or profession; (*b*) among the sources from which a trade, industry or profession obtains a product; (*c*) among the outlets through which a trade, industry or profession disposes of a product; or (*d*) otherwise than as described in paragraphs (*a*) to (*c*)." The Tribunal is empowered to make a remedial order when a merger is found to either lessen or prevent competition substantially.

15 Subsection 92(2) provides that the Tribunal shall not find that a merger or proposed merger prevents or lessens, or is likely to prevent or lessen, competition substantially "solely on the basis of evidence of concentration or market share." However, the Tribunal has found that these two factors nonetheless may help in assessing whether or not a merger or proposed merger could result in a substantial lessening or prevention of competition (The Commissioner of Competition v CCS Corporation et al, 2012 Comp Trib 14 (" at para 360, rev'd 2013 FCA 28, rev'd 2015 SCC 3; The Commissioner of Competition v Superior Propane Inc, 2000 Comp Trib 15 (" at paras 126, 304-313; Director of Investigation and Research v Hillsdown Holdings (Canada) Ltd(1992), 41 CPR (3d) 289 (Comp Trib) ("*Hillsdown*") at pp 315-316, 318).

16 Section 93 sets out a non-exhaustive list of market-specific factors that the Tribunal may consider in determining whether a merger prevents or lessens, or is likely to prevent or lessen, competition substantially. These factors include the following: foreign products as effective competition; failing firm considerations; availability of acceptable substitutes; removal of a vigorous and effective competitor; barriers to entry; remaining effective competitors; and change and innovation. The list is open-ended, as it includes at paragraph (*h*) "any other factor that is relevant to competition in a market that is or would be affected by the merger or proposed merger."

17 The Act also carves out certain exceptions to the application of the Tribunal's section 92 remedial powers. One such exception, which is relevant in this case, is what is commonly named the "efficiencies defence," in section 96 of the Act. This exception provides that the Tribunal shall not make an order under section 92 if it finds that the merger in respect of which

the application is made is likely to bring about efficiency gains which are greater than and likely to offset the anti-competitive effects resulting from the merger.

18 The Commissioner bears the burden of satisfying the elements of section 92, and the Tribunal must make a positive determination in respect of those elements before it may issue a remedial order. However, as will be discussed in more detail below, P&H bears most of the burden of proof under the efficiencies defence in section 96.

19 The burden of proof is the civil standard, that is, the balance of probabilities. In that respect, the Tribunal remains guided by the principles established in FH v McDougall, 2008 SCC 53 (“, where the Supreme Court of Canada ("*SCC*") held that there is only one civil standard of proof in Canada, the balance of probabilities (see also *Tervita SCC* at para 66). Speaking for a unanimous court, Justice Rothstein stated in his reasons that the only legal rule in all cases is that "evidence must be scrutinized with care by the trial judge" and that "evidence must always be sufficiently clear, convincing and cogent to satisfy the balance of probabilities test" (*McDougall* at paras 45-46). In all civil cases, the trier of fact "must scrutinize the relevant evidence with care to determine whether it is more likely than not that an alleged event occurred" (*McDougall* at para 49).

20 The full text of the relevant provisions of the Act is reproduced in Schedule "A" to these Reasons.

D. The parties' pleadings

21 In his Application, the Commissioner seeks an order requiring P&H to divest either the Virden Elevator or the Moosomin Elevator, as well as an order prohibiting P&H from acquiring any Elevator in the relevant markets for a certain period of time.

22 The Commissioner submits that the relevant product is the supply of GHS. According to the Commissioner, GHS includes the following services: the elevation, grading, and segregation of the grain performed by the Elevators, as well as the cleaning, drying, blending, and storage that may be offered. The Commissioner pleads that the relevant markets should be defined as "the supply of [GHS] for wheat and the supply of [GHS] for canola for the aggregated locations of farmers that benefited from competition between the Virden Elevator and Moosomin Elevator." The Commissioner says that there are no functional substitutes for these GHS.

23 Turning to the geographic dimension of the relevant markets, the Commissioner pleads that the wheat and canola purchased by an Elevator usually originate from nearby farms, and that the relevant geographic market is therefore local due to transportation costs, with the most affected farms being located in a narrow corridor between the Virden and Moosomin Elevators, within a one-hour drive of each Elevator.

24 The Commissioner contends that the Virden Acquisition causes, or is likely to cause, a substantial lessening of competition in the relevant markets, due to the elimination of an important competitor [2] . The Commissioner alleges that, with the acquisition of the Virden Elevator, P&H can unilaterally exercise enhanced market power in the relevant markets, at the expense of farms located in certain parts of Saskatchewan and Manitoba. According to the Commissioner, P&H will be able to materially raise the implicit price that farms pay for GHS for wheat and canola in the Virden-Moosomin corridor, and farmers will be paid less for their wheat and canola.

25 The Commissioner maintains that canola Crushers and more distant Elevators are not sufficient to constrain an exercise of market power by P&H owing to higher transportation costs for farms to deliver their grain.

26 The Commissioner further claims that several section 93 factors support these conclusions, in that: 1) Elevators and direct purchasers in other countries cannot compete directly for the purchase of wheat and canola from farms in the relevant markets because of transportation costs; 2) for the vast majority of farms in the relevant markets, there are no viable substitutes; 3) barriers to entry and expansion are high, owing to significant capital costs and difficulty finding a suitable location to build an Elevator and accompanying access to rail transportation; 4) P&H no longer intends to expand the rail car capacity at the Moosomin Elevator, which would have increased this Elevator's ability to handle more wheat and canola and the level of competition in the relevant markets; 5) the closest remaining Elevator to the Virden and Moosomin Elevators is an Elevator owned by Viterra Inc. ("*Viterra*") in Fairlight, Saskatchewan ("*Fairlight Elevator*"), but it is insufficient to constrain an exercise

of market power by P&H due to its location on a secondary road, 35 kilometers south of the Trans-Canada Highway; 6) the Virden Elevator, which has now been removed as a competitor, was previously a vigorous and effective competitor to P&H; and 7) the market for the delivery of GHS is not subject to material change through innovation.

27 The Commissioner adds that, even if the relevant product markets were more broadly defined to be the purchase by Elevators of wheat and canola from farms, the Acquisition still causes, or is likely to cause, a substantial lessening of competition in these product markets due to P&H's ability to materially decrease the price of wheat and canola paid to farms.

28 P&H opposes the Commissioner's Application and asks the Tribunal to dismiss it with costs. In P&H's view, the Commissioner improperly defines both the relevant product market and the relevant geographic market. Furthermore, P&H submits that the Acquisition does not enable it to materially lower the prices it pays to farms for their wheat or canola, nor does it lead to a substantial lessening of competition in any relevant and properly defined market.

29 P&H submits that the relevant product market is the purchase of wheat or canola. It states that, contrary to what the Commissioner advances, it does not supply GHS to farms.

30 P&H argues that the prices it pays for grain at the Virden or Moosomin Elevators are largely dependent on global prices, which are independent of changes to the local competitive landscape around the Virden and Moosomin Elevators. According to P&H, the prices that it offers to pay farms for grain are centrally set: they are derived from the demand and prices it receives from its sales to customers in international and domestic markets, as well as by the costs to transport grain from its network of Elevators to export terminals or to domestic buyers.

31 P&H also disagrees with the relevant geographic market as defined by the Commissioner. P&H maintains that Elevators purchase grain from farms located farther away than what the Commissioner alleges. P&H contends that the Virden and Moosomin Elevators each purchase grain from hundreds of farms mostly located outside the geographic area between these two Elevators along the Trans-Canada Highway, well beyond a one-hour drive. According to P&H, the Virden and Moosomin Elevators must purchase grain at competitive prices against many other rival Elevators whose draw areas extend farther than the narrow "corridor of concern" and the proposed geographic markets identified by the Commissioner. Therefore, in P&H's view, the relevant geographic market is much broader than the Commissioner alleges since the purchase prices set by the Moosomin and Virden Elevators are influenced by rival Elevators located far beyond the respective individual draw areas of the two Elevators at issue. P&H claims that it does not hold or exercise monopsony power in a relevant geographic market as alleged by the Commissioner, or even in the broader area of Southeastern Saskatchewan and Southwestern Manitoba.

32 P&H contends that in the face of vigorous and effective competition from competing Elevators, as well as from canola Crushers and other direct purchasers of wheat and canola, P&H's control of the Virden Elevator gives it neither the ability nor the incentive to exercise monopsony power in any properly defined market. Rival Elevators and other purchasers within and beyond the draw areas of the Virden and Moosomin Elevators already purchase grain from farms that also sell to the Virden and Moosomin Elevators, have significant excess capacity to purchase additional grain, and can increase their purchases from those farms at low cost. In other words, says P&H, the Virden Acquisition will not substantially lessen competition.

33 P&H further argues that barriers to entry and expansion are low, with the result that P&H's ability to exercise any monopsony power would be constrained by the expansion of existing Elevators' purchases and/or by new entry.

34 Moreover, even if the Virden Acquisition were found to substantially lessen competition, P&H argues that the gains in efficiency that the Acquisition is likely to bring about will be greater than, and will offset, the effects of any alleged lessening of competition. According to P&H, it will not likely attain such gains in efficiency if the Tribunal makes the orders sought by the Commissioner. The efficiencies claimed by P&H from the Acquisition include the following: improved scale economies and cost savings at the Fraser Grain Terminal ("*FGT*") located in British Columbia; elimination of the margin that LDC formerly paid to use the Vancouver export terminal owned by Kinder Morgan; output expansion and improved scale economies at the Virden Elevator; and administrative synergies.

35 In his reply, the Commissioner opposes P&H on this last point and submits that the Virden Acquisition will not generate cognizable gains in efficiencies to the extent alleged by P&H. The Commissioner further maintains that, if the Tribunal makes the orders sought, P&H's ability to achieve the alleged efficiencies being claimed would not be impacted. In any event, the Commissioner holds that any cognizable efficiencies that P&H may obtain through the Virden Acquisition and that would be lost if the orders sought were made will not be greater than or offset the anti-competitive effects of the Acquisition.

E. Procedural history

36 Around the time the Commissioner filed the Application in December 2019, he stated that he would request an expedited scheduling order in accordance with the Tribunal's *Practice Direction regarding an Expedited Proceeding Process before the Tribunal*, dated January 2019. Under an expedited scheduling order, an application will typically be heard by the Tribunal within five to six months after the filing of the notice of application.

37 P&H opposed the Commissioner's request and asserted that procedural fairness concerns would arise under an expedited process. P&H proposed an alternative schedule pursuant to which the hearing would take place approximately three to four months later than the hearing dates contemplated under the expedited process.

38 On January 13, 2020, the Tribunal denied the Commissioner's request for an expedited process (Canada (Commissioner of Competition) v Parrish & Heimbecker, Limited, 2020 Comp Trib 1). The Tribunal was not persuaded that in the absence of P&H's consent, the expedited process was a reasonable option given the circumstances and fairness considerations arising in this case. Moreover, the period of three to four months that could be gained with the expedited process did not justify the imposition of the process over P&H's strong objections. The Tribunal adopted the alternative schedule proposed by P&H and issued a scheduling order in early March 2020, pursuant to which the hearing of the Commissioner's Application would start in November 2020 (Canada (Commissioner of Competition) v Parrish & Heimbecker, Limited, 2020 Comp Trib 2 (“). Adjustments were subsequently made to various steps of the Scheduling Order as a result of the COVID-19 pandemic. The parties nonetheless continued to work towards the November 2020 hearing dates.

39 In October 2020, P&H advised the Tribunal that its expert was no longer available in November because of unforeseen personal circumstances. The Tribunal agreed to adjourn the hearing with the consent of both parties. Eventually, the Tribunal issued an amended Scheduling Order, pursuant to which the hearing would now proceed in early January 2021 (Canada (Commissioner of Competition) v Parrish & Heimbecker, Limited, 2020 Comp Trib 13).

40 In the course of the proceedings leading up to the hearing, counsel for P&H insisted on various occasions on an in-person hearing notwithstanding the COVID-19 pandemic and the implementation of various lockdowns. While counsel for the Commissioner initially accommodated P&H's request and agreed to a hybrid hearing, the Commissioner eventually opposed the request as the pandemic worsened. In December 2020 and early January 2021, the Tribunal ordered that the hearing would take place remotely by way of videoconference using the Zoom platform (Canada (Commissioner of Competition) v Parrish & Heimbecker, Limited, 2020 Comp Trib 14; Canada (Commissioner of Competition) v Parrish & Heimbecker, Limited, 2021 Comp Trib 1).

41 In anticipation of the hearing, the parties exchanged witness statements in accordance with the schedule fixed by the Tribunal. These witness statements included statements from farmers in Western Canada, as well as initial and reply witness statements by John Heimbecker, the Chief Executive Officer ("*CEO*") of P&H.

42 On November 27, 2020, the Commissioner moved to strike some paragraphs of the initial witness statement of Mr. Heimbecker on the basis that it contained inadmissible hearsay and inadmissible lay opinion evidence. In December 2020, the Tribunal granted this motion in part and ordered P&H to prepare a revised witness statement from Mr. Heimbecker (Canada (Commissioner of Competition) v Parrish & Heimbecker, Limited, 2020 Comp Trib 15 (“).

43 Initially, both parties agreed to designate the identity of their respective farmer witnesses as Confidential Level B in accordance with the Confidentiality Order issued by the Tribunal (Canada (Commissioner of Competition) v Parrish &

Heimbecker, Limited, 2020 Comp Trib 3). As the hearing approached, however, P&H revised its position. By way of letter, P&H advised the Tribunal at the end of November 2020 that witness statements prepared by three farmers on behalf of P&H would no longer be designated confidential. Moreover, P&H expressed doubts about the merits of the Commissioner's confidentiality designations and eventually asserted that the Commissioner should file a formal motion to designate as confidential the identities of his farmer witnesses. On December 7, 2020, the Commissioner moved for an order designating the identities of five farmers as confidential.

44 On December 29, 2020, the Tribunal dismissed the Commissioner's motion and reasons for this decision were issued in early January 2021 (Canada (Commissioner of Competition) v Parrish & Heimbecker, Limited, 2021 Comp Trib 2). The Tribunal found that the Commissioner had failed to present clear and convincing evidence sufficient to satisfy the Tribunal that the requirements for the confidentiality designations were met. Further to that decision, only three of the five farmer witnesses originally identified by the Commissioner appeared at the hearing in a public setting.

45 The hearing was held virtually between January 6 and February 4, 2021, and the witnesses testified by videoconference in accordance with a witness protocol that was developed by the Tribunal with the parties' input.

46 Not only was this the first virtual hearing for the Tribunal, but this was also the first time that experts testified together as part of a panel of expert witnesses formed in accordance with Rules 75 and 76 of the Competition Tribunal Rules, SOR/2008-141 ("*CT Rules*"). CT Rule 76 provides that the Tribunal "shall direct the manner in which the panel [of witnesses] shall testify" and that counsel can cross-examine and re-examine the witnesses. The protocol for this concurrent expert evidence session (also known as "hot-tubbing") was set out in a specific Direction issued by the Tribunal with the parties' consent.

47 The purpose of this "hot-tubbing" process is to streamline the testimonies of expert witnesses, and to allow experts to ask questions from each other and highlight their areas of agreement and disagreement. Pursuant to the Tribunal's Direction, the experts and counsel for the parties agreed on a list of five main issues to be addressed by the experts at the concurrent evidence session, and the experts identified their areas of agreement and disagreement on each issue. The parties also exchanged short statements of each expert's proposed expertise. Each expert was granted a full and fair opportunity to present and explain their respective position on each issue, and opposing counsel were able to cross-examine the experts. A significant benefit that flowed from this concurrent evidence session was that experts were able to rapidly focus on the key areas of disagreement between them. In the view of all members of the Tribunal, the process worked well and helped the Tribunal to have a solid understanding of each expert's position, while allowing the Tribunal and the parties to narrow the disputed issues between the experts.

III. FACTUAL BACKGROUND

A. The Canadian grain industry

48 The grain supply chain in Canada involves an interconnected network of businesses and infrastructure that moves grain from individual farms to end customers, such as companies that manufacture food or feeds. The main participants include farmers who produce grain, grain companies that purchase grain from farmers, railways that transport grain from Elevators to export terminals or to domestic customers, and export terminals where the grain is delivered for storage and shipping.

49 Canadian farmers grow a variety of grains such as wheat, barley, soybeans, peas, and canola. The Commissioner's Application in this case focuses solely on two types of grain, namely, wheat and canola. Wheat and canola are both commodity products.

50 Farmers can sell their wheat to Elevators, and their canola to Elevators or Crushers. For many years before 2012, when the Canadian Wheat Board ("*CWB*") was in existence, grain companies bought wheat and barley on behalf of the CWB on a toll basis. At the time, the CWB was, by law, the sole marketer of wheat and barley for export and domestic human consumption. Grain companies then acted as the agents of and service providers to the CWB. Grain companies purchased other grains such as canola directly from farmers, without the intervention of the CWB. However, in August 2012, the CWB's role ended and grain companies ceased being service providers to the CWB. The grain companies now purchase and sell wheat and barley from farmers on their own account for sale to their own customers, as they do for other types of grain. With the end of the

CWB's role as a sole purchaser of certain grain, the historical tariffs and fees that had been in place for the service provided by grain companies ended. But, as will be discussed below, the heritage from the CWB days has an impact on certain purchasing and selling practices in the grain business.

51 Canadian grain companies sell grain domestically or to overseas customers by transporting it by rail to export terminals located at Canadian ports. At the export terminals (and at some local Elevators), grain is segregated by type and quality attributes, stored, blended, and loaded onto vessels.

52 In addition to P&H, there are several major grain companies that purchase wheat and canola in competition with P&H in Western Canada. The two largest are Viterra and Richardson International Limited ("*Richardson*"). Viterra is a privately-held subsidiary of Glencore, a British-Swiss multinational corporation; it has 79 Elevators and six port facilities across Canada and parts of the United States ("*U.S.*"). Richardson is a privately-held Canadian subsidiary of James Richardson & Sons, Limited which owns 73 grain Elevators and has ownership or partnership interests in the largest three grain terminals in Canada.

53 Other major grain companies operating in Western Canada include Cargill Limited ("*Cargill*"), Paterson Grain Limited ("*Paterson*"), Ceres Global Ag Corp. ("*Ceres*"), Bunge Ltd ("*Bunge*"), Archer-Daniels-Midland Limited ("*ADM*"), and G3 Canada Limited ("*G3*"). Cargill is a vertically-integrated company with 31 Elevators and port terminals across Canada. Paterson operates more than 40 Elevators whereas G3 has 17 Elevators and four export terminals.

54 In addition to these major players, other local grain companies such as GrainsConnect Canada also compete in Western Canada.

B. Elevators and Crushers

55 Elevators are designed to stockpile and store the grain they purchase from spatially dispersed farms. The Elevators, upon receiving the grain from a farm, will grade it, elevate it, and segregate it; they may also clean, blend, dry, and store the grain at the Elevator until a railcar or a truck comes to take the grain to its next destination. This is what the Commissioner refers to as GHS. Elevators' staff will typically examine grain samples from the farms' trucks, assess for dockage as needed, grade the grain, unload the trucks delivering the grain, elevate the grain to the appropriate storage bins, store the grain and keep it in condition, blend the grain as appropriate, assist with weighover (i.e., inventory counts), dry the grain as needed, prepare cash settlements for farms, and load the grain into railcars for shipment to a port terminal or to a further processing mill such as flour mills. Grain companies incur costs for those activities, such as costs related to any cleaning or drying, transportation from Elevators to export terminals or domestic locations, developing export and domestic customers, and managing risk with respect to fluctuations in exchange rates and commodity prices.

56 Grain is graded in accordance with the Official Grain Grading Guide published by the Canadian Grain Commission ("*CGC*"). A grading factor is a physical condition of grain that indicates a certain quality level. For wheat, the highest quality grade under the CGC's classification system is grade 1 Canadian Western Red Spring Wheat ("*1CWRS*"). Turning to canola, the most common grade for harvested canola is 1CAN CANOLA. In the case of wheat, the protein content also affects the price. The base protein content commonly used by grain companies is 13.5%, and a higher protein wheat commands a higher price relative to 1CWRS 13.5. Protein spreads reflect the cash price adjustments (either up or down from the cash price for 1CWRS 13.5) based on the protein content of the wheat.

57 Elevators have varying grain storage capacities. The storage capacity of P&H's Elevators ranges from 22,000 MT at the Glossop Elevator (located in Glossop, Manitoba) to 106,000 MT at the Weyburn Elevator (located in Weyburn, Saskatchewan).

58 Elevators are often located close to railways, as the grain is typically loaded onto railcars and transported by rail. The term "rail car spots" is commonly used within the industry and refers to the number of railcars at an Elevator that can be accommodated for loading on a sidetrack (or spur line) off the main track line.

C. Farms

59 Even though some farms will have storage and elevating capacity, farms typically rely on Elevators as they could not achieve the same efficiencies in moving their grain from the farm to the domestic customers or to export terminals for delivery to international end customers. Farms can sell their wheat and canola to multiple grain companies and are offered prices by Elevators and Crushers for their grain.

60 In most instances, farms are responsible for hauling their grain to the Elevators. Some farms have their own trucks to transport their grain, while others employ commercial trucking companies to load, ship, and unload their grain. In certain circumstances, some Elevators or Crushers might offer pick-up service, which is charged to farms through a trucking allowance.

61 The transportation costs incurred by farms to bring their grain to an Elevator will vary with distance but also with travel time, road conditions, and seasonal road weight restrictions that may affect certain secondary roads. All else being equal, most farms prefer to sell their grain to closer Elevators.

D. Pricing and contracts

62 Grain companies such as P&H buy wheat or canola at their Elevators by paying farms a "net" or "cash" price for their grain ("*Cash Price*" or "*CP*"). The Cash Price is also sometimes referred to as the "flat" or "bid" price for the grain. No matter how it is worded or expressed, the Cash Price represents the actual amount of money (per MT or per bushel) received by a farm for the net quantity of grain delivered and sold at an Elevator. P&H posts its Cash Price for grain for each of its Elevators. Farms can also use P&H's mobile application, named "P&H Direct," to see the Cash Prices at each of P&H's Elevators across Western Canada.

63 The price of grain can be expressed in terms of dollars per MT or dollars per bushel. There are 36.744 bushels of wheat to the MT and 44.092 bushels of canola to the MT.

64 The Cash Price that a farmer receives for grain is comprised of two components: the futures price ("*Futures Price*" or "*FP*") and what is commonly known in the grain industry as the "basis." The term "basis" refers to the difference between the Futures Price and the Cash Price ("*Basis*" or "*B*") [3] .

65 The Futures Price reflects the global commodity market price for the grain, set by global supply and demand forces. Neither the farms nor the Elevators have control over the Futures Prices, as these are global commodity prices. The world Futures Prices for wheat and canola are determinative of P&H's prices for those commodities. For wheat, P&H uses the Minneapolis Hard Red Spring wheat futures contract price for CWRS. This price trades in U.S. dollars ("*USD*") per MT. For canola, P&H uses the Intercontinental Exchange futures price for canola in Saskatchewan. This price trades in Canadian dollars ("*CAD*") per MT. Grain companies (including P&H) typically use 1CWRS as their base grade for wheat pricing and 1CAN CANOLA as their base grade for canola pricing.

66 While both the Commissioner and P&H agree that the Cash Price, the Futures Price and the Basis are the three components of the pricing process for grain, they fundamentally disagree on the interrelation between these three components. The Commissioner claims that P&H has no control over the Futures Price and sets the Basis, and that the Cash Price paid to farms is the resulting amount. In other words, the Commissioner argues that FP - B = CP. P&H instead argues that the Basis numerically results from the difference between the Cash Price it sets and the Futures Price over which it has no control. In sum, P&H submits that FP - CP = B. The Commissioner claims that the relevant price for the purposes of a competition analysis is the price for GHS — which, he says, equates to the Basis — , whereas P&H is of the view that the relevant price is the Cash Price effectively paid to the farms.

67 Farms can sell and deliver their grain at different times throughout the year and they can sell a portion of their crop before it is harvested. Some farms can store some or all of their grain on their farm if they have the proper elevating capacity, which allows them to sell their grain at a time of their choosing.

68 The Cash Price ultimately received by the farms can sometimes be adjusted upwards when Elevators offer limited-tonne or limited-time pricing "specials" to fill remaining space in a train or a vessel or to obtain additional grain supplies to meet sales

commitments. From time to time, the Cash Price or the Basis can also be adjusted to reflect individual negotiations between farms and the Elevators. P&H estimates that this occurs in approximately [text omitted] of its grain purchase transactions.

69 In terms of contracts with Elevators and Crushers, farms can enter into different types of agreements to sell their grain. They can enter into fixed price contracts, grain pricing order agreements ("*GPOs*") — also known as grain purchase orders or target contracts — , and basis contracts.

70 Under a fixed price contract, the Cash Price, Futures Price and Basis are fixed. Similarly, the quantity and quality of grain to be delivered, as well as the delivery period, are determined in the fixed price contract. Fixed price contracts are used for forward or deferred delivery purchase transactions as well as for spot purchase transactions. Forward or deferred delivery refers to a delivery of grain at some point in the future. Farms can enter into forward or deferred delivery contracts to deliver a specific quantity and quality of grain to an Elevator for an agreed Cash Price within a prescribed delivery window in the future. In P&H's fixed price contracts, the Cash Price appears as the "net" price.

71 Under a GPO, a farm sets a targeted Cash Price above an Elevator's posted Cash Price ("*Target Cash Price*") at which the farm agrees to sell and deliver to that Elevator a specific type of grain in a specified delivery month. If the Elevator's posted Cash Price reaches a farm's Target Cash Price, the GPO is triggered and the Elevator must purchase the farm's grain at the Target Cash Price. If a GPO is triggered, it becomes a fixed price contract. Farms always keep the option to amend or cancel a GPO at any time before it is triggered. A farm chooses the expiry date for the GPO, which may be in effect for days, weeks, or months.

72 The third type of agreement that farms can enter into is a basis contract. Under such a contract, the Basis is agreed upon and fixed in the contract, but the Futures Price for contracting purposes is taken from the international markets and fixed by the farms' actions at a later date. Such agreements allow farms to lock in what they consider to be a favorable Basis. Under a basis contract, the quantity and quality of grain to be delivered, as well as the delivery period, are set, but the Cash Price is determined once the farm triggers the basis contract, which sets the Futures Price.

73 When P&H buys wheat or canola from a farm, it takes title to the grain at the time the farm delivers the grain to the Elevator. At that point in time, the farm receives the contracted Cash Price for its grain and ownership of the grain then passes to P&H. The Cash Price may be adjusted at the time of delivery of the grain to the Elevator if the quality of the wheat or canola delivered is different from the quality the parties had agreed upon in the contract.

E. P&H's business

74 P&H operates within the grain business by buying and selling grain for its own account throughout the crop year, which spans from August 1 to July 31 of the following year.

75 P&H buys wheat and canola from farmers via a network of 29 Elevators located throughout Western Canada, including the Moosomin Elevator and the 10 Elevators purchased from LDC in December 2019. P&H's 29 Elevators are the entry points to its grain network in Western Canada.

76 P&H sells the varieties of grain it purchases, such as wheat and canola, to customers located in Canada, Europe, Asia, and South America. Just over half of P&H's total wheat and canola sales are for export. P&H's export customers pay for wheat and canola at the Canadian port.

77 In order to move the wheat and canola it sells to its customers located overseas, P&H utilizes the rail network to ship grain from its Elevators in Western Canada to its export terminals located on the West Coast and in Thunder Bay, Ontario.

78 P&H has an interest in three export terminals located near Vancouver in British Columbia, namely, the Alliance Grain Terminal ("*AGT*"), the Fraser Surrey Docks ("*FSD*"), and the FGT, where P&H has recently invested [text omitted]. P&H also has an interest in the Superior terminal located in the port of Thunder Bay in Ontario ("*Superior*"). The vast majority of grain exported by P&H moves through its export terminals. The storage capacities are 102,000 MT at AGT, 18,000 MT at FSD, 176,000 MT at Superior, and 92,000 MT at FGT, where P&H has a partial entitlement to storage and throughput capacity.

79 Export terminals are used to receive grain from rail, segregate and store grain by type and quality attributes, clean grain when required, blend grain, and load grain onto vessels. As with other commodities, wheat and canola of the same grade received from different P&H Elevators are commingled at the terminals. The cleaning and blending of grain occur principally at P&H's export terminals, rather than at its Elevators, given the greater economies of scale available at these terminals.

80 P&H also operates a milling group that sources Canadian wheat to produce flour and cereal products. P&H moves the wheat supplied to its milling group by rail or truck from its Elevators to its mills in Western and Eastern Canada.

81 Additionally, P&H operates a Crop Inputs and Services business, which supplies fertilizer, seed, and pesticides as well as agronomic services to farms through dual crop inputs and grain facilities at its Elevators across Canada. P&H has a "one-stop-shop" crop inputs retail and grain purchase business model. The former LDC Elevators purchased by P&H did not offer crop inputs services.

82 P&H's audited consolidated financial statements for the 2018 fiscal year indicate that, across all of its lines of businesses, it generated consolidated revenues of approximately [text omitted] and gross profit of [text omitted]. By comparison, P&H reported consolidated revenues of approximately [text omitted] and gross profit of [text omitted] for the 2017 fiscal year.

83 In March of every year, P&H sets its annual grain-purchasing budget for Western Canada for the upcoming fiscal year, which begins on May 1 of each year. Its grain purchase targets aim to increase P&H's total grain volumes and share over time.

F. The Moosomin and Virden Elevators

84 Prior to the Transaction, P&H and LDC respectively owned and operated the Moosomin Elevator and the Virden Elevator, located in proximity to one another near the Manitoba-Saskatchewan border. Then, LDC would send grain from the Virden Elevator westward by rail to its export terminals on the West Coast. Following the Transaction, these two Elevators were re-assigned to P&H's Thunder Bay catchment area, meaning that the grain purchased by these Elevators is shipped to the Superior terminal in Thunder Bay. However, the Moosomin Elevator, which is located west of the Virden Elevator, is also in a position to ship grain to P&H's West Coast terminals.

85 For rail transportation, the Moosomin Elevator has 56-car spots while the Virden Elevator has 112-car spots. In terms of storage capacity, the Moosomin Elevator has a capacity of 26,000 MT and an annual throughput capacity in the range of [text omitted] MT. For its part, the Virden Elevator has a storage capacity of 46,000 MT and an annual throughput capacity in the same range of [text omitted] MT.

IV. EVIDENCE — OVERVIEW

86 Over the course of the hearing, the Tribunal heard from 16 lay witnesses and three expert witnesses. Over 250 exhibits were filed.

A. Fact witnesses

(1) The Commissioner

87 The Commissioner led evidence from three farmer witnesses located in Manitoba or Saskatchewan, namely:

- Alistair Pethick: Mr. Pethick and his brother operate a farm located in McAuley, Manitoba. They mainly grow wheat and canola, but also soybeans, oats, and hay as well as other speciality crops in some years. Mr. Pethick sold his wheat to the Moosomin, Virden, and Fairlight Elevators, as well as to the Ceres Elevator located in Northgate, Manitoba;

- Chris Lincoln: Mr. Lincoln and his family own and operate two farms located in Maryfield and Wawota, Saskatchewan. They grow wheat and canola. Mr. Lincoln's farms have the capacity to store 80-85% of his grain. The Fairlight Elevator operated by Viterra is the closest Elevator to Mr. Lincoln's farms. Since harvesting his crops in November 2019, Mr.

Lincoln has sold all his crop to the Fairlight Elevator. In 2018, he sold 20% of his commodity crop to the Virden Elevator and the balance to the Fairlight Elevator; and

• Ian Wagstaff: Mr. Wagstaff owns a 6,000-acre farm approximately two miles south of Manson, Manitoba. He is a wheat and canola farmer. He harvests approximately 100,000 bushels of wheat and canola per year. Mr. Wagstaff can store 60,000 to 70,000 bushels of wheat at his farm, meaning that he must sell approximately 25-30% of his crop at harvest time. In the past two years, he has sold most of his crop to the Virden Elevator.

88 The Commissioner had two other farmer witnesses, [text omitted] and [text omitted], who decided not to testify in public at the hearing. However, the parties filed an agreed statement of facts regarding the testimonies of these two farmer witnesses.

89 The Commissioner also led evidence from Harvey Brooks, who is the General Manager of the Saskatchewan Wheat Development Commission ("*Sask Wheat*"). Sask Wheat is a producer-led organization established to grow Saskatchewan's wheat industry through research, market development, and advocacy. Mr. Brooks has been General Manager of Sask Wheat since 2014. Prior to joining Sask Wheat, Mr. Brooks served as Deputy Minister of Agriculture for the Government of Saskatchewan, Director of Policy and Economic research with the Saskatchewan Wheat Pool, and Head of Corporate Policy at the CWB. He holds a Ph.D. in Economics from Iowa State University and a Masters degree in Agricultural Economics from the University of Saskatchewan.

90 Eight representatives of grain companies other than P&H also testified before the Tribunal for the Commissioner. These companies had provided data to the Commissioner during his investigation of the Transaction. These witnesses were:

• Dean McQueen: Mr. McQueen is the Vice President, Grain Merchandising and Transportation (North America) at Viterra. Viterra markets and handles grain, oilseeds, and pulses. It operates grain elevators and special crop facilities, port terminals, and processing facilities. Mr. McQueen is responsible for overseeing the merchandising and transportation of grain, oilseeds, and pulses, including procurement, through the Viterra country grain Elevator network;

• Ray Elliot: Mr. Elliot is a Manager for Seed Procurement at Bunge's Harrowby Crusher facility located in Russell, Manitoba. Bunge is an agribusiness and food company that buys oilseeds and softseeds from producers and sells finished products to customers. Mr. Elliot is responsible for managing all the seed purchases for Bunge's crushing plants in Western Canada;

• Brett Malkoske: Mr. Malkoske is the Chief Financial Officer of G3. He previously was the Vice President of Business Development and Communications at G3, where he was responsible for external communications and facilitating the development and execution of G3's strategic plans in Canada;

• Darcy Jordan: Ms. Jordan has been a Management Accounting and Reporting Senior Analyst at Cargill since 2019. Cargill is a merchandiser and processor involved in crop inputs product retailing, grain handling, milling, salt distribution, and merchandising. In her role, Ms. Jordan is responsible for Cargill's management reporting, supporting the Manitoba region for margins, and implementing the controls framework and profit and loss statements;

• Kara Hawryluk: Ms. Hawryluk is the Canada Operational Controller at LDC. Along with its parent company Louis Dreyfus Company B.V., LDC is a global merchant and processor of agricultural goods. Ms. Hawryluk is responsible for working with LDC's commercial and operational teams to ensure timely and accurate reporting of Elevator and trading information;

• Jeff Wildeman: Mr. Wildeman is the Origination and Supply Chain Solutions Manager at Ceres. Ceres is involved in the procurement and provision of North American agricultural commodities, industrial products, fertilizers, energy products, and supply chain logistics services. Mr. Wildeman is responsible for the origination of Canadian agricultural commodities for Ceres's grain merchandising operations;

- Mark Irons: Mr. Irons is the Vice-President, Softseed Crush for ADM, an American global food processing and commodities trading corporation. Mr. Irons oversees the management of commercial activities related to ADM's softseed crush assets in North America; and

- Bryce Geddes: Mr. Geddes is a Marketing Specialist at Richardson, a worldwide handler and merchandiser of major grains and oilseeds, and a vertically integrated processor and manufacturer of oats and canola-based products. Mr. Geddes is responsible for collecting and analyzing transactional data for Western Canadian markets in which Richardson conducts its grain and crop inputs businesses.

91 The Tribunal notes that the Commissioner obtained data from nine grain handling companies including 15 Elevators and five Crushers. This data was used in the preparation of the expert evidence filed by the Commissioner.

92 The Tribunal generally found the Commissioner's farmer witnesses and Mr. Brooks to be credible, forthright, helpful, and impartial. They were knowledgeable about their respective businesses and farm operations. With respect to the representatives of competing grain companies and Crushers, the Tribunal found that these witnesses were reliable and gave no reasons to doubt the accuracy of the transaction data they provided.

(2) P&H

93 Turning to P&H, it led evidence from the following three farmer witnesses, who are all based within the Commissioner's proposed geographic market and his narrower "corridor of concern" in Manitoba and Saskatchewan:

- Kristjan Hebert: Mr. Hebert owns a 22,000-acre farm located in Fairlight, Saskatchewan, which is operated through Hebert Grain Ventures. Mr. Hebert grows wheat and canola as well as malt barley, hybrid rye, and yellow peas;

- Tim Duncan: Mr. Duncan owns and operates an approximately 3,000-acre farm located west of Cromer, Manitoba. He grows wheat, canola, and oats. From year-to-year, he will also grow barley, peas, and/or soybeans; and

- Edward Paull: Mr. Paull owns and operates an approximately 3,400-acre farm located 4.5 miles outside of Elkhorn, Manitoba, a town located between the Moosomin and Virden Elevators. He grows wheat and canola every year.

94 Mr. Heimbecker, the CEO of P&H, also testified at the hearing and was the only witness representing P&H itself. In addition to being CEO, Mr. Heimbecker is the President of P&H's Grain Division Canada. Mr. Heimbecker has been at P&H and in the grain business for his entire professional career, which started in May 1987. He was named CEO of P&H in September 2019. As President of Grain Division Canada, he is in charge of P&H's grain business for all of Canada. Mr. Heimbecker also acted as P&H's main witness on the issue of efficiencies.

95 As was the case for the Commissioner's farmer witnesses, the Tribunal generally found P&H's farmer witnesses to be credible, forthcoming, helpful, and impartial. As to Mr. Heimbecker, the Tribunal also found him forthcoming and knowledgeable about P&H's business. The Tribunal, however, observes that Mr. Heimbecker was not close to the day-to-day operations of P&H's Elevators, and was of more limited assistance to the panel in this respect. In addition, some of his evidence was distinctly oriented towards a successful outcome for P&H in this proceeding and was therefore less helpful to the Tribunal in such instances.

B. Expert witnesses

96 Three expert witnesses provided expert reports and testified at the hearing.

(1) The Commissioner

97 Dr. Nathan Miller and Mr. Andrew Harington testified on behalf of the Commissioner.

(a) Dr. Miller

98 Dr. Miller is the Saleh Romeih Associate Professor at the McDonough School of Business at Georgetown University in Washington, DC. He holds a B.A. in Economics and History from the University of Virginia and a Ph.D. in Economics from the University of California at Berkeley. He served as a Visiting Professor at Toulouse School of Economics in 2019-2020. Prior to joining Georgetown University in 2013, he served as a Staff Economist in the U.S. Department of Justice from 2008 to 2013. Dr. Miller's area of expertise is in industrial organization, with a specialization in antitrust economics and a focus on collusion and the competitive effects of mergers.

99 The Commissioner asked Dr. Miller to prepare a report examining the competitive effects and the deadweight loss ("*DWL*"), if any, with respect to the acquisition of grain Elevators and related assets from LDC by P&H (namely, the Transaction). His report focused specifically on the Virden Acquisition. Dr. Miller was also asked to reply to the report filed by P&H's expert, Ms. Margaret Sanderson, in response to his initial expert report.

100 With the parties' agreement, Dr. Miller was accepted as an expert qualified to give opinion evidence in industrial organization and competition law economics. The Tribunal generally found Dr. Miller to be credible, forthright, objective, and impartial. Dr. Miller was a cooperative witness and explained his models and analyses with clarity.

(b) Mr. Harington

101 Mr. Harington is a Chartered Professional Accountant, a Chartered Financial Analyst charterholder, and a Chartered Business Valuator. He is a Principal in the Toronto office of The Brattle Group, an economic consulting firm with offices around the world. Mr. Harington has provided business and intellectual property valuation and merger and acquisition advisory services for over 25 years.

102 Mr. Harington's mandate was to comment on the witness statements of Mr. Heimbecker as they relate to an assessment of efficiencies under section 96 of the Act. Mr. Harington was asked in particular to comment on whether, and if so the extent to which, the efficiencies that Mr. Heimbecker identified are cognizable under section 96 of the Act and would likely be lost if the Tribunal made the orders sought by the Commissioner.

103 At the hearing, Mr. Harington was qualified as an expert in the quantification of efficiencies. The Tribunal found Mr. Harington to be credible, forthright, objective, and impartial, as well as willing to acknowledge the weaknesses/shortcomings in his own evidence or in the Commissioner's case. He was a reliable and knowledgeable expert.

(2) P&H

104 Ms. Margaret Sanderson appeared on behalf of P&H as an expert witness.

105 Ms. Sanderson is the Vice President and the global practice leader of the Competition and Antitrust Economics practice for the consulting firm Charles River Associates International Limited, a multinational firm that provides economic, financial, and business strategy consulting. She holds a M.A. in Economics and a B.Sc. in Economics and Quantitative Methods from the University of Toronto. Prior to joining Charles River Associates, Ms. Sanderson was Assistant Deputy Director of Investigation and Research within the Economics and International Affairs Branch of the Competition Bureau. She has 30 years of experience addressing the competitive effects of mergers and other firm conduct.

106 Ms. Sanderson's mandate was to provide her opinion on the likely anti-competitive effects of P&H's Acquisition of the Virden Elevator and to respond to the initial expert report of Dr. Miller.

107 With the parties' agreement, Ms. Sanderson was accepted as an expert qualified to give opinion evidence in industrial organization and competition law economics. The Tribunal generally found Ms. Sanderson to be credible, forthright, objective, and impartial. Ms. Sanderson was helpful to the panel in her explanations.

C. Documentary evidence

108 The list of exhibits that were admitted in this proceeding is attached as Schedule "B" to these Reasons.

V. PRELIMINARY ISSUES

109 At the hearing, counsel for P&H raised issues regarding the Commissioner's evidence and obligations in these proceedings. These preliminary matters must be addressed before dealing with the main issues in dispute in the Commissioner's Application. They are as follows: 1) challenges to the evidence provided by the Commissioner's experts; 2) adverse inferences and the Commissioner's duty of fairness and obligations regarding the gathering of evidence; and 3) the legal burden of proof in this Application. Each will be dealt with in turn.

A. Challenges to the Commissioner's experts

(1) Mr. Harington's evidence

110 At the hearing, P&H challenged a number of paragraphs found in Mr. Harington's expert report on the issue of efficiencies. In particular, P&H asked the Tribunal to strike or give no weight to approximately 49 paragraphs of Mr. Harington's report, on the basis that they express opinions of law related to statutory construction or the interpretation of cases. P&H further asserted that a number of other paragraphs of Mr. Harington's expert report constitute inappropriate legal opinion evidence or inappropriate hearsay evidence related to the grain industry.

111 The Commissioner responds that none of the challenged paragraphs should be struck. He submits that Mr. Harington set out his understanding of the legal framework as it informed his opinion on efficiencies. With respect to P&H's claim that some paragraphs of Mr. Harington's report should be struck because they constitute opinion evidence related to the grain industry, the Commissioner explains that efficiencies and economic experts need to set out their factual understanding of the industry before they can give their opinion. The Commissioner further notes that in this case, Mr. Harington cited all sources in support of the factual statements contained in his report.

112 For the reasons that follow, the Tribunal agrees in part with P&H and will give limited weight to the legal opinions expressed by Mr. Harington as part of his expert report.

113 As the Tribunal noted in The Commissioner of Competition v Vancouver Airport Authority, 2019 Comp Trib 6 (“, it has consistently applied the principles articulated by the SCC in R v Mohan, [1994] 2 SCR 9 (“ and its progeny when it is tasked with determining the admissibility of expert evidence (*VAA CT* at para 107). In White Burgess Langille Inman v Abbott and Haliburton Co, 2015 SCC 23 (“, the SCC set out a two-step test for determining the admissibility of expert evidence. It held that in order to be admissible, expert opinion evidence must first meet the four threshold requirements established in *Mohan*, namely, relevance, necessity in assisting the trier of fact, absence of any exclusionary rule, and a properly qualified expert. At the second step, the decision maker engages in a balancing exercise and weighs the potential benefits of admitting the proposed evidence against the risks.

114 It is well recognized that, under the principle of "necessity," expert evidence must provide the courts with information that is considered as being "outside the experience and knowledge of a judge" (Mohanat p 23). The proposed expert opinion evidence must be necessary to assist the trier of fact, bearing in mind that necessity should not be judged strictly. This is notably the case where the expert evidence is needed to assist a court or a tribunal due to the technical nature of the issues at stake, or where the expertise is required to enable the decision maker to appreciate a matter at issue and to help it form a judgment on a matter where ordinary persons are unlikely to do so without the help of those with special knowledge.

115 Experts, however, must not substitute themselves for the trier of fact (Mohanat p 24). As the Tribunal stated in *VAA CT*, "evidence that provides legal conclusions or opinions on issues and questions of fact to be decided by the court is inadmissible because it is unnecessary and usurps the role and functions of the trier of fact" (*VAA CT* at para 109, referring to Quebec (Attorney General) v Canada, 2008 FC 713 at para 161, aff'd 2009 FCA 361, 2011 SCC 11 and to Mohanat p 24). In sum, expert witnesses are not entitled to opine on legal matters, which fall within the scope of the court or Tribunal's experience

and knowledge. An expert opinion that is analogous to a memorandum of fact and law can become inadmissible as it "merely summarizes legal decisions, offers legal submissions on those decisions, and then expresses the author's personal views on the ultimate issue that is for this Court to decide" (Es-Sayyid v Canada (Public Safety and Emergency Preparedness), 2012 FCA 59 at para 41). The closer the expert evidence approaches an opinion on the ultimate issue to be decided, the stricter the application of the principle will be.

116 In many paragraphs of his expert report, Mr. Harington examines in detail the framework for quantifying cognizable efficiencies under section 96 of the Act. He does an extensive review of the provisions of the Act, of the case law, and of the Competition Bureau's 2011 Merger Enforcement Guidelines, Competition Bureau Canada, October 6, 2011 ("*2011 MEGs*")[4]. Relying on these legal sources, he provides his interpretation of section 96 of the Act dealing with efficiencies.

117 It is not disputed that Mr. Harington is not a legal expert. The Tribunal agrees with P&H that the impugned paragraphs of his report constitute legal conclusions and opinion on an important issue that is up to the Tribunal to decide upon, namely, efficiencies. There is no doubt that the interpretation of section 96 and the determination of the proper legal framework to assess the efficiencies defence advanced by P&H falls within the Tribunal's experience, expertise, and knowledge. The legal opinion expressed by Mr. Harington on this issue, strictly speaking, intrudes on the role and functions of the Tribunal.

118 At the same time, the Tribunal acknowledges the extensive and well-recognized experience and expertise of Mr. Harington regarding the complex issue of efficiencies in merger reviews. Section 96 of the Act is a very technical provision and the Tribunal appreciates that Mr. Harington's comments on how the jurisprudence has been thought through were made to provide the background of his analysis and to help the panel understand his reasoning. The Tribunal accepts that it would have been difficult for Mr. Harington to prepare his expert report and offer his opinion on P&H's claimed efficiencies without providing some legal assumptions or basis to anchor his assessment of the particular facts in this case. In these circumstances, the Tribunal will not declare the impugned paragraphs of Mr. Harington's report inadmissible as they are necessary to understand his opinion on efficiencies, but it will give them limited weight in the determination that the Tribunal is called upon to make on the appropriate legal framework under section 96 of the Act.

119 Turning to P&H's complaint about Mr. Harington's comments on the Canadian grain industry, the Tribunal accepts that Mr. Harington is not a grain industry expert. The Commissioner was indeed not offering Mr. Harington's evidence as such. However, the Tribunal is satisfied that, in making comments on the grain industry in his expert report, Mr. Harington was simply providing his factual understanding of the grain industry based on the documents contained in the evidence. P&H also had an opportunity to cross-examine him to expose the limits of his knowledge on this front. The factual references to the grain industry made by Mr. Harington are grounded on various portions of the evidence, and the Tribunal is not convinced that they should be declared inadmissible or given no weight. The Tribunal is not accepting what Mr. Harington says on the grain industry as a fact. It is simply taking note of the factual sources Mr. Harington relied on for his opinions.

(2) Objectivity of the Commissioner's experts

120 P&H also asserted in its closing submissions that Dr. Miller failed to provide his expert opinion in an objective manner because he advanced a product market based on GHS, without examining the possibility of alternative product markets. P&H further submitted that neither Dr. Miller nor Mr. Harington opined objectively in their expert reports because of what it termed "their speculative approach" to what has occurred since the Transaction was completed. Echoing an observation made by Justice Moldaver (then at the Ontario Court (General Division)) in R v Clarke Transport Canada Inc, 1995 CanLII 7327, P&H claimed that the Commissioner's experts were "hired guns."

121 The Tribunal does not agree.

122 Nothing in Dr. Miller's and Mr. Harington's expert reports and testimonies, including in their respective cross-examinations, allows the Tribunal to conclude that these two experts did not provide their evidence objectively and in an impartial manner. Experts have a duty to provide independent assistance to a court at common law (*White Burgess* at para 26). Like many courts at the federal level and in provinces and territories, the Tribunal has also provided explicit guidance on the duty

of experts by issuing its *Notice on Acknowledgement of Expert Witnesses* in December 2010. Pursuant to that Notice, experts appearing before the Tribunal have the obligation to sign a form acknowledging that they will comply with the Tribunal's code of conduct for expert witnesses.

123 The Tribunal's code of conduct provides that experts must assist the Tribunal impartially, that they must be independent and objective, and that their role should not be conflated with that of an advocate for a party. In the Tribunal's opinion, this is exactly what both Dr. Miller and Mr. Harington have done in this case. P&H's claim that they were "hired guns" is entirely without merit and finds no support in the evidence heard by the Tribunal in this case.

B. The Commissioner's duty of fairness and adverse inferences

124 A second area of preliminary issues relates to the Commissioner's duty of fairness and his obligations regarding the gathering of evidence in the context of this Application. More specifically, P&H asked the Tribunal to draw adverse inferences against the Commissioner. P&H's position is two-fold. First, P&H submitted that the Tribunal should draw an adverse inference against the Commissioner "generally" in this proceeding. Second, P&H argued that an adverse inference should be drawn against the Commissioner because he failed to obtain and produce evidence that was "peculiarly" within his power with respect to subsection 96(3) of the Act on efficiencies and the counterfactual test established in subsection 96(1).

125 In its written submissions, P&H submitted that there are some circumstances in which a party who bears a burden of proof is not the party best situated to adduce the evidence related to the issue at stake, because the relevant facts lie particularly within the knowledge of the other party. The failure of a party to adduce evidence within its power may be considered as a matter of evidentiary weight and can lead to an adverse inference against it. In support of its position, P&H relied on the SCC's decision in R v Jolivet, 2000 SCC 29 (“.

126 P&H argued that in weighing the evidence in the record in this Application generally, and more specifically under section 96, the Tribunal must be "alive to what evidence is *not* in the record." P&H maintained that, if there are gaps in the evidence, and the missing evidence was uniquely within the ability of the Commissioner to obtain, the Tribunal should weigh this consideration and be prepared to draw an adverse inference that such evidence, had it been produced, would not support the Commissioner's position with respect to the Application generally and to efficiencies under section 96.

127 In addition to the legal principles set out in *Jolivet*, P&H also referred to Tribunal decisions which, according to P&H, established a general duty of fairness owed by the Commissioner during proceedings under the Act (Commissioner of Competition v Canada Pipe Company, 2004 Comp Trib 2 (“ at paras 60-64, aff'd 2004 FCA 76; see also Commissioner of Competition v Canada Pipe Company, 2003 Comp Trib 15 (“ at para 53).

128 During cross-examination of the Commissioner's witnesses, counsel for P&H posed questions designed to show that the witnesses had additional documents, or information, or both, that the Commissioner had not elected to obtain and disclose, or had not included in the individual's witness statement.

129 During oral argument at the hearing, P&H further submitted that while the Commissioner had collected documents from the merging parties, made market contacts, and collected data from grain companies and Crushers prior to commencing this proceeding, the more important question was what the Commissioner did *not* obtain and file before the Tribunal. P&H contended that the Commissioner did not request nor obtain, from the grain companies or Crushers, any contemporary business documents related to market shares, markets, rail capacity and expansions, excess capacity, barriers to entry, or competition generally. According to P&H, it was incumbent on the Commissioner, acting in the public interest, to investigate the matter fully before commencing this proceeding and to put a full and proper evidentiary record before the Tribunal. The Commissioner having failed to ask for and obtain the evidence, P&H claims that an adverse inference should be drawn by the Tribunal against him.

130 Not surprisingly, the Commissioner disagrees with P&H's submissions. During the hearing, the Commissioner submitted that he had complied with his obligations. The Commissioner disagreed with P&H's characterization of Justice Blanchard's reasons in *Canada Pipe* *2004* because in that case, the Tribunal considered the 1994 Competition Tribunal Rules, SOR/94-290,

which are no longer in effect. Relying on McIlvenna v Viebig, 2012 BCSC 218, aff'd 2013 BCCA 411, the Commissioner argued that the decision to draw an adverse inference is discretionary and should not occur unless it is warranted in all the circumstances.

131 At the hearing, the Commissioner further argued that *Jolivet* was a criminal case about whether the Crown's failure to call a witness at a criminal trial could be the subject of comment in the address to a jury by defence counsel. In the Commissioner's submission, the decision in *Jolivet* confirmed that the Crown was under no obligation to call a witness it considered unnecessary to its case.

132 The Commissioner also countered P&H's arguments about best evidence with his own submission, stating that the best evidence of how P&H competes on a day-to-day basis at an Elevator through pricing should have come from grain merchants such as P&H's employees, rather than relying solely on the evidence of Mr. Heimbecker, a senior executive of P&H. The Commissioner noted that two specific P&H employees were exclusively within the control of P&H and that there was no legitimate explanation for not calling them as witnesses.

(1) Legal principles

(a) Adverse inferences

133 The drawing of an adverse inference from the *absence* of evidence relies on the reasoning that the failure by a party to call certain evidence may, depending on the circumstances, amount to an implied admission that the evidence would be contrary to the party's case, or at least would not support it (*Jolivet* at para 28).

134 In *Jolivet*, the SCC considered whether a jury was entitled to draw an adverse inference from the Crown's failure to call a witness. During the trial, the Crown had indicated to the jury, twice, that it would be calling the witness to corroborate important admissions allegedly made by the accused. Just prior to the close of the prosecution's case, the Crown advised the court that it no longer intended to call that witness and provided an explanation for this decision. Speaking for the SCC, Justice Binnie referred to the general rule developed in civil cases about adverse inferences from the failure to tender a witness, noting that a party may provide a satisfactory explanation for not doing so. A party may have no special access to the potential witness, or the missing proof may lie in the peculiar power of the party against whom the adverse inference is proposed — in which case the argument for an adverse inference is stronger (*Jolivet* at paras 25 - 27). The SCC also held that one "must be precise about the exact nature" of the adverse inference to be drawn. The SCC concluded that, because Crown counsel had announced to the jury its intention to call the allegedly corroborative witness, an adverse inference of "unhelpfulness" would have been a fair result owing to the Crown's failure to substantiate its assertion of the existence of corroborative evidence (*Jolivet* at paras 29-30).

135 The authors of Sopinka, Lederman & Bryant, *The Law of Evidence in Canada*, 5th ed (LexisNexis Canada Inc, 2018) describe the situations in which an adverse inference may be drawn as follows:

> §6.471 In civil cases, an unfavourable inference can be drawn when, in the absence of an explanation, a party litigant does not testify, or fails to provide affidavit evidence on an application, or fails to call a witness who would have knowledge of the facts and would be assumed to be willing to assist that party. In the same vein, an adverse inference may be drawn against a party who does not call a material witness over whom he or she has exclusive control and does not explain it away. The inference should only be drawn in circumstances where the evidence of the person who was not called would have been superior to other similar evidence. The failure to call a material witness amounts to an implied admission that the evidence of the absent witness would be contrary to the party's case, or at least would not support it.
>
> §6.472 An adverse inference should be drawn only after a prima facie case has been established by the party bearing the burden of proof.

136 The Federal Court of Appeal ("*FCA*") has applied this passage in Deyab v Canada, 2020 FCA 222 at para 46 and Caron Transport Ltd v Williams, 2020 FCA 106 at para 10.

137 The FCA also considered adverse inferences in Toronto Real Estate Board v Commissioner of Competition, 2017 FCA 236 (" and Apotex Inc v Canada (Health), 2018 FCA 147 (". In *TREB FCA*, the court concluded that the Tribunal made no error in declining to draw an adverse inference against the Commissioner in the circumstances. The FCA held that the requested inference was tantamount to finding that the Commissioner had a legal obligation to quantify anti-competitive effects under section 92, which he had not because of the binding precedent issued by the SCC in *Tervita SCC*. In addition, the FCA stated as follows with respect to the Commissioner's and the Tribunal's roles in the proceeding:

> [104] Considering that the Commissioner had no such legal obligation, he, like any other plaintiff, had to decide what evidence he had to put forward to prove his case. As we know, he chose to do so by way of qualitative evidence and in so doing, he took the risk of failing to persuade the Tribunal that the anti-competitive effects of TREB's practice resulted in a substantial prevention of competition. As it turned out, the Tribunal was persuaded by the qualitative evidence adduced by the Commissioner.
>
> [105] We have carefully considered the case law and cannot see any basis to accept TREB's and CREA's proposition that the Tribunal ought to have drawn an adverse inference against the Commissioner for failing to conduct an empirical assessment of markets in the United States and in Nova Scotia, or for that matter in the GTA. That, in our respectful view, would be akin to giving the Tribunal the power to dictate to the Commissioner how he should present his case. There is no authority for such a proposition.
>
> [Emphasis added.]

138 In *Apotex*, the FCA confirmed that recent decisions have treated the drawing of an adverse inference as a matter of discretion, to be exercised only where warranted in all of the circumstances. The court identified two reasons for this evolution. First, court rules now go a long way towards rendering witnesses and documents available to both sides, through discovery and other procedural mechanisms. Second, courts have recognized that whether or not an adverse inference is warranted on particular facts is bound up inextricably with the adjudication of the facts (*Apotex* at para 68, citing *TREB FCA* at para 107).

(b) Discovery under the current CT Rules

139 Pursuant to Rule 60 of the CT Rules, a party to a proceeding has to serve an affidavit of documents on each other party, identifying the documents that are "relevant" to any matter in issue and that are or were in the possession, power, or control of the party. CT Rule 60 does not distinguish between the Commissioner and the other parties for the purposes of discovery, and parties are all subject to the requirement of disclosing what is "relevant." CT Rule 65 adds that access to what is disclosed must be provided.

140 Relevance is determined by the way the issues are framed in the pleadings. A document of a party is considered relevant if the party intends to rely on it, if the document tends to adversely affect or support another party's case, or if the document might fairly lead a party to a "train of inquiry" that could have either of these consequences (Antonio Di Domenico, *Competition Enforcement and Litigation in Canada*, (Toronto: Emond Montgomery Publications Limited, 2019) ("*Di Domenico*") at p 736, referring to subsection 222(2) of the Federal Courts Rules, SOR/98-106 ("*FC Rules*")). The definition of relevance is therefore quite broad and applies to all parties.

141 FC Rule 226 further provides that the disclosure obligation is continuous. This requirement has been imported by the Tribunal in its proceedings (Tervita v Canada (Commissioner of Competition), 2013 FCA 28 (" at para 74; The Commissioner of Competition v Air Canada, 2012 Comp Trib 20 at para 22). The continuous disclosure obligation entails that the initial disclosure affidavit must be updated any time a party becomes aware that it is deficient.

142 The most recent court decision to have considered the Commissioner's disclosure obligations is Vancouver Airport Authority v Commissioner of Competition, 2018 FCA 24 (", in which the FCA said the following:

[30] The procedural fairness obligations require the Commissioner of Competition to disclose to the Airport Authority evidence that is relevant to issues in the proceedings. This is necessary for the Airport Authority to know the case it has to meet and to fairly defend itself against the allegations. Often — as the Commissioner has recognized in this case by releasing roughly 8,300 documents from his investigatory file — this includes exculpatory material or other material resting in the investigatory file that could assist the party whose conduct is impugned in testing the evidence called by the Commissioner or in building its own case. [...] In some cases, there may be limits on the obligation to disclose based on materiality, proportionality, applicable legislative standards and the nature of the proceedings. [...]

[Citations omitted.]

143 The FCA further noted that the Tribunal proceedings are adjudicative in nature, which typically commanded high procedural fairness requirements (*VAA FCA* at para 29).

(c) Disclosure and the Commissioner's duty of fairness

144 In light of P&H's submissions, it is also important to consider the issue of adverse inferences in the context of the more general legal principles governing the Commissioner's disclosure obligations and duty of fairness. These go back to the Tribunal's decision in *Canada Pipe 2004*.

145 In *Canada Pipe 2004*, the respondent had requested additional disclosure from the Commissioner and to examine witnesses before the hearing. The procedural rules governing Tribunal proceedings back then were different from today's; they applied a standard of *reliance* for the Commissioner's general disclosure obligations, as opposed to the standard of *relevance* currently in place. In that case, the Tribunal dismissed the motion for additional discovery of documents and persons.

146 In the Tribunal's reasons, Justice Blanchard addressed the "duty of fairness" of the Commissioner (*Canada Pipe 2004* at paras 60-64). He found that, although the Commissioner's disclosure obligation was dictated by a standard of reliance under the then-rules, the Commissioner was "nonetheless required to act fairly in the exercise of her duties." He noted that the Commissioner is a public officer with significant statutory powers to gather information and exercise public interest privilege, and there was a presumption that the Commissioner was acting in good faith. He further found that in those proceedings, the Commissioner was not a normal adversary, but rather a public officer with a statutory obligation to act fairly (*Canada Pipe 2004* at para 62; see also *Canada Pipe 2003* at para 53). Justice Blanchard likened the Commissioner's obligations to that of a prosecutor who must act fairly, referring to the criminal law decisions in Boucher v The Queen, [1955] SCR 16 (“ and R v O'Connor, [1995] 4 SCR 411 (“. He then stated:

[64] It naturally follows that just as the Crown prosecutor must be motivated by fairness and not the notion of winning or losing, so too the Commissioner must be motivated by goals of fundamental fairness and not by achieving strategic advantage on the proceeding. This is not to say that the duties articulated in such landmark criminal cases as *Boucher*, *supra*, or *O'Connor*, *supra*, should be directly imported into an administrative law setting. The Tribunal is an administrative Tribunal with an administrative process and procedural fairness must be customized to accommodate the expedited process required by the legislation and rules which govern its proceedings. Though the standard of disclosure may justifiably be different in proceedings before the Tribunal than in criminal proceedings, the underlying notion of fairness must remain constant for both. It is in this context that the reliance standard is to be applied.

147 The Tribunal pauses to note that Justice Rand's opinion in *Boucher* made comments about all available proof of facts being presented in a criminal matter. The passage from Justice L'Heureux-Dubé's reasons for the SCC in *O'Connor* further referred to "full and fair disclosure as a fundamental aspect of the Crown's duty to serve the Court as a faithful public agent, entrusted not with winning or losing trials but rather with seeing that justice is served" (*O'Connor* at para 101).

148 P&H's arguments in this proceeding do not concern *disclosure* obligations of the Commissioner so much as whether the Commissioner has an obligation to *collect* evidence (*i.e.*, information, documents, and data) from third parties during an investigation or inquiry, and then to present that evidence fully to the Tribunal during proceedings commenced under section

92. The Tribunal observes that P&H cited no case dealing specifically with the Commissioner's obligation to gather evidence during an investigation or inquiry, nor about whether the Commissioner may have an obligation to obtain an order under section 11 of the Act before a hearing, in order to assist a respondent with its case. P&H also did not refer to any cases involving other statutory officers' or law enforcement officials' obligations to carry out full and fair investigations or to obtain court orders to gather information for a party whose transaction or conduct is under review.

149 Neither party referred to any prior determination of the Tribunal or appellate courts about the scope of the Commissioner's obligation to present a full evidentiary record to the Tribunal, nor the obligations of any comparable statutory or law enforcement official (other than *Boucher*). Indeed, neither party referred to the remarks made by the FCA in *TREB FCA* at paragraphs 104 - 105, about the Commissioner's decisions in presenting a case to the Tribunal.

150 In addition, since Justice Blanchard's decision, the procedural landscape during Tribunal proceedings, including disclosure rules, has changed. The Tribunal's procedural rules passed in 2002 have been replaced by the CT Rules issued in 2008, which now contemplate a relevance-based approach to documentary discovery of the Commissioner. Since *Canada Pipe 2004*, the FCA has also revised the characteristics of the public interest privilege that existed in 2004 and examined procedural fairness obligations during Tribunal proceedings (*VAA FCA* at paras 28-35).

151 In this context, it is fair to consider whether, and how, the Commissioner's duty of fairness may have changed since *Canada Pipe 2004*, owing to a respondent's right to disclosure and production of all non-privileged records in the possession or control of the Commissioner under the current CT Rules and the respondent's ability to make its own comprehensive submissions and call its own evidence based on that same body of evidence. The Tribunal did not receive meaningful legal submissions on that question, nor does it have submissions on how the absence of the third party evidence in the present case adversely affected P&H's already-vigorous defence against the Commissioner's case — apart from general submissions criticizing the Commissioner's efforts to collect the evidence and examples of what else could have been requested.

(2) Tribunal's assessment

152 With these considerations in mind, the Tribunal will now consider the adverse inferences requested by P&H.

(a) The "general" adverse inference

153 For the following reasons, the Tribunal declines P&H's request to draw an adverse inference against the Commissioner "generally" in this proceeding.

154 First, P&H provided no specifics as to the exact nature of the adverse inference to be drawn. During the hearing, it made submissions that criticized the Commissioner's investigation and lack of document production and data gathering, and it added generalized submissions of the same nature in oral argument. However, it did not specify that, because a particular piece of evidence was not tendered to the Tribunal or because a certain witness did not testify, the Tribunal should infer that some particular fact did occur, or that the Tribunal should draw an adverse inference of a specific nature against the Commissioner.

155 The Tribunal finds it preferable to be asked much more precisely what inference to draw and on what basis, before deciding whether to draw an adverse inference (*Jolivet* at para 28). In the Tribunal's view, such specificity is particularly important when a party asks the Tribunal to draw an inference against a party based on the absence of evidence or the absence of a witness. In the case at bar, the generalized adverse inference requested by P&H is too amorphous for meaningful adjudication.

156 Second, the Tribunal is unaware of anything that prevented P&H from attempting to obtain documents or information itself (setting aside additional data, discussed separately below). P&H could have interviewed the farmer witnesses and could have attempted to interview or send written questions to the grain companies' witnesses in advance of the hearing (or even while the merger review was occurring), and could have asked them for documents. There was no suggestion that P&H attempted to do so and was rebuffed, or that the Commissioner tried to interfere with any such attempts.

157 Third, the Commissioner does not bear the exclusive or entire burden of adducing evidence for the Tribunal. In litigation in respect of a merger under section 92, the Commissioner is not required to present every bit of evidence at the hearing. Contested proceedings under section 92 are adversarial by nature. The Commissioner called some farmer witnesses to support his case under section 92 in relation to issues for which he had the evidentiary and legal burden of proof. It was the Commissioner's risk not to obtain and present specific evidence from them (*TREB FCA* at paras 104-105).

158 This is also not a situation where the witnesses were not called to testify at all. P&H had the opportunity to cross-examine each of the Commissioner's farmer witnesses to expose missing or incomplete information, and it did so in several respects. The cross-examination revealed that there were additional inquiries that *could* have been made to the farmer witnesses and there were documents that *could* have been requested from them.

159 In these circumstances, the Tribunal prefers a more surgical alternative instead of a general adverse inference against the party that called the witness to testify. Incomplete evidence gathered from or presented by a witness during examination-in-chief may adversely affect the credibility or reliability of the witness's testimony. Exposed during cross-examination at a hearing, it can sometimes be damaging to a party's case. Given that P&H could also have easily sought the same information and documents, apparently did not do so, but exposed the issues at the hearing, the Tribunal concludes that the Commissioner took on the risk of failing to discharge his burden under section 92 and of having adverse reliability or credibility findings made by the Tribunal against the witnesses.

160 Fourth, the absence of data from rival Elevators is addressed separately, below. That analysis supports the Tribunal's conclusions on the requested general adverse inference.

161 Finally, having considered the parties' submissions, the Tribunal is disinclined in this case to make a legal ruling with potentially far-reaching consequences concerning the Commissioner's general duty of fairness as it concerns either gathering evidence for a proceeding under section 92 or presenting that evidence. The Tribunal notes that P&H's pleading in response to the Application ("*Response*") did not express any concerns about the Commissioner's investigation or inquiry into the proposed merger. P&H did not later seek to amend its pleading after it received the Commissioner's Affidavit of Documents or after its oral discovery of the Commissioner. Nor did P&H raise any concerns to the Tribunal on receipt of the witness statements, or else seek any further order before the hearing. Considering how and when P&H raised the issue and the scope of the parties' submissions, the Tribunal considers it unnecessary and inappropriate to make more detailed comments.

162 In light of the foregoing, the Tribunal exercises its discretion not to make a generalized adverse inference against the Commissioner. In stating this conclusion, the Tribunal should not be understood to express a view on the scope of the Commissioner's fairness duties as submitted by P&H and denied by the Commissioner in this case. Resolving issues related to the Commissioner's general fairness obligations in the disclosure process will be for another day.

(b) The adverse inferences related to efficiencies under section 96

163 P&H also argued that the Tribunal should draw a more specific adverse inference against the Commissioner for his failure to obtain certain data from third-party grain companies that compete with it at the Virden Elevator, and which had an impact on the evidence relating to the efficiencies defence.

164 P&H took the position that the Transaction would increase throughput at the Virden Elevator, resulting in cognizable efficiencies for the purposes of section 96. During the cross-examination of Mr. Harington, the Commissioner's expert on efficiencies, P&H drew attention to paragraph 130 of Mr. Harington's expert report. In that paragraph, Mr. Harington stated that the only way a redistribution of throughput between competing Elevators would result in an efficiency to the Canadian economy is if "the entity from which the increased throughput is being taken operates at a higher per unit variable operating cost" than P&H (Exhibits P-A-195, CA-A-196 and CB-A-197, Expert Report of Mr. Andrew Harington ("*Mr. Harington Report*"), at para 130). Mr. Harington testified under cross-examination that he did not have the variable operating costs of the rival Elevators to the Virden Elevator. Without that, he said, he could not do the comparison contemplated by his paragraph 130. Because his mandate was to respond to the alleged efficiencies claimed by P&H in Mr. Heimbecker's initial witness statement

on efficiencies, rather than to determine the efficiencies himself, Mr. Harington did not request or obtain the variable operating cost data of the rival Elevators.

165 Mr. Harington testified that in fact, he would have required a lot more than the variable operating costs data: he would have needed all of the data on locations of farms that shifted volumes of grain from one Elevator to another, and what the transportation costs were for those farms. He would have looked at the efficiencies implications for all of Canada. Mr. Harington further noted that he would not reasonably expect P&H to have its competitors' variable cost data. However, Mr. Harington testified that he had all of the evidence he needed to do the job he was asked to do (*i.e.*, to respond to P&H's position on increased throughput at the Virden Elevator as an efficiency under section 96).

166 P&H submitted that the Tribunal should draw an adverse inference against the Commissioner owing to the Commissioner's failure to request and obtain the variable operating costs data from rival Elevators because, without the data, a precise assessment could not be completed for the purposes of the counterfactual test contemplated in subsection 96(1) of the Act and the redistribution analysis under subsection 96(3). According to P&H, the Commissioner could have obtained the required data either by request or by obtaining an order under section 11 of the Act.

167 The Commissioner responded that he had no such burden under section 96. Referring to paragraph 122 of the SCC's decision in *Tervita SCC*, the Commissioner observed that the merging parties bear the onus of establishing all elements of the efficiencies defence after the Commissioner has discharged his initial burden to prove the anti-competitive effects and the DWL for the purposes of section 96. A respondent's burden includes proof of the extent of the efficiency gains and whether the gains are greater than and offset the anti-competitive effects. The Commissioner noted that P&H's position, according to which the Commissioner did not collect evidence enabling it to prove an efficiency claim, was not raised in its own initial Response pleading. The Commissioner noted that P&H could have sought, but did not seek, discovery from third parties to obtain the information it now requires. P&H decided to discharge its burden to quantify cognizable efficiencies through a witness statement from Mr. Heimbecker, rather than from an expert witness. According to the Commissioner, P&H cannot shift the burden onto the Commissioner for its own failure to discharge its burden.

168 The Tribunal agrees with the Commissioner and will not draw the specific adverse inferences requested by P&H against the Commissioner in relation to efficiencies. There are three reasons for this determination.

169 First, it is not clear what exactly P&H seeks from the Tribunal by way of adverse inference. Again, P&H did not specify which rival Elevators' data were at issue, who owed them, what the variable costs data would necessarily or could reveal (by itself or in combination with other unidentified data), or what the outcome would be under subsections 96(1) or (3) following analysis and quantification.

170 For example, P&H did not explain how the absence of variable operating costs data at one or more unnamed Elevators constitutes an implied admission against the Commissioner that the data will lead to a cognizable and quantifiable efficiency under section 96. It would be speculative to find that such an implied admission follows from the sole absence of unknown data. To do so would require making several assumptions about the contents of the data and the outcome of calculations using those data. As Mr. Harington's testimony confirmed, significant additional data would be required to do the analysis he envisioned. Accordingly, no inference is warranted based on an absence of the variable operating costs data.

171 Second, P&H has not demonstrated that the Commissioner had an obligation to obtain the data. It has cited no case nor pointed to a principled basis for such an obligation. Apart from the initial burden on the Commissioner under section 96 to show and quantify anti-competitive effects as established in *Tervita SCC*, the legal burden under section 96 is on the respondent. While P&H sought to argue that *Tervita SCC* did not settle the evidentiary burden under section 96, it provided no compelling legal or factual reason to shift a further burden onto the Commissioner on the facts of this case.

172 Third and relatedly, P&H has not shown that the Commissioner knew or should have known that P&H needed the data in the present case. There is no evidence that P&H made any efforts itself to request or obtain the variable operating costs data.

While P&H may well be correct that its competitors would not voluntarily provide that data to a rival, it did not try to obtain the data by way of request to them or by filing a motion with the Tribunal.

173 On the evidence, the Tribunal does not accept that the Commissioner should (or even could) have known that P&H required the data. P&H acknowledged during argument that it did not ask the Commissioner to obtain it. When asked by the Tribunal how the Commissioner would have known that P&H needed it, or whether the Commissioner should have filed an application for an order under section 11 of the Act to obtain it, P&H did not provide a clear answer.

174 Moreover, based on the events leading up to the hearing, the Tribunal sees no realistic basis on which the Commissioner could have known that he should obtain the impugned data:

• At the pleadings stage in this proceeding, P&H did not raise possible efficiencies arising from increased throughput at the Virden Elevator, nor anything specific about subsection 96(3) of the Act. Its Response pleaded that the efficiencies from the Transaction "include: improved [FGT] scale economies and cost savings, elimination of the margin that [LDC] formerly paid to use the Vancouver export terminal owned by Kinder Morgan, outlay expansion and improved scale economies at the former [LDC] elevator and administrative synergies;"

• There was no suggestion that P&H noted the absence of the data and raised it after receiving the Commissioner's Affidavit of Documents;

• At the oral examinations for discovery, P&H declined to provide the Commissioner with any specific insight about its efficiencies defence. Counsel for the Commissioner asked several questions requesting information about efficiencies to Mr. Heimbecker. The answers provided by P&H's counsel were essentially that it was a matter for an expert report to be filed later and that otherwise, no substantive answers would be provided at discovery;

• Mr. Heimbecker repeated that position in his subsequent responses to undertakings and questions taken under advisement;

• However, P&H did not file an expert report concerning efficiencies;

• Mr. Heimbecker's reply witness statement, delivered over two months before the hearing started, set out evidence to advance P&H's position on efficiencies. However, it made no reference to any need for variable operating costs data from rival Elevators;

• P&H also did not raise any need for data after it received a copy of Mr. Harington Report, also more than two months before the hearing commenced. As noted above, this expert report referred directly to variable operating costs of other entities;

• P&H did not file a motion to the Tribunal seeking an order to compel the Commissioner to obtain the data; and

• The issue did not come to light until Mr. Harington's cross-examination, near the end of the hearing.

175 In these circumstances, the Tribunal finds it unrealistic to expect that the Commissioner would be or could have been aware that P&H required variable operating costs data of rival Elevators for its efficiencies defence. It was equally unrealistic to expect the Commissioner to be aware that P&H expected him to attempt to obtain that data either by request or under section 11 of the Act. Rather, the Tribunal finds P&H's position on the need for this data to be late-blooming and tactical, rather than based on a substantive need to support its position on efficiencies arising at the Virden Elevator.

176 Exercising its discretion based on the evidence and arguments made, the Tribunal therefore declines to make any specific adverse inferences on issues related to efficiencies. To draw an adverse inference against the Commissioner in the present circumstances would be demonstrably unfair.

C. Legal and evidentiary burden applicable to sections 92 and 96 of the Act

177 The last preliminary issue that needs to be briefly addressed is the legal burden of proof in this Application. In its submissions, P&H suggested that the allocation of the burden of proof established by the SCC in *Tervita SCC* has left some questions unanswered regarding the Commissioner's burden under section 96 of the Act.

178 With respect, the Tribunal disagrees.

179 It is not disputed that, under section 92, the Commissioner bears the burden of proving that the merger will create, maintain, or enhance market power through the merged entity's ability to profitably influence price, quality, service, or other dimensions of competition. However, there is no requirement for the Commissioner to prove that the merged entity will, in fact, exercise these powers (The Commissioner of Competition v Canadian Waste Services Holdings Inc, 2001 Comp Trib 3 (“ at para 108, aff'd 2003 FCA 131, leave to appeal refused, [2004] 1 SCR vii; *Superior Propane I* at para 258). In determining whether the Commissioner has met his burden on this point, a forward-looking analysis of whether the merger will give the merged entity the ability to prevent or lessen competition substantially compared to the pre-merger benchmark — or "but for" world — must be conducted (*Tervita SCC* at para 51).

180 With respect to section 96, Justice Rothstein in *Tervita SCC* clearly stated that "the [*Superior Propane* cases] established that the Commissioner has the burden under s. 96 to prove the anti-competitive effects" of a merger (*Tervita SCC* at para 122). Conversely, the merging parties bear the onus of establishing all the other elements of the efficiencies defence, including the extent of the efficiency gains and whether the gains are greater than and offset the merger's anti-competitive effects (*Tervita SCC* at para 122). To meet his burden, the Commissioner must quantify the quantifiable anti-competitive effects he relies upon. Where these effects are measurable, they must be calculated or at least estimated, and a failure to quantify quantifiable effects will not result in such effects being considered qualitatively or remaining undetermined (*Tervita SCC* at paras 125-133). Justice Rothstein explained that an approach that would permit the Commissioner to meet his burden without at least establishing estimates of the quantifiable anti-competitive effects would fail to provide the merging parties with the information they need to know the case they have to meet (*Tervita SCC* at para 124). Qualitative anti-competitive effects which are not quantifiable can also be taken into account, provided they are supported by the evidence and the reasoning for the reliance on the qualitative aspects is clearly articulated by the Tribunal (*Tervita SCC* at para 147).

181 In the Tribunal's view, there is at present no legal precedent for the Commissioner to have any additional burden under section 96 beyond that established by the SCC in *Tervita SCC*. P&H has not provided any argument or sufficient supporting evidence that could allow the Tribunal to revisit, revise or enlarge the clear standard set out in *Tervita SCC* on the legal and evidentiary burden of the Commissioner under the merger provisions of the Act.

VI. ISSUES

182 The following broad issues are raised in this proceeding:

- What is or are the relevant product market(s) for the purposes of this proceeding?;

- What is or are the relevant geographic market(s) for the purposes of this proceeding?;

- Has the Commissioner established, on a balance of probabilities, that the Virden Acquisition lessens, or is likely to lessen, competition substantially?;

- If the Commissioner has established that the Virden Acquisition lessens, or is likely to lessen, competition substantially, what is the remedy to be ordered?;

- Has P&H established, on a balance of probabilities, that the gains in efficiency will be greater than, and will likely offset, the effects of any lessening of competition pursuant to section 96 of the Act?;

- What costs should be awarded?

183 Each of these issues will be discussed in turn.

VII. ANALYSIS

A. What is or are the relevant product market(s) for the purposes of this proceeding?

184 In order to determine whether the Virden Acquisition lessens competition substantially, or is likely to do so, the Tribunal must first identify the product and geographic dimensions of the relevant market(s) for the purposes of this proceeding. In this case, the fundamental dispute between the parties is how to properly characterize the product market — and more specifically, the relevant *product* and the relevant *price* — in a situation where the merging firms' alleged specific contribution of value is only a component of the final price of the product. The Commissioner claims that P&H supplies GHS for wheat and canola to farmers, whereas P&H submits that it purchases wheat and canola from farmers. The Commissioner submits that the relevant price is the "imputed" price for GHS — which, he says, approximates the Basis — , while P&H argues that it is the Cash Price charged to farmers for their grain.

185 As acknowledged by both Dr. Miller and Ms. Sanderson during their respective testimony, the definition of the relevant product market is a key element that has an impact on the rest of the Tribunal's analysis in this case (*i.e.*, the geographic market, the competitive effects analysis, the market shares, the surplus calculations, etc.).

(1) Analytical framework

(a) The purpose of market definition

186 In assessing whether, under section 92 of the Act, a merger lessens competition substantially or is likely to do so, the focus is on whether the merger is likely to create, maintain or enhance the ability of the merged entity to exercise market power, unilaterally or in coordination with other firms (*Tervita SCC* at para 44).

187 Market power is not defined in the Act. Market power has been described by the Tribunal as the ability to "profitably influence price, quality, variety, service, advertising, innovation or other dimensions of competition" (*Canadian Waste* at para 7) or as "the ability to maintain prices above the competitive level for a considerable period of time without such action being unprofitable" (Hillsdownat p 314). Both of these descriptions were cited with approval in *Tervita SCC*, at paragraph 44.

188 The first step in measuring market power is to define the relevant market. Put differently, the purpose of identifying the relevant product (or geographic) market is to identify the possibility for the exercise of market power (*Canadian Waste* at para 39; *Superior Propane I* at para 47; Director of Investigation and Research v Southam(1992), 43 CPR (3d) 161 (Comp Trib) at pp 177-178). Market definition is often considered a critical component in assessing market power because it frames the context within which competitive effects can be analyzed (*Di Domenico* at p 408).

189 The Tribunal and the courts have traditionally considered it necessary to define a relevant market before proceeding to assess the competitive effects of mergers under the Act (Canada (Director of Investigation and Research) v Southam Inc, [1997] 1 SCR 748 at para 79; *Tervita CT* at paras 92, 360-364; *Superior Propane I* at para 56; Hillsdownat p 297). The relevant market is typically a predicate to a finding of substantial lessening or prevention of competition in merger cases because the merger must be one that will substantially lessen or prevent competition, or is likely to do so, within an area of actual or potential competition.

190 However, the Tribunal has cautioned against losing sight of the ultimate inquiry and task of the Tribunal, which is to determine whether the merger being assessed prevents or lessens, or is likely to prevent or lessen, competition *substantially* (*Superior Propane 1* at para 48). Market definition is not an end in itself: it is merely an analytical tool to assist in evaluating anti-competitive effects (*Superior Propane I* at para 48; 2011 MEGs at para 3.2).

191 It is further important to note that a competition market is an analytical construct, and neither the product market nor the geographic market needs to coincide with the market as it is considered by a business or industry (*Superior Propane I* at

paras 67, 85, 101, 106). Relevant markets for the purpose of a merger analysis are not always intuitive and may not align with how industry participants use the term "market" or view their "market."

192 Market definition is typically the subject of contested submissions and can often be outcome-determinative in merger matters under section 92.

(b) Rationale and tools for market definition

193 When defining relevant markets in proceedings brought under section 92 of the Act, the Tribunal considers whether there are close substitutes for the product at issue. Market definition is based in part on substitutability, and it focuses primarily on demand responses to changes in relative prices after the merger. The ability of a firm to raise prices without losing sufficient sales to make the price increase unprofitable ultimately depends on the purchasers' willingness to pay the higher price. This is determined by analyzing evidence of the ability of purchasers to switch their purchases to substitute products and locations in response to a price increase (*Tervita CT* at paras 58-60). Close substitutes have been defined in terms of whether "buyers are willing to switch from one product to another in response to a relative change in price, *i.e.*, if there is buyer price sensitivity" (Canada (Commissioner of Competition) v Tele-Direct Publications Inc(1997), 73 CPR (3d) 1 (Comp Trib) ("*Tele-Direct*") at p 35, citing the test adopted by the FCA in Canada (Director of Investigation and Research) v Southam Inc, [1995] 3 FC 557, 63 CPR (3d) 1 (FCA) ("*Southam FCA*"), rev'd on other grounds [1997] 1 SCR 748).

194 In assessing the extent of the product (and geographic) dimensions of relevant markets in the context of proceedings under the Act, the Tribunal has generally followed the well-established hypothetical monopolist analytical framework, or hypothetical monopolist test ("*HMT*") (*VAA CT* at para 300; The Commissioner of Competition v The Toronto Real Estate Board, 2016 Comp Trib 7 (" at paras 121-124; The Commissioner of Competition v Visa Canada Corporation and MasterCard International Incorporated, 2013 Comp Trib 10 (" at para 173; *Tervita CT* at para 58; *Superior Propane I* at para 57).

195 In *Tervita CT* and *Superior Propane I*, two merger cases, the Tribunal embraced the description of that framework set forth in the Competition Bureau's MEGs (see, for example, 2011 MEGs at para 4.3). Under this approach, a relevant product market is defined as the smallest group of products (including at least one product of the merging parties) in respect of which a sole profit-maximizing seller — the hypothetical monopolist — controlling all suppliers in the proposed market would find it profitable to impose and sustain a small but significant and non-transitory increase in price ("*SSNIP*") above levels that would likely exist in the absence of the merger. The purpose of the HMT is to determine the extent to which customers in the candidate market will switch to other products in response to a SSNIP (*Visa Canada* at para 198). In the determination of whether a SSNIP would be profitable, the HMT makes use of demand elasticity and cross-elasticity evidence as well as what are known as practical indicia. If a small price increase would drive purchasers to an alternative product, then that product must be reasonably substitutable for those in the proposed market and must therefore be part of the market, properly defined. The conceptual exercise is repeated to include a broader array of products until it defines a product set over which a hypothetical monopolist could profitably impose a SSNIP (Brian A. Facey and Cassandra Brown, *Competition and Antitrust Laws in Canada: Mergers, Joint Ventures and Competitor Collaborations*, 3rd ed (Toronto: LexisNexis Canada Inc, 2020) ("*Facey and Brown*") at p 205).

196 Pursuant to the HMT framework, the product dimension of a relevant market is defined in terms of the *smallest* group of products in respect of which a hypothetical monopolist would have the ability to impose and sustain a SSNIP above levels that would likely exist in the absence of the merger. The "smallest group" principle is an important component of the test because, without it, there would be no objective basis upon which to draw a distinction between a smaller group of products in respect of which a hypothetical monopolist would have the ability to profitably impose a SSNIP and a larger group of products in respect of which that monopolist may also have such an ability (*VAA CT* at para 326; *TREB CT* at para 124).

197 The SSNIP will be applied to the price that is being paid by the purchasers of the candidate product (*Visa Canada* at para 198), often referred to as the "base price" (see, for example, 2011 MEGs at para 4.6).

198 Generally, for the purposes of determining the SSNIP, the objective benchmarks are as follows (and are reflected as such in the 2011 MEGs): an "increase in price" is typically one of 5% or more, and a "non-transitory" price increase is typically one

that is maintained for at least one year. This 5%/one-year approach is generally treated as a "threshold" used to identify market power at the market definition stage, where the objective is to define the smallest market in which a substantial lessening of competition would be possible. If sellers of a product or of a group of products in a provisionally defined market, acting as a hypothetical monopolist, would not have the ability to profitably impose and sustain a 5% price increase lasting one year, the product bounds of the relevant market will be progressively expanded until the point at which a hypothetical monopolist would have that ability and degree of market power. Essentially the same approach is applied to identify both the product and geographic dimensions of relevant markets.

199 Indeed, the Commissioner and P&H both acknowledged that a 5% increase and a one-year time frame are the standard thresholds for a SSNIP, here in Canada and in many other jurisdictions. However, these benchmarks can be adjusted to reflect the specific realities of a given industry or business.

200 The Tribunal agrees that the HMT approach adopted in previous Tribunal cases, consistent with the 2011 MEGs, should continue to be used in this case.

201 Given the practical challenges associated with determining the base price in respect of which the SSNIP assessment must be conducted in a proceeding brought under section 92 of the Act, market definition will often include not only the analysis of prices through the HMT framework but also other evidence of substitutability or customer switching. Market definition may therefore involve assessing indirect evidence of substitutability, including factors such as: functional interchangeability in end-use of the products; switching costs; the views, strategies, behaviour and identity of buyers; trade views, strategies and behaviours of other market participants; physical and technical characteristics; and price relationships and relative price levels.

(c) The language of section 92

202 During final argument, the Tribunal raised an issue related to the interpretation of section 92. The Tribunal observed that, contrary to other provisions of the Act such as civil agreements between competitors (section 90.1), section 92 on mergers does not expressly refer to a substantial lessening or prevention of competition "in a market." Subsection 92(1) rather uses broader language incorporating the phrase "trade, industry or profession" in four paragraphs referring to the effect of the merger on competition: "(*a*) in a trade, industry or profession; (*b*) among the sources from which a trade, industry or profession obtains a product; (*c*) among the outlets through which a trade, industry or profession disposes of a product; or (*d*) otherwise than as described in paragraphs (*a*) to (*c*)."

203 Both parties expressed the view that the absence of the word "market" in subsection 92(1) makes no difference, that the merger provision clearly relates to a substantial lessening or prevention of competition "in a market," and that determining the relevant "market" forms part of the analysis to be conducted by the Tribunal.

204 The Tribunal agrees and finds that the absence of the word "market" in the opening part of section 92 should not be interpreted as implying that a relevant *competition market* does not need to be defined or utilized in merger analysis.

205 The principled approach to statutory interpretation requires that section 92 be read in its entire context, in its grammatical and ordinary sense, harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament (see, for example, Bell ExpressVu Limited Partnership v Rex, 2002 SCC 42 (“ at para 26).

206 Looking first at the wording of section 92, the Tribunal agrees with P&H that a merger as defined in section 92 clearly encompasses the concept of market or markets. A merger is defined in section 91 as the taking of control of a "business." The word "business" is in turn defined broadly in section 2 of the Act as "the business of (a) manufacturing, producing, transporting, acquiring, supplying, storing and *otherwise dealing* in articles, and (b) acquiring, supplying and *otherwise dealing* in services" [emphasis added]. The French version of the Act uses the words "tout autre commerce" to translate the expression "otherwise dealing." The use of the word "business" in the definition of "merger" therefore makes it clear that a merger for the purposes of a section 92 assessment is with respect to the market or commercial activity of the "business." Moreover, since a "business" is defined in terms of activities dealing in articles or services, the definition must concern one or more articles or services (as each are defined in subsection 2(1)) that are bought or sold as part of a commercial activity.

207 Importantly, there are also express references to the notion of "market" in subsection 92(2) and section 93 of the Act, which provide direction on how to assess whether a merger lessens or prevents competition substantially. Subsection 92(2) prohibits the Tribunal from making a finding and exercising its discretionary power to impose a remedy under subsection 92(1) solely on the basis of evidence of "concentration or market share." The assessment under section 92 is further informed and limited by section 93, which sets out factors that may be considered in determining whether a merger affects competition in a significant way for the purposes of section 92. Section 93 contains sustained references to the concept of "market" in paragraphs 93(d), (e), (g), (g.1), (g.2), and (*h*), and implies that such a market has been defined to make the competitive assessment. For example, paragraph (*h*) refers to "any [...] factor that is relevant to competition in a market that is or would be affected by the merger or proposed merger."

208 Turning to the object and purpose of section 92, there is no doubt that the Tribunal's focus is on assessing the degree to which *market power* is created, maintained or enhanced by the merger at issue. The concept of a competition or antitrust *market* is implicit in many provisions of the Act for the identification of anti-competitive conduct and for the substantiality threshold that must be applied to the assessment of anti-competitive effects.

209 The Tribunal further observes that since the Tribunal's first decision in a contested merger proceeding (*i.e.*, *Hillsdown*), subsection 92(1) has consistently been interpreted as synonymous with "market" by the Tribunal and the courts (*Tervita SCC* at para 44; Hillsdownat pp 297-314), and by the Commissioner. In *Tervita SCC*, the SCC made it clear that the assessment of the substantial effect on competition was an effect on the "market": it "involves assessing the degree and duration of any effect it would have on the *market*" [emphasis added] (*Tervita SCC* at para 78).

210 In sum, section 92 does not have a different scope in its relationship to the substantial lessening of competition even if it refers to the effect of competition in a "trade, industry or profession," as opposed to a "market." Given the definition of "merger" and the fact that several factors listed in subsection 92(2) and section 93 expressly contemplate an evaluation made in relation to a "market," the Tribunal is satisfied that, even though section 92 does not expressly refer to a substantial lessening or prevention of competition in a market, "Parliament intended that competition must be shown to be likely to be prevented or lessened substantially in a competition law or antitrust market" (Paul S. Crampton, *Mergers and the* Competition Act, (Carswell, 1990) ("*Crampton 1990*") at p 261).

(d) HMT and monopsony

211 Finally, the Tribunal observes that the approach to market power and to market definition, which has mostly developed in matters involving the *sale* of a product, is similar in the context of the *purchase* of a product: the market power of buyers is the "ability of a single firm (monopsony power) [...] to profitably depress prices paid to sellers [...] to a level that is below the competitive price for a significant period of time" (2011 MEGs at para 2.4).

212 The HMT framework therefore applies to define relevant markets for both the sale and the purchase of a product. For monopsony power, the 2011 MEGs describe the analytical process as follows, at paragraph 9.2:

> [...] The conceptual basis used for defining relevant markets is, mirroring the selling side, the hypothetical monopsonist test. A relevant market is defined as the smallest group of products and the smallest geographic area in which a sole profit-maximizing buyer (a "hypothetical monopsonist") would impose and sustain a significant and non-transitory price decrease below levels that would likely exist in the absence of the merger. The relevant product market definition question is thus whether suppliers, in response to a decrease in the price of an input, would switch to alternative buyers or reposition or modify the product they sell in sufficient quantity to render the hypothetical monopsonist's price decrease unprofitable.

213 In such cases, the SSNIP becomes "a small but significant and non-transitory decrease in price" ("*SSNDP*") below levels that would likely exist in the absence of the merger[5] .

(2) Parties' positions

(a) The Commissioner

214 The Commissioner submits that the proper way to characterize the relevant product market is to define it as the provision of GHS for wheat and canola to farmers who, prior to the Acquisition, benefited from competition between the Virden and Moosomin Elevators. He argues that the supply of GHS for wheat is a relevant product market and that the supply of GHS for canola is a separate one. According to the Commissioner, a hypothetical monopolist of GHS for each of wheat and canola could profitably impose a 5% SSNIP. Moreover, says the Commissioner, there are no functional substitutes for GHS for wheat or canola.

215 The Commissioner maintains that local competition between Elevators for wheat or canola manifests itself through the Basis, and not through the final Cash Price that an Elevator pays to the farmer. He submits that, because P&H has no control over the Futures Price, the only component of the Cash Price it can control is the Basis, and that only the Basis component of the Cash Price is affected by local competition between the Elevators. The Basis, or the "imputed" price for GHS calculated by Dr. Miller, adds the Commissioner, represents the Elevators' specific contribution of value in the final Cash Price paid to farmers. The Commissioner argues that the relevant product market should therefore reflect an economic framework that analyzes the competition actually impacted by the Virden Acquisition.

216 The Commissioner contends that P&H's approach to the product market allows it to mask and obscure the anti-competitive effects of its Acquisition by focusing on the grain itself and on the Cash Price it pays to the farmers, whereas the services effectively provided by P&H are only a small part of the overall value of the grain they purchase from the farmers and resell to their end customers.

217 By the end of the hearing, both the Commissioner and Dr. Miller agreed that their proposed approach to the product market definition could be qualified or described as a "value-added" approach, even though the Commissioner did not use these specific terms in his pleadings or even in his opening submissions at the hearing, and even though Dr. Miller did not describe his analytical approach as such in his initial expert report.

218 The Commissioner maintains that economics, the facts, and the law support his "value-added" approach to product market definition.

219 With respect to economics, the Commissioner submits that defining the product market as the sale of GHS by P&H "facilitates" an economic analysis focused on the competition affected by the Virden Acquisition and the Elevators' contribution of value. On this point, the Commissioner mostly relies on Dr. Miller's initial and reply expert reports and on his testimony. Using common features of the market definition exercise, such as the HMT, diversion ratios, and upward pricing pressure ("*UPP*") calculations, Dr. Miller testified that he relied on the "imputed" price of GHS because, in his view, this aligns with the service that the Elevators effectively give to farmers. Dr. Miller opined that receiving GHS from Elevators is what is enabling the farmers to access the worldwide market. According to Dr. Miller, the price for GHS is an important factor in a farm's choice of Elevators, and price competition between Elevators is reflected in the Basis and the "imputed" price he calculated for GHS.

220 With respect to facts, the Commissioner relies on four main elements to support his proposed product market: 1) P&H recognizes the role of the Basis in competition between Elevators, and as one of the two components of the Cash Price, along with the Futures Price; 2) the only component of the price of grain that P&H can set is the Basis. P&H claims that it uses its "*Workback Algorithm*" to determine its Cash Prices but, according to the Commissioner, this algorithm sets the Basis and not the Cash Price, which can fluctuate during the day with the variations of the Futures Price. Moreover, P&H sends mass communications about the Basis on a daily basis, through emails and on its P&H Direct application; 3) the Basis is also carried over to the contracts concluded between Elevators and farmers, and this is done by all grain companies with the exception of LDC; and 4) farmers are affected by local competition and they use the Basis to make comparisons between Elevators. In sum, argues the Commissioner, the provision of GHS is how the industry operates, and the Basis is an important industry-wide practice.

221 Turning to the law, the Commissioner submits that characterizing the product market as GHS is consistent with the purpose clause of the Act, with previous merger cases, and with the 2011 MEGs. With respect to the so-called "value-added" approach, he claims that the U.S. Horizontal Merger Guidelines issued in 2010 (U.S. Department of Justice and the Federal Trade Commission, Horizontal Merger Guidelines, August 19, 2010 ("*US HMEGs*")) actually recognize that in situations where the price of a merging firm's contribution to value can be identified with "reasonable clarity," the price used to assess the merger can be a component of the final price of the product that the firms effectively compete on.

(b) P&H

222 P&H responds that GHS is not a product supplied by P&H and the other grain companies. The relevant products, says P&H, are the wheat and canola purchased from farmers by P&H, for which the farmers receive the Cash Price. According to P&H, the so-called GHS are only internal processes that the grain companies may apply to the grain after the title to the grain has passed from the farmer to the grain company: in other words, the GHS claimed by the Commissioner are merely costs to the grain companies. Furthermore, it is export terminals that are used to do the following: to receive grain from rail; to grade, segregate, and store grains by type and quality attributes; to clean when required and blend; and to load grain onto vessels. Therefore, many of the GHS claimed by the Commissioner are not services that are performed at the Elevator level.

223 P&H argues that the documentary and *viva voce* evidence shows that GHS are not actually transacted, contracted, or discussed between farms and P&H or other grain companies. P&H adds that Mr. Heimbecker's testimony and evidence clearly establishes that P&H does not supply any GHS, and this evidence was unchallenged on cross-examination.

224 P&H further submits that there are no precedents in Canadian law for utilizing an imputed price for the merging firms' specific contribution to the value of a product and for determining the relevant market and the applicable SSNIP on the basis of the so-called "value-added" approach. In fact, adds P&H, the Commissioner has never publicly endorsed the "value-added" approach he is suddenly advancing in this case. Moreover, the Commissioner's approach would suffer from numerous flaws identified by economists with respect to the "value-added" approach advocated in the US HMEGs.

225 While Dr. Miller asserts that the price for GHS drives the farmers' decisions, P&H points to the fact that the testimonies of farmer witnesses on both sides make it clear that farmers base their sale decisions on the posted Cash Price, which is what the grain companies actually compete on.

(3) Tribunal's assessment

226 As the Commissioner rightly indicated, the fundamental disagreement in this case is how to define the product market, and more specifically the relevant product that is being exchanged when the farmers sell their grain to an Elevator. Ms. Sanderson indeed acknowledged that the main issue to be determined by the Tribunal is the choice between the Cash Price for grain and the "imputed" price for GHS.

227 For the reasons set below, the Tribunal agrees with P&H on this issue and concludes that there are two relevant product markets in the present case, namely, the purchase of wheat and the purchase of canola by P&H.

228 The Tribunal finds that the Commissioner's proposed product market (*i.e.*, the sale of GHS) is not grounded in commercial reality and in the evidence, and that in this case, the "value-added" approach advanced by the Commissioner fails on three fronts: on the facts, from a precedential and legal standpoint, and from a conceptual and economic perspective. It fails factually, because there is no clear and convincing evidence to conclude, on a balance of probabilities, that GHS effectively exist as a relevant "value-add" product or "add on feature" that is transacted and to which a price can be attached. The Commissioner created an analytical price for operational activities associated with the purchase of grain by Elevators. It further fails as a legal argument, because the Commissioner's position finds no support in the authorities he cites, including the US HMEGs, cases in Canada and elsewhere, and his own MEGs. Finally, it fails conceptually, because the Commissioner did not address the issue of the appropriate SSNIP threshold, as described by the current MEGs, despite the fact that adopting a "value-added" approach would profoundly change the HMT framework and the effective SSNIP level used for market definition purposes.

(a) The product and the price at issue

229 At its core, four critical elements determine the characteristics and boundaries of a relevant competition market: 1) a product for which there is a source of demand and a source of supply; 2) a price at which the product is transacted; 3) a geography within which the product is transacted; and 4) the extent of available substitution between different sources of demand or supply for the product if there is a sufficient price incentive.

230 Since products can be said to be in the same *market* if they are close substitutes (Tele-Directat p 36), the debate around the product market definition has typically revolved around the issue of substitutability. However, this is not the case here, as the parties are not debating the extent to which there are functional substitutes to selling GHS to the farmers or to purchasing grain by the Elevators. The parties instead agree that there are *no* substitute products for either GHS or for grain (namely, each of wheat and canola).

231 The debate around the product market definition in this case is about how to characterize what occurs when a farmer sells grain to an Elevator. The debate does not center on the definition of the product *market*, but rather on the definition of the relevant *product* itself, and of the relevant *price* attached to it.

232 Before dealing with the product market — or the geographic market — , the Tribunal must first determine what the product at issue is and what its price is. It is important to distinguish the "product" and the "price" from the product "market." The Tribunal does not dispute that the *product market* is an analytical framework and an artificial construct, where the Tribunal needs to determine the presence and extent of substitutes (*Superior Propane I* at para 101). However, the underlying product or the underlying price for it are not analytical or theoretical constructs themselves. The product and the price attached to a product need to be anchored in the evidence and, indeed, tied to commercial reality. Determining the relevant product and the relevant price is an inquiry that must be based on the evidence of each case.

233 On the facts of this case, the relevant product is not the sale of GHS, but the purchase of grain.

(i) The notions of product and price

234 In the legal and economic context relevant to merger analysis, the term "product" refers to the output that a producer (seller) provides to a purchasing customer, or the input that a producer (purchaser) acquires from a supplying customer.

235 To identify the relevant product for the purpose of defining a relevant competition market, the starting point is to determine what the customer actually buys or sells, and at what price. In the context of a merger, it starts with the product(s) in respect of which, prior to the merger, the merging entities were competitors. In other words, what is the product that P&H and LDC sold or purchased in the marketplace, in competition with one another, prior to the Transaction?

236 For a product to exist in the economic sense and in the context of the relevant market definition for the purpose of an application under section 92 of the Act, there must be a separate and identifiable supply and demand for it. It must be transacted and it must have a *price* attached to it. Product market definition is based on substitutability and focuses on demand responses to changes in prices. The SSNIP must therefore be applied to the price that is being received by the sellers or paid by the purchasers of the candidate product (*Visa Canada* at para 198). In fact, in order to apply the HMT, a relevant price for the relevant product must be identified. The focus is on the price of the good or service effectively being sold or bought. There can be no product, and no price for such product, if the product has no independent existence and market presence. The Tribunal further accepts P&H's view that an article or a service which would be neither bought nor sold cannot fall within the definition of a "business" under the Act (and hence, the definition of a merger in section 91), because it would not be a product that is acquired, supplied, or otherwise dealt in.

237 According to the MEGs, the "base price" to be used for market definition purposes and to postulate a price increase in the HMT framework "is typically the prevailing price in the relevant market" (2011 MEGS at para 4.6). This, once again, refers to a price observed in a market. The base price is the price used in the normal course of business, namely, whatever price "is

ordinarily considered to be the price of the product in the sector of the industry (e.g., manufacturing, wholesale, retail) being examined" (2011 MEGs at para 4.7). The MEGs therefore make it clear that the relevant price must echo what is effectively occurring in the industry being considered.

238 The price that has been typically employed in the standard approach to market definition and in the HMT analysis is the "cumulative price," namely, "the total value of the product when it leaves the stage of the industry in question. This simply represents the sum of input costs plus value added" (*Crampton 1990* at p 265, fn 11). The author Crampton (now a judicial member of the Tribunal) also referred to alternative "prices" such as the "value added price" representing the difference between the cost of all inputs and the cumulative price, and he specified that this price "has been employed in situations where the value added is billed as a separate fee, with no mark-up being applied to the product in relation to when the service is performed" (*Crampton 1990* at p 265).

239 However, the Tribunal underlines that price and cost are two different notions. A price is the amount that a customer buying a product or a person supplying one is willing to pay or receive for it. The price is ascertained from the perspective of the customer or the purchaser. On the other hand, a cost is the expense incurred for making a product or offering a service that is sold. It is ascertained from the perspective of the producer. A cost cannot simply be equated with a price, though there is evidently a relationship between the two, since costs have a direct impact on the price of a product.

240 The Tribunal has found no precedent, and the Commissioner has not referred to any, where it was recognized by the courts or by the economic literature that there can be a "market" for a product that is not sold and purchased as such, but is only a cost component of a final product. The Tribunal accepts that a specific part can be categorized as a separate product and can constitute the basis for a separate product market (see, for example, Canada (Director of Investigation and Research) v Xerox Canada Inc(1990), 33 CPR (3d) 83 (Comp Trib) ("*Xerox*")). But a product must have a price attached to it. In other words, the notion of product for market definition purposes and the calculation of a SSNIP implies a transacted price, not solely a theoretical price derived from allocating revenue to the cost of selected activities associated with the purchase or sale of a product.

(ii) GHS is not a transacted product

241 The evidence indicates that GHS, as defined by the Commissioner, is not a product that actually exists in the grain industry or that is being supplied by the Elevators and purchased by the farmers: GHS are not transacted or contracted between the farms and the grain companies.

242 The Tribunal has found no reference to GHS in P&H's materials nor a description of any service provided by P&H or other grain companies under the label of GHS. Neither the Elevators, the Crushers, nor even the farmers themselves recognize GHS as a separate, identifiable product. It is not even a term of art used in the grain industry. There is no evidence that farmers and grain companies transact on the basis of the sale and purchase of GHS.

243 More specifically, none of the six farmer witnesses who testified at the hearing on behalf of either the Commissioner or P&H referred to GHS as an actual service they receive from the Elevators and pay for. Farmers do not talk in terms of GHS.

244 Similarly, the Elevators do not refer to the notion of GHS. Mr. Heimbecker, for P&H, and the witness from Cargill, Ms. Jordan, both confirmed that in the industry, grain companies do not charge farmers for GHS and rather consider the services covered by the Commissioner's definition of GHS as costs. At one point in his submissions, the Commissioner mentioned the fact that P&H refers to its grain handling and trading business in its own financial reporting documents. However, the Commissioner has pointed to no evidence, whether from P&H or from any other grain company, containing a reference to grain handling *services*. The "grain handling business and trading" is not to be confused with "grain handling services" (as a product). P&H purchases grain for the purpose of trading it in national and international markets and grain handling is an operational process in the purchase and resale of the grain.

245 While the Tribunal agrees with Dr. Miller that the participants and competitive constraints at each stage of an industry are distinct, the Tribunal finds that GHS is not a product that is transacted as such between farmers and Elevators, at any stage of the

grain handling and trading business. It is an artificial bundle of services that the Commissioner and Dr. Miller have constructed for the purposes of this proceeding.

246 Mr. Heimbecker testified that P&H does not supply GHS in the post-CWB era (Exhibits CA-R-115 and P-R-116, Witness Statement of Mr. John Heimbecker ("*Heimbecker Statement*"), at para 115). This evidence was not contradicted and the Tribunal accepts the evidence of Mr. Heimbecker on this point.

247 In sum, GHS, or the "value-added" product identified by the Commissioner in this case, is not a product that farms and grain companies recognize and effectively buy and sell. Moreover, GHS is not a separate value-added product that farms transact separately from the grain, and for which they could find substitute sources of supply (*i.e.*, sellers offering just the GHS value-added service).

248 The Tribunal pauses to observe that, from an industry perspective, the notion of GHS advanced by the Commissioner corresponds to a historical nomenclature that disappeared when the CWB was dismantled on July 31, 2012 (Heimbecker Statement at paras 113-117). Before its dismantling, the CWB purchased certain types of grain — including wheat — from farms and grain companies handled that grain on behalf of the CWB on a "toll basis," effectively providing the type of services included by the Commissioner in his definition of GHS. However, with the end of the CWB, grain companies are no longer intermediaries between the CWB and farmers, and the market interrelation between the farmers and the grain companies has changed. As a result, grain companies have assumed part of the role of the CWB in the supply chain, namely, as purchaser of grain with the risks attached to the marketing and sale of the product. With the end of the CWB, the historical tariffs and fees that used to be charged for a service also came to an end. In the post-CWB world, P&H (like other grain companies) buys wheat and canola from farms, taking title to the grain at the time the farm delivers it to the Elevator. At that point in time, the farm receives the contracted Cash Price for its grain and ownership of the grain passes to P&H or the other Elevators. From that point on, the farm has no right or interest in the grain and bears no risk in relation to the purchase transaction. Instead, P&H is fully responsible for the costs, risks, and rewards of aggregating, transporting, and selling the grain to a customer.

249 True, as will be discussed below, the farmers and Elevators sometimes negotiate on one component of the Cash Price (namely, the Basis) because information on the Basis is provided by the Elevators. The Tribunal is satisfied that this reflects a historical heritage from the CWB days (or, as argued by P&H, a linguistic vestige of the CWB era). But what were services at the time of the CWB are now costs to the Elevators, not GHS to which a price can be attached.

250 For the purpose of this Application, the only products that are exchanged and transacted between the farms and the Elevators are wheat and canola.

(iii) There is no price for GHS

251 Furthermore, the Tribunal concludes that there is no "price" associated with GHS.

252 As was the case for GHS as a product, the Tribunal finds no evidence of a "price" for GHS. The evidence from the farmer witnesses indicates that they do not talk about receiving GHS and are not charged any fees or price for GHS. All farmer witnesses testified that there are no separate charges for GHS. In addition, no price exists for GHS in the contracts or agreements concluded by P&H and other grain companies with the farmers.

253 Nor is a price for GHS recorded or kept in the transaction data reported by the grain companies in the usual course of business. The transaction data obtained from the grain companies provides address information for farms delivering canola or wheat to the Elevators and Crushers, with some exceptions. The farm address information allowed Dr. Miller and Ms. Sanderson to identify deliveries to the Elevators from farms with addresses in the various regions used in their respective analyses, as well as any other location. The transaction data report Cash Prices and deliveries to each grain company but they do not include any information on GHS or on a price for such alleged bundle of services.

254 It is of note that, just as they do not consider GHS to be a separate product offered for purchase and sale, the grain companies do not keep an amount representing the price of GHS — or even the Basis, as will be discussed below — in

their transaction data set. If GHS were meaningful for the Elevators or the farmers from a transactional perspective, the grain companies would likely keep track of its price in their transaction data.

255 Indeed, the Commissioner recognized at the hearing and in his written submissions that the farmers are not charged for GHS as a separate, added service to the purchase of grain. Moreover, a witness for the Commissioner in the discovery process and Dr. Miller in his testimony each confirmed that the price for GHS had to be "imputed" and that it is a constructed price.

256 As GHS is neither observed as an added service feature nor transacted as such, Dr. Miller had to create a measure for the price of it. In his expert report, Dr. Miller imputed the price of GHS for each transaction as the difference between the Cash Price and the Futures Price from the financial market, as of the transaction date, adjusting for exchange rates in the case of wheat. Dr. Miller sometimes referred to the price of GHS as the Basis, although he admitted that his constructed price of GHS is not equal to the Basis used by Elevators for wheat or canola for each transaction. Dr. Miller's transaction-level prices of GHS were estimated with error, in part because the contract date (which often determines the relevant Futures Price) is unobserved in the transaction data.

257 In sum, there is no observed or observable added feature for GHS, no price is attached to it, and none appears in the transaction data or can be otherwise identified. The evidence from the Commissioner reveals that the "imputed" price for GHS is a constructed price, and not an explicit or implicit price transacted between buyer and seller. Here, there is no doubt that it is not a situation where a farmer pays a price for an actual specific service, such as delivery, transportation or processing fees.

258 The farmer witnesses (*i.e.*, Mr. Lincoln, Mr. Wagstaff, Mr. Pethick, Mr. Paull, Mr. Duncan, and Mr. Hebert) all testified that the Cash Price they ultimately receive for their grain drives their decisions to sell their grain to an Elevator. As admitted by the Commissioner, farmers care about the money they receive from the sale of their grain, and they never talk about GHS as separately transacted.

259 In his witness statement, Mr. Pethick stated that he considers the "basis price" but also the overall price (*i.e.*, the Cash Price) communicated by the Elevators when deciding where to deliver his grain (Exhibit P-A-001, Witness Statement of Mr. Alistair Pethick ("*Pethick Statement*"), at paras 19-20). Similarly, Mr. Lincoln also referred to the importance of "competitive prices" and to being offered a "higher price," generally, without suggesting that this was limited to the Basis (Exhibits CB-A-025 and P-A-026, Witness Statement of Mr. Chris Lincoln ("*Lincoln Statement*"), at paras 13, 15). The Agreed Statement of Facts for the two farmer witnesses who did not testify at the hearing indicates that [text omitted] "regularly checks the prices" at various Elevators, without limiting his comment to the Basis (Exhibits CA-R-242 and P-R-243, Compilation of Additional Documents Added to Agreed Book, Agreed Statement of Facts re [text omitted] and [text omitted]). For their part, each of Mr. Hebert, Mr. Paull, and Mr. Duncan said in their respective witness statements that the Cash Price is what drives their decisions to sell to Elevators or Crushers.

260 The evidence from Mr. Heimbecker also reveals that most pricing-related communications made by P&H to farmers refer to the Cash Price, with no mention of the Basis (Heimbecker Statement at para 61; Exhibits CB-A-134 and P-A-135, Read-in Brief of the Commissioner ("*Commissioner Read-In*")). Industry participants also use the Basis and the Cash Price interchangeably, to refer to the net final price that farmers effectively receive for their grain. Mr. Hebert, for example, testified that when he is using the Basis, he is "calculating it back to the cash price that [he is] going to deposit" (Consolidated Transcript, Confidential B, at p 870). In short, he is using the Basis to compare the Elevators' net prices for the grain.

261 In the Tribunal's view, on the facts of this case, the only "base price" for market definition purposes is the Cash Price paid to farmers to purchase their wheat or canola, not the "imputed" price of GHS that is never separately or identifiably charged to farmers by Elevators to handle their grain. Farms sell grain to Elevators and Crushers for a single Cash Price. Elevators and Crushers purchase grain from farms for a single Cash Price. The Cash Price paid to farms to purchase grain is the ordinary and prevailing price in the relevant markets.

(iv) The Basis differs from GHS and is not the price of GHS

262 In his submissions on the product market and on GHS, the Commissioner relied heavily on the Basis and on the evidence related to it.

263 The Commissioner argues that the Basis is a component of the Cash Price, along with the Futures Price. Both combine to form the Cash Price paid to the farms. According to the Commissioner, the Basis component of the Cash Price is the mechanism that P&H uses to ensure that the price at which it buys the grain from the farmers is a price that allows it to cover the expenses of operating the Elevator where the farmers deliver their grain. The Commissioner maintains that the Basis "is an amount subtracted from the Futures Price in the case of canola (and added to the Futures Price in the case of wheat to account for exchange rate differences) that covers the grain company's costs to operate the Elevator while also providing the grain company with a margin." He claims that it is not a simple mathematical construct, as alleged by P&H and Mr. Heimbecker. According to Dr. Miller, the Basis covers the costs of the Elevators and allows for a profit. Dr. Miller claims that it is the relevant price "in terms of how competition plays out" in the grain industry, "in terms of the value added" by the Elevators, and "in terms of just the profitability of the [grain handling] business" (Consolidated Transcript, Public, at p 1430).

264 The Commissioner further submits that all contracts entered into by the Elevators and the farms refer to the Basis, or even to the "basis price," and that farmers use the Basis in their dealings with the Elevators. The Commissioner adds that the problem with GHS and the Basis is an "implementation issue" as neither the Basis nor the price of GHS appear in the transaction data of the grain companies. In sum, throughout his submissions, the Commissioner effectively equates GHS to the Basis to justify his approach to the product market definition.

265 The Tribunal is not persuaded by the Commissioner's arguments and finds that the existence of the Basis is not sufficient to transform GHS into a relevant product to which a relevant and reliable base price can be attached. The evidence does not support that the Basis can be equated with the notion of GHS advanced by the Commissioner and Dr. Miller. There is a distinction and a difference between the use of the Basis by farmers and grain companies in the sale and purchase of grain on the one hand, and GHS as an operational cost to the grain companies on the other.

266 The Tribunal acknowledges that the Basis is an industry benchmark, recognized and used by the participants in the grain handling business. But the Basis is not a product that is transacted as such. The Basis is not a price either. Despite the repeated references made by the Commissioner to a "basis price" in his oral and written submissions, the Tribunal is not persuaded that, on a balance of probabilities, the evidence supports a conclusion that the Basis represents a price attached to a product. Mr. Heimbecker testified that the Basis is not a price expressed in dollar terms, even though there is often a dollar sign apposed to its numerical figure in some of P&H's own documents. In the Tribunal's view, the Basis is best described as the numerical difference between the Cash Price and the Futures Price, as determined by P&H's Workback Algorithm. The Workback Algorithm is only run once a day by P&H, but the Cash Price that a farmer sees in P&H Direct will adjust instantaneously to reflect any changes in the Futures Price. This evidence has not been contradicted, and was confirmed by farmers such as Mr. Duncan and Mr. Hebert in their respective testimony (see, for example, Consolidated Transcript, Confidential B, at p 929). Yes, the Basis is a metric used in the grain business, but it is not a price for a product.

267 One of the farmer witnesses, Mr. Paull, testified that the Basis is just a tool used to track or monitor the Cash Price that he will receive when he delivers his grain to the Elevators. One of P&H's customer service representatives, since promoted to managing an Elevator, explained the Basis in emails sent to hundreds of customers as follows: "[t]his premium or discount to the futures value is commonly referred to as a basis. The basis reflects each grain company's own particular handling, transportation and marketing costs, combined with the bid values from their own-end use customers" (Exhibit CB-A-149, P&H Email Subject: Gain From You Grain, dated February 16, 2017).

268 The Tribunal observes that the Basis is not identified by the farms or the grain companies as a price associated with GHS or with any specific service. The grain industry participants instead refer to the Basis, without more. It is never the "Basis for GHS" or for any other specific product. Nowhere in the evidence is there a reference to a Basis *for something*. It is a concept and a notion used in the grain industry, but there is no evidence that the Basis refers to or is attached to a particular product.

As is the case for GHS, and even though it is an information communicated by the Elevators in their dealings with the farms, the Basis is not recorded in the transaction data by the grain companies.

269 Moreover, when the farmers refer to the effect of changes in the Basis, they always refer to changes expressed in terms of cents *per bushel or per MT*. The bushel or the MT is a unit of measurement for the grain, not for GHS. In other words, the farms always refer to the impact that a change in the Basis will have on the price for the grain itself, expressed in terms of a dollar value per bushel or MT. The changes to the Basis are never expressed in terms of cents for GHS or for any type of service provided by an Elevator.

270 Even if a change to the Basis offered is the subject of negotiations between grain companies and farmers, what ultimately changes is the Cash Price from which the Basis is derived. What changes is the price expressed in dollars and cents per bushel or MT, for the grain being purchased by the Elevator and sold by the farmer.

271 Further to its review of the evidence, the Tribunal therefore concludes that the Basis is best described as a component of the price of *grain*, not as a price attached to a specific product or a separate value added. In fact, the Tribunal finds that the evidence from P&H and the grain companies establishes that the Basis is not a price of a product by itself but a cost element for the Elevators.

272 The Tribunal adds that merely displaying the components of a price, itemizing the price of a product, or providing the breakdown of the components of a product being sold or purchased, does not have the effect of creating a separate product if such an itemized component does not have an economic life of its own, and is not transacted in a market for a price. This is exactly the case for the Basis and the GHS.

273 In his final argument, the Commissioner submitted that this is not even a case where the price for GHS is implicit. He claims that there is nothing implicit about GHS and that its price or value appears in the contracts that P&H and other grain companies enter into with farmers. The Commissioner claims that the price for GHS is in fact explicit and only appears to be implicit because the Basis is not subsequently recorded in the transaction data of the grain companies. The Commissioner argues that the explicit price underlying his product market is the Basis being charged to the farmers by the Elevators. And that the problem is strictly one of implementation because the Basis sets the price for GHS.

274 The Tribunal does not agree. This is not a situation where there is an explicit price for GHS that is part of the contract price between the farmers and the Elevators.

275 First, the Commissioner confuses the price of GHS and the Basis. The evidence clearly establishes that the Elevators do not post a price for GHS; they post a Basis. The Basis sometimes shows up in the information posted by P&H and other grain companies, as well as on some invoices and in some contracts. But not GHS. The Basis and GHS are not the same thing, and Dr. Miller clearly acknowledged that he had to "impute" the price of GHS from the Basis information (Exhibits P-A-169, CA-A-170 and CB-A-171, Expert Report of Dr. Nathan Miller ("*Dr. Miller Report*"), at para 173). Dr. Miller used a computed price as a proxy for the Basis, because neither the Basis, nor a price for GHS, appears in the transaction data. Dr. Miller and a representative of the Commissioner indeed acknowledged, in their testimony and on discovery, that the imputed price for GHS is a "subset of the Basis" (Exhibits CA-R-242 and P-R-243, Compilation of Additional Documents Added to the Agreed Book, P&H Read-in Brief ("*P&H Read-In*"), at pp 21-22). Dr. Miller further admitted that the imputed price for GHS does not always correspond to what the Basis component of the Cash Price actually is.

276 Second, a calculated or imputed price is not a price that can be correctly described as being observed or observable. Here, Dr. Miller has not used the observed Basis; he has estimated a price for GHS (which he sometimes refers to as a Basis) for each transaction from the difference between the Cash Price and an assumed Futures Price at a given date. Dr. Miller testified that at a transaction level, the estimation leads to variance between the observed Basis of which a corresponding Cash Price was transacted and the constructed price for GHS for that transaction.

277 The Commissioner submits that the price of GHS imputed by Dr. Miller is a good approximation of the Basis. For the Virden and Moosomin Elevators, Dr. Miller takes the median of the transaction-level prices of GHS and he uses the Virden

Elevator median price to calculate his mark-up. The median prices calculated by Dr. Miller are the benchmark prices he uses in his HMT analysis.

278 Dr. Miller and Ms. Sanderson agree that taking a median over thousands of observations measured with error reduces the measurement error. However, they disagree about whether the median prices for GHS obtained by Dr. Miller for the Virden and Moosomin Elevators are reliable estimates for the Basis.

279 Referring to the contracts of [text omitted], a farmer, Dr. Miller said that the difference between his computed median price of CAD $31.02 per MT for GHS for wheat and the corresponding value of the Basis in [text omitted] contracts of CAD $34.83 per MT was "reasonably close," using 37 deliveries made by [text omitted]. The Tribunal observes that it is still a significant difference of 12% — namely, CAD $3.76 per MT or 10.23 cents per bushel of wheat. And that difference is a variance of only a few transactions out of thousands. However, when Dr. Miller compares the median for all wheat transactions at the Moosomin Elevator, calculated by his own model as being CAD $34.78 per MT, to the actual Basis in the contracts of [text omitted] (*i.e.*, CAD $ 34.83), the two values are very similar. In light of that, the Commissioner claims that the price for GHS imputed by Dr. Miller represents a good approximation of the actual Basis found in the contracts.

280 Ms. Sanderson testified that the large difference in the median between the Moosomin and Virden Elevators for both wheat and canola is likely due to a larger error between Dr. Miller's predicted median and the median of the actual Basis. Ms. Sanderson points to the fact that for wheat, the GHS median value is 20% lower at the Virden Elevator than at the Moosomin Elevator, whereas in the case of canola, the Virden Elevator median value is 60% higher than the Moosomin Elevator value, in a situation where the Virden Elevator had larger sales than Moosomin. Ms. Sanderson attributed these differences to the uncertainties in the methodology used by Dr. Miller.

281 Like Ms. Sanderson, the Tribunal does not share the Commissioner's confidence in Dr. Miller's calculations. The Tribunal is not persuaded that using a median to correct for the error terms between the estimated and the actual values is sufficient, in this case, to correct for the high uncertainty in the estimated values. The median calculated by Dr. Miller includes several sources of uncertainty stemming from the fluctuation of the Futures Price and exchange rates within a day that may not be correlated with the actual transactions, the choice for delivery dates, and negotiations on delivery. The Tribunal agrees that in theory, using the median of a very large data set (in this case, thousands of transaction data) provides a much smaller error than the error of each observation. However, in his attempt to correlate a Futures Price for an estimated delivery date for each transaction, Dr. Miller did not provide convincing evidence to give the Tribunal the level of confidence or precision needed to conclude that the median predicts the actual Basis. The Tribunal adds that if the measurement errors are systematically skewed from actual delivery periods or Futures Price and exchange rates spot price reflected in the application at the time of sale, the results will also be skewed. Dr. Miller did not provide the Tribunal with evidence that this did not occur.

282 In any event, whether Dr. Miller's "imputed" price of GHS is a good or not so good approximation of the Basis is not a determinative issue in this case. The Tribunal finds that neither the "imputed" price of GHS nor the Basis can be used as the foundation of a product market definition since neither is a transacted price attached to an identifiable product.

283 The Tribunal pauses to note that, if in a given case, the evidence enabled it to isolate or identify a value-added component or feature of a product with sufficient precision, and to find a value-added price from business records, the Tribunal may conclude that the computed price is the price of that value-added component. In this case, the evidence does not permit to make such a conclusion.

(v) The Basis plays a role in competition

284 That being said, the Tribunal appreciates that the Basis is a touchstone of competition between the Elevators, and that it is an important factor to understand the rivalry between Elevators as well as the competitive dynamics in the grain industry. One cannot ignore what is going on at the Elevator's level (including competition on the Basis) when determining whether there is an increase in market power and a substantial lessening of competition.

285 The evidence supports a conclusion that the Basis component of the price of grain is affected by local competition. Farmers such as Mr. Pethick, Mr. Paull, and Mr. Hebert testified that they can play Elevators against each other based, among other things, on the Basis. Mr. Paull and Mr. Hebert admitted on cross-examination that they use not only the Cash Price to compare Elevators, but also the Basis. Even Mr. Heimbecker admitted that farmers use the Basis to compare grain prices between Elevators. There was also evidence that P&H sends email blasts to customers containing references to the Basis. The vast majority of grain companies also incorporate references to the Basis as well as the Futures Price and the Cash Price in their contracts with farmers. Farmers can also enter into Basis contracts, though Mr. Heimbecker testified that these were rare in the grain industry. Furthermore, P&H can and does adjust the Basis to account for local competition from Elevators: P&H and other grain companies will offer limited-time or limited-tonnage specials to farms to attract their grain, and such premiums above the posted Cash Price are sometimes expressed through changes in the Basis.

286 The Tribunal accepts that the Basis captures an aspect of competition between the Elevators. The Basis is one part of competition between the Elevators and, as will be discussed below, it is an element to consider in the substantial lessening of competition analysis. However, this does not mean that the Basis, or Dr. Miller's "imputed" price for GHS, can constitute the base price for market definition purposes, or that the existence of the Basis is sufficient to transform GHS into a relevant product.

287 The Commissioner is urging the Tribunal to adopt, for its product market definition, an economic framework that allows for and facilitates an analysis focused on the local competition allegedly impacted by the Acquisition. This is what led the Commissioner and Dr. Miller to identify GHS as a product and to "impute" a price for it, derived from the Basis. Dr. Miller opined that, economically, constructing an imputed price to approximate the Basis was the right way to analyze the "effects" of the Virden Acquisition. However, in an effort to define a relevant product market, the Commissioner developed a theoretical framework that does not reflect the commercial reality of the grain industry, where GHS does not exist as a product, does not have a "price," and is not transacted. In short, the Commissioner's position ignored the fundamental premise of product market definition, which requires the existence of a transacted product whose price is the ordinary price in the sector of the industry being examined.

288 In sum, the Tribunal finds that the evidence does not support the existence of a separate relevant "market" for the sale of GHS. GHS is an artificial product, with an artificial price, that cannot form the foundation of an acceptable relevant product market for the purpose of the Tribunal's analysis. On the facts of this case, the relevant products are the purchase of wheat and canola and the relevant price is the Cash Price.

(b) The "value-added" approach

289 The Commissioner submits that the law acknowledges it can be appropriate to define the relevant product market around a component of the price of the final product which represents the specific value provided at an intermediary level by the merging firms. In this case, the Commissioner maintains that an Elevator's specific contribution of value, namely, providing GHS as part of the Cash Price farmers receive for their grain, can be identified with reasonable clarity. According to the Commissioner, a product market definition focused on the competition affected by the merger and on the merging firms' contribution to value is an approach supported by the jurisprudence from Canada, the U.S., and the European Union.

290 The Tribunal disagrees. Further to its analysis, the Tribunal instead concludes that there are no precedents, in Canada or in any other jurisdiction, where the "value-added" approach referred to in the US HMEGs has actually been used and applied by an adjudicating court or tribunal to define a relevant product market in a merger case. Moreover, the "value-added" approach advocated by the Commissioner cannot be reconciled with the history of the MEGs and the current 2011 MEGs issued by the Commissioner himself.

(i) The US HMEGs

291 In support of his "valued-added" approach to the product market definition, the Commissioner relies heavily on the US HMEGs. These guidelines describe the approach to merger review by the U.S. antitrust agencies and were adopted in 2010. In his reply expert report, Dr. Miller referred specifically to them, drawing an analogy between the present case and the examples

used in the US HMEGs (Exhibits P-A-172, CA-A-173 and CB-A-174, Reply Expert Report of Dr. Nathan Miller ("*Dr. Miller Reply Report*"), at paras 34-36 and fn 33).

292 In its section 4 on "Market Definition", the US HMEGs contemplate that in certain situations, the benchmark price used for analyzing a product market — *i.e.*, the base price — can be different from the price effectively charged for a final product. The US HMEGs indicate that, in a situation where explicit or implicit prices for the merging firms' contribution to the value of the final product can be identified with reasonable clarity, the price used to assess the merger and define the relevant market can be the component of the price that the firms compete on. Similarly, the SSNIP threshold can also be adjusted. In paragraph 4.1.2 on "Benchmark Prices and SSNIP Size," the US HMEGs state as follows:

> The Agencies most often use a SSNIP of five percent of the price paid by customers for the products or services to which the merging firms contribute value. However, what constitutes a "small but significant" increase in price, commensurate with a significant loss of competition caused by the merger, depends upon the nature of the industry and the merging firms' positions in it, and the Agencies may accordingly use a price increase that is larger or smaller than five percent. Where explicit or implicit prices for the firms' specific contribution to value can be identified with reasonable clarity, the Agencies <u>may base</u> the SSNIP on those prices.
>
> [Emphasis added.]

293 The US HMEGs then refer to three specific examples, illustrating situations where implicit prices for the firms' specific contribution to value can be identified. These examples read as follows:

> *Example 8:* In a merger between two oil pipelines, the SSNIP would be based on the price charged for transporting the oil, not on the price of the oil itself. If pipelines buy the oil at one end and sell it at the other, the price charged for transporting the oil is implicit, equal to the difference between the price paid for oil at the input end and the price charged for oil at the output end. The relevant product sold by the pipelines is better described as "pipeline transportation of oil from point A to point B" than as "oil at point B."
>
> *Example 9:* In a merger between two firms that install computers purchased from third parties, the SSNIP would be based on their fees, not on the price of installed computers. If these firms purchase the computers and charge their customers one package price, the implicit installation fee is equal to the package charge to customers less the price of the computers.
>
> *Example 10:* In Example 9, suppose that the prices paid by the merging firms to purchase computers are opaque, but account for at least ninety-five percent of the prices they charge for installed computers, with profits or implicit fees making up five percent of those prices at most. A five percent SSNIP on the total price paid by customers would at least double those fees or profits. Even if that would be unprofitable for a hypothetical monopolist, a significant increase in fees might well be profitable. If the SSNIP is based on the total price paid by customers, a lower percentage will be used.

294 The US HMEGs therefore contemplate two situations where the usual base price and/or SSNIP threshold could be modified. The first one looks at the explicit or implicit price of the value added by the merging firms and, in cases where the value-added component can be identified with reasonable certainty, a base price other than the usual total price of the product may be used. The second refers to situations where the SSNIP remains based on the total price paid for the product, but the usual 5% SSNIP threshold is adjusted to deal with the realities of an industry.

295 However, the US HMEGs provide no guidance as to when the contribution to value, as opposed to the total price of a product, would be appropriate for the purposes of the relevant market definition. Nor do they contain any guidance on how and when the usual 5% SSNIP threshold should be adjusted. The Tribunal finally notes that the US HMEGs simply mention that the U.S. antitrust agencies "may base" the SSNIP and the HMT analysis on the price for the value added by the merging firms.

(ii) No court or tribunal has ever applied the "value-added" approach

296 As correctly pointed out by P&H in its submissions, a review of the existing jurisprudence reveals that, contrary to the Commissioner's submissions, there are no legal precedents, in Canada, in the U.S., or in any other jurisdiction, where a court or a tribunal has effectively applied or recognized the "value-added" approach set out in the US HMEGs. While the concept advanced by the Commissioner has been argued in a few cases in the U.S., the European Union and Australia, it has either been rejected by the courts or applied by competition agencies to facts which are distinguishable from the facts of this case. The Tribunal further observes that the "value-added" approach has never been considered or applied in respect of an "imputed" price. In other words, the Tribunal has not found any situation where a court or tribunal has accepted and retained an implicit price for the merging firms' specific contribution to the value of a product to determine the relevant product, the relevant price, the SSNIP, and the relevant market in a merger case.

297 In essence, on this issue of the "value-added" approach, the Commissioner is asking the Tribunal to go where no other court or tribunal has yet agreed to go.

• *Canada*

298 As far as Canadian cases are concerned, the Commissioner relies on *Hillsdown* and *Xerox*. He claims that these cases both demonstrate that the value added by the merging firms can form the basis of a product market definition and that, to define the relevant product market, the Tribunal can focus on the portion of the final price that is impacted by the merger.

299 The Tribunal is not persuaded by the Commissioner's arguments.

300 In *Hillsdown*, the first contested merger review proceeding under section 92, the Tribunal analyzed the merger of two companies that operated rendering businesses for the by-products from slaughterhouses and other entities. On the product market definition, the Tribunal had to decide whether to characterize the relevant market as the supply of "renderable material" from slaughterhouses to the renderers, or as the provision of the specific services that contribute to the end product's value, namely, "rendering services" offered by the renderer to the slaughterhouses, meat processing plants, grocery stores, etc. Since the Tribunal decided to characterize the market as the provision of rendering services, claims the Commissioner, it recognized that the product market can be limited to the services capturing the value provided by an intermediary.

301 The Tribunal considers that *Hillsdown* is of no assistance to the Commissioner on the "value-added" approach since in that case, the Tribunal expressly said that there was *no difference* between the two contemplated approaches to the product market, even though it decided to characterize the market as the provision of rendering services. If the first characterization was used, then the analysis for competition purposes would have focused on the possible monopsony power of the renderers as buyers of the raw materials. If the second characterization was used, then the analysis would have focused on the possible market power of the renderers as sellers of the rendering services. But, said the Tribunal, no significant difference resulted from the two characterizations. Moreover, there was clearly a price paid for the renderable materials or for the services provided (Hillsdownat pp 293 d-h, 299). In light of the foregoing, the panel finds that the *Hillsdown* decision is at best inconclusive on the issue of the "value-added" approach.

302 In *Xerox*, a non-merger case, the Tribunal found that the relevant product market was the provision of intermediary services, namely, servicing copier parts that were not constrained by the sale of copiers to end customers. It is true that the Tribunal then recognized that a subset of a final product (*i.e.*, the servicing of parts for copiers) can constitute a relevant product. However, in that case, there was a specific price charged for the specific service offered by the parties. Again, this precedent therefore offers at best weak support to the "value-added" approach contemplated by the Commissioner in this case, as no specific price is charged for GHS.

• *U.S.*

303 Turning to the U.S., even though the US HMEGs were adopted more than 12 years ago in August 2010, the Commissioner has not referred the Tribunal to any decision of a U.S. court where the "value-added" approach set out in the US HMEGs was accepted and actually applied.

304 In his submissions to the Tribunal, the Commissioner referred to a matter involving Conagra Foods (*United States of America v Conagra Foods, Inc, et al*, 14-CV-000823 "*Conagra*")) and to FTC v Whole Foods Market, Inc, 502 F.Supp. 2d 1 (2007) ("*Whole Foods*"). The Tribunal concludes that neither of these matters constitutes a convincing precedent to assist the Commissioner on the "valued-added" approach.

305 The *Conagra* example was a case in the flour business, where a fee was charged by the millers for converting wheat into flour. The Commissioner claims that this was a situation where the U.S. Department of Justice applied the SSNIP to a component of the final price for the flour, namely, the converting fee, because this component was the subject of the effective competition at issue between the merging flour mills. However, this precedent is of no value to the Tribunal as the Commissioner was strictly relying on the argument presented to the court by the U.S. antitrust agency itself, and not on a decision issued by a U.S. court. This case is therefore not a legal authority but instead solely reflects the position taken by another competition authority on the "value-added" approach.

306 With respect to *Whole Foods*, it was not a case where a "value-added" approach was applied or even considered by the U.S. court. It was instead a matter where the court mentioned that in the context of the HMT framework, lower SSNIP levels may be more appropriate for mergers in markets or industries characterized by high-volume sales but low-profit margins (Whole Foods at pp 9-11). This case therefore did not involve the application of a "value-added" approach to a component of a product but turned instead on the possible use of a smaller SSNIP threshold on the final product sold by the grocers. The Tribunal points out that in *Whole Foods*, the U.S. court did not analyze nor provide any guidance on the factors to take into account or the evidence required in order to determine the appropriate level of such a lower SSNIP level.

• *European Union*

307 The Commissioner also referred to two cases issued by the European Commission ("*EC*") in the European Union, where the US HMEGs were approved and followed by the EC. These decisions dealt with extruded metals and, according to the Commissioner, recognized the value-added by an intermediary as a relevant and separate product market.

308 In *Norsk Hydro/Orkla/JV* (Case No COMP/M.6756), 13 May 2013 ("*Norsk Hydro*"), two companies had operations in the aluminum sector where extrusion premia were charged. The extrusion premia represent the price paid by customers for the value added by companies that extrude the aluminum. In *Norsk Hydro*, the EC noted that there was a significant and persistent difference in the extrusion premia charged by soft-alloy extrusion suppliers in two different geographic markets. Therefore, in analyzing the merger between extruders, the EC considered that the relevant benchmark price was the actual price for the premium charged for the extruding process, and not the full price of the aluminum eventually sold to customers. The EC concluded that "in the presence of a similar price structure, it seems appropriate to take as a relevant benchmark price the extrusion premia rather than the full price" — citing with approval the US HMEGs (*Norsk Hydro* at paras 66-67). The EC found that the price negotiations were only on the extrusion premium, as other factors such as the price of aluminum or the billet conversion costs were typically fixed.

309 The second European Union case relied on by the Commissioner is *Inco/Falconbridge*, (Case No COMP/M.4000), 4 July 2006 ("*Inco*"). In that case, the EC considered the market for high-purity nickel, stating that "the price increase must be seen in relation to the added value provided by the firms in the relevant market" (*Inco* at para 379). The EC observed that a price increase of an input good may have only a minor effect on the price of the final product (depending on the share of total input cost represented by the input good), but can nonetheless be considered significant from a competition perspective. Since the premium charged was directly negotiated with the customers, the EC determined that it was a separate product, with a separate price.

310 The Tribunal pauses to note that P&H also referred to a third similar EC matter, also dealing with extruded metals, namely, *Glencore/Xstrata* (Case No COMP/M.6541), 22 November 2012. In that case, a premium applicable to the extruded metal differentiated the extruded product from the raw metal price, and was also the main element of the price negotiated between buyers and sellers.

311 The Tribunal finds that these European Union cases are of no real precedential value. In any event, they are clearly distinguishable from the present case.

312 Regarding their precedential value, the Tribunal underlines that these three matters are decisions issued by the EC, which is the European competition agency and the equivalent of the Commissioner in the European Union. These EC decisions are not decisions issued by an independent adjudicative court or tribunal. Under the European Union competition law regime, and in merger matters in particular, the EC is not strictly an investigator and law enforcer as is the Commissioner under the Act. The EC has the dual role of being not only the investigative authority but also the first-instance decision-maker. The EC decisions relied on by the Commissioner thus represent the position of the competition authority itself, as opposed to a decision by an independent judicial body like the courts or the Tribunal. The Tribunal is thus of the view that such decisions of the EC, while informative, carry less persuasive weight. They can certainly not be qualified as legal precedents on the issue of the "value-added" approach.

313 The Tribunal further concludes that the *Norsk Hydro* and *Inco* precedents are of limited assistance to the Commissioner as they are distinguishable from the present case: according to the evidence in those cases, the premia were a separate price charged for a separate product, and were openly negotiated between the suppliers and the customers. These were situations where there was a specific price for the premia at issue. In other words, the price of the value-added product was not constructed or implicit. It was explicit and transacted.

• *Australia*

314 In its final submissions, P&H referred to an Australian case, Australian Competition and Consumer Commission v Metcash Trading Limited, [2011] FCA 967 (“Metcash”), aff'd [2011] FCAFC 151. This was in response to a Direction the Tribunal had issued prior to final oral argument, where it notably invited counsel for both parties to identify legal precedents in which a court or tribunal considered situations where it was proposed that an implicit price for the merging firms' specific contribution to the value of a product should be used to determine the SSNIP and the relevant market, as well as legal precedents which considered situations where in applying the HMT and in defining the relevant market, a SSNIP smaller or larger than 5% should be used, and/or reviewed the factors to take into account in determining the appropriate level of the SSNIP.

315 In the *Metcash* case, the Australian Competition and Consumer Commission ("*ACCC*") challenged a merger of wholesale grocery suppliers. The ACCC sought to use an imputed price purporting to represent the value added by grocery wholesalers at their stage in the supply chain as the basis for considering the impact of a SSNIP in defining markets. The ACCC's approach, which echoed the US HMEGs, was soundly rejected by the Federal Court of Australia (and affirmed on appeal). The Australian court found that the purported value-added services for which the ACCC sought to use an imputed price were not the extent of what the wholesaler actually provided, and that an imputed price solely for these services could therefore not be used as the basis for defining the relevant market. The court noted that "the associated services provided by [the wholesaler] are not available in the absence of the acquisition by a retailer of packaged groceries from [the wholesaler]" (*Metcash* at para 196).

316 The Commissioner argues that this case is distinguishable as it involves a considerably more complex market structure, in an industry characterized by a mixture of self-supplying retailers and independent retailers, and involving different categories and types of products across multiple levels of the supply chain.

317 The Tribunal does not share the Commissioner's view. As admitted by counsel for the Commissioner at the hearing, *Metcash* is the sole judicial precedent identified by the parties that actually dealt directly with the so-called "value-added" approach exposed in the US HMEGs and advocated by the Commissioner in the present case. In *Metcash*, the Australian courts clearly rejected the "value-added" approach to product market definition and the use of an imputed price covering only a subset of the product effectively sold by the merging parties, as it did not reflect the commercial activity of the merging firms. Moreover, the alleged value added by the grocery wholesalers was not independently transacted.

318 In the Tribunal's view, this Australian case bears a number of striking similarities with the present case: like the situation in *Metcash*, the so-called value-added for GHS does not have a commercial life of its own, and the "imputed" price for GHS

— or the Basis — is not the price ordinarily used in the grain industry for the product being transacted between the farmers and the Elevators. The Tribunal considers that the reasoning in this Australian decision, while not binding, is persuasive and is generally consistent with the Tribunal's analysis in the present case.

(iii) The "value-added" approach is not supported by the Commissioner's own MEGs

319 The Commissioner finally submits that the "value-added" approach he is proposing finds support in his own MEGs.

320 With respect, the Tribunal again does not agree. The Tribunal instead finds that the Commissioner's proposed approach to the application of the HMT and the choice of the price of GHS for market definition purposes cannot be reconciled with the removal, in 2004, of the "value-added" language that existed before then and the continued absence of such language in the current 2011 MEGs.

321 It is worth reminding that the MEGs articulate the analytical framework that the Competition Bureau and the Commissioner apply in determining whether a merger is likely to substantially lessen or prevent competition. The MEGs were first introduced in 1991 to provide guidance to the Competition Bureau's enforcement approach to the new merger provisions enacted in 1986 ("*1991 MEGs*"). The Competition Bureau's 1991 MEGs were superseded in September 2004 with the release of the 2004 MEGs, which were themselves replaced by new, revised guidelines in October 2011, when the 2011 MEGs were issued. The Tribunal pauses to note that the 2011 MEGs followed the issuance of the revised US HMEGs in August 2010.

322 Since the first adoption of the MEGs in 1991, several important changes have been made to the product market approach presented by the Commissioner. More specifically, the "value-added" approach, which the Commissioner is apparently attempting to resuscitate in this case, was expressly abandoned in the most recent iterations of the MEGs.

323 In the 1991 MEGs, the Commissioner discussed the conceptual framework for market definition. With respect to the base price, the 1991 MEGs stated the following (1991 MEGs at p 9):

> In general, the base price that is employed in postulating a significant and non-transitory price increase is whatever is ordinarily considered to be the price of the product at the stage of the industry (e.g., manufacturing, wholesale, retail) being examined. This is typically the <u>cumulative value</u> of the product, inclusive of the value added (mark-up) at the industry level in question. However, in certain industries, the <u>value added is billed as a separate fee</u>, and no mark-up is applied to the product in relation to which the service (or other value added) is performed. In such cases, the price increase will usually be postulated in relation to the fee.
>
> [Emphasis added.]

324 The 1991 MEGs therefore made an express distinction between the "cumulative price" and the "value added" price. They specifically identified a "value added" approach as an exception to the typical approach of using the cumulative price, and specified that this exception would apply if two conditions were met: "the value added is billed as a separate fee, and no mark-up is applied to the product in relation to which the service (or other value added) is performed." The 1991 MEGs thus established that the value-added price could "be employed where it is billed as a separate fee and no mark-up is applied to the product in relation to which the value-added is applied" (Paul S. Crampton, Canada's New Enforcement Guidelines*: a "Nuts and Bolts" Review*, 36 Antitrust Bulletin 883, 1991) ("Crampton 1991") at p 914), The author, who was the drafter of the 1991 MEGs, used a pipeline example — similar to what the US HMEGs would use some 20 years later — to illustrate a situation where the value-added price could be used as the base price for market definition purposes: when two pipeline operators simply charge a tariff for transporting the oil, such billed fee can be used as the base price for the HMT analysis (*Crampton 1991* at p 914).

325 However, it is clear from the 1991 MEGs that the mainstream approach was to use the "cumulative value of the product" as the base price to postulate a SSNIP: the 1991 MEGs adopted the "common sense approach of using cumulative prices except where it is industry practice to bill the value added as a separate fee" (A. Neil Campbell, Merger Law and Practice: The Regulation *of Mergers under the* Competition Act, (Scarborough, Ontario: Carswell, 1997) ("*Campbell*") at p 61).

326 In the 2004 and 2011 MEGs, this reference to the alternative value-added price approach was taken out of the MEGs, and the sole reference to the base price remained the price "ordinarily considered to be the price of the product at the stage of the industry (e.g., manufacturing, wholesale, retail) being examined." The Tribunal underlines that, even though the 2011 MEGs were adopted 14 months after the US HMEGs, they did not revive the value-added price abandoned in 2004 or echo the "implicit or explicit price" exceptions described in the US HMEGs.

327 The Tribunal further understands that, before the present case, not a single merger was judicially contested by the Commissioner on the basis of a value-added price or the "value-added" approach.

328 On March 10, 2021, the Tribunal sent a Direction to counsel inviting the parties to provide submissions regarding the specific reference that was contained in the 1991 MEGs to a "value-added" price and its absence from the subsequent iterations of the MEGs published by the Competition Bureau in 2004 and 2011.

329 In his submissions to the Tribunal, the Commissioner did not identify a particular reason why the paragraph discussing the value-added approach was not explicitly retained in subsequent iterations of the MEGs. He noted that most commentators remained silent on the issue when the new version of the 2004 MEGs was discussed in draft form. The Commissioner submitted that even though the explicit reference to the value-added price was removed, the concept remains embedded in the subsequent versions of the MEGs. He added that a significant change in the 2004 MEGs was to explain that market definition is based on substitutability and focuses on demand responses to changes in relative prices, and that the focus of the market definition exercise is on those dimensions of competition that purchasers of the product value.

330 The Commissioner further argued that, despite their silence on the "value-added" approach, the 2011 MEGs define the notion of price in a way that encompasses such a "value-added" approach, and that the language of the MEGs provides "latitude on what price is analyzed in a merger." According to the Commissioner, the 2011 MEGs contemplate flexibility on the SSNIP test to be applied and on the 5% threshold. He added that in paragraph 4.2 of the 2011 MEGs, the reference to price is intended to capture any market that may be anti-competitive, and that the guidelines are agnostic as to how the price to supply the product is defined. The Commissioner also relied on the fact that the MEGs are also clear that in terms of the SSNIP, 5% is generally appropriate but "market characteristics may support using a different price increase" (2011 MEGS at para 4.3).

331 The Tribunal is not convinced by the Commissioner's arguments.

332 The Tribunal first observes that the Commissioner's references to the apparent flexibility in the 2011 MEGs language strictly relate to the level of the SSNIP threshold, not to the definition of the base price. In the 2011 MEGs, the Competition Bureau refers to the notion of "base price" at paragraphs 4.6 and 4.7. It expressly states that the base price used to postulate a price increase is "typically the prevailing price in the relevant market" (2011 MEGs at para 4.6). The Competition Bureau may elect not to use the prevailing price when market conditions (absent the merger) would likely result in a lower or higher price in the future. It then states that "[i]n general, the base price used to postulate a price increase is whatever is ordinarily considered to be the price of the product in the sector of the industry (e.g., manufacturing, wholesale, retail) being examined" (2011 MEGs at para 4.7). The Tribunal is unable to read in those provisions any direct, oblique, or implied reference to a value-added price or to the situations alluded to in the US HMEGs.

333 Furthermore, the Tribunal does not accept the Commissioner's disconcerting contention that the 2011 MEGs could or should somehow continue to be read as implicitly containing the express language of the 1991 MEGs that the Commissioner explicitly removed and abandoned in 2004, and did not re-insert when he issued his revised MEGs in 2011.

334 In fact, as the panel indicated at the hearing, the Tribunal is left with the distinct impression that the Commissioner is urging the Tribunal to follow the US HMEGs and to prefer them to his own 2011 MEGs. This is not a path that the Tribunal will follow.

335 The Tribunal instead agrees with P&H that the evolution of the MEGs since 1991 reinforces its position that the base price to be used for purposes of market definition is "whatever is ordinarily considered to be the price of the product at the

stage of the industry [...] being examined," which is "typically the cumulative value of the product, inclusive of the value added (mark-up) at the industry level in question" (1991 MEGs at p 9; see also 2004 MEGs at para 3.8 and 2011 MEGs at para 4.7). In the present case, what is ordinarily considered to be the price of the product in the sector of the industry being examined, and what is the cumulative value of the product, is the Cash Price received by the farmers for their grain, be it wheat or canola.

336 What is more, the conditions of the "value added" price once recognized by the Commissioner in the 1991 MEGs — namely, that the value added be "billed as a separate fee" with "no mark-up [...] applied to the product in relation to which the [...] value added is performed" — would not be met in this case. These conditions speak of a separate price attached to the value-added product and imply that the value-added element must be more than a simple cost component and must be transacted. Here, the Commissioner's proposed price for GHS is founded on an imputed price equal to only a fraction of the total value-added provided by grain companies, there is no separate fee (either explicit or implicit) for the alleged value-added provided by grain companies for GHS, and P&H does not charge and bill a separate fee for GHS, or even for the Basis.

337 The Tribunal is mindful of the fact that the MEGs are neither sacrosanct nor legally binding (*Southam* FCAat p 41). The MEGs do not restate or revise the law, nor do they substitute for professional advice (Canada (Commissioner of Competition) v Superior Propane Inc, 2001 FCA 104 (" at paras 144-146). However, published guidelines such as the MEGs do provide guidance and notice to the public of how the Commissioner interprets the Act (Canada (Commissioner of Competition) v Canada Pipe Co, 2006 FCA 233, at paras 33, 39; JD Irving Ltd v General Longshore Workers, Checkers and Shipliners of the Port of Saint John, 2003 FCA 266 (" at para 37). The Tribunal agrees with P&H that the MEGs serve as an important tool for the public and the business community to understand the application of the Act. While not legally binding, they serve as a meaningful element to delineate legal and economic principles that are not fully reflected in the Act itself, and they may be considered as an aid to the Act's interpretation (Eli Lilly and Co v Apotex Inc, 2005 FCA 361 at para 33). The Tribunal has indeed often noted that the MEGs provide "important enforcement guidelines reflecting the Commissioner's view on how the Act should be interpreted" (*Superior Propane I* at para 393).

338 It is worth repeating the comments made by the Tribunal at paragraph 397 of *Superior Propane I*:

> It must not be forgotten that the point of view put forward in the MEGs represents the considered opinion of the Commissioner, the official appointed by the Governor in Council to administer and enforce the Act. That view, it goes without saying, is the view arrived at by the Commissioner following careful advice given to him by his legal and economic advisers regarding the meaning of the various provisions of the Act. Although the Commissioner is not bound by the MEGs nor are they binding upon this Tribunal, the MEGs should be given very serious consideration by this Tribunal. Needless to say, the Tribunal can disagree and in fact should disagree if it is of the opinion that the interpretation proposed in the MEGs is wrong. However, when referring and considering the MEGs, one should bear in mind the comments in the preface to the MEGs made by Howard Wetston, then Director of Investigation and Research. He stated that the MEGs were published to promote a better understanding of the Director's merger enforcement policy and to facilitate business planning. He also noted the extensive consultation process which was followed in their preparation.

339 It cannot be said that the Commissioner was unaware of the fact that the "value-added" approach was expressly removed from the 2004 MEGs and is absent from 2011 MEGs, even if this most recent iteration was issued after the US HMEGs had been adopted in the U.S.

340 The Commissioner provided no satisfactory explanation or compelling argument to convince the Tribunal that it should now depart from the 2011 MEGs, revive a "value-added" approach the Commissioner abandoned and removed from the MEGs in 2004, and embrace a new standard for product market definition that no longer forms part of the MEGs and the Commissioner has not publicly endorsed since at least 2004.

341 The Tribunal is of the view that parties to transactions in Canada should be able to rely reasonably on statements of principle made by the Commissioner in published enforcement guidelines, including the MEGs, in order to know the rules applicable to their future activities and planned transactions. As the official responsible for the administration and enforcement of the Act, the Commissioner has a particular responsibility to provide guidance to parties through the publication

and consistent application of relevant principles and approaches. Although the MEGs are not legally binding on the Tribunal or the Commissioner, if the Commissioner proposes to depart materially from them in litigated proceedings, the departure should be recognized, explained and justified (for example, by noting an amendment to the Act, or a recent Tribunal or court decision on point, or an advance in economic thinking or methodology) (see also *JD Irving* at para 37). The Commissioner did not do so with respect to the proposed new "value-added" approach to product market definition that he is inviting the Tribunal to adopt.

342 In sum, from a legal standpoint, the Tribunal finds no support in adjudicated precedents or in the MEGs for the "value-added" approach to product market definition advocated by the Commissioner in this case. If anything, both the existing precedents and the MEGs instead reinforce the conclusion that, in this case, the relevant products are the purchase of wheat and canola and the relevant price is the Cash Price.

(iv) The US HMEGs do not apply to this case

343 The Tribunal makes one last observation on the US HMEGs. In his submissions, the Commissioner tries to draw a parallel between the present case and the hypothetical situations described in those guidelines. He argues that, just as in the US HMEGs, the Elevators' specific contribution to value can be "identified with reasonable clarity," through the Basis.

344 The Tribunal is not persuaded that, even if they were retained, the US HMEGs' requirements would be met in this case.

345 The US HMEGs expressly require that in order to base a SSNIP on the value added by the merging firms, the firms' specific contribution to value must be identifiable with reasonable clarity. In the Tribunal's view, this is not a situation where an Elevator's specific contribution of value (by providing GHS) to the Cash Price farmers receive for their wheat or canola can be identified with reasonable clarity. As discussed above, the evidence indicates that the price of GHS, as "imputed" by Dr. Miller, cannot be identified explicitly by the grain companies or the farmers, nor is it implicitly observable by industry participants, as it is not the actual Basis. And if the price for GHS is neither observed nor observable, the "value-added" approach must fail.

346 The Commissioner's price for GHS is neither implicit nor explicit; it is a constructed price. In the present case, the two observed or observable prices are the Futures Price and the Cash Price. Not the price for GHS. Moreover, the US HMEGs' "value-added" approach requires a transacted price, not only a cost component.

(c) The HMT framework and the SSNIP test

347 The "value-added" approach proposed by the Commissioner also raises concerns from a conceptual perspective. As proposed, applying a 5% price increase as part of the SSNIP test *only to the value-added portion* of the price of a product would effectively alter the price change that a hypothetical monopolist must be able to sustain. That alteration to the HMT, without more, would have the effect of seriously modifying the current well-accepted economic analysis underlying market definition and the HMT framework. Since no consideration was given by the Commissioner to whether or how the applicable SSNIP threshold would have to be modified in a value-added scenario, adopting his proposed approach to the product market definition would imprint a profound change to the review of mergers and would significantly recalibrate the current HMT framework governing the market definition exercise.

348 The Tribunal points out that such impact can be significant. Where the value-added component of a product accounts for 10% of the final price, applying a 5% SSNIP threshold to the value-added component is equivalent to applying a *de minimis* 0.5% SSNIP to the final price of the product. Conversely, in order to keep the usual well-accepted 5% SSNIP benchmark applied to the final transacted product, it would require applying a 50% SSNIP threshold when considering a component representing a 10% value-added to the final transacted product.

349 As demonstrated by Ms. Sanderson in her testimony and by P&H in its final argument, the 5% SSNIP threshold used by Dr. Miller in his HMT analysis based on the "imputed" price of GHS (as a proxy for the Basis) translates into an unprecedentedly low SSNIP level when transposed to the total price of grain: the "value-added" approach of the Commissioner would mean that the equivalent SSNIP percentage calculated by Dr. Miller would vary between 0.6% and 0.8% for the purchase of wheat when expressed in terms of the Cash Price, and between 0.1% and 0.2% for the purchase of canola.

350 The Tribunal is not convinced that in the circumstances of this case, the Commissioner has provided clear and convincing evidence, or arguments, supporting such a fundamental change to the market definition exercise. The Commissioner provided no submissions nor evidence on what the appropriate SSNIP threshold should be in the context of his "value-added" approach, or why it should nonetheless be kept at 5% when a smaller component of the final price is used as the base price. The Commissioner's position simply assumed that the usual 5% SSNIP threshold should remain, and he applied it in the HMT analysis. These gaps in the conceptual framework undermine the approach he is proposing in this case.

351 Antitrust economists in the U.S. have voiced concerns about the revised US HMEGs, pointing out that the "value-added" approach would lead to fewer potential substitutes and to lower effective SSNIP thresholds. In response to the draft version of the US HMEGs, some economists identified a fundamental flaw in the "value-added" approach to product market definition proposed in the guidelines, indicating that in many cases, "the value-added service is not actually purchased by customers on a standalone basis" and "customers are not able to substitute to sellers of just the value-added service" (E.M. Bailey, G.K. Leonard and L. Wu, "Comments on the 2010 Proposed Horizontal Merger Guidelines", *HMG Revision Project — Comment*, Project No. P092900, June 3, 2010 at p 5). This is precisely the case here with GHS or the Basis. Other economists observed that "one implication of applying the [HMT] using a value-added approach is that it will tend to produce more narrowly defined markets whenever the threshold used for the value added test is *not sufficiently increased to account for the ratio of value added to prices*" [emphasis added] (P Davis and U Haegler, "Should competition agencies focus on 'value added' instead of final prices?", March 1, 2016 http://ssrn.com/abstract=2740706 at p 16). Again, in the present case, neither the Commissioner nor Dr. Miller turned their mind to the impact of their proposed "value-added" approach on the effective SSNIP threshold.

352 In *Metcash*, the Federal Court of Australia noted that on the facts of that case, applying a 5% SSNIP to the imputed value-added price (*i.e.*, the wholesaler profit margin) would reflect approximately a 0.26% increase in the final retail price. The Australian court did not accept that such a small price increase could be used to define a product market, and refused the proposed "value-added" approach.

353 The Tribunal is unaware of any precedent — and the Commissioner has not mentioned any — where a price increase of less than 5% has been utilized as the SSNIP threshold in applying the HMT analysis. The Tribunal finds that the "value-added" approach as proposed would profoundly change the current HMT framework, and it is not ready to accept that minimal price increases of less than 1% can become the yardstick to justify an intervention in the market. Lower effective SSNIP thresholds lead to narrower product markets, and to a higher likelihood of intervention in mergers.

354 The Tribunal notes that in response to a question from the panel, Dr. Miller acknowledged that the "value-added" approach, whereby a component of the final price of a product is used as the base or benchmark price for a HMT analysis, is not really addressed in the broader empirical industrial organization literature (Consolidated Transcript, Public, at pp 1431-1432).

355 In the Tribunal's view, espousing the "value-added" approach cannot simply be a question of modifying the base price that will be used for the product market definition. Given its impact on the effective price increase it entails for the final product, it also implies, at a minimum, a consideration of the appropriate SSNIP threshold that should be used and an explanation or justification for the selected SSNIP threshold. One cannot dissociate the issue of the "value-added" approach from the issue of the SSNIP threshold. Here, the Commissioner has not presented any evidence nor any economic analysis or authority that would support keeping the 5% SSNIP threshold in the context of his "value-added" approach. Even though the scientific or economic foundation for adopting and using a 5% level remains unclear, the Tribunal underlines that this 5% SSNIP threshold was developed in a context where the base or benchmark price was the cumulative price for the final product sold or purchased. In this case, Dr. Miller and the Commissioner simply transposed this 5% threshold to a value-added price and to their HMT analysis, without explaining or justifying why such threshold could be imported as is in this different context.

356 In light of this shortcoming in the Commissioner's economic analysis and evidence, the Tribunal is not persuaded that the Commissioner's proposed "value-added" approach can be sustained in the circumstances.

357 The Tribunal makes one other observation.

358 As acknowledged by Dr. Miller at the hearing, the US HMEGs refer to two possibilities for dealing with market definition in situations where the value added by the supplier of a product allegedly relates to a small portion of the total price of the product. The first option is resorting to a smaller component of the final price corresponding to the value-added to determine the base price, when the explicit or implicit price of the value-added can be identified with reasonable clarity, with an appropriate SSNIP threshold. The second option, when the merging firms' specific contribution to value is not an implicit or explicit price, is to keep the overall final price of the product as the base price, but use a lower SSNIP threshold in the HMT analysis, adapted to the realities of the industry being examined.

359 Since the constructed price for GHS, or the Basis, is a small component of the total price of grain that is not transacted in itself, the Commissioner could therefore have argued — as was alluded to in *Whole Foods* — that a lower SSNIP should be used in a HMT analysis based on the final price of the grain. However, this second option was not considered by the Commissioner nor by Dr. Miller in this case. At the hearing, the Tribunal asked Dr. Miller and Ms. Sanderson about the issue of using a smaller SSNIP threshold on the Cash Price, but did not receive clear answers from either expert.

360 Resorting to this second option would have required evidence and some economic analysis supporting the different SSNIP threshold to be used. The Tribunal notes that no legal precedent has been identified where, in applying the HMT and in defining the relevant market, a court or a tribunal has discussed the factors or the evidence to be taken into account in order to adjust the appropriate level of the SSNIP threshold in light of the realities of a particular industry. Similarly, the Commissioner has not provided economic or antitrust literature pointing to analyses that could have been done to determine the appropriate SSNIP threshold to be used in the context of a small value added by the supplier or purchaser of a product.

361 Given the profound change that adopting the "value-added" approach would entail for the current well-accepted HMT analysis underlying market definition, the Tribunal is of the view that no change can be adopted without addressing the SSNIP threshold, in one form or another. The failure to address the SSNIP threshold leaves the Tribunal with no clear and convincing evidence to assess whether either of the two options mentioned in the US HMEGs (*i.e.*, the "value-added price component" or the "reduced SSNIP") should or could be retained and applied in this case.

(4) Conclusion on relevant product market(s)

362 For all the reasons detailed above, the Tribunal concludes that the relevant product markets for the purpose of these proceedings are the purchase of wheat and the purchase of canola. Considering the evidence on the record in this proceeding, the Commissioner has not established, on a balance of probabilities, that there is a distinct relevant market for the supply of GHS for each of wheat and canola. When it comes to the value added by P&H and other Elevators further to their purchase of grain from farmers, there is no separate relevant "market" associated with it in which to conduct the necessary quantitative analysis.

363 The main considerations weighing in favour of a conclusion that there are distinct relevant markets for the purchase of wheat and canola include the factual evidence as well as the absence of legal foundation or SSNIP threshold analysis supporting the "value-added" approach argued by the Commissioner.

364 For greater clarity, the Tribunal is not saying that a "value-added" approach to product market definition could never be contemplated or applied. But if the Commissioner intends to resort to such an approach in future cases, he should first clarify the MEGs in that respect. Furthermore, for the Tribunal to be in a position to assess the merits of a "value-added" approach in any given case, the Commissioner would need to present clear and convincing evidence and submissions showing that the contemplated component of a final product is transacted, that it has a price attached to it or a measurable one, and that consideration is given to the SSNIP threshold to be used.

365 As will be discussed below, this product market issue significantly influences many elements in the remainder of the Tribunal's analysis.

B. What is or are the relevant geographic market(s) for the purposes of this proceeding?

366 The parties took different approaches to the geographic scope of their respective proposed competition markets. The Commissioner initially proposed a local geographic market in which the Virden, Moosomin, and Fairlight Elevators provided GHS to farmers for their wheat and canola. In its pleadings, P&H submitted that in the competition markets for the purchase of wheat and/or canola, the proper geographic area was at least Southeastern Saskatchewan and Southwestern Manitoba, comprising more than 20 Elevators and Crushers.

(1) Analytical framework

367 When identifying the geographic dimension of a competition market, the Tribunal typically applies the HMT, as it does for the product dimension. The HMT is designed to assist the Tribunal in identifying the smallest geographic area in which the merged entity, acting as a hypothetical monopolist or monopsonist, may profitably impose a SSNIP or SSNDP respectively — that is, the smallest geographic area over which it could exercise market power (*Tervita CT* at para 94; *Canadian Waste* at paras 61, 68, 69, 73; *Superior Propane I* at paras 84-85; see also *VAA CT* at paras 300-301; *TREB CT* at paras 121-124; *Facey and Brown* at pp 226-230; John S. Tyhurst, *Canadian Competition Law and Policy*, (Toronto: Irwin Law Inc., 2021) at pp 172-180).

368 Given the practical challenges associated with determining the base price in respect of which the SSNIP or SSNDP assessment must be conducted, the market definition exercise will sometimes need to go beyond the analysis of prices through the HMT framework and to consider other evidence of substitutability or customer switching. Geographic market definition may therefore involve assessing indirect evidence of substitutability, including factors such as: switching costs; transportation costs; the views, strategies, behaviour and identity of buyers; trade views, strategies, and behaviours of other market participants; price relationships and relative price levels; and shipment patterns (2011 MEGs at paras 4.17-4.24).

369 In defining the geographic scope of the relevant competition market, the Tribunal has previously concluded that it may be neither possible nor necessary to establish geographic boundaries with precision. The boundaries may well overlap with adjacent markets and be indistinct from those adjacent markets at many geographic points (*VAA CT* at para 305; Hillsdownat pp 301-302, 310; Canada (Director of Investigation and Research) v Laidlaw Waste Systems Ltd(1992), 40 CPR (3d) 289 (Comp Trib) at p 324). The Tribunal has also held, in particular, that there may be restraints on a merged firm's market power that come from both inside and outside the defined geographic market (*VAA CT* at para 305; Hillsdownat p 310).

370 It should once again be emphasized that business markets, service or trade areas, or operational areas used by company management, are not necessarily the same as a geographic market for the purposes of a competition analysis (*Canadian Waste* at para 72; *Superior Propane I* at paras 85, 101, 106).

(2) Parties' positions

(a) The Commissioner

371 Supported by expert testimony from Dr. Miller, the Commissioner submitted that the relevant geographic market is local in nature. The Commissioner's principal position was that the Moosomin, Virden, and Fairlight Elevators constituted a relevant market. More precisely, the Commissioner proposed a geographic market around these three Elevators in which a hypothetical monopolist could impose a SSNIP for GHS. Dr. Miller's expert evidence included a HMT analysis (for the purposes of the Commissioner's proposed product market for the delivery of GHS) and concluded that the Moosomin, Virden, and Fairlight Elevators, acting as a hypothetical monopolist, would have the ability and incentive to impose a SSNIP for GHS in the geographic area served by these three Elevators. Dr. Miller used a 5% SSNIP threshold in his analysis.

372 In addition, at the hearing and in response to Ms. Sanderson's critique on the product market definition, Dr. Miller testified that the geographic area around the Virden, Moosomin, Fairlight, and Whitewood Elevators could serve as the relevant geographic dimension of a competition market for the cash sale of wheat, again based on his HMT analysis (Exhibits CA-A-192 and P-A-193, Relevant Results from Ms. Sanderson's HMT Calculations ("*Dr. Miller Revised HMT*").

373 To support the argument for a local market, the Commissioner emphasized the importance to farmers of the distance between their farm and the point of delivery, and the associated transportation costs, when deciding on an Elevator or Crusher for the sale of their grain. The Commissioner submitted that most farms analysed by Dr. Miller deliver their grain to Elevators located less than 100 kilometers away. The Commissioner submitted that the size of the service areas from which the Moosomin and Virden Elevators draw at least 90% of the wheat or canola they handle demonstrated that most of the volumes are drawn from farms located near each of those Elevators.

374 Dr. Miller developed a model of demand to understand how farms make decisions as between Elevators and Crushers to sell their grain. In his expert report, Dr. Miller relied on four qualitative elements, namely, a review of case documents, the distances that farms tend to send their grain, the distances between the Elevators, and the profit margins. He also relied on his HMT analysis (Dr. Miller Report at para 4).

375 Dr. Miller testified that in his opinion, proximity is an important factor in a farm's choice of a "primary" Elevator for the sale of its grain. Dr. Miller considered the driving distance between the Moosomin and Virden Elevators, and calculated the drive time and drive distance from farms to Elevators using various data, including data from the Elevator operators.

376 During his analysis, Dr. Miller identified farms that were customers of the three Elevators (*i.e.*, Moosomin, Virden, and Fairlight) in his proposed geographic market for the delivery of GHS. In developing a model for demand, Dr. Miller considered the "draw areas" for the Elevators and used available data to determine each Elevator's "service area" — described as the set of closest Census Consolidated Subdivisions from which each Elevator draws at least 90% of its total wheat or canola intake. Dr. Miller used the service areas for these three Elevators to define a "Farmer Region," namely, a collection of farms useful for understanding the pricing incentives at the three Elevators and how their current and prospective customers would respond to price changes ("*Farmer Region*") [6] .

377 In Dr. Miller's analysis, the respective service areas for the Moosomin and Virden Elevators were contiguous with each Elevator. In addition, the service areas for the two Elevators substantially overlapped, suggesting that both Elevators expect to purchase grain from similar or geographically clustered farms. After determining the service areas for other Elevators and for more distant Crushers, Dr. Miller's analysis of service areas also found that the median farm selling canola may be more willing to travel longer distances to sell to Crushers.

378 Dr. Miller also quantified the role of distance in his demand model and considered internal documents from the merging parties to support a conclusion that the Moosomin, Virden, and Fairlight Elevators were close competitors. He also observed the margin (or mark-up) earned by the Virden Elevator, both for wheat and for canola, which supported a conclusion that the Virden Elevator faced a relatively small set of competitors.

379 Turning to his HMT analysis, Dr. Miller determined that a HMT using a merger simulation model showed that the Moosomin, Virden, and Fairlight Elevators comprised a relevant geographic competition market where a hypothetical monopolist would find it profitable to impose a SSNIP on the price of GHS. For GHS for wheat, Dr. Miller's predicted price increase of a hypothetical monopolist was CAD $9.03 per MT at the Moosomin Elevator and CAD $5.88 per MT at the Virden Elevator, representing changes in price (compared to his constructed pre-Acquisition price for GHS at each Elevator) of 26.0% at Moosomin and 21.6% at Virden. With respect to GHS for canola including Crushers, his predicted price increase of a hypothetical monopolist was CAD $2.76 per MT at the Moosomin Elevator and CAD $1.51 per MT at the Virden Elevator, representing changes in price (compared to his constructed pre-Acquisition price for GHS) of 22.2% at Moosomin and 7.6% at Virden (Dr. Miller Report at paras 74-79 and Exhibit 9). According to Dr. Miller, his simulation and the resulting projected price changes demonstrated that a hypothetical monopolist of the Moosomin, Virden and Fairlight Elevators would "increase price by far more than a typical SSNIP" (*i.e.*, 5%) (Dr. Miller Report at para 79).

(b) P&H

380 P&H submitted that the relevant geographic area for competition market purposes was much larger. P&H submitted that all farmer witnesses can and do haul their wheat and canola significant distances to Elevators and (for canola) to Crushers because it is financially worthwhile to do so. P&H submitted that farms closer to a particular Elevator receive a premium for their products, because they do not have high costs associated with hauling their grain to that Elevator. In P&H's submission, transportation costs do not provide any kind of constraint on competition in the relevant geographic market that shields the Virden and Moosomin Elevators from competition.

381 P&H first relied on Mr. Heimbecker's evidence. Mr. Heimbecker testified that in the area surrounding the Virden and Moosomin Elevators, P&H competes with numerous Elevators and Crushers to purchase wheat and canola from farms. For wheat in that area, Mr. Heimbecker identified over 20 rival Elevators owned by six competing grain companies. For canola in that area, he identified at least 27 rival purchasing locations owned by nine grain companies. Mr. Heimbecker also referred to P&H's internal documents, including business plans, internal emails, and the competitors identified in "Draw Analysis Reports" prepared by third party consultants for P&H.

382 P&H also relied on the expert evidence provided by Ms. Sanderson. Ms. Sanderson initially proposed a geographic market of "(at least) southeastern Saskatchewan and southwestern Manitoba" (Exhibits P-R-180 and CA-R-181, Expert report of Ms. Margaret Sanderson ("*Ms. Sanderson Report*"), at para 14). She adopted a monopsony framework, analysing the market for the purchase of wheat or canola by Elevators and Crushers. Ms. Sanderson's view was that the Virden and Moosomin Elevators were small buyers in an unconcentrated market or industry and, specifically, that the geographic market is wider than merely the area around the Moosomin, Virden, and Fairlight Elevators. She did not conduct a formal HMT analysis to support her broad proposed geographic market but relied on other quantitative and qualitative evidence and draw areas.

383 However, Ms. Sanderson did comment on hypothetical monopolist issues in responding to Dr. Miller's HMT analysis in her hearing slides and during her testimony (Exhibits P-R-182, CA-R-183 and CB-R-184, Slides of Ms. Sanderson ("*Ms. Sanderson Slides*"), at pp 72, 74-75). While she did not do her own HMT analysis, Ms. Sanderson did a recalculation of Dr. Miller's model to generate new values based on a different denominator — namely, the Cash Price instead of the constructed price for GHS — , using Dr. Miller's diversion ratios and his Virden margin. Ms. Sanderson's revised HMT analysis resulted in the same absolute price changes calculated by Dr. Miller, but with different relative price variations in light of the different denominator she used.

384 Ms. Sanderson's recalculation of Dr. Miller's HMT analysis suggested that when the Cash Price is used as the denominator, a market made up of the Moosomin, Virden, Fairlight, Oakner, Whitewood, Elva, Shoal Lake, and Carnduff Elevators would be a relevant geographic competition market for wheat. The relevant geographic market for canola would be larger and would include other Elevators as well as several Crushers such as Bunge Harrowby and LDC Yorkton (Ms. Sanderson Slides at pp 74-75). Ms. Sanderson based her HMT results on the same diversion ratios as Dr. Miller and on the weighted average price changes for the Moosomin and Virden Elevators (as calculated by Dr. Miller), but she used the wheat prices prevailing at the Virden Elevator as the reference price to calculate her relative price decreases. Ms. Sanderson indicated in her testimony that she used the Virden prices because Virden was the Elevator from which Dr. Miller had calculated the margin he used in his economic model (Consolidated Transcript, Confidential A, at p 1782).

385 In addition to her HMT recalculations, Ms. Sanderson studied the evidence in the transaction data and witness testimonies to provide an opinion on the relevant geographic market based on the number of competing buyers (Elevators and Crushers) P&H faced in purchasing wheat or canola, farms' switching alternatives amongst the Elevators and Crushers, and the distance farms were prepared to travel to sell their products.

386 Ms. Sanderson prepared "draw area" maps for the Elevators in Southeastern Saskatchewan and Southwestern Manitoba, and so-called "heat maps" derived from the overlapping draw areas. The draw areas for the Moosomin and Virden Elevators substantially overlapped.

387 Ms. Sanderson also studied the Farmer Region identified by Dr. Miller as well as the "corridor of concern" identified by the Commissioner prior to the commencement of this proceeding. As described by Ms. Sanderson, the corridor of concern was a geographic polygon focused on approximately 80 farms located between the Virden and Moosomin Elevators on either side of the Trans-Canada Highway. (By definition, the "corridor of concern" included farms within a one-hour driving distance from both Elevators using commercial trucking roads. It included two small non-contiguous areas south of the main polygon.) The Moosomin and Virden Elevators' draw areas both covered this "corridor of concern."

388 Ms. Sanderson observed that given the range of options available to farms for the sale of their crops, the Cash Prices set by P&H to purchase wheat and canola must be competitive with the Cash Prices set by numerous Elevators operated by many competitors, because they are all buying from the same farms.

389 Ms. Sanderson also referred to internal documents of P&H and LDC. Ms. Sanderson's report noted that P&H and its customer service representatives at the Moosomin Elevator referred to and tracked prices of more than a dozen other Elevators and Crushers, in addition to the Virden Elevator. LDC's documents also showed that the Virden Elevator competed with almost a dozen other competitor purchase locations in addition to the Moosomin and Fairlight Elevators. Ms. Sanderson made specific reference to Elevators and Crushers identified by P&H before the Virden Acquisition in its fiscal 2019 and fiscal 2020 business plans for the Moosomin Elevator.

390 Ms. Sanderson concluded that the transaction data, testimonies and documentary evidence demonstrated that there was a large set of relevant competing Elevators buying as much or more volume than the Moosomin or Virden Elevators from farms within Dr. Miller's Farmer Region, that the geographic market had many participants, and that P&H had a small share of that market.

391 In his reply expert report, Dr. Miller addressed the geographic market analysis of Ms. Sanderson. He testified that farms in the towns close to the Moosomin, Virden, and Fairlight Elevators were particularly likely to rely on those Elevators for the sale of their grain. Dr. Miller concluded that the desirability of travelling to a particular Elevator differs for farms located at different points within each Elevator's draw area. Looking at the percentage of MT sold and the quantity sold on a town-by-town basis, Dr. Miller found that farms close to the centre of the geographic area served by the three Elevators had a "distinct preference" for working with the Moosomin, Virden, and Fairlight Elevators. He also found that while it was rare for a farm located directly between the Moosomin and Virden Elevators to choose a more distant Elevator, the frequency increases for farms farther from this centralized location — both for wheat and for canola, including Crushers.

392 During the experts' concurrent evidence session at the hearing, Ms. Sanderson agreed that distance matters to an individual farm and that farms preferred to sell closer and to travel a shorter distance to sell their wheat and canola. She also agreed that the transaction data, supported by the testimony of the farmer witnesses, were helpful in understanding what makes an Elevator attractive to a farm for the sale of wheat or canola. Dr. Miller and Ms. Sanderson agreed that the diversion ratios summarized the information about farmers' sale behaviour in relation to the Elevators available and the relative distance to be travelled for delivery.

393 As mentioned above, at the hearing and in response to Ms. Sanderson's recalculation of his HMT analysis using the Cash Price, Dr. Miller also testified that the geographic area around the Virden, Moosomin, Fairlight, and Whitewood Elevators could serve as the geographic dimension of a competition market for the "cash sale of wheat." In response, Ms. Sanderson observed that her analysis of the purchases from farms within Dr. Miller's Farmer Region concluded that several other Elevators had higher wheat purchases than the Whitewood Elevator from the farms in that Farmer Region, and that two other Elevators (in addition to Whitewood) were located within it. Ms. Sanderson testified that an application of the HMT in Dr. Miller's alternative geographic market would engage a larger set of Elevators than just the Moosomin, Virden, and Fairlight Elevators, but that the question was how many more.

394 Both experts agreed that neither the Moosomin nor the Virden Elevator have any special or unusual competitive significance in the marketplace.

(3) Tribunal's assessment

395 After considering all the evidence in this case, the Tribunal is able to describe the geographic dimension of the relevant competition markets based on the factual and expert evidence.

396 Although Dr. Miller's proposed product market (i.e., the delivery of GHS to farms by Elevators and Crushers) has not been accepted by the Tribunal, the panel nonetheless found his geographic market analysis to be helpful and persuasive in understanding certain aspects of the behaviour of farms in selecting an Elevator or Crusher to sell their grain. The panel also found Ms. Sanderson's evidence useful, including her recalculation of Dr. Miller's HMT analysis on the basis of the Cash Price, and incorporated it into its assessment.

397 In addition to the evidence on the HMT analyses conducted by the two experts, the Tribunal also assessed a number of factors in determining the geographic scope of the relevant competition markets. The salient evidence concerned the purchases of wheat and canola by the Moosomin and Virden Elevators and other Elevators and Crushers in the area, and the corresponding selling behaviour of farms. It included the following: the experts' analysis of transaction data in relation to the purchase and sale of wheat and canola to those Elevators and Crushers, and the oral testimony of the farmer witnesses; the evidence related to the distance that must be travelled to deliver grain to an Elevator or Crusher (and relatedly, the transportation costs and time it takes to travel that distance) and the volume and frequency of those purchases by Elevators from farms; expert evidence as to draw areas, heat maps, and diversion ratios; evidence as to prices paid to farms at the Elevators, including price-setting and prices that are negotiated and therefore depart from the Cash Price or Basis offered for each Elevator; and internal documents from the merging parties suggesting the perceived scope of the geographic market, including communications with farms about the purchase of their crops.

398 In the result, the Tribunal's analysis of the geographic dimension of the competition markets is not restricted to the geographic area identified in Dr. Miller's analysis. However, the Tribunal does not agree with the much wider region initially advocated by P&H and described in Ms. Sanderson's testimony (*i.e.*, Southeastern Saskatchewan and Southwestern Manitoba). Like certain aspects of both Dr. Miller's and Ms. Sanderson's analyses, the Tribunal finds that the geographic area relevant to a competition analysis for wheat is different from the relevant geographic area for canola.

399 The Tribunal concludes that, in general, Elevators that are closer to a farmer's crop are more attractive to farms for the purchase of their wheat. Considering in particular the farmers' testimonies concerning their selection of purchaser Elevators and the role of transportation costs, the setting and negotiation of prices, and the expert evidence, the Tribunal finds that the key competitors to the Moosomin and Virden Elevators are rival Elevators nearby to them, particularly the Fairlight Elevator. By contrast, Elevators that are farther away are not part of the relevant geographic market for competition purposes. Although more distant Elevators may purchase some quantity of grain and may provide some degree of competitive discipline on the Cash Price (including specifically, on the Basis) offered to farms by the Moosomin and Virden Elevators, that does not necessarily lead to the conclusion that those Elevators are all within the relevant competition market.

(a) HMT analyses

400 Three different HMT analyses have been presented to the Tribunal by Dr. Miller and Ms. Sanderson.

401 Dr. Miller's initial HMT analysis, summarized at Exhibit 9 of his expert report, concluded that the Moosomin, Virden, and Fairlight Elevators formed a relevant geographic competition market where a hypothetical monopolist would find it profitable to impose a SSNIP on the price of GHS. For GHS for wheat, Dr. Miller's model predicted that a hypothetical monopolist could impose an increase of 26.0% on the constructed pre-Acquisition price for GHS for wheat at the Moosomin Elevator, and of 21.6% on the price for GHS for wheat at Virden. With respect to GHS for canola including Crushers, Dr. Miller's predicted price increase of a hypothetical monopolist was 22.2% at the Moosomin Elevator and 7.6% at the Virden Elevator. In each case, Dr. Miller compared his projected price increase to his computed price for GHS prevailing at each of the Moosomin and Virden Elevators. Since all of his projected price increases clearly exceeded the typical 5% SSNIP threshold — they ranged from 7.6% to 26.0% — , Dr. Miller arguably did not have to calculate weighted average reference prices for GHS for wheat or canola,

or weighted average price increases representing the combined average price increase for the Moosomin and Virden Elevators (which, in the Tribunal's view, would be a more accurate basis for price change analysis under the HMT framework).

402 Given the Tribunal's finding on the relevant product market, and its conclusion that the relevant products are the purchase of wheat and canola and that the relevant base prices are the Cash Prices of wheat and canola paid to the farms by P&H, the Tribunal cannot entirely retain Dr. Miller's initial HMT analysis: his projected price increases, expressed in terms of percentages, are based on the wrong base price, namely, the computed prices for GHS for wheat and canola.

403 The second HMT analysis is the recalculation of Dr. Miller's model done by Ms. Sanderson as part of her presentation at the hearing (Ms. Sanderson Slides at pp 72-75). This recalculation replicated Dr. Miller's model, including the diversion ratios and the Virden Elevator margin calculated by Dr. Miller, but determined the relative values of the projected price changes based on a different denominator, namely, the Cash Prices instead of the constructed prices for GHS. The Tribunal observes that both experts agree on the absolute figures of the predicted price variations for each of wheat and canola (expressed in dollars per MT) coming from Dr. Miller's HMT analysis (Consolidated Transcript, Confidential A, at p 1795).

404 Ms. Sanderson's revised HMT analysis used the same absolute price changes as those calculated by Dr. Miller but resulted in different relative price variations in light of the different denominator she used. Ms. Sanderson's recalculation concluded that a hypothetical monopsonist controlling each of the Moosomin, Virden, and Fairlight Elevators could impose a price change of only 3.9% on the pre-Acquisition Cash Price for wheat at the Moosomin Elevator (*i.e.*, CAD $9.03 on CAD $229.73 per MT), and of 2.5% on the Cash Price for wheat at the Virden Elevator (*i.e.*, CAD $5.88 on CAD $239.11 per MT) (Ms. Sanderson Slides at p 72; Ms. Sanderson Report at Figure 49). As the price variations would be in the purchase of grain, these would be price *decreases*. With respect to canola including Crushers, Ms. Sanderson's predicted price decrease was 0.6% on the pre-Acquisition Cash Price at the Moosomin Elevator (*i.e.*, CAD $2.76 on CAD $461.46 per MT), and 0.3% to the Cash Price at the Virden Elevator (*i.e.*, CAD $1.51 on CAD $452.80 per MT). None of the resulting price decreases exceeded the usual 5% SSNIP or SSNDP threshold, which led Ms. Sanderson to conclude that, based on her revised HMT analysis using Cash Prices, the relevant geographic market had to be larger than the Moosomin, Virden, and Fairlight Elevators.

405 In her presentation at the hearing, Ms. Sanderson provided results for more Elevators than in Dr. Miller's HMT analysis, using the Cash Prices (Ms. Sanderson Slides at pp 74-75). She concluded that, when the Cash Price is used as the denominator, a market made up of the Moosomin, Virden, Fairlight, Oakner, Whitewood, Elva, Shoal Lake, and Carnduff Elevators would be a relevant geographic competition market for the purchase of wheat. The relevant geographic market for the purchase of canola would be larger and would include the Moosomin, Virden, Fairlight, Oakner, Whitewood, Brandon (Richardson), Melville, Souris East, Shoal Lake, and Elva Elevators as well as the Crushers at Harrowby (Bunge), Yorkton (LDC), Velva (ADM), and Yorkton (Richardson). Ms. Sanderson based her HMT results on the same diversion ratios as Dr. Miller and on the weighted average absolute price changes for each of wheat and canola. In terms of average relative price changes, she expressed the price variations as a percentage of the weighted average wheat and canola prices calculated for the Virden Elevator (*i.e.*, CAD $239.11 per MT and CAD $452.80 per MT, respectively).

406 The third iteration of the HMT analyses prepared by the experts is Dr. Miller's response to Ms. Sanderson's recalculation, presented at the concurrent evidence session and summarized in Dr. Miller Revised HMT. This Revised HMT analysis only looked at the geographic market for the purchase of wheat, and did not consider canola. Since the HMT framework dictates that additional candidates for market definition purposes must be ordered by their diversion ratios, Dr. Miller determined that, for wheat, the next closest competitor Elevator to the Moosomin and Virden Elevators (other than the Fairlight Elevator) was the Whitewood Elevator. Dr. Miller testified that, based on his analysis, the diversion ratios for wheat were higher at the Whitewood Elevator than at the Oakner Elevator, when these ratios are weighted by sales from the Virden and Moosomin Elevators, or weighted by sales from the Virden, Moosomin, and Fairlight Elevators. Dr. Miller concluded that, even using the Cash Price as a denominator in his Revised HMT analysis, the relevant geographic market for wheat would be a smaller market comprising only the Moosomin, Virden, Fairlight, and Whitewood Elevators, as such relevant market would reach the 5% SSNIP threshold.

407 The Tribunal pauses to note that Dr. Miller did not discard the recalculated HMT analysis made by Ms. Sanderson based on his data, model, and framework but using the Cash Prices — as opposed to his constructed price for GHS — as a

denominator. On the contrary, in his Revised HMT analysis, Dr. Miller simply redid Ms. Sanderson's recalculation by looking at additional Elevators using their respective weighted averaged diversion ratios (Consolidated Transcript, Confidential A, at pp 1787 ff). He also used a different "reference price" as the basis to calculate the relative price changes he observed: instead of solely using the prevailing pre-Acquisition price for wheat at the Virden Elevator as Ms. Sanderson did, he developed the weighted average HMT price change relative to the pre-Acquisition price for each of the Moosomin Elevator (CAD $229.73 per MT) and the Virden Elevator (CAD $239.11 per MT). He then selected the Moosomin Elevator price change and this led him to conclude that a geographic market comprised of the Moosomin, Virden, Fairlight, and Whitewood Elevators would meet the 5% SSNIP threshold, since his relative price change based on the lower Moosomin Elevator price was 5.06%. Dr. Miller's table reproduced in his Revised HMT analysis indicates that, had he used the higher prevailing wheat price at the Virden Elevator, the relative price change would have been 4.86% and would thus have been below the 5% SSNIP threshold.

408 It thus appears that the two experts disagree on the "reference price" to use for the calculation of the relative HMT price variations: Dr. Miller relied on the lower Moosomin Elevator price in his Revised HMT analysis, whereas Ms. Sanderson used the higher Virden Elevator price in her recalculation. Neither Dr. Miller nor Ms. Sanderson apparently considered using a weighted average of the Moosomin and Virden Elevators prices, which would be a more accurate base for price change analysis under the HMT framework. This is especially true in a case like the present one, where the results of adding candidate markets in the HMT analysis are each very close to the 5% benchmark. The purpose of the HMT analytical framework is to assess how a "hypothetical monopolist" (or "hypothetical monopsonist") controlling a hypothetical group of entities would behave; as such, the proper relevant "reference price" of a product has to be the weighted average price of all entities controlled by such hypothetical monopolist or monopsonist that are supplying or purchasing the product. The Tribunal notes that in this particular case, changing the "reference price" has a direct impact on the conclusions to be drawn from the HMT analyses based on the Cash Price, as it significantly modifies the group of Elevators needed to meet the 5% SSNIP/SSNDP threshold. The Tribunal further observes that, even though Dr. Miller opted to calculate a weighted average of the Moosomin and Virden Elevators to determine the appropriate diversion ratios to the rival Elevators and used weighted average dollar price changes in his Revised HMT analysis, he relied solely on the lower Moosomin price for wheat as a denominator to determine his estimated price variations. During the concurrent evidence session, Dr. Miller provided no explanation for not also using a weighted average reference price in his calculations.

409 At the hearing, Dr. Miller relied on his reading of paragraph 4.4 of the 2011 MEGs to state that the HMT is satisfied "if any price of the merging firms goes up by five per cent" (Consolidated Transcript, Confidential A, at p 1784). With respect, the Tribunal does not agree with Dr. Miller's interpretation of the MEGs. What the 2011 MEGs say is that the HMT is met when "the price increase of at least *one product* of the merging parties" [emphasis added] exceeds the SSNIP threshold (2011 MEGs at para 4.4). It does not say the price of a product of *one* of the merging firms. Here, all the Elevators purchase the same product, namely, wheat or canola. And what the Tribunal needs to assess is the predicted price variation for wheat or canola for the selected Elevators acting as a hypothetical monopolist. In the Tribunal's view, this has to be measured in relation to the weighted average price variation of wheat and canola for all Elevators involved — not to the price of just one of the merging firms.

410 The Tribunal has not found in the evidence what the weighted pre-Acquisition average price for wheat would be for the Moosomin and Virden Elevators taken together, or for any larger group of Elevators. However, the Tribunal underlines that the simple arithmetical average between the weighted average base price for wheat at the Moosomin and Virden Elevators would be CAD $234.42 per MT (*i.e.*, ($229.73 + $239.11) ÷ 2). Moreover, since the evidence indicates that, pre-Acquisition, the Virden Elevator handled relatively more wheat than the Moosomin Elevator (see, for example, Ms. Sanderson Report at Figure 62 and Consolidated Transcript, Confidential A, at p 1789), it is a mathematical certainty that the weighed average price for wheat for the Moosomin and Virden Elevators would be higher than the straight arithmetical average mentioned above, since the Virden Elevator has both the higher weighted average price and the higher volume quantity. Had Dr. Miller used a weighted pre-Acquisition average price for wheat, or even the more conservative arithmetical average of CAD $234.42 per MT, in his Revised HMT analysis, it is clear from his evidence that the results of his Revised HMT analysis for wheat using the Cash Prices would have concluded that even a geographic market made up of the Moosomin, Virden, Fairlight, Whitewood, and Oakner Elevators would not be large enough to satisfy the 5% SSNIP/SSNDP threshold: using the more conservative arithmetical average, the

predicted price changes would not have exceeded 4.96% in a geographic market including the Whitewood Elevator, and 4.90% in a market including both the Whitewood and Oakner Elevators.

411 Turning to Ms. Sanderson's HMT analysis, had she used a weighted pre-Acquisition average price for wheat as a "reference price," instead of the higher Virden Elevator price, the results of her recalculated HMT analysis for wheat using the Cash Prices would have yielded slightly higher relative changes. For example, for the group of seven Elevators ending with the Shoal Lake Elevator, her estimated price change of 4.86% would have been 4.96% (i.e. CAD $11.63 / CAD $234.42) and suggest that the 5% SSNIP/SSNDP threshold would have been close to be met with one less Elevator (i.e., without the need of adding the Carnduff Elevator).

412 The Tribunal is mindful of the fact that Dr. Miller's (and Ms. Sanderson's) calculations twirl around the 5% threshold as soon as four or five Elevators are included in the geographic competition market for wheat, and that there are margins of error in these calculations.

413 In light of the foregoing, based on the evidence before it regarding the HMT analyses using the Cash Prices, and considering possible margins of error regarding the median of the Basis, the Tribunal concludes that a geographic market for wheat including only the Moosomin, Virden, Fairlight, and Whitewood Elevators, or even those four Elevators plus the Oakner Elevator, has not been established on the evidence. In sum, in his HMT analyses, the Commissioner has not adduced clear and convincing evidence that the relevant geographic market for wheat could be limited to those four or five Elevators. Thus, further to its review of the HMT analyses, the Tribunal is of the view that, on a balance of probabilities, the relevant geographic market for wheat is more likely than not to include at least the following Elevators listed in Ms. Sanderson's recalculated HMT analysis: the Moosomin, Virden, Fairlight, Oakner, Whitewood, Elva, and Shoal Lake Elevators. The Tribunal says "at least" because determining whether the Carnduff Elevator identified by Ms. Sanderson should also be included in the relevant geographic market is too close to call in light of the above discussion on the weighted pre-Acquisition average price for wheat.

414 In the competition market for the purchase of canola, the Tribunal accepts that Crushers play a more significant role in the competitive process and reduce the likelihood that the Moosomin and Virden Elevators, acting as a hypothetical monopsonist, could impose a SSNDP in the purchase of canola. The evidence suggests that Crushers are able to attract some canola purchases from a longer distance than Elevators and that some canola deliveries to Crushers by-pass Elevators that are closer in distance to a farm. A Crusher may therefore have greater competitive impact on the merged entity's prices and limit its ability to impose a SSNDP than would have an Elevator that buys canola. Furthermore, the Tribunal notes that in the concurrent evidence session, Dr. Miller did not respond to Ms. Sanderson's recalculation HMT analysis for canola using the Cash Prices, found at page 75 of Ms. Sanderson Slides. In her analysis, Ms. Sanderson concluded that the relevant geographic market for the purchase of canola would include at least the Moosomin, Virden, Fairlight, Oakner, Whitewood, Brandon (Richardson), Melville, Souris East, Shoal Lake, and Elva Elevators as well as the Crushers at Harrowby (Bunge), Yorkton (LDC), Velva (ADM), and Yorkton (Richardson). Even for this larger group of Elevators and Crushers, Ms. Sanderson's predicted price decrease of a hypothetical monopsonist would only be 3.08% (*i.e.*, a weighted average price change of CAD $13.94 per MT on the pre-Acquisition price of CAD $452.80 at the Virden Elevator), significantly below the usual 5% threshold for market definition purposes. Here, the pre-Acquisition price for canola at the Moosomin Elevator (*i.e.*, CAD $461.46) is higher than at Virden, and Virden's purchases of canola are much higher than Moosomin's (Ms. Sanderson Report at Figure 62). In light of the foregoing, and based on the evidence before it regarding the HMT analyses using the Cash Prices, the Tribunal concludes that, on a balance of probabilities, the relevant geographic market for canola is more likely than not to include at least all the Elevators and Crushers listed in Ms. Sanderson's recalculated HMT analysis. Again, the Tribunal says "at least" because Ms. Sanderson's HMT analysis stopped at a 3.08% SSNIP level, and it is uncertain how many other Elevators and/or Crushers would need to be added to reach the typical 5% SSNIP threshold.

(b) Distance, transportation costs, and farms' preferences

415 Turning to other factors, the Tribunal accepts that most farms deliver grain to Elevators located less than 100 kilometers from the location of their crops. Like both Dr. Miller and Ms. Sanderson, the Tribunal finds that farms prefer to travel shorter distances to sell their grain. Most of the volume of grain purchased by the Moosomin and Virden Elevators comes from farms

located in proximity to them. The Tribunal also finds, based on Ms. Sanderson's data, that in the "corridor of concern," a significant number of farms sell their wheat exclusively or substantially to the Moosomin, Virden, and Fairlight Elevators.

416 At the hearing, several farmers testified about the sales of their grain to Elevators and Crushers. In general, they expressed a preference to sell to Elevators closer to their farms unless a more distant Elevator or Crusher made it worthwhile financially to travel the extra distance. The three farmers called to testify by the Commissioner generally stated their preference to sell most of their grain to the Virden and Moosomin Elevators, and sometimes to the Fairlight Elevator, rather than to more distant Elevators and Crushers. In several cases, the witnesses acknowledged in cross-examination that they have also delivered some proportion of their wheat and canola crops to purchasers more distant than the Moosomin, Virden, and Fairlight Elevators. When selling canola to Crushers, their canola crops would also travel past a number of possible Elevators to which they could have sold while en route to a Crusher location.

417 When selecting an Elevator or Crusher for a shipment of their grain, the farmers' principal considerations were price, timing (*i.e.*, when grain could be accepted by the Elevator), the grade of the grain to be sold, and the travel distance to the purchase point. Additional factors included the farmers' business relationship with each Elevator, each farmer's ability to store grain at their own farm, road conditions including restrictions on the use of some highways in the springtime, and whether an Elevator was located on a main or a secondary highway (which affects the number of trips, speed of the truck en route, and the wear and tear on the vehicle).

418 The testifying farmers called by the Commissioner and P&H generally indicated that a higher price is necessary to cause them to sell to a more distant location — to make it worthwhile to travel the extra distance to deliver the crop. Mr. Lincoln advised that his transportation cost was approximately CAD $8 per MT, with each additional 15 minutes drive costing CAD $1 per MT. Mr. Paull testified that he would not leave a local Elevator for a few pennies per bushel, but would do so for CAD $0.10, $0.15 or $0.20 per bushel. Sometimes, he could even get CAD $0.30 or $0.40 more per bushel to go a longer distance. He would sell to a more distant Elevator if there was "enough profit" in it. Mr. Wagstaff testified that his decision to do so also depended on his own time and the efficiency of deliveries. From his farm, he could deliver four loads per day with his own trailer to the Virden Elevator, but could only make one trip per day to the Crusher located in Bloom, Manitoba, which is much farther away from his farm. Mr. Duncan, Mr. Paull, and Mr. Hebert all testified that Crushers made it financially worthwhile to sell canola at a longer distance away from their respective farms.

419 The Tribunal found Dr. Miller's evidence concerning farms' behaviour in selecting a purchaser to be helpful in assessing the geographic dimension of the markets for the purchase of wheat and canola by Elevators and Crushers. Dr. Miller's analysis found that farms select anElevator for the sale of their grain based on proximity to the farm, because it decreases delivery costs and because they may have a relationship with personnel responsible for the Elevator. The farms' travel time and cost to deliver the grain to the purchase point were important factors in the choice, together with price. Farms incur delivery costs by crop weight and by kilometre, whether they deliver themselves or hire commercial trucks to do so.

420 Dr. Miller's analysis considered travel distance and time between Elevators and from farms to the Moosomin and Virden Elevators, to identify close competitors to the merged entity. He used data collected from the merging parties and several other grain companies comprising over 20 Elevators, as well as census data and other source data. Dr. Miller found that the Fairlight Elevator was the most proximate competitor to the Moosomin and Virden Elevators.

421 Dr. Miller also calculated the range of travel time for the delivery of each of wheat and canola, representing a percentage of deliveries. In general, the range of travel time for 50% of deliveries was longer for canola than for wheat. Based on travel distance and time, and weighted by quantity of grain sold, Dr. Miller analysed the range of time taken by 90% of farms to travel to each of the Moosomin, Virden, and Fairlight Elevators, all other Elevators, and Crushers. Dr. Miller's analysis showed that the median, representing 50% of farms, was approximately half an hour drive time for both wheat and canola. Dr. Miller's analysis also showed that 90% of farms travelled from four to 79 minutes to deliver wheat to all chosen Elevators in the model and from four to 75 minutes to deliver canola to Elevators. The time range to canola Crushers increased to 44 minutes up to a maximum of 147 minutes. Recognizing that this analysis occurred over one crop year, the Tribunal accepts Dr. Miller's evidence to show that close proximity of a delivery point is important to farms when selling wheat and canola.

(c) Draw areas and heat maps

422 As noted, both Dr. Miller and Ms. Sanderson used draw areas (or service areas) for Elevators in their analyses. Both indicated that Elevators and Crushers draw the grain they purchase from areas surrounding them, creating a geographic cluster of supplier farms.

423 Dr. Miller's review found that proximity was an important factor in the farms' choice of an Elevator for the sale of their grain. He also noted that some Crushers attract supply from greater distances than Elevators. He found, for example, that the median farm selling to the Moosomin Elevator is just five kilometers from its location and the median farm selling to the Virden Elevator is about 20 kilometers from it, whereas the median farm selling to the Yorkton Crusher is over 100 kilometers away from it. To Dr. Miller, this suggested that farms might be more willing to travel farther distances to sell to Crushers.

424 Ms. Sanderson's draw area maps displayed the geographic area for 95% of an Elevator's purchases from farms, using the address of each farm. In these maps, the draw areas for the Moosomin and Virden Elevators could be compared to the draw areas for other Elevators and for Crushers that could be competitors for a farm's sales. In this way, Ms. Sanderson's analysis could indicate the number of farms that switch between buyers and the distance travelled to deliver their crops.

425 Ms. Sanderson's expert report found that for the crop year 2018-2019, the Moosomin Elevator purchased canola from [text omitted] farms and the Virden Elevator purchased from [text omitted] farms. The Moosomin Elevator drew [text omitted] of its canola from a distance as far as [text omitted] kilometers while the Virden Elevator drew [text omitted] of its canola from farms located as far as [text omitted] kilometers. Both were based on commercial trucking travelling those distances. As for wheat, the draw area for the Moosomin Elevator included [text omitted] farms, while the draw area for the Virden Elevator comprised [text omitted] farms. The Moosomin Elevator drew [text omitted] of its wheat from a distance as far as [text omitted] kilometers while the Virden Elevator drew [text omitted] of its wheat from farms located as far as [text omitted] kilometers.

426 Ms. Sanderson found that approximately two-thirds of the farms closest to the Moosomin and Virden Elevators (*i.e.*, in the "corridor of concern") sold crops to other rival Elevators and Crushers. Only four farms sold exclusively to the Moosomin and Virden Elevators in the last three crop years combined. Seven farms sold only to the Moosomin Elevator, while 17 farms sold only to the Virden Elevator. In addition, farms in the corridor of concern sold to more distant Elevators and Crushers. Ms. Sanderson's written testimony included details for each of the 82 farms within the corridor of concern for both canola and wheat. Ms. Sanderson noted significant deliveries from those farms to Elevators and Crushers outside of Dr. Miller's proposed geographic market.

427 Ms. Sanderson prepared heat maps by overlapping all of the draw area maps cumulatively. The heat maps showed areas in darker colours where a higher number of Elevators and Crushers buy grain. Ms. Sanderson concluded that all farm locations within the draw areas for the Moosomin and Virden Elevators had more than six Elevators/Crushers bidding for their wheat and for their canola.

428 Dr. Miller observed in his reply expert report that Ms. Sanderson's use of overlapping draw areas did not present any evident consideration of what factors affect a farm's choice of Elevator or, most importantly, how the farms would likely respond to a price change. Dr. Miller agreed with Ms. Sanderson that some farms scattered throughout the geographic region may elect to work with a more distant Elevator. Dr. Miller observed, however, that the overlap analysis masked that the desirability of travelling to a particular Elevator will differ for farms located at different points. In Dr. Miller's view, Ms. Sanderson's draw area maps assumed that every farm customer inside the boundary of the Elevator's draw area is equally willing to choose that Elevator, which does not address the question posed by geographic market definition, *i.e.*, where those farms would likely turn in reaction to a price increase.

429 Specifically, Ms. Sanderson submits that what she referred to as "heat maps" provide a count of farms and their locations supplying canola and wheat to Elevators within the overlapping draw areas. However, the Tribunal observes that the overlapping draw areas do not incorporate the volume density supplied, frequency, and the respective geographic locations of those volumes.

Such presentation does not assist the Tribunal in visually understanding the concentration of grain supply and corresponding distance to each Elevator as provided by the transaction data.

430 The Tribunal recognizes that overlapping draw area maps may be useful in initially identifying the possible range of geographic scope of one or more candidate competition markets. They also may identify suppliers or customers who could be affected by a proposed transaction. However, they may be of less help in more precisely defining the scope of the relevant geographic competition market, unless they are coupled with evidence about the reaction of affected suppliers or customers to a change in price or another dimension of competition.

431 In this case, the panel agrees with Dr. Miller's concerns that the draw area maps and heat maps have less value on their own, insofar as they treat farms at different distances from an Elevator as likely to react the same way to a change in price. Draw area maps and heat maps may, together, suggest that farms have more ability to switch in the overlapping areas but must be taken as a non-definitive factor in the assessment of a geographic area for competition purposes. In this case, Ms. Sanderson's draw area maps, on their face, give equal weight to each farm having sold grain to an Elevator regardless of frequency of sales and volumes sold. In sum, the heat maps provided additional information but, on their own, they are of limited assistance because they do not account for volume and the location of the farms from which those volumes are drawn. Both must be weighed with the evidence concerning farms' behaviour, including from the farmers' testimonies, the diversion ratio evidence, and other data and information as to preferences and switching.

432 On this issue, the Tribunal finds Dr. Miller's observations in his reply expert report to be compelling. Dr. Miller analyzed the percentage of MT of wheat and canola sold to the Moosomin, Virden, and Fairlight Elevators by town. The analysis showed that a farm close to an Elevator is more likely to rely on that Elevator and that more distant farms are less likely to do so. He found that farms close to the centre of the area around the Moosomin, Virden, and Fairlight Elevators had a distinct preference to work with those Elevators. This analysis is consistent with the testimonies of farmers. It also provides some more nuanced insight to assist in understanding the likely behaviour of customers in response to a price change — specifically, whether they are likely to switch Elevators.

433 The Tribunal further finds that farms, as sellers of grain to Elevators, are less likely to switch to more distant rivals if the farm is near the centre of the geographic market, and more likely to switch as the location moves away from the centre and, the Tribunal infers, away from each of the Moosomin, Virden, and Fairlight Elevators. Consistent with this conclusion and with Dr. Miller's report, the Tribunal finds that the closer farms are to the Moosomin and Virden Elevators, the more volumes they sell to those Elevators. Conversely, farms located farther away are delivering less to these two Elevators and more to other Elevators.

434 The Tribunal has considered the "corridor of concern." Ms. Sanderson's analysis of the deliveries of wheat and canola from those farms to the Moosomin and Virden Elevators over three crop years showed that many farms sell all, or a very substantial proportion, of those crops to the Moosomin and Virden Elevators. In her report, Ms. Sanderson noted that 54 of the 82 farms in the "corridor of concern" (*i.e.*, about two-thirds) sold wheat or canola to Elevators or Crushers that compete with the Moosomin and Virden Elevators at different points in the three successive crop years used in her analysis (Ms. Sanderson Report at Figures 19-21). She also noted that farms located in proximity adopted different approaches during that period (i.e., decide to sell at least once to a rival, or not). The Tribunal finds this analysis to be highly sensitive to change — a single sale (above the minimum volume Ms. Sanderson used) of either wheat or grain to a rival over the three crop years would change the classification of a farm. Ms. Sanderson's observation also implies that a substantial number of the farms in the corridor of concern (*i.e.*, 28 of 82, or a third) did not sell to a rival and therefore sold their wheat and canola only to the Moosomin or Virden Elevators (or to both) over three successive crop years. Ms. Sanderson also noted that the Fairlight Elevator is frequently listed as a purchaser from the corridor farms.

435 As the Commissioner observed during final argument, Ms. Sanderson's data effectively showed that 75% of the farms in the corridor of concern (*i.e.*, 60 farms out of 80 [7]) sold all of their wheat exclusively to the Moosomin, Virden, and Fairlight Elevators in any given year. For canola, the corresponding percentage was 55% of the farms selling canola only to those Elevators. The Tribunal notes that for the vast majority of the farms in the corridor, the Whitewood Elevator was not a purchaser

over that time period. Finally, for canola, the corridor farms taken as a group sometimes sold to Crushers (*e.g.*, to Bunge at Harrowby).

436 There are some examples of switching behaviour by farms in the corridor of concern, through the sale of wheat or canola to Elevators or Crushers other than the Moosomin, Virden, and Fairlight Elevators. However, the weight of the evidence is that these farms rely acutely on the Moosomin and Virden Elevators, as well as the Fairlight Elevator, for the sale of their grain, particularly wheat.

(d) Diversion ratios

437 Both Dr. Miller and Ms. Sanderson provided diversion ratio calculations. Diversion ratios are calculated to estimate the proportion of a competitor's customers lost to one or more rivals if that competitor raises its price. Higher diversion ratios imply more substitution between two competitors. That is, in a HMT analysis, if competitor A raises its price for the supply of a product, the diversion ratios calculation shows the resulting switching (*i.e.*, diversion) of customers to the product offered by competitors B, C, and D. Diversion ratios are expressed as a percentage, namely, the proportion of customers diverted to the products of each of competitors B, C, and D, as a percentage of the overall number of diverted customers. The same type of calculation may be done for diversions caused by a monopsonist that lowers its price.

438 Diversion ratios assist in the assessment of how close two or more competitors may be. As part of a larger model, diversion and information about profit margins may be used to understand the dollar value of diverted sales and specifically, the dollar value of customer purchases that may be recaptured by a merged entity (for example, after the merger of competitors A and B in the example above). The results assist to understand the incentive of a merged entity to raise prices and the predicted price effects of a proposed merger (2011 MEGs at para 6.15).

439 Dr. Miller's estimated diversion ratios indicated that many farms viewed the Moosomin and Virden Elevators as substitutes. For wheat, Dr. Miller calculated the diversion ratios from the Moosomin Elevator to the Virden Elevator to be 23.8%, and 16.8% from Virden to Moosomin. In Dr. Miller's view, the diversion ratios for wheat between the Moosomin and Virden Elevators indicated that they were "relatively close competitors" (Dr. Miller Report at para 114 and Exhibit 11). For canola, the diversion ratios between the Moosomin and Virden Elevators were smaller, at 13.1% and 5.3% respectively. However, the Fairlight Elevator had large diversion ratios with both Elevators, suggesting to Dr. Miller that there was likely indirect competition between the Moosomin and Virden Elevators, through the Fairlight Elevator, for both wheat and canola.

440 Ms. Sanderson also presented diversion ratios. Methodologically, Ms. Sanderson reran diversion ratios using the formulas in Dr. Miller's expert report based on farm data within the union of the 90% service areas for the Moosomin, Virden, and Fairlight Elevators.

441 In that context, Ms. Sanderson did not dispute Dr. Miller's estimates of the diversion from the Moosomin Elevator to the Virden Elevator for each of wheat, canola including Crushers, and canola excluding Crushers, and the diversion from Virden to Moosomin in the same categories. Ms. Sanderson also presented diversion ratios from each of the Moosomin, Virden, and Fairlight Elevators to many other Elevators and Crushers, in several figures attached to her expert report (Ms. Sanderson Report at Figures 47, 48, 50).

442 The Tribunal finds that Ms. Sanderson's diversion ratios indicated, generally, that the Moosomin, Virden, and Fairlight Elevators were relatively close competitors, more so for wheat than for canola. As Ms. Sanderson observed in her expert report, there were smaller diversion ratios for canola from the Virden Elevator to the Moosomin Elevator than from Virden to several other Elevators and Crushers. The same was true for the canola diversion ratios from the Moosomin Elevator to the Virden Elevator. Ms. Sanderson's diversion ratios to rival Elevators beyond the Moosomin, Virden, and Fairlight Elevators also showed, as she testified, that estimated diversions from both the Moosomin Elevator and the Virden Elevator to all other rivals (in the aggregate) were high for both wheat and canola. For wheat, the diversion ratios found by Dr. Miller were 23.8% from the Moosomin Elevator to the Virden Elevator, and 36.3% to the Fairlight Elevator, for a total of 60.1%. This means that 40% of the sales of wheat diverted from the Moosomin Elevator would go to rival Elevators other than Virden or Fairlight. Conversely, for

the Virden Elevator, the diversion ratios for wheat were 16.8% to the Moosomin Elevator and 20.3% to the Fairlight Elevator, for a total of 37.1% of the sales to these two Elevators. This, observed Ms. Sanderson, means that 63% of the diverted sales of wheat from the Virden Elevator would go to Elevators other than Moosomin or Fairlight. In the case of canola, 65% of the sales diverted from the Moosomin Elevator would go to rival Elevators other than Virden or Fairlight, and 77% of the sales diverted from the Virden Elevator would be absorbed by Elevators other than Moosomin or Fairlight. In light of these figures, Ms. Sanderson opined that the diversion ratios to rival Elevators other than Moosomin, Virden, or Fairlight are significant, with many other Elevators and Crushers having diversion ratios similar or higher than those calculated for the Moosomin and Virden Elevators.

443 In his reply to Ms. Sanderson's opinion that the geographic market should include more Elevators given their large diversion ratios, Dr Miller referred to the extract from the 2011 MEGs stating that a relevant market is defined as the "smallest group of products" including at least one product of the merging parties, and the "smallest geographic area," in which a sole profit-maximizing seller would impose and sustain a SSNIP above levels that would likely exist in the absence of the merger. Dr. Miller further explained that defining a relevant market is important because it is impractical to consider all sources of competition. Indeed, doing so would significantly increase the burden of antitrust inquiry, while shedding very little light on the competitive effects of the Transaction.

444 The Tribunal observes that, in aggregate, 60.1% of switched volumes of wheat are diverted from Moosomin to Virden and Fairlight, and 37.1% are diverted from Virden to Moosomin and Fairlight. The Tribunal finds that the magnitude of these diversions signals a meaningful potential impact of the Acquisition on reducing alternatives for local wheat farms residing in the corridor of concern. But the diversion ratios also reflect the fact that Elevators other than Moosomin, Virden, and Fairlight represent alternatives for the purchase of wheat.

445 The Tribunal takes less certain direction concerning the purchase of canola, as the diversion ratio data are much less convincing. The Tribunal does not agree with the position, advanced by Ms. Sanderson in her expert report, that higher comparative diversion ratios *necessarily* leads to the inclusion of *all* additional Elevators or Crushers on the periphery of the service areas for the Moosomin and Virden Elevators. However, the diversion ratios for canola suggest that it is less likely that the Moosomin and Virden Elevators, acting as a hypothetical monopsonist, would be able to exercise market power in a market defined geographically around the Moosomin, Virden, and Fairlight Elevators. The panel notes that the diversion data suggest that the Whitewood Elevator and the Harrowby Crusher are the next closest competitors to the Moosomin, Virden, and Fairlight Elevators for the purchase of canola, and that other Crushers and Elevators offer alternatives to the farmers for their canola.

(e) Evidence related to prices and price negotiations

446 P&H emphasized that its posted prices were set on a centralized basis, and that the vast majority of its sales were at the Cash Price offered each day based on the Basis set each morning and the fluctuating Futures Price.

447 Dr. Miller testified that he found evidence that farms may sometimes individually negotiate prices with Elevators. Such negotiations may depend on long-standing relationships and revenue dependence, as well as subjective assessments of whether a farm could credibly purchase GHS from another, competing Elevator. Dr. Miller also found documentary evidence that farms negotiate prices that deviate from posted prices in a number of ways, including price matching by Elevators of their competitors' prices, not charging for certain services, and purchasing grain on the basis of a higher grade price with the intent to blend the grain for later sale. Dr. Miller also noted that a farm's commitment to purchase crop input products from the Elevator could also affect price.

448 While the Tribunal agrees that uniformity of prices may be indicative of a geographic competition market, the evidence disclosed that there was a material proportion of transactions that involved a negotiated price. Specifically, P&H confirmed that approximately [text omitted] of its transactions occurred at a price set as a result of a successful negotiation of a Cash Price between a farm and the company through its representatives at a particular Elevator. (There was no percentage provided in respect of unsuccessful or attempted price negotiations.)

449 There was also some evidence that, while negotiating a price to be offered to a farm, P&H representatives were aware of the specific distance from specific farms to the company's Elevators and to competitor Elevators, and that this information affected the assessment of whether a rival Elevator's offered price would be matched or not. In determining a potential purchase price for grain, representatives of the Elevator were able to closely analyze circumstances affecting price that were material to an individual farm. Knowledge of the location of the farm, and thus the distance from the farm to each Elevator bidding for the crop, was a key factor in deciding whether to raise the price to be offered for the crop. The internal correspondence recognized that a farm located closer to a rival Elevator would find the rival more attractive as a purchaser at the same price; a higher price would be required to attract volumes of grain away from the rival in order to make up for the time and cost of transportation.

450 This evidence is indicative of an ability by P&H to discriminate on price when departing from the Basis determined by using its Workback Algorithm. It also further demonstrates the salience of distance (and associated transportation costs) and shows the sophistication of the buy-side analysis of price.

(f) Mr. Heimbecker's testimony and P&H business records identifying competitors

451 The Tribunal appreciates that Mr. Heimbecker identified many competitors to the Moosomin and Virden Elevators during his testimony, and that there are documents to support the view that those Elevators and Crushers are competitors in a business sense. Those competitors were principally those within the draw areas of the Elevators. Like Mr. Heimbecker's testimony, the parties' submissions both referred to documents from the files of the merging parties that identified various competitors. Those documents included reports for planning purposes, emails that identified a rival Elevator to which a farm's sale was lost, and emails for bidding or individual price negotiation purposes (*i.e.*, to obtain supply from a farm).

452 The Tribunal has considered this documentary evidence and Mr. Heimbecker's testimony. For the purposes of a competition analysis and geographic market definition, not all business competitors are equal: different competitors may have different abilities to affect the competitive process. Some may have considerable ability to constrain a price increase by the merged entity (or otherwise discipline key dimensions of competition in a market), while others have little or no ability to do so. In this case, applying an HMT approach, the panel finds that the competitive rivals that can constrain a SSNDP by the merged entity do not correspond with competitors from a business perspective. The evidence of internal documents and from Mr. Heimbecker identifying business rivals is relevant but, overall, is a less weighty factor in the Tribunal's assessment of the geographic scope of the competition markets.

(4) Conclusion on relevant geographic market(s)

453 Having considered all the quantitative and qualitative factors described above, the Tribunal concludes that the relevant geographic markets for the purchase of each of wheat and canola are not likely to be smaller or larger than those resulting from the HMT analyses. The Tribunal acknowledges that factors such as the price negotiations on a non-negligible proportion of grain purchases, the diversion ratios between the Moosomin, Virden, and Fairlight Elevators on wheat, the purchases of farmers in the "corridor of concern," and the evidence on distance travelled by farmers suggest a geographic market definition that would be more localized. Conversely, the Tribunal is not persuaded that the evidence flowing from heat maps or business records identifying numerous competitors is sufficient to justify an expansion of the relevant geographic markets resulting from the HMT analyses. In the end, the Tribunal finds that the evidence related to the geographic markets does not amount to clear and convincing evidence allowing the Tribunal to move away from the results coming from the HMT analyses.

454 Therefore, on a balance of probabilities, the Tribunal is of the view that the relevant geographic market for the purchase of wheat is more likely than not to include at least the Moosomin, Virden, Fairlight, Oakner (Cargill), Whitewood (Richardson), Elva (Cargill), and Shoal Lake (Richardson) Elevators. With respect to the relevant geographic market for the purchase of canola, it includes at least the Moosomin, Virden, Fairlight, Oakner (Cargill), Whitewood (Richardson), Brandon (Richardson), Melville (G3), Souris East (Viterra), Shoal Lake (Richardson), and Elva (Cargill) Elevators, as well as the Crushers at Harrowby (Bunge), Yorkton (LDC), Velva (ADM), and Yorkton (Richardson).

C. Has the Commissioner established, on a balance of probabilities, that the Virden Acquisition lessens, or is likely to lessen, competition substantially?

455 The Tribunal now turns to the main element of the merger provisions, namely, whether the Virden Acquisition lessens competition substantially, or is likely to have that effect.

(1) Analytical framework

(a) The statutory language

456 Subsection 92(1) of the Act provides that the Tribunal may make a remedial order if it finds that a merger or proposed merger prevents or lessens, or is likely to prevent or lessen, competition substantially.

457 The anti-competitive threshold is directly linked to the concept of market power. As discussed above, market power is the ability to profitably influence the price or non-price dimensions of competition in the market for the supply or purchase of a product. The price and non-price dimensions of competition show the intensity of rivalry between or among competitors in a market (*Tervita SCC* at para 44; *Tervita CT* at paras 371-373). A merger will only be found to lessen or prevent competition substantially if it is likely to create, maintain, or enhance the ability of the merged entity to exercise market power, whether unilaterally or in coordination with other firms. The market power analysis in respect of a merger centres on the question of whether the merged entity is able, or is likely to be able, to exercise more market power than it could have exercised in the absence of the merger. When a merger is not likely to have market power effects, "it is generally not possible to demonstrate that the transaction will likely prevent or lessen competition substantially" (2011 MEGs at para 2.8). Without market power effects, section 92 will not generally be engaged (*Tervita SCC* at para 44).

458 If there are no market power implications of a merger, there can be no anti-competitive implications. If there are market power implications of a merger, competition can be taken to be lessened or prevented to some extent (see *Facey and Brown* at p 181; *Campbell* at p 100). However, it is only where the prevention or lessening of competition is *substantial* that the Tribunal can intervene under section 92. There can therefore be situations where market power is created, maintained or increased without necessarily resulting in a substantial lessening or prevention of competition.

459 Subsection 92(2) expressly provides that the Tribunal "shall not find" that a merger or proposed merger prevents or lessens, or is likely to prevent or lessen, competition substantially "solely on the basis of evidence of concentration or market share." However, depending on the circumstances, post-merger market share may be a useful or reliable indicator of market power (Hillsdownat p 318). In sum, evidence of changes in market shares and concentration levels are relevant and often influential, but not determinative (*The* Commissioner of Competition v Parkland Industries Ltd, 2015 Comp Trib 4 at para 89; *Tervita CT* at para 360; *Canadian Waste* at para 108, 193-195, 204-205, 224; *Superior Propane I* at paras 126, 304-313).

460 Section 93 of the Act provides a non-exhaustive list of factors that the Tribunal may consider when assessing whether a merger substantially lessens or prevents competition or is likely to do so. These factors include whether a party is a failing business, the availability of acceptable substitutes, barriers to entry into the relevant market, the extent to which effective competition remains or would remain after a merger, whether the merger would result in the removal of a vigorous and effective competitor, and the nature and extent of change and innovation in a relevant market.

461 The Tribunal points out that none of the section 93 factors specifically refers to exports or to the pro-competitive dimension or business rationale of a merger. The Tribunal further reaffirms that the intent of the parties is irrelevant in determining whether a merger will likely reduce competition (*Canadian Waste* at para 118).

(b) The "substantial lessening" analysis

462 As the present case solely concerns an alleged substantial lessening of competition, the Tribunal's analysis will focus on that branch of the assessment of anti-competitive effects. In *Tervita SCC*, the SCC confirmed that the language in section 92 concerning anti-competitive effects is very close to the corresponding words in paragraph 79(1)(c) of the Act dealing with

abuse of dominance (*Tervita SCC* at para 50). The legal framework applicable to analysis of effects under the two provisions has common features, so court and Tribunal decisions under both provisions provide guidance in relation to the assessment of a substantial lessening of competition.

463 As the Tribunal discussed in *VAA CT* at paragraphs 632-644 and in *TREB CT* at paragraphs 456-483, there are two dimensions in the Tribunal's substantial lessening of competition analysis. The first considers a forward-looking, counterfactual comparison. The second considers whether the alleged anti-competitive effects are substantial.

464 First, the Tribunal's review under section 92 examines whether the merger will give the merged entity the ability to lessen competition, compared with the pre-merger benchmark or "but for" world. The analysis involves a forward-looking counterfactual scenario where the Tribunal compares the state of competition that exists or would likely exist in the presence of the merger with the state of competition that would have likely existed in the absence of the merger (*Tervita SCC* at paras 51, 54; *Tervita FCA* at para 108). The focus is on whether the merged entity is likely to be able to exercise materially greater market power than in the absence of the merger, through either materially higher prices or materially lower non-price aspects of competition in the market (*Tervita SCC* at paras 15, 50-51, 54, 80-81; *Tervita FCA* at para 108; *VAA CT* at paras 636, 642; *Tervita CT* at paras 123, 229(iv), 377) [8] . The Tribunal's approach thus contemplates an assessment that emphasizes the comparative and *relative* state of competition before and after the merger, as opposed to the absolute state of competition at those two points in time. In a case involving an alleged likely substantial lessening of competition, the Tribunal will assess whether the merger is likely to enable the merged entity to exercise new or enhanced market power (*Tervita SCC* at para 55, citing *Tervita CT* at para 368). That is, the Tribunal will consider whether the merger has likely created a new ability to exercise market power, or enhanced the merged entity's existing ability to exercise market power.

465 In the second part of its analysis, the Tribunal determines whether the difference between the level of competition in the presence of the merger, and the level that would have existed "but for" the merger, is substantial. The extent of a merger's likely effect on market power is what determines whether its effect on competition is likely to be "substantial" (*Tervita SCC* at para 45; *TREB FCA* at paras 82, 86-92). The issue is whether competition would likely be substantially greater, "but for" the implementation of the merger or proposed merger, through the merged entity's ability to profitably influence price, quality, service, advertising, innovation, or other dimensions of competition (*Canadian Waste* at paras 7, 108; *Di Domenico* at p 554). For a merger to be subject to a remedial order by the Tribunal, it is not enough to demonstrate that an actual or likely lessening of competition will result, or the mere creation or enhancement of market power. In a merger review, the Tribunal's assessment focuses on "whether the merged entity is likely to be able to exercise *materially greater market power* than in the absence of the merger" [emphasis added] (*Tervita SCC* at para 54, citing *Tervita CT* at para 367).

466 Again, the test is relative and requires an assessment of the difference between the level of competition in the actual world and in the "but for" world (*TREB FCA* at para 90). What is substantial is not defined in the Act. The Tribunal may consider evidence of market shares and concentration levels, together with the factors listed in paragraphs 93(a) to (g.3) of the Act and, under paragraph 93(h), "any other factor" relevant to competition in a market that is or would be affected by the merger or proposed merger. In each given case, all relevant indicators of market power need to be considered, but the relevance and weight to be assigned to each indicator will vary with the factual context. There is no precise scale by which to measure what is substantial, and this determination will be "highly contextual" (*Facey and Brown* at p 184).

467 In conducting its assessment of substantiality, the Tribunal will look at three key components, namely, the degree, scope, and duration of the lessening of competition (*Tervita SCC* at para 45; *VAA CT* at para 640).

468 With respect to degree, or magnitude, the Tribunal assesses whether the impugned merger is enabling or is likely to enable the merged entity respondent to exercise materially greater market power than in the absence of the merger (*Tervita SCC* at paras 50-51, 54). When assessing whether competition with respect to prices is or is likely to be lessened substantially, the test applied by the Tribunal is to determine whether prices are or likely would be *materially higher* than in the absence of the merger. With respect to non-price dimensions of competition, such as quality, variety, service, or innovation, the test applied is to determine whether the level of one or more of those dimensions of competition is or likely would be *materially lower* than in the absence of the merger (*Tervita SCC* at para 80; *TREB FCA* at paras 89-92; *Tervita CT* at paras 123-125, 376-377; *VAA CT* at para 642).

469 In assessing whether the degree, or magnitude, of lessening of competition is sufficient to be considered "substantial," the Tribunal will consider the overall economic impact of a merger in the relevant market. Proof of a likely post-merger price increase must be assessed in relation to its materiality in the specific market at issue, the nature and extent of pre- and post-merger competition, and the rest of all the quantitative and qualitative evidence related to the affected dimensions of competition.

470 On the price dimension of competition, the Tribunal has not found it useful to apply rigid numerical criteria in conducting this assessment. In short, there is no specific quantum of price variation implying that a merger lessens competition substantially. The Tribunal agrees with the 2011 MEGs that there is no rigid "numerical threshold" for a material price increase (2011 MEGs at para 2.14; see also Hillsdownat p 329). The Tribunal pauses to underline that the use of a 5% increase in price for the purposes of the HMT analysis must not be confused with the materiality of a price increase under the substantial lessening of competition analysis. The conceptual SSNIP threshold of 5% in the HMT analysis for market definition purposes is distinct from the assessment of substantiality of anti-competitive effects. It is therefore incorrect to state that the Commissioner must adduce quantitative evidence showing a 5% variation in post-merger prices in order to establish a lessening of competition that is "substantial." The required magnitude of a "substantial" price increase will instead vary from case to case and will depend on the facts of each case (*Tervita SCC* at para 46; *TREB FCA* at para 88; Hillsdownat pp 328-329). A substantial price variation can be less than 5%.

471 In fact, as Chief Justice Crampton explained in his concurring opinion in *Tervita CT*, the degree of market power used in assessing whether competition is likely to be prevented or lessened substantially must be recalibrated downward when a 5% price increase is used to assess the degree of market power held by a hypothetical monopolist for the purposes of the HMT analysis and the SSNIP threshold. At paragraphs 376-377 of *Tervita CT*, he said:

> [376] [...] However, given that the Tribunal has now embraced the hypothetical monopolist framework and the SSNIP test for market definition, it is necessary to revisit this definition of substantiality. This is because if the degree of market power used to define relevant markets is the same as the degree of market power used to assess competitive effects, a merger would not be found to be likely to prevent or lessen competition substantially unless the degree of new, enhanced or maintained market power of the merged entity is the same degree of market power held by as [*sic*] the hypothetical monopolist that was conceptualized for the purposes of market definition.
>
> [377] Accordingly, the degree of market power used in assessing whether competition is likely to be prevented or lessened substantially must be recalibrated downwards. That recalibrated degree of market power is a level of market power required to maintain prices *materially* higher, or to depress one or more forms of non-price competition to a level that is *materially* lower, than they likely would be in the absence of the merger. [...]
>
> [Emphasis in original.]

472 In sum, the substantiality level contemplated by the "substantial lessening of competition" analysis can be lower than the level under the HMT analysis and the SSNIP threshold.

473 It must also be emphasized that there is no requirement for the Tribunal to find a likely increase in price; it is sufficient for the Tribunal to conclude that the merged entity has the *ability* to increase price or to reduce quality, service, or product choice.

474 Turning to scope, the assessment involves determining whether the lessening of competition affects the entire relevant market or a material part of it. If the alleged anti-competitive effects do not extend throughout the totality of the relevant market, the Tribunal will assess their scope and whether they extend throughout a "material" part of the market, or in respect to a material volume of sales / business (*Tervita FCA* at para 108; *Tervita CT* at paras 375, 378).

475 With respect to duration, the test applied by the Tribunal is whether a material increase in price or material reduction in non-price dimensions of competition resulting from a merger is likely to be maintained for approximately two years (*Tervita SCC* at para 80; *Tervita CT* at para 123).

476 In assessing substantiality and its various components, the Tribunal considers quantitative evidence, qualitative evidence, or both, related to the price and non-price dimensions of competition (*TREB FCA* at para 16; *VAA CT* at paras 124, 639; *TREB CT* at paras 469-471). In *Tervita SCC*, the SCC held that the Commissioner was not, in law, required to quantify any anti-competitive effects under section 92 (*Tervita SCC* at paras 121-122, 166; *TREB FCA* at paras 99 - 100; *TREB CT* at para 469). That said, in all situations, the Commissioner must always adduce sufficiently clear and convincing evidence, and he bears the burden to demonstrate, on a balance of probabilities, that the merger lessens or is likely to lessen competition substantially, as well as the basic facts of the "but for" scenario that are required to make that demonstration (*Tervita SCC* at paras 65-66; *TREB FCA* at paras 87; *Tervita FCA* at paras 107-108; *VAA CT* at para 644).

(2) Parties' positions

(a) The Commissioner

477 The Commissioner submits that the Virden Acquisition is likely to cause a substantial lessening of competition in the relevant markets owing to the elimination of a vigorous and effective competitor, namely, the Virden Elevator. The Commissioner claims that both the quantitative and qualitative evidence demonstrates that farmers in the relevant markets will pay materially more for GHS for wheat and canola over the next two years and will lose other impactful aspects of competition. With the control of the Virden Elevator, says the Commissioner, P&H has the ability and incentive to unilaterally exercise market power in the relevant markets. The Commissioner contends that the lessening of competition is substantial in terms of magnitude, duration, and scope: it adversely impacts competition to a degree that is material, the duration of the anti-competitive effects is substantial, and the anti-competitive effects extend to a substantial part of the relevant markets.

478 In his final submissions, the Commissioner argued that the substantial lessening of competition is demonstrated by the following elements, which echo many of the factors listed in section 93 of the Act: 1) the high margins at the Virden Elevator, which provide direct evidence of P&H's existing market power; 2) P&H's ability to engage in price discrimination; 3) P&H's high market shares in the relevant markets; 4) the removal of the vigorous and effective competition to the Moosomin Elevator that the Virden Elevator provided prior to the Acquisition; 5) the material impact of the Virden Acquisition on the price for GHS for wheat and canola; 6) the postponement of the planned expansion of the Moosomin Elevator that would have made P&H a more effective competitor to the Virden Elevator in the absence of the Acquisition; 7) the inability of Viterra's Fairlight Elevator to constrain an increased exercise of market power by P&H; and 8) the existence of high barriers to entry and expansion.

479 The Commissioner further submitted that other more distant Elevators, canola Crushers, and direct purchasers of wheat or canola are unable to constrain an exercise of market power by P&H as they do not have sufficient capacity and farmers would have to incur higher transportation costs to deliver their wheat and canola to these locations. While the Commissioner's submissions mostly focused on the anti-competitive price effects of the Virden Acquisition, the Commissioner maintains that quantified price effects are only one element of the substantial lessening of competition caused by the Acquisition. According to the Commissioner, there is also significant other evidence demonstrating that the contemplated price effects are material to the farmers.

480 The Commissioner submits that the Tribunal should adopt a framework that allows for an economic analysis that can credibly assess the impact of local competition between Elevators that was lost when P&H acquired the Virden Elevator from LDC. The Commissioner considers that such local competition is expressed through the Basis. He states that the main issue to be determined by the Tribunal can be summarized as follows: when competition effectively takes place on, and affects one component of, the overall final price of a product, as he suggests is the case here, how should the Tribunal assess and measure the magnitude of harm and the materiality required for the lessening of competition to be substantial?

481 In support of his arguments on the substantial lessening of competition, the Commissioner relies on three pillars of evidence: the expert evidence of Dr. Miller (including his merger simulation model), the fact witnesses (notably, the farmers who testified at the hearing), and the documentary evidence.

482 The Commissioner does not dispute that he has the burden to adduce sufficiently clear and convincing evidence to demonstrate, on a balance of probabilities, that competition is or is likely to be lessened substantially as a result of the Virden Acquisition.

(b) P&H

483 P&H responds that the Virden Acquisition does not, and is not likely to, lessen competition substantially in any relevant market. More specifically, P&H submits that the Commissioner has failed to meet his burden to prove, on a balance of probabilities, his alleged substantial lessening of competition. According to P&H, the evidence on the record does not establish that the markets at issue would be substantially more competitive, "but for" the Virden Acquisition.

484 In its Response, P&H denied that the Virden Acquisition creates, enhances, or maintains monopsony power in any properly defined market for the purchase of wheat or canola. P&H argued that it will continue to face vigorous and effective competition from numerous competing Elevators and Crushers located in Manitoba and Saskatchewan. P&H further claimed that barriers to entry and expansion are low and that rival Elevators have excess capacity, allowing them to expand their purchases of wheat and canola and to constrain any attempt by P&H to exercise monopsony power. P&H also submitted that the predicted price variations determined by Dr. Miller are immaterial and unlikely.

485 In its closing submissions, P&H elaborated by focusing on the fact that: 1) barriers to entry and expansion are low; 2) the Virden Elevator has become and will remain a vigorous and effective competitor further to the Transaction; and 3) the Transaction enhances non-price competition.

486 In support of its arguments on the absence of any substantial lessening of competition, P&H relies on Ms. Sanderson's expert evidence, more particularly her critique of the price effects alleged by Dr. Miller and her post-Acquisition price analysis, and on the evidence provided by the farmer witnesses.

(3) Tribunal's assessment

487 The Tribunal notes at the outset that the evidence adduced by the Commissioner on the substantial lessening of competition primarily focused on the quantification of the alleged price effects of the Virden Acquisition. As the Commissioner said in his oral submissions, his demonstration that the lessening of competition is substantial was mostly done through Dr. Miller's quantification work including evidence such as market shares and margins. As part of its assessment, the Tribunal has therefore considered whether the Cash Prices paid by P&H to the farmers for their wheat or canola are or would likely be materially lower, "but for" the Virden Acquisition. The Tribunal also assessed other evaluative factors raised by the Commissioner and covered by section 93 of the Act. These factors notably included likely entry and expansion, excess capacity, and the extent of any remaining vigorous and effective competitors.

488 For the reasons discussed below, the Tribunal concludes that the Commissioner has not demonstrated, on a balance of probabilities, that the Virden Acquisition lessens, or is likely to lessen, competition substantially in the relevant markets. The Tribunal accepts that the joint control of the Virden and Moosomin Elevators by P&H has and will continue to have some limited adverse effects on competition in the purchase of wheat. However, on the evidence before it, the Tribunal is not persuaded that such lessening of competition reaches or is likely to reach the substantiality required by section 92 of the Act.

489 The Tribunal also acknowledges that the materiality level to assess the substantial lessening of competition varies from case to case, and that a lower materiality level could apply in cases, such as this one, where competition between rivals takes place, at least in part, on one more specific component of the overall final price of a product. However, the Tribunal observes that, even though the Commissioner insisted that competition between Elevators and Crushers revolved around the Basis, he has not provided any compelling submissions, nor any clear and convincing evidence, supporting a particular materiality level that the Tribunal should apply in the current circumstances. Moreover, even considering that some competition between Elevators effectively takes place on one component of the overall price of grain, namely, the Basis, the Tribunal finds that the

low magnitude of harm revealed by the evidence is not enough to meet the materiality required for the lessening of competition to be substantial, whether in relation to the Basis or the Cash Price.

(a) P&H's alleged pre-existing market power

490 The Commissioner argues that P&H already had existing market power prior to the Acquisition and now has the ability to increase this market power by virtue of its ownership of the Moosomin and Virden Elevators. He claims that two pieces of evidence demonstrate P&H's pre-existing market power: the high margins prevailing at the Virden Elevator and P&H's ability to price discriminate.

491 In his expert report, Dr. Miller calculated that the Virden Elevator earned a 55.2% margin on GHS for wheat and a 39.3% margin on GHS for canola. In Dr. Miller's opinion and experience, those are relatively high margins "consistent with localized competition rather than significant competition from many distant competitors" (Dr. Miller Report at para 72). Dr. Miller's margins are economic margins. Ms. Sanderson did not provide any specific margin estimates of her own. Apart from Dr. Miller's estimates, no other evidence was provided to the Tribunal with respect to Elevators' margins on the purchase of grain.

492 To calculate his margins for the Virden Elevator, Dr. Miller identified those Virden Elevator costs which are marginal or incremental, and he excluded fixed costs. Ms. Sanderson did not dispute Dr. Miller's categorization of the fixed and marginal costs, but she criticized his estimated margins on the ground that they were overstated and failed to include certain freight costs and other costs relating to export terminal operations.

493 The Tribunal accepts Dr. Miller's estimated margins for the Virden Elevator, based on his allocation of both revenue and costs to Elevators for the purposes of estimating marginal costs. The Tribunal agrees that the marginal costs related to GHS are a satisfactory proxy for the marginal costs associated with the purchase of grain. Although Dr. Miller's allocations were based on variable costs associated with the delivery of GHS, the same operating activities are also closely associated with the purchase of grain. The Tribunal finds that the variable costs allocated by Dr. Miller are properly allocable to the purchase of grain (and respective revenue generated) at an Elevator, in contrast with freight and other costs that are properly attributable to the marginal cost for (and revenue generated by) the sale and distribution of grain downstream at export terminals and other destinations.

494 Turning to price discrimination, the evidence from discovery is clear that P&H knows the location of its customers and has the ability to use that information to engage in price discrimination. To the extent that Elevators sometimes negotiate individual prices with farmers, a price-discrimination framework may thus be more descriptive of the grain industry. However, the evidence on the record indicates that price negotiations between farms and P&H only occur for about [text omitted] of P&H's transactions with farmers, with the vast majority (*i.e.*, the remaining [text omitted]) of transactions between farmers and the Elevator being done on the basis of posted prices. This [text omitted] percentage is arguably conservative, as it does not include those transactions where farms attempted price negotiations but were unsuccessful. The Tribunal also points out that, while there is some evidence of price discrimination, Dr. Miller stated that a posted price model was the appropriate framework to study how prices are set in the grain industry (Dr. Miller Report at paras 140-142). The Tribunal considers that the evidentiary record in this case demonstrates that P&H has some ability to price discriminate based on its customers' locations, and that it can exercise that ability when it is in its interest to do so. However, the evidence shows that P&H's actual use of this ability is limited.

495 The Tribunal agrees that high margins and the ability to price discriminate can constitute direct evidence that P&H has some pre-existing market power. This was recognized by the Tribunal in *Tele-Direct* at paragraphs 286 and 297. In that case, the Tribunal looked at Tele-Direct's behaviour towards consultants and whether it had abused its dominant position. The Tribunal found that "[w]here a firm with a high degree of market power is found to have engaged in anti-competitive conduct, smaller impacts on competition resulting from that conduct will meet the test of being "substantial" than where the market situation was less uncompetitive to begin with" (*Tele-Direct* at para 758). The Tribunal points out that in that case, Tele-Direct was found to have "overwhelming" market power.

496 Based on the evidence before it, the Tribunal is satisfied that the high margins calculated by Dr. Miller at the Virden Elevator constitute clear and convincing evidence of P&H's pre-existing market power. Similarly, while the evidence with

respect to P&H's ability to price discriminate is not as compelling given that the evidence showed a practice affecting only a limited portion of P&H's purchases of wheat and canola, the Tribunal is satisfied that, on a balance of probabilities, this evidence also supports a finding of some pre-existing market power for P&H.

(b) Price effects

497 With respect to the price effects, the Commissioner relied on the expert evidence of Dr. Miller to support his position that prices for GHS are or will likely be materially higher than they would have been in the absence of the Virden Acquisition.

498 In his analysis, Dr. Miller found that the diversion ratios between the Moosomin and Virden Elevators ranged between 15% and 25% for wheat and between 5% and 15% for canola. More detail about these diversion ratios were provided above in the Tribunal's discussion of the geographic market definition. Dr. Miller used these diversion ratios to quantify the UPP created by the Acquisition. The UPP is a tool that is often used in merger review to approximate the incentive for the merging parties to unilaterally increase prices following a merger, and to measure such price effects. Dr. Miller computed several measures of UPP, all of which showed that prices for GHS would likely rise as a result of the Acquisition, for both wheat and canola. His results suggested that the Transaction generates impetus for price increases, with UPPs of over CAD $2.50 per MT for wheat and over CAD $0.30 per MT for canola. He estimated the gross UPP indices ("*GUPPI*") at over 9% for wheat and over 1% for canola.

499 As explained by both Dr. Miller and Ms. Sanderson in the concurrent evidence session, the magnitudes of UPP, GUPPI, and price effects from merger simulations depend on the amount of diversion between the merging firms and on the mark-up (or margin). Holding all else equal, greater diversion ratios between the merging firms and higher margins will increase UPP, GUPPI, and the simulated price effects.

500 Using his diversion ratios and his estimate of the Virden Elevator's margin, Dr. Miller constructed a merger simulation model to quantify the price impact of the Virden Acquisition on farmers. A merger simulation model is a widely accepted econometric method for calculating the predicted price effects from a merger, and to quantify changes to consumer surplus, profit, and the DWL. It is not disputed that the models constructed by Dr. Miller for his farm choice and his merger simulation are standard economic models, and that Dr. Miller's analysis reflects the principles established in the economic literature. The Tribunal pauses to mention that Dr. Miller's merger simulation model was used both for market definition purposes and for measuring the anti-competitive effects of the Acquisition.

501 The Tribunal notes that there was no disagreement between Dr. Miller and Ms. Sanderson on the calculation of the diversion ratios that went into the merger simulation model; those diversion ratios came out of the transaction-level data.

502 For his substantial lessening of competition analysis, Dr. Miller considered a large number of competing entities, namely, 15 Elevators in the case of wheat and, for canola, 15 Elevators and five Crushers. These were Elevators and Crushers to which there are positive deliveries of canola or wheat made by farms located within Dr. Miller's Farmer Region. In sum, Dr. Miller's merger simulation model included Elevators and Crushers that come from both inside and outside the defined geographic markets resulting from his HMT analysis.

503 There was agreement by both experts that they were able to interpret the data provided and that Dr. Miller relied on a rich and robust data set for his merger simulation model. P&H had voiced concerns about the fact that the Commissioner did not collect data from two Paterson Elevators located at Carnduff and Binscarth, nor from the Cargill Elevator at Nesbitt. All six farmers who testified at the hearing said they do not sell to any of these three Elevators and did not produce receipts showing sales to these Elevators. In addition, no reference was made by Ms. Sanderson to these Elevators as a competitor in any of the Moosomin business documents. The Tribunal is therefore satisfied that, in the end, there were no real issues with alleged missing data in Dr. Miller's model.

504 Dr. Miller's merger simulation model provided both relative and absolute values for his predicted price effects. Dr. Miller and Ms. Sanderson agreed on the magnitude, in absolute dollar terms, of the price effects predicted by Dr. Miller's merger simulation model. They however disagreed on the percentage of the price variations, as the relative price changes varied significantly depending on the denominator being used (*i.e.*, the price of GHS or the Cash Price).

505 In light of the foregoing, the Tribunal is satisfied that it can accept Dr. Miller's merger simulation model and its absolute results.

506 Both Dr. Miller and Ms. Sanderson further acknowledged that, if the diversion ratios and the mark-ups are positive, a merger simulation model will always predict price increases whenever efficiencies are not directly modeled (Ms. Sanderson Report at para 78; Consolidated Transcript, Public, at pp 1525-1526, 1529; Consolidated Transcript, Confidential A, at pp 1711, 1718-1719, 1784-1785, 1871-1872). This is a reflection of economic theory, which says that, when there is competition, there will be lower prices. In other words, a merger that reduces competition in the sale of a product will raise prices to some degree. The Tribunal must, however, determine whether the predicted price increases — or, in the case of a monopsony, price decreases — are meaningful and substantial.

507 Further to its review of the evidence, the Tribunal is not persuaded that the Virden Acquisition is decreasing or will likely decrease the Cash Prices for wheat or canola to a material degree in the relevant markets, relative to the prices that likely would have existed "but for" the Acquisition. Stated differently, the Commissioner has not demonstrated that, "but for" the Virden Acquisition, the prices received by farmers for their wheat and canola are or would likely be materially lower. This is the case for both the relative and absolute measures coming out of Dr. Miller's evidence.

(i) Relative measures

508 The Tribunal first considers the relative price changes predicted by Dr. Miller's model, as this is typically how expected price effects are measured and assessed by the Tribunal. The relativity of predicted price changes is an important benchmark, as price effects are not measured in a vacuum, but against a certain reference or base price. Price variations will be material when they represent a meaningful proportion of the reference price.

509 Dr. Miller's merger simulation model based on the farmers' choices of Elevator predicts that the price of GHS for wheat will increase by CAD $2.49 per MT for the Moosomin Elevator, and by CAD $2.07 per MT for the Virden Elevator (Dr. Miller Report at Exhibit 14). This corresponds to 7.1% and 7.6% price increases, respectively, relative to the reference pre-Acquisition price of GHS for wheat at each Elevator. Turning to the price of GHS for canola, Dr. Miller's projected price increases will be between CAD $0.91 per MT and CAD $1.21 per MT at the Moosomin Elevator, and between CAD $0.25 per MT and CAD $0.35 per MT at the Virden Elevator. The range reflects the different values for canola including or excluding Crushers. These observed variations amount to a 7.3% — 9.7% and 1.3% — 1.7% increase in the price of GHS for canola at the Moosomin and Virden Elevators, respectively.

510 Dr. Miller's expert opinion is that the Virden Acquisition allows P&H to charge farmers 7% to 8% more to handle their wheat, and between 1% to 7% more to handle their canola (using the data for canola including Crushers) (Dr. Miller Report at para 6). According to Dr. Miller and the Commissioner, these results from Dr. Miller's merger simulation show a material increase in the price of GHS per MT, for both wheat and canola, when considered against the price farmers pay for GHS.

511 The Tribunal notes that the highest predicted price increase of CAD $2.49 per MT for wheat represents a variation of 6.8 cents per bushel (*i.e.*, CAD $2.49 / 36.7444 bushels). The corresponding highest predicted price increase of CAD $0.91 per MT for canola (including Crushers) equates to 2.1 cents per bushel (*i.e.*, CAD $0.91 / 44.092 bushels). Both of these highest price variations were measured for the Moosomin Elevator.

512 Ms. Sanderson further calculated that, for wheat, the *average* price increase predicted by Dr. Miller for the Moosomin, Virden, and Fairlight Elevators would be CAD $1.39 per MT (or 4 cents per bushel). The average price increase for canola would be CAD $0.23 per MT (or 1 cent per bushel). When expressed as a percentage of the weighted average imputed prices for GHS at the Moosomin, Virden, and Fairlight Elevators, the price effects calculated by Dr. Miller are, on average, 1.51% for canola and 4.62% for wheat (Ms. Sanderson Slides at pp 93-94).

513 However, as Ms. Sanderson points out in her evidence, when the predicted price changes found by Dr. Miller are expressed in relation to the Cash Prices, the picture of the relative price variations is quite different.

514 In the period of reference used by Dr. Miller, the weighted average price for wheat was CAD $229.73 per MT at the Moosomin Elevator, and CAD $239.11 per MT at the Virden Elevator. For its part, the weighted average price for canola was CAD $461.46 per MT at the Moosomin Elevator, and CAD $452.80 per MT at the Virden Elevator. Therefore, for wheat, Dr. Miller's predicted price variations of CAD $2.49 per MT for the Moosomin Elevator and CAD $2.07 per MT for the Virden Elevator represented changes of only 1.1% and 0.9%, respectively, compared to the pre-Acquisition Cash Price for wheat at each Elevator. With respect to canola including Crushers, Dr. Miller's projected price variations of CAD $0.91 per MT for the Moosomin Elevator, and CAD $0.25 per MT for the Virden Elevator amounted to relative changes of 0.2% and 0.05%, respectively, compared to the pre-Acquisition Cash Price for canola at each Elevator. When expressed as a percentage of the average Cash Prices at the Moosomin, Virden, and Fairlight Elevators, the average relative price effects calculated by Dr. Miller are 0.05% for canola and 0.60% for wheat (Ms. Sanderson Slides at p 94).

515 The Commissioner therefore asks the Tribunal to find a substantial lessening of competition in a situation where his expert's average predicted price increases represent 1.51% of his imputed price for GHS for canola, expressed as a percentage of the average price for GHS at the Moosomin, Virden, and Fairlight Elevators, and 4.62% of his imputed price for GHS for wheat at those same Elevators. When they are expressed in relation to the product market and the appropriate reference price identified by the Tribunal — namely, the Cash Price — , Dr. Miller's predicted price changes represent between 0.05% and 0.2% of the Cash Price for canola, and between 0.60% and 1.1% of the Cash Price for wheat. The Commissioner claims that, even if the purchase of grain and Cash Prices should be the denominator, these price effects are still material when viewed against the qualitative evidence.

516 With respect, the Tribunal disagrees. The Tribunal is of the view that price changes of this magnitude (*i.e.*, at most 1.1% of the Cash Price for wheat and at most 0.2% of the Cash Price for canola) cannot be qualified as "material." On the contrary, the Tribunal finds that predicted price variations representing such a small fraction of the pre-Acquisition price for wheat or canola at the Moosomin or Virden Elevators are immaterial, especially in light of the fact that a merger simulation model will always predict a price increase. For the purchase of canola, price variations of 0.2% or less (or between one and two cents a bushel) are *de minimis*. For the purchase of wheat, price variations reaching at most 1.1% (or a maximum of seven cents a bushel) are very minor and far from substantial in this market. Indeed, the Tribunal observes that, in his submissions at the hearing, the Commissioner admitted that such relative price changes were "small" when expressed in terms of percentage. Hence, the Commissioner's focus on the absolute values of the predicted price changes, to which the Tribunal will turn below.

517 The Tribunal accepts that the Basis plays a certain role in the competition between Elevators at the local level. The evidence indicates that there can be adjustments to the Basis or to the Cash Price after or in addition to changes in the Futures Price. In some cases, the Basis fluctuates for reasons other than a change in the Futures Price, such as negotiations between farms and Elevators or limited-tonne and limited-time specials offered by the Elevators. The Tribunal also accepts that the price variation threshold can certainly be lower than 5% (contrary to P&H's argument) in order to meet the substantiality level. The Tribunal is further mindful of the fact that, when a firm has *high* pre-existing market power, smaller impacts on competition can be enough to meet the test of substantiality (*Tele-Direct* at para 758). The Tribunal pauses to note that, while it finds that P&H had "some pre-existing market power" in this case, the facts do not support a conclusion that P&H had "high" market power and certainly not "overwhelming" market power as in *Tele-Direct*.

518 However, the Commissioner has not presented any compelling argument nor any clear and convincing evidence regarding the materiality level (in terms of percentage) that should apply to the substantial lessening of competition analysis in this case. More specifically, the Commissioner has not made submissions regarding the relative materiality level that should apply in a case where competition allegedly takes place on one component of the final price for wheat or canola, namely, the Basis. Similarly, the Commissioner has submitted no analysis nor any evidence to demonstrate that, in the particular circumstances of this case, the acceptable materiality level for a price decrease could be as low as around 1% or less.

519 In fact, the Tribunal is not aware of any merger cases, in Canada or in any other jurisdiction, where a court or tribunal has recognized that a predicted price effect revolving around 1% could be enough to meet the test of substantiality. Indeed, since merger simulation models predict price increases (as discussed above), the Tribunal is of the view that, absent expert evidence

allowing it to conclude differently, relative price variations predicted by a merger simulation model have to be more than 1% in order to have any significance or materiality.

520 For all the above reasons, the Tribunal agrees with P&H and Ms. Sanderson that the relative effect of the Virden Acquisition on the Cash Prices paid by P&H for wheat or canola is not material.

(ii) Absolute measures

521 The Commissioner also takes the position that the absolute price variations observed by Dr. Miller are material. In his submissions, the Commissioner relied on the absolute magnitude of Dr. Miller's predicted price increases and what he claimed was their resulting materiality. The Commissioner argued that, in this case, the Tribunal should prefer and adopt an absolute notion of materiality with respect to the price effects and consider the impact that the Acquisition will have on farmers, in terms of changes in "cents per bushel" they will pay for GHS or receive for their grain. The Commissioner submits that the absolute amount of the effects measured by Dr. Miller is evidence of a substantial lessening of competition. The price increases projected by Dr. Miller, says the Commissioner, are also well above 2 cents per bushel (or, equivalently, CAD $0.73 per MT for wheat and CAD $0.88 per MT for canola), and this is sufficient to demonstrate materiality.

522 As mentioned above, Dr. Miller's highest predicted price variations are 6.8 cents per bushel for wheat and 2.1 cents per bushel for canola. Dr. Miller and Ms. Sanderson agree that these absolute effects are the same regardless of whether the product market is GHS or the purchase of grain. In sum, these price effects are not dependent upon the definition of the relevant market or on the selection of the SSNIP. The relevant market only impacts the computation of the price effects in relative terms, and the experts indeed disagree on the percentage of the price variations (in terms of the imputed price of GHS or the Cash Price).

523 The Commissioner further claims that price increases of 2 cents to 7 cents per bushel are material when viewed against the qualitative evidence and the pre-existing market power of P&H. The Commissioner submits that the materiality of the price effects is enhanced when all of the other evidence of a substantial lessening of competition is considered, namely, P&H's pre-existing high margins, high market shares, and ability to price discriminate, the removal of the Virden Elevator as a vigorous and effective competitor, and the loss of competition between the Virden and Moosomin Elevators as a result of the Moosomin Elevator's delayed expansion.

524 The Tribunal is not persuaded by the Commissioner's submissions and evidence. More specifically, the Tribunal is not convinced that there is evidence showing, on a balance of probabilities, that 2 cents a bushel "matter" to farmers. The evidence is only in respect of amounts much higher than that, and higher than Dr. Miller's predicted price increases. The Tribunal agrees with P&H that arguing that a 2 cents per bushel price increase, or even a 7 cents price increase, is material is inconsistent with the farmers' evidence and with the high volatility of prices in the grain industry, often vacillating by plus or minus 10 cents a bushel in a day.

525 The Commissioner first relies heavily on the so-called "2 cents challenge." The "2 cents challenge" refers to an email sent by [text omitted] to [text omitted] and [text omitted] in the regular course of business (Commissioner Read-In at p 643). In that email, [text omitted] said that 2 cents per bushel translated into CAD $3.2 million in profitability for P&H. The Commissioner claims that this evidence is very important to assessing materiality because [text omitted] posted that if P&H bought each bushel 2 cents cheaper, it would add more than CAD $3 million in profitability to P&H. Moreover, when Mr. Heimbecker was asked on discovery what CAD $3.2 million in profit meant to him, he said that such a sum of money was "not insignificant" (Commissioner Read-In at p 178).

526 The Commissioner adds that 2 cents per bushel is a reasonable threshold for materiality as it represents 2.1% of GHS for wheat and 7.1% of canola handling prices for the Moosomin Elevator, and 2.7% of GHS for wheat and 4.4% of canola handling prices for the Virden Elevator.

527 The Commissioner also refers to another email where [text omitted] from P&H said that he does not need to be [text omitted] per bushel higher than his competitors on wheat, and that the damage of such a discount to P&H's buying program

would be [text omitted] (Commissioner Read-In at p 800). On the basis of this evidence, the Commissioner maintains that P&H cares about pennies on the bushel.

528 The Tribunal does not find this evidence convincing on the issue of materiality of price effects in the context of its substantial lessening of competition analysis. For the purpose of section 92 of the Act and the Tribunal's assessment of anti-competitive effects, materiality is analyzed in relation to a market situation, to the competitive behaviour of market participants as a result of a merger, and to competition in the relevant market. It is not analyzed in relation to a firm's overall profitability or bottom line. In this case, it is analyzed in relation to the situation in the relevant geographic markets for wheat and canola as a result of the Virden Acquisition. The Tribunal appreciates that 2 cents a bushel, when projected on the overall profitability of P&H, may have some significance for P&H. But the fact that 2 cents a bushel may be important to P&H's overall bottom line does not constitute clear and convincing evidence that such an amount is or would likely be "material" with respect to a lessening of competition in the purchase of wheat or canola in the relevant markets defined above.

529 The materiality of predicted price changes, whether relative or absolute, is not to be measured in relation to the general profitability of one specific producer or supplier, or one specific customer. This is even more so when the Commissioner's Application only challenges one specific portion P&H's business, namely, the acquisition of only one Elevator out of an overall network of 29. The issue to be determined by the Tribunal is whether the adverse price effects on competition are material in relation to the market and industry at stake. The "2 cents challenge" email offers no clear and convincing evidence to support the Commissioner's position on the alleged price effects attributable to the Virden Acquisition.

530 The Tribunal further observes that virtually any business person would say that any additional cent of profit per unit of product sold does matter and has some significance for his or her business. In the Tribunal's view, the assessment of materiality was not meant to be reduced, and cannot be reduced, to a single comment such as those made by [text omitted].

531 With respect to the email from [text omitted] the Tribunal notes that the [text omitted] comment was not made in reference to a specific benchmark, let alone to a 2 cents per bushel benchmark. It was generally made in reaction to sales representatives saying that "farmers are getting better prices somewhere" with no information to support such claims. Moreover, when [text omitted] referred to a particular amount P&H should not contemplate, he said that P&H did not need to be [text omitted] per bushel higher than its competitors. [text omitted] per bushel is far higher than the 2 cents or even 7 cents a bushel measured by Dr. Miller.

532 The Commissioner further submits that cents per bushel matter not only to P&H, but also to farmers. In that regard, the Commissioner relies on several extracts and comments made by the farmer witnesses regarding the price changes they face in their business.

533 Again, the Tribunal is not persuaded by the Commissioner's submissions. The Tribunal has not found clear and convincing evidence allowing it to conclude, on a balance of probabilities, that a few cents a bushel matter to farmers and to their behaviour in the market. On the contrary, the evidence from farmers is in respect of amounts much higher than 2 cents a bushel and higher than the predicted price increases of Dr. Miller.

534 It is true, as the Commissioner argues, that Mr. Lincoln (a farmer called by the Commissioner) testified in his witness statement that that he needs "every penny to be able to hit the profitability levels" required to operate his farm (Lincoln Statement at para 16). However, immediately before he made that statement, Mr. Lincoln referred three times to an example of what a material amount meant to him: it was *10 cents* a bushel. He indicated that the Moosomin Elevator would have to offer him 10 cents a bushel above the Fairlight Elevator for it to be worthwhile driving past this Elevator (Lincoln Statement at para 15). When he went on to quantify the adverse impact of a price decrease on his business, he again used the value of 10 cents per bushel (Lincoln Statement at para 16). Nothing in the Lincoln Statement supports the contention that an amount as low as 2 cents a bushel or in the range predicted by Dr. Miller would be material to him and to his competitive behaviour in the sale of his grain.

535 The Commissioner also referred to the testimony of Mr. Hebert, one of P&H's farmer witnesses, singling out his comments and podcasts about the farmers' margins being squeezed. Further to its review of Mr. Hebert's evidence, the Tribunal finds no

support in that evidence for the proposition that 2 cents or a few cents a bushel matter to Mr. Hebert. The documents mentioned by Mr. Hebert in his testimony contained comments he made about his "5% rule" in the context of the farmers' business: for Mr. Hebert, farmers should concentrate on trying to improve certain metrics of their business by 5%. The only references to cents per bushel were to an amount of 50 cents per bushel. Again, this is far above 2 cents or 7 cents per bushel.

536 Mr. Paull, another farmer witness called by P&H, testified that he will only switch to a more distant Elevator if it means receiving more cents a bushel. Regarding the magnitude of the price differential, Mr. Paull testified that he would not leave a local Elevator for "a few pennies a bushel or a few cents a bushel," but if he could make "10 or 15, 20 cents, sometimes 30 or 40 cents by going further," he would (Consolidated Transcript, Confidential B, at p 1020). Mr. Paull added that he would not switch from a local Elevator if the difference in net price is 5 cents a bushel or lower (Consolidated Transcript, Confidential B, at p 1022). He also mentioned that he would not haul his grain 50 or 100 miles away for a few cents a bushel. More distant Elevators would need to offer higher prices than that for him to consider sending his grain farther. In fact, Mr. Paull sold all of his canola in the last four years to Bunge Altona, a Crusher located some 350 kilometers and three and a half hours away from his farm. He did it because it was profitable to do so.

537 In sum, Mr. Paull testified that a few pennies are not material enough for him to change his selling behaviour and to switch Elevators. It starts to matter for him at 10 cents per bushel.

538 As Mr. Duncan, Mr. Paull, and Mr. Hebert all said in their witness statements, the net price or Cash Price they receive from the Elevators is what matters to them as farmers.

539 In his submissions, the Commissioner indicated that farmer witnesses were not meant to be a statistically representative sample and were not the way the Commissioner intended to demonstrate that the lessening of competition is substantial. He said that substantiality flows from Dr. Miller's quantification work and other evidence on market shares and margins. However, even the farmers' examples used by the Commissioner do not support his argument that 2 cents per bushel is a material price impact on the facts of this case.

540 Dr. Miller also testified that the price effects he calculated would represent a loss of about CAD $2,000 per farm in the Elkhorn area, located between the Moosomin and Virden Elevators. However, the Commissioner did not point to any clear evidence allowing the Tribunal to determine how such an amount could be material or not to the farmers, or whether this would change their selling or competitive behaviour in the relevant markets for wheat or canola.

541 The Tribunal makes one other observation in relation to the "2 cents per bushel" issue. P&H pointed out that volatility in the grain industry is often in excess of 10 cents a bushel on any given day. In her expert report, Ms. Sanderson calculated the average of the within-day price variations (Ms. Sanderson Report at para 104 and Figure 30). The average within-day variation is CAD $4.32 per MT for canola and CAD $3.82 per MT for wheat. When expressed in dollars per bushel, these values translate into approximately 10 cents a bushel for each of wheat and canola. Should a farm be successful in timing its grain sale within any given day, it can therefore achieve a purchase price that is 10 cents a bushel higher by selling grain at the right hour of the day. This evidence was not contradicted.

542 In light of this evidence, said Ms. Sanderson, a 2 cents variation that is significantly lower than the typical within-day daily fluctuations in the purchase price of wheat or canola cannot be a material price variation in the grain industry. Furthermore, Ms. Sanderson stated that, during 2018-2019, the average cash purchase price paid at the Moosomin Elevator for canola was CAD $10.47 a bushel (or CAD $461.46 per MT), making 2 cents equal to 0.19% of the Cash Price of canola. During the same period, the average cash purchase price paid at the Moosomin Elevator for wheat was CAD $6.25 CAD a bushel (or CAD $229.73 per MT), making 2 cents equal to 0.32% of the Cash Price of wheat (7 cents would be equal to 1.12%).

543 According to Ms. Sanderson, this evidence suggests that a material change in price cannot be less than 10 cents a bushel. The Tribunal agrees. The weighted average price increases predicted by Dr. Miller's merger simulation model are only 1 cent per bushel in canola and 4 cents per bushel for wheat (in relation to the average price at the Moosomin, Virden, and Fairlight Elevators), which are both well below 10 cents per bushel.

544 In sum, even looking at the absolute price effects measured by Dr. Miller, the Tribunal does not find evidence supporting the Commissioner's position that the projected price variations are material. They are rather of a small magnitude and immaterial, consistent with the fact that P&H faces considerable competition from several rival Elevators and Crushers to constrain material price decreases after the Transaction.

545 The Tribunal pauses to note the following. On this whole issue of P&H's prices, the Tribunal agrees with the Commissioner that little weight should be given to Mr. Heimbecker's evidence on this front, as he was obviously not very familiar with P&H's day-to-day operations in relation to these pricing issues. However, even without taking into account Mr. Heimbecker's evidence, there is no clear and convincing evidence of a material decrease in the price for wheat or canola, in absolute or relative terms.

546 The Tribunal concludes that the evidence of absolute pricing variations does not constitute clear and convincing evidence supporting a conclusion that, "but for" the Virden Acquisition, the prices of wheat or canola paid to farmers by P&H are or would likely be "materially" lower.

(iii) Difference-in-differences analysis

547 As part of her expert report, Ms. Sanderson did a difference-in-differences regression analysis to verify whether, since the closing of the Transaction, P&H has effectively lowered the Cash Prices "it pays farms at Virden or Moosomin post-Acquisition in an economically significant way" (Ms. Sanderson Report at para 110). Ms. Sanderson's difference-in-differences is a retrospective merger analysis based on what actually happened to P&H's post-Acquisition posted prices since the merger.

548 Difference-in-differences regressions can be informative to study the effect of events such as mergers if the facts are consistent with the empirical framework. These analyses are called difference-in-differences because they aim at determining whether the merger has created a difference going above and beyond the other changes that would have occurred in any event, and whether the relative difference will be the same through the review period.

549 In this case, Ms. Sanderson used a difference-in-differences regression analysis of posted prices at the Moosomin and Virden Elevators to test if the Acquisition has effectively reduced P&H's Cash Prices at Moosomin and Virden, relative to the prices prevailing at a benchmark P&H Elevator (namely, the Dutton Elevator) that is unaffected by the Acquisition. Ms. Sanderson considered that the Dutton Elevator was an appropriate comparator Elevator as it was unaffected by the Acquisition and was outside of any acquired LDC Elevator's draw areas, it was subject to the same network dynamics as the Moosomin Elevator, and it had posted prices. The graphs provided in Ms. Sanderson's expert report show that the Dutton Elevator had closely similar behaviour and common trends compared to the Virden and Moosomin Elevators, with no evidence of materially lower purchase prices than the Virden and Moosomin Elevators.

550 Ms. Sanderson calculated a difference-in-differences regression comparing net price changes for the Moosomin and Virden Elevators using the post-Acquisition months from December 10, 2019 to June 30, 2020 and the same months for 2016 to 2019 in the pre-Acquisition period. By using similar months every year, Ms. Sanderson removed added seasonal variations that increase modeling noise, and she chose the Dutton Elevator outside the Transaction's competitive markets to control for impact of market conditions external to the impact of the Transaction.

551 Ms. Sanderson concluded to a minimal decline in the Cash Price of canola and to a posted Cash Price increase of 1.5% for wheat since the Acquisition (Ms. Sanderson Report at para 112 and Figure 33; Ms. Sanderson Slides at p 86). More specifically, for the Moosomin Elevator, her difference-in-differences analysis found that canola prices were 0.5% higher and that wheat prices were 0.6% lower. For the Virden Elevator, she found that canola prices were 0.6% lower and wheat prices 1.5% higher. On that basis, she concluded that her regression analysis constituted further evidence that, as far as price effects are concerned, the Virden Acquisition does not, and is not likely to, lessen competition substantially.

552 Dr. Miller acknowledged that Ms. Sanderson's difference-in-differences methodology was "about as good as you can do" and "as good as the economic literature can get you here" (Consolidated Transcript, Confidential A, at p 1889). However,

Dr. Miller considered that Ms. Sanderson's regression framework does not fit the facts of this case, and is not a good predictor of P&H's pricing in the future.

553 Three concerns were expressed by Dr. Miller about Ms. Sanderson's difference-in-differences analysis. First, Dr. Miller's main issue was about the usefulness of doing such an analysis while a merger review process is still on-going. In other words, he questioned the probative value of a retrospective merger analysis while the merger itself is still under review before the Tribunal, and had serious reservations about it. Second, he questioned the use of posted prices as opposed to realized transactions which could include results of negotiations (bearing in mind that, according to the evidence, [text omitted] of P&H's prices for wheat and canola are negotiated). These negotiations often impact the Basis, and not only the Cash Price. Third, he was concerned about the reliability of the data in the period surrounding the Transaction, which is influenced by an international trade war and the effects of the COVID-19 pandemic. Dr. Miller also submitted that Ms. Sanderson does not have enough data post-merger to do a robust analysis, nor does she have a sufficient control set against which to reliably interpret her results, as she only had one benchmark Elevator, the Dutton Elevator, in her control group.

554 In her presentation at the hearing, Ms. Sanderson took into account the concerns raised by Dr. Miller (Ms. Sanderson Slides at p 87). She responded that she used the Dutton Elevator to counter the impact of factors such as an international trade war or COVID-19. She is comparing the changes at the Moosomin and Virden Elevators to the changes at the Dutton Elevator. All three Elevators were impacted by these exogenous factors, and the assumption was that the broader market effects would be similar on the three Elevators.

555 With respect to the quality of her price data, Ms. Sanderson emphasized that her regression is a difference-in-differences analysis, and that using the posted price data would be suitable for picking up whether there is a difference due to the Acquisition. Approximately [text omitted] of P&H's transactions are at posted prices, and there was no evidence that the situation about negotiated prices is different at the Moosomin and Virden Elevators from what it is at other Elevators, including the Dutton Elevator. More generally, Ms. Sanderson advised that there is no indication that the Dutton Elevator was an outlier or had delivered results different from other Elevators in the P&H network. Ms. Sanderson's model results also indicate that the R-squared variable, which is an indicator measuring how well the variables in the regression predict the dependent variable, is fairly high, thus showing a good fit for her model.

556 The Tribunal notes that Dr. Miller identified a few reasons as to why Ms. Sanderson's methodology could provide inadequate results, but no evidence was provided to show that this occurred with Ms. Sanderson's model in this case.

557 However, the Tribunal agrees with some of Dr. Miller's concerns about Ms. Sanderson's difference-in-differences regression, in that it did not account for autocorrelation in the modeling, which leads to overstating the precision of her results. The Tribunal also notes that the post-Acquisition time period for the data used by Ms. Sanderson, being less than a year, is fairly short and that there were inventory issues at the Virden Elevator towards the end of 2019.

558 One member of the Tribunal, Ms. Samrout, has additional methodological concerns with Ms. Sanderson's analysis. Ms. Samrout is of the view that Ms. Sanderson's regression treated the Futures Price as a control variable that explains a portion of the variation in the observed Cash Price. Although this variable provides the average change in the Cash Price pre- and post-Transaction as the Futures Price changes, while holding all other variables constant, it is unclear whether the model fully or partially explains the magnitude of the variation in the Cash Price since the interaction between the timing of the transaction (pre- and post-Transaction) and the Futures Price was not tested. In other words, a variable should have been included to capture the difference in the magnitude of how well the Cash Price is affected by the Futures Price pre- and post-Transaction.

559 As part of her difference-in-differences analysis, Ms. Sanderson also presented in her testimony (Ms. Sanderson Slides at pp 82-85) the line trends tracking the difference in Cash Price before and after the Acquisition in comparison with the Dutton Elevator's Cash Price, showing that there is little difference between the Moosomin and Virden pricing behaviour in Cash Price in comparison to Dutton. Ms. Samrout notes that Ms. Sanderson compared the Cash Price before and after the Acquisition without any visual linkage to the fluctuation and trending of Futures Prices and their corresponding posted Basis to arrive at the Cash Prices.

560 In the end, the Tribunal is satisfied that Dr. Miller's critiques do not significantly alter Ms. Sanderson's conclusions and agrees that, on a balance of probabilities, it is more likely than not that P&H has not lowered its purchase prices for wheat and canola since the Acquisition. In sum, the Tribunal is of the view that Ms. Sanderson's difference-in-differences analysis is more consistent with P&H's position than the Commissioner's, and that it provides some support for the non-material nature of the price effects resulting or likely to result from the Virden Acquisition. However, the Tribunal finds the analysis to be of more limited assistance given the concerns raised by the limitation of the data and by the fact that it is looking at the behaviour of P&H while the Virden Acquisition was under review. The Tribunal thus concludes that it should be given little weight in its price effects analysis.

(iv) Conclusion on price effects

561 In light of the foregoing, the Tribunal is left with unpersuasive and insufficient evidence regarding the alleged substantiality of the price effects of the Virden Acquisition. The measured price effects are *de minimis* for the purchase of canola. For wheat, the Tribunal finds that the Acquisition is having or is likely to have some very minor price effects on the purchase of wheat but they are far from substantial. In sum, having regard to the evidence presented, the Tribunal finds that the likely price variations due to the Virden Acquisition, whether in absolute terms or in relative terms, are immaterial and are likely to remain immaterial for both the purchase of wheat and the purchase of canola.

562 The Tribunal underlines that, even though farmers located in the "corridor of concern" are arguably the most affected by the Virden Acquisition as a vast majority of them sell their wheat and canola exclusively to the Virden, Moosomin, and Fairlight Elevators, the Commissioner presented no quantitative evidence regarding the predicted price changes in that specific part of the relevant geographic markets for wheat and canola. There is therefore insufficient evidence allowing the Tribunal to determine the relative or absolute magnitude of the predicted price variations for the farmers located in the corridor of concern.

(c) Market concentration and market shares

563 The Tribunal now turns to the effect of the Virden Acquisition on P&H's post-merger market shares. As discussed above, Dr. Miller and Ms. Sanderson disagree as to the number of participants in the relevant geographic markets; hence, they disagree on whether or not the merged firm will have a market share that exceeds 35%, which is considered a "safe harbour" in the Commissioner's 2011 MEGs.

564 Relying on *Tele-Direct* at paragraph 226, the Commissioner submits that high market shares are an indirect indicator that the Virden Acquisition allows P&H to exercise increased market power: in this case, Dr. Miller's calculations indicate that P&H's post-Acquisition market shares are 59.6% for wheat and 53.9% for canola (Dr. Miller Report at Exhibit 10). These calculations are for Dr. Miller's original relevant geographic market based on the "imputed" price for GHS, which was defined by Dr. Miller as including solely the Virden, Moosomin, and Fairlight Elevators.

565 According to Ms. Sanderson, using the geographic markets based on the Cash Prices with a 5% SSNIP threshold, P&H's post-Acquisition market shares would be much lower (Ms. Sanderson Slides at pp 74-75). It would be 31.6% in the relevant geographic market for the purchase of wheat, defined by Ms. Sanderson as including the Moosomin, Virden, Fairlight, Oakner, Whitewood, Elva, Shoal Lake, and Carnduff Elevators, using the average price at the Virden Elevator as the reference price. Based on Ms. Sanderson's figures, this percentage would increase to 34.6% if the Carnduff Elevator is left out of the market. Post-Acquisition market shares would amount to only 16.1% in the relevant geographic market for the purchase of canola, defined by Ms. Sanderson as including the Moosomin, Virden, Fairlight, Oakner, Whitewood, Brandon (Richardson), Melville, Souris East, Shoal Lake, and Elva Elevators as well as the Crushers at Harrowby (Bunge), Yorkton (LDC), Velva (ADM), and Yorkton (Richardson).

566 Ms. Sanderson further opined that what matters for the competitive effects analysis is P&H's post-merger share of purchases, because this determines the competitive alternatives available to farms if P&H were to seek to reduce its purchase prices for wheat and canola post-Acquisition. Ms. Sanderson testified that, post-Acquisition, the Moosomin and Virden

Elevators account for only 15% of total canola purchases and only 26% of total wheat purchases from farms within Dr. Miller's Farmer Region.

567 While subsection 92(2) of the Act expressly precludes the Tribunal from making a finding of substantial lessening of competition "solely on the basis of evidence of concentration or market share," it is not disputed that evidence of changes in market shares and concentration levels are relevant and often influential in the Tribunal's assessment. The Tribunal further agrees with the Commissioner that, in its market share and concentration calculations, it should not take into account the purchases of all Elevators located both inside and outside the relevant markets; the market shares should instead be computed based on the purchases made by those participants that are part of the relevant markets, as these markets are defined by the Tribunal.

568 In this case, based on the evidence before it and considering the geographic market definition discussed above, the Tribunal finds that the post-Acquisition market share of P&H would be at most 16.1% in the relevant geographic market for the purchase of canola. This is a conservative measure, as the relevant geographic market for canola identified by Ms. Sanderson was based on SSNIP level well below 5% — it was 3.08% — and on the lower Virden Elevator price for canola as a reference price. This concentration level is significantly below the 35% safe harbour threshold identified in the MEGs, and cannot be considered indicative of a lessening of competition in the purchase of canola, let alone a substantial one.

569 Turning to wheat, the Tribunal concludes that the post-Acquisition market share of P&H would likely fall within a range corresponding to the potential relevant geographic markets discussed above: these market shares would vary between 31.6% for a relevant geographic market including all Elevators retained by Ms. Sanderson in her analysis and approximately 34.6% if the market is limited to the Moosomin, Virden, Fairlight, Oakner, Whitewood, Elva, and Shoal Lake Elevators (and excludes the Carnduff Elevator). These market share figures approaching 35% provide, in the Tribunal's view, no more than weak evidence of enhanced market power in the purchase of wheat.

(d) Removal of a vigorous and effective competitor

570 The Commissioner submits that the Virden Acquisition eliminates intense rivalry between the two main suppliers of GHS for wheat and canola in the corridor of concern. He asserts that the Moosomin and Virden Elevators competed head-to-head on price and service, and were each other's closest competitors. The removal of a vigorous and effective competitor is one of the factors specifically contemplated by section 93, at paragraph (*f*).

571 The Tribunal agrees with the Commissioner on this point.

572 Three sources of evidence support the Commissioner's arguments: the diversion ratios, the documentary evidence, and the farmers' testimonies.

573 One of the factors that can be relevant when considering the likely competitive effects of a merger is the diversion ratios between the products of the merging parties. This is because such ratios can provide information regarding the closeness of competition between those products. In this case, the diversion ratios calculated by Dr. Miller demonstrate that the Virden and Moosomin Elevators are close competitors. For wheat, the diversion ratios found by Dr. Miller were 23.8% from the Moosomin Elevator to the Virden Elevator, and 36.3% to the Fairlight Elevator. Conversely, for the Virden Elevator, the diversion ratios for wheat were 16.8% to the Moosomin Elevator and 20.3% to the Fairlight Elevator. True, the highest diversion ratios from each of the two Elevators were to the Fairlight Elevator. But the diversion ratios between the Moosomin and Virden Elevators were second, reflecting the fact that the Moosomin and Virden Elevators are relatively close competitors. As will be discussed below, the Tribunal is mindful of the fact that these diversion ratios — being around 20% and far below 50% — are not objectively high, and that there is significant diversion to rival Elevators other than Moosomin, Virden, or Fairlight. However, this does not diminish the fact that, in light of these observed diversion ratios, the Acquisition removes a vigorous and effective competitor.

574 There is also ample documentary evidence of direct, head-to-head competition between the Moosomin and Virden Elevators.

575 Finally, the farmer witnesses who testified on behalf of the Commissioner — Mr. Lincoln, Mr. Pethick, and Mr. Wagstaff — all referred to the fact that they were using the two Elevators and complained about the loss of one competitive option further to the Virden Acquisition.

576 Based on all this evidence, the Tribunal finds that the Acquisition eliminates a vigorous competitor — the Virden Elevator — which was a close rival to the Moosomin Elevator. The Tribunal is satisfied that, in the absence of the Acquisition, the Virden and Moosomin Elevators would have continued to vigorously compete in the relevant markets for the foreseeable future. There is no evidence to indicate that the Virden Elevator would have ceased being a vigorous and effective competitor, but for the Acquisition.

(e) Effective remaining competitors

577 While the removal of a vigorous and effective competitor is a factor that the Tribunal may have regard to, paragraph 93(e) of the Act also directs the Tribunal to consider the "extent to which effective remaining competition remains or would remain" in a market affected by the merger. P&H maintains that there are several remaining Elevators and Crushers which will continue to discipline the Virden and Moosomin Elevators after the Acquisition, in the purchase of both wheat and canola, and that these rivals will be capable of constraining P&H's ability to exercise increased market power after the Acquisition.

578 The Tribunal agrees in part with P&H. The fact that the Moosomin and Virden Elevators went toe-to-toe on several occasions does not mean that they did not also have to go toe-to-toe with other rival Elevators located farther away. At the stage of the substantial lessening of competition, the Tribunal considers whether rivals' purchase locations (including those close to the border of the relevant geographic market) provide competition and constrain the supply/purchase locations that are within the geographic market (*VAA CT* at para 305; Hillsdownat p 330).

579 Dr. Miller and Ms. Sanderson agree that, for the purpose of analyzing anti-competitive effects and the substantial lessening of competition, the Tribunal needs to consider competitors located both inside and outside the defined relevant geographic markets in order to assess their constraining impact on the price and non-price dimensions of competition. In other words, the competitive constraints on a merged firm can come from rivals within and outside the relevant geographic markets (Consolidated Transcript, Public, at p 1831). Indeed, the number of competitors considered by Dr. Miller for his substantial lessening of competition analysis were not limited to those Elevators he had included in his narrow geographic market definition; they instead extended to 15 Elevators for wheat and, for canola, to these same 15 Elevators as well as five Crushers. In sum, Dr. Miller's merger simulation model included Elevators and Crushers that come from outside the defined geographic markets.

580 In her testimony before the Tribunal, Ms. Sanderson stated that, however the geographic market is defined, what matters for anti-competitive effects is P&H's post-merger share of purchases because this determines the competitive alternatives available to farms if P&H were to seek to reduce its purchase prices post-Acquisition. Dr. Miller and Ms. Sanderson did not dispute P&H's share of purchases. As mentioned above, post-Acquisition, the Moosomin and Virden Elevators account only for 15% of canola purchases and 26% of wheat purchases from farms within Dr. Miller's Farmer Region.

581 P&H's evidence indicates that it competes with numerous Elevators and Crushers in the purchase of wheat and canola in Dr. Miller's Farmer Region. According to P&H, its competitors for wheat include the following Elevators and grain companies: Viterra at Fairlight, Brandon, Souris East, Grenfell, Waldron, Binscarth, and Carnduff; Paterson at Binscarth and Carnduff; Richardson at Shoal Lake, Kemnay, Langenburg, Melville, Minnedosa, Estevan, and Whitewood; Ceres at Northgate; Cargill at Oakner, Nesbitt, and Elva; and G3 at Bloom and Melville (Heimbecker Statement at paras 119, 121-124). P&H adds that its competitors for canola include the following Elevators and Crushers, and grain companies: Viterra at Fairlight, Brandon, Souris East, Grenfell, Waldron, Binscarth, and Carnduff; Paterson at Binscarth and Carnduff; Richardson at Shoal Lake, Kemnay, Langenburg, Yorkton, Melville, Minnedosa, Estevan, and Whitewood; Ceres at Northgate; Cargill at Oakner, Nesbitt, and Elva; G3 at Bloom and Melville; LDC at Yorkton; ADM at Velva; and Bunge at Harrowby and Altona (Heimbecker Statement at paras 120-125).

582 According to Ms. Sanderson, there are many other Elevators and Crushers buying canola and wheat from farms in Dr. Miller's Farmer Region. As indicated in Ms. Sanderson's expert report, 11 rival Elevators and Crushers are buying more canola than does the Moosomin Elevator (Ms. Sanderson Report at Figure 24; Ms. Sanderson Slides at pp 77-78). And Viterra's Fairlight Elevator and Bunge's Harrowby Crusher also purchase more canola than the Virden Elevator. For wheat, while the Virden, Moosomin, and Fairlight Elevators are the largest purchasers of wheat, six rival Elevators each have at least a 5% share of total wheat purchases (Ms. Sanderson Report at Figure 25; Ms. Sanderson Slides at pp 79-80).

583 P&H further submits that internal business documents from both its records and LDC's records further show that each of the Moosomin and Virden Elevators compete with and track prices of many other Elevators beyond Moosomin, Virden, and Fairlight (Ms. Sanderson Report at paras 81-82). In her evidence, Ms. Sanderson referred to numerous contemporaneous business documents from P&H and LDC where they referred to competitor pricing, such as Viterra at Carnduff, or Richardson at Whitewood.

584 Ms. Sanderson's analysis of P&H's documents and LDC's Producer Reports showed that individual price negotiations are relatively infrequent, echoing the evidence demonstrating that about [text omitted] of P&H's transactions are at posted prices. In her analysis of those instances where price negotiations actually occurred, Ms. Sanderson found that 72 of the 213 reports referring to negotiations at the Virden Elevator identified farms using rival Elevator prices in a negotiation: only six of those 72 mentioned the Moosomin Elevator, and 27 mentioned Viterra's Fairlight Elevator. Other rival grain companies identified in the reports included G3 (13 times), Cargill (11 times), and Richardson (eight times). Conversely, 17 reports referring to negotiations at the Moosomin Elevator identified farms using rival Elevator prices in a negotiation: five of those mentioned Virden, and the Fairlight Elevator appeared 12 times (Ms. Sanderson Report at paras 116-117, Figures 35a — 35b; Ms. Sanderson Slides at p 88). This evidence, says P&H, reflects the presence of other remaining Elevators and Crushers constraining P&H's pricing behaviour.

585 Turning to the diversion ratios found by Dr. Miller, Ms. Sanderson advises that, for wheat, they show that 40% of the sales diverted from the Moosomin Elevator would go to rival Elevators other than Virden or Fairlight. For the Virden Elevator, 63% of the diverted sales of wheat from the Virden Elevator would go to Elevators other than Moosomin or Fairlight. In the case of canola, these percentages are higher: 65% of the sales diverted from the Moosomin Elevator would go to rival Elevators and Crushers other than the Virden or Fairlight Elevators, and 77% of the sales diverted from the Virden Elevator would be absorbed by Elevators and Crushers other than the Moosomin or Fairlight Elevators (Dr. Miller Report at Exhibit 11; Ms. Sanderson Report at Figure 50). The Tribunal agrees with Ms. Sanderson that these diversion ratios to rival Elevators other than Moosomin, Virden, or Fairlight are not insignificant, with several other Elevators and Crushers having diversion ratios for canola that are similar or higher than those calculated between the Moosomin and Virden Elevators (Ms. Sanderson Report at Figure 47). For wheat, diversion ratios from one of the Moosomin or Virden Elevators exceed 10% to the Fairlight (Viterra), Whitewood (Richardson), Souris East (Viterra), and Oakner (Cargill) Elevators (Ms. Sanderson Report at Figure 48).

586 Distance (and hence trucking costs) between individual farms and Elevators was included in Dr. Miller's farm choice model, which found that the Virden and Moosomin Elevators would lose a significant portion of their wheat or canola sales to rival Elevators other than Moosomin, Virden, and Fairlight.

587 According to Ms. Sanderson, the relatively small price variations predicted by Dr. Miller's merger simulation model reflect the relatively low diversion ratios between the Moosomin and Virden Elevators, compared to the diversion ratios to rival Elevators and Crushers (Ms. Sanderson Slides at p 5). P&H submits that the diversion ratios support a finding that P&H also faces competition from several rival Elevators and Crushers.

588 The evidence from the farmer witnesses also suggests that farmers have numerous alternatives to which they sell their grain, and to which they could sell more, should P&H attempt to reduce its purchase prices for wheat or canola (Ms. Sanderson Report at paras 12-13). Any farm located within the draw areas of the Moosomin and Virden Elevators has at least six other Elevators or Crushers available to it, should it not want to sell its grain to P&H, if the price offered price at those other locations was attractive. According to P&H, the evidence establishes that all farmers in the Commissioner's relevant geographic

market and in the Commissioner's corridor of concern within that geographic market, including each of the farmer witnesses, consistently sell to numerous Elevators and Crushers beyond the Virden, Moosomin, and Fairlight Elevators. P&H also argued that the evidence also establishes that the farmers could easily switch to other Elevators and Crushers without negative financial impact on them in the event that P&H were to attempt to pay them less for their wheat or canola (P&H Read-In at pp 26-27, 52-54, 61-67, 77, 551, 553 — 556, 558).

589 The three farmer witnesses called by the Commissioner (*i.e.*, Mr. Lincoln, Mr. Wagstaff, and Mr. Pethick) have sold their grain to Elevators located farther away when offered an acceptable price from more distant Elevators. Farmer witnesses further confirmed in their testimony that while transportation costs are important to farmers in deciding between competing Elevators and/or Crushers, they do not preclude sales of grain to competing alternatives available to farmers at a greater distance. This is so because rival Elevators and Crushers offer posted Cash Prices that are high enough to cover farmers' hauling costs and make it worthwhile for them to sell to those Elevators and Crushers (Exhibit P-R-14, Witness Statement of Mr. Edward Paull, at para 25; Exhibit P-R-077, Witness Statement of Mr. Kristjan Hebert, at para 26; Exhibit P-R-095, Witness Statement of Mr. Timothy Duncan, at para 21).

590 In light of the foregoing, the Tribunal agrees that there are some effective remaining competitors able to constrain P&H's attempt to increase its market power further by the Virden Acquisition. The more difficult question is to identify how many there is and who they are. The Tribunal is not persuaded that all rival Elevators and Crushers singled out by P&H remain, and are likely to remain, effective competitors post-Acquisition. All competitors are not equal, even if they purchase some grain from the farms located in Dr. Miller's Farmer Region.

591 In the Tribunal's view, the effective remaining competitors certainly include those Elevators and Crushers forming part of the relevant geographic markets accepted by the Tribunal. For wheat, these competitors are the following Elevators (and grain companies): Fairlight (Viterra), Oakner (Cargill), Whitewood (Richardson), Elva (Cargill), and Shoal Lake (Richardson). For canola, this effective remaining competition includes several Elevators — namely, Fairlight (Viterra), Oakner (Cargill), Whitewood (Richardson), Brandon (Richardson), Melville (G3), Souris East (Viterra), Shoal Lake (Richardson), and Elva (Cargill) — as well as four Crushers — namely, Harrowby (Bunge), Yorkton (LDC), Velva (ADM), and Yorkton (Richardson). The Tribunal observes that these competing Elevators and Crushers are all operated by major grain companies that purchase wheat and canola in competition with P&H throughout Western Canada, including Viterra and Richardson, the two largest. They also include most of the Elevators and Crushers having the higher diversion ratios discussed above, as well as all the rivals which buy more canola than the Virden or Moosomin Elevators and four out of the six Elevators having at least a 5% share of total purchases of wheat.

592 One notable exception is the Viterra Elevator in Souris East, which is not part of the relevant geographic market for wheat despite its high diversion ratio from the Virden Elevator (*i.e.*, 12.9%) and its 5.3% share of total wheat purchases. The Tribunal is of the view that, in light of this evidence, this rival Elevator can be considered as an effective remaining competitor in wheat even though it is not part of the relevant geographic market.

593 With respect to other competing Elevators and Crushers located outside the relevant geographic markets identified in these Reasons, the Tribunal accepts that, from time to time, they are purchasing grain from farms located in Dr. Miller's Farmer Region. However, the Tribunal does not find that, on a balance of probabilities, they can be qualified as "effective" remaining competitors able to constrain P&H post-Acquisition.

594 In sum, the Tribunal agrees with P&H that there is and will be several remaining effective competitors in the relevant markets for the purchase of wheat and canola. On a balance of probabilities, there are competitors remaining that are able to discipline P&H's attempts to exercise market power.

(f) Fairlight Elevator

595 The Commissioner claims that, while the Fairlight Elevator will remain as an effective competitor, it is not sufficient to constrain the exercise of market power by P&H post-Acquisition.

596 According to the Commissioner, the simple way to demonstrate this is through Dr. Miller's quantitative evidence. There is also qualitative evidence to support this quantitative evidence: the Virden and Moosomin Elevators are both on the Trans-Canada Highway, while the Fairlight Elevator is located approximately 35 kilometers away down a secondary road. This secondary road is subject to weight restrictions in the spring. Mr. Wagstaff testified that, contrary to the Trans-Canada Highway where one can drive at an average speed, going up highway 41 or down road no. 8 to get to the Fairlight Elevator is more difficult, as the road conditions are worse, and it takes longer to haul the grain.

597 The Tribunal accepts that, in and of itself, the presence of the Fairlight Elevator may not be enough to constrain the exercise of increased market power by P&H post-Acquisition. However, the Tribunal nonetheless observes that the Fairlight Elevator is a very important competitive constraint that will remain after the merger given its market shares and the evidence of diversion ratios. In the geographic market for wheat, the Fairlight Elevator would have the highest market share after the Moosomin-Virden combination. In the geographic market for canola, it would have the second highest market share after the Crusher in Harrowby and Moosomin-Virden. Moreover, the Fairlight Elevator's diversion ratios (at 20.3% and 36.3%) are respectively higher than the Moosomin Elevator (16.8%) and Virden Elevator (23.8%) for diversion of wheat from the Virden Elevator and the Moosomin Elevator. It is also true for canola: the Fairlight Elevator's diversion ratios (at 17.2% and 22.2%) are respectively higher than those of the Moosomin Elevator (5.3%) and the Virden Elevator (13.1%) for diversion of wheat from the Virden Elevator and the Moosomin Elevator.

598 For those reasons, the Tribunal is of the view that the Fairlight Elevator is a significant competitor that, on the evidence, cannot be qualified as being less effective than other remaining Elevators and Crushers.

(g) Moosomin expansion

599 The Commissioner contends that P&H's decision not to expand the Moosomin Elevator's rail capacity is another reflection of the anti-competitive effects caused by the Virden Acquisition. Prior to the Acquisition, P&H had planned to expand railcar access at the Moosomin Elevator, allowing it to load up 112 railcars at once, instead of its current limit of 56. This expansion would have allowed the Moosomin Elevator to access lower bulk rates on its freight, and to be more competitive.

600 Considering the evidence provided by Mr. Heimbecker on the reasons for the delayed expansion at the Moosomin Elevator, the Tribunal is not persuaded by the Commissioner's arguments. In sum, there is no clear and convincing evidence supporting the Commissioner's assertion that the delay in expansion is or could likely be the result of the Virden Acquisition.

601 The evidence before the Tribunal shows that in July 2019, P&H made the decision not to expand rail capacity at the Moosomin Elevator as initially planned before LDC solicited P&H to buy its 10 Elevators, including the Virden Elevator. Mr. Heimbecker further testified that later in 2019, P&H decided to postpone all capital expenditures, including the Moosomin Elevator expansion, for a period of one year, as a matter of prudent financial management, in light of the fact that P&H would be spending more than [text omitted] to purchase the LDC Elevators (Heimbecker Statement at para 138, Exhibit 34). Mr. Heimbecker further confirmed in his testimony that, subject to the outcome of this Application (as a result of which P&H could potentially be ordered to divest the Moosomin Elevator), the P&H Board is expected to approve the 112-car spot expansion at the Moosomin Elevator.

602 The Tribunal accepts Mr. Heimbecker's evidence on that point, which has not been contradicted. The Tribunal does not dispute that if the Moosomin Elevator's rail capacity had been expanded, the Moosomin Elevator would have been a more vigorous competitor. But the evidence before the Tribunal does not allow it to conclude that the delayed Moosomin expansion can be attributed to the Virden Acquisition.

603 This is therefore not a factor supporting the Commissioner's claim of a substantial lessening of competition caused by the Virden Acquisition.

(h) Barriers to entry and expansion

604 In assessing whether competition is or is likely to be substantially lessened by a merger, an important factor to consider is whether entry or expansion into the relevant market likely is or likely would be substantially faster, more frequent, or more significant "but for" the merger (*TREB CT* at para 505). This factor is specifically mentioned at paragraph 93(d) of the Act. As previously noted by the Tribunal, "[t]he conditions of entry into a relevant market can be a decisive factor in the Tribunal's assessment of whether a merger is likely to prevent or lessen competition substantially" (*Tervita CT* at para 216).

605 In assessing whether new entry into, or expansion within, a relevant market can be relied upon to conclude that a substantial lessening of competition is likely to occur, the Tribunal will consider whether such entry or expansion will be timely, likely, and sufficient (*Tervita CT* at para 217). For a new entry to be timely, the assessment is not limited to the actual construction time. The period starts when firms begin considering sites and go through the regulatory approval process.

606 According to the Commissioner, entry or expansion by competitors into the relevant markets is unlikely to occur in a timely and sufficient way because barriers to entry and expansion are high in the grain industry. They include capital costs of CAD $40-50 million to construct an Elevator, as well as having to find a location where there is sufficient demand and a suitable site permitting adequate rail and road access. A potential entrant would further take more than two years to build an Elevator, says the Commissioner.

607 P&H responds that, in terms of entry, there is evidence that at least 20 new high throughput Elevators have been built in Western Canada since 2015, including 10 Elevators by G3, two Elevators by P&H, one by Ceres, and four by GrainsConnect. P&H adds that G3 also has three additional Elevators currently under construction.

608 For the reasons detailed below, the Tribunal finds that the Commissioner has provided credible and persuasive evidence confirming that barriers to entry and expansion are high. This evidence came from G3 and from P&H itself.

609 Mr. Malkoske of G3 testified that, based on his experience with G3's Vermillion site, the total costs to build a new Elevator are approximately [text omitted] (Exhibits P-A-047 and CB-A-048, Witness Statement of Mr. Brett Malkoske, at para 8). He also stated that it typically takes between [text omitted] months from deciding to construct an Elevator to commencing operations.

610 The evidence of G3 was corroborated by P&H's own evidence.

611 When building a new Elevator in Dugald, Manitoba, P&H considered sites in June 2018 and, going through the permit process, regulatory approvals, and construction, it expected the Elevator to be completed in [text omitted], approximately [text omitted] months after its initial consideration. P&H further estimated the cost of building a new Elevator to be in the range of [text omitted] to [text omitted].

612 The Tribunal notes P&H's evidence on its experience that a motivated competitor wishing to construct greenfield Elevators could build a new Elevator in the Virden/Moosomin area in approximately 18 months. However, the Tribunal is not convinced by the general statement of Mr. Heimbecker on this point, in light of the other specific evidence on the record, referring to actual experiences by both G3 and P&H itself in building new Elevators over a much longer timeframe.

613 As a result, the Tribunal is satisfied that there is clear and convincing evidence to support the conclusion that entry or expansion is not likely to occur on a sufficient scale or scope within the next two years and that new entrants are not sufficient to have a material impact on the price and non-price dimensions of competition in the purchase of wheat and canola. Having regard to the foregoing evidence, the Tribunal finds that there are significant barriers to entry into the purchase of wheat and canola. Entry and expansion within the relevant markets is not likely to be sufficient to ensure that the Virden Acquisition does not and will not likely lessen competition substantially, and to prevent P&H from imposing and sustaining decreased prices for its purchase of wheat and canola.

(i) Excess capacity

614 At the Elevator level, the general issue of entry and expansion entails considering the potential of adding capacity through new entry, the possibility of expanding existing capacity, and the existence of excess capacity that already lies dormant in the industry.

615 In his submissions, the Commissioner addresses the first two elements — namely, entry and expansion — but not the last one, excess capacity.

616 P&H claims that the presence of significant excess capacity is and will remain a constraining factor on P&H after the Virden Acquisition. In paragraphs 141 to 147 and 152 of his witness statement, Mr. Heimbecker discussed the maximum observed throughput and actual throughput at P&H and other Elevators in the grain industry. Using publicly available CGC data (Heimbecker Statement at Exhibit 35), Mr. Heimbecker prepared a table setting out the average amount of grain purchased and shipped annually by each of P&H's rival Elevators over a five-year period between the 2014-2015 and 2018-2019 crop years. The table also provided information on each of the Elevators' maximum annual throughput in that five-year period and their average and best turn rates (Heimbecker Statement at paras 143-145).

617 Summing their individual maximum annual throughputs, Mr. Heimbecker testified that the aggregate maximum "capacity" of competing Elevators (*i.e.*, Elevators other than Moosomin and Virden) is at least 4,562,400 MT. In comparison, the five-year average of total throughput of these Elevators was 3,570,700 MT (Heimbecker Statement at para 146). A comparison of these two figures led Mr. Heimbecker to conclude that these rival Elevators are capable of handling at least 991,700 MT more than their average throughput over the five-year period. In his witness statement, Mr. Heimbecker also addressed the rail shipping capacity, at paragraphs 148 to 151, and concluded that the unused car spot capacity added up to 4,765,200 MT.

618 In a preliminary motion objecting to some paragraphs of the Heimbecker Statement, the Commissioner submitted that Mr. Heimbecker cannot opine as to what rival Elevators can do and took exception with Mr. Heimbecker's statements that rival Elevators "could easily increase their purchases of wheat and canola from farms in the Virden/Moosomin area" or "add significant grain purchasing capacity," made at paragraphs 141 and 152 of the Heimbecker Statement.

619 In a decision issued in December 2020, the Tribunal agreed with P&H that those paragraphs on average throughput and capacity generally described Mr. Heimbecker's observations and perceptions from data published by the CGC showing the volume of grain that P&H and rival Elevators purchased and shipped (i.e., their effective and maximum throughput) in the five-year period between the 2014-2015 and 2018-2019 crop years (*Parrish & Heimbecker* at paras 25-30). The Tribunal was satisfied that the statements on the actual measures of capacity and throughput generally reflected Mr. Heimbecker's own observation of data and amounted to simple arithmetical calculations required to establish averages, totals, and differences regarding maximum throughput at Elevators within a five year span. Given his long experience in the grain industry, the Tribunal noted that Mr. Heimbecker was well positioned to assist the Tribunal in this regard. However, the Tribunal held that Mr. Heimbecker was not qualified to form conclusions as to what the rival Elevators would do with their alleged excess capacity. Extrapolating from the throughput data to what rival Elevators could do in their businesses and to their future conduct in terms of purchases of wheat and canola are inferences or conclusions that could be done by experts or argued by counsel, and which will ultimately be for the Tribunal to determine. The Tribunal therefore struck certain passages of the Heimbecker Statement as inadmissible lay opinion evidence.

620 Mr. Heimbecker's evidence on throughput and excess capacity calculations was not contradicted. The Tribunal, however, observes that no evidence has been provided regarding what other Elevators not owned by P&H could or would do with their excess throughput capacity or railcar capacity, and how it could or would translate in terms of their purchases of wheat and canola.

621 In their testimonies, Mr. McQueen from Viterra and Mr. Wildeman from Ceres confirmed the nature of the data and information reported to the CGC regarding Elevators' throughput, which was used by Mr. Heimbecker for his calculations.

622 The Commissioner did not adduce (or obtain) any evidence as to excess capacity nor did he challenge the evidence put forward by P&H in this regard.

623 The Tribunal is not satisfied that the arithmetic calculation presented by Mr. Heimbecker can qualify as a true measurement of excess capacity. Mr. Heimbecker's calculations provide no reference to grain volumes produced during each crop year corresponding to the grain purchased and shipped for that year, as well as to the grain companies' ability to ship and sell those volumes. Nor do they provide a clear understanding of the supply chain capacity and fluidity impacting Elevators' throughput with respect to ships availability, and the capacities of export terminals, Elevators, ports, and rail networks.

624 In previous decisions, the Tribunal has considered excess capacity in its substantial lessening of competition analysis and when considering market power at the market definition stage (see, for example, Hillsdown, at pp 318-321). In *Hillsdown*, the Tribunal noted that if rival firms in a market have excess capacity, they "can respond to a supra-competitive price rise by flooding the market at a lower price level" (Hillsdownat p 318). As a result, "the best question to ask when assessing market power, in some circumstances, is whether the respondents' [merging parties'] current competitors have capacity available to service what otherwise would be the merged firm's customers" (Hillsdownat p 318).

625 The Tribunal in *Hillsdown* considered evidence about the excess capacity of several specific rivals and the merged firm's own excess capacity. At page 320, the Tribunal concluded that in the industry, it was fairly easy for renderers to increase their capacity or, in the case of multi-plant firms, to shift renderable material among different plants to open up capacity at a given plant when it was needed. The Tribunal also found that there appeared to be significant excess capacity in the industry generally, and that the merged firm was not capacity-constrained. The excess capacity of firms both inside and outside the relevant market would provide a degree of competitive pressure on the merged firm and restrain to a considerable degree its ability to raise prices (Hillsdownat p 321).

626 In the present case, the Tribunal accepts that, at an industry level, the Elevators are likely able to move more grain as suggested by Mr. Heimbecker's evidence and to transport it by rail to ports. However, the Tribunal cannot place much weight on this general finding in its substantial lessening of competition assessment. An assessment of excess capacity in the grain industry would have had to consider many additional factors and evidence that is not before the Tribunal. For instance, in the Tribunal's view, there is insufficient evidence about the excess capacity of specific rival Elevators close to the Moosomin and Virden Elevators — namely, how the owners of those rival Elevators could adjust their local grain inventories and rail capacities at different points in the crop year to respond to lower grain purchase prices offered to farmers at those two P&H Elevators. In the absence of additional factual evidence (*e.g.*, from rival Elevator owners) or expert evidence about the industry that assessed capacity issues in more detail, the Tribunal can reach no firm conclusion on the impact of any excess throughput capacity on the intensity of rivalry after the Transaction, or on the ability of P&H to decrease prices for wheat and canola.

(j) Other factors

627 Paragraph 93(h) of the Act also allows the Tribunal to take any other relevant factor in consideration in its assessment of the substantial lessening of competition. The Tribunal is aware that, following the most recent amendments to the Act entered into force after the hearing of this Application, the Act specifically recognizes, at paragraph 93(g.3), that the Tribunal may have regard to any effect of a merger on "price and non-price competition, including quality, choice or consumer privacy."

628 In this case, the non-price effects alleged by the Commissioner are very limited. More specifically, there is no issue of change and innovation being affected by the Virden Acquisition (see paragraph 93(g)).

629 In his final submissions, the Commissioner argued that the evidence also supports the existence of non-price competition. He referred to evidence from Mr. Pethick stating that the ability of an Elevator to accept grain during harvest is important to him (Pethick Statement at para 13). He also mentioned that the ability of an Elevator to quickly and efficiently receive grain, and its capacity to do so, is an aspect of non-price competition that the Tribunal should consider. The Commissioner however added that, while these aspects of competition are not necessarily reflected in the Elevator's posted price, they "ultimately all are reflected in the price paid to the farmers by the Elevator" (Commissioner's Closing Submissions at para 44).

630 The non-price effects alleged by the Commissioner thus appear to be reflected in the transaction data and in the Cash Prices ultimately charged to the farmers by P&H and other Elevators for their wheat and canola. They are part of the price effects on which the Commissioner has focused in his submissions and in the evidence he presented.

631 The Tribunal therefore determines that there is no clear and convincing evidence of separate non-price factors demonstrating, in and of themselves, a lessening of competition, let alone a substantial one.

(k) Magnitude, duration, and scope of the anti-competitive effects

632 Having regard to all of the foregoing, the Tribunal concludes that, "but for" the Virden Acquisition, there are and will likely be some fairly limited adverse effects on competition in the purchase of wheat in the relevant markets, and virtually no proven effects in the purchase of canola. More specifically, there is not, and would likely not be, any new entry or expansion; there is, or likely would be, some very minor price decreases in the amount paid to farmers for their wheat; the Acquisition removes a close competitor to P&H's Moosomin Elevator, as the Virden Elevator provided vigorous and effective competition; and there is also evidence of some pre-existing market power held by P&H. However, those anti-competitive effects are far less than what the Commissioner alleged.

633 The Tribunal finds that the price effects, whether they are measured in relative or absolute terms, are minimal and immaterial in the circumstances, for both wheat and canola. Moreover, there will be several remaining effective rival Elevators and Crushers to compete with the Virden and Moosomin Elevators, and this situation is unlikely to change for the foreseeable future. In addition, the post-merger market shares of P&H would be far below the safe harbour threshold in the 2011 MEGs for purchases of canola; for wheat, the market shares are more likely than not to be slightly lower than the 35% safe harbour. Finally, the postponement of the Moosomin expansion cannot be attributed to the Virden Acquisition, and there appears to be some varying capacity at rival Elevators though the evidence does not allow the Tribunal to assess its constraining impact on P&H.

634 The Tribunal must now determine whether the limited anti-competitive effects attributable to the Virden Acquisition and identified above, taken together, rise to the level of substantiality required by section 92. Further to its assessment of all the evidence before it, and notably the immaterial price effects resulting from the Virden Acquisition, the Tribunal finds that this is not the case. In particular, the Tribunal puts significant weight on the evidence showing an absence of any material price effects resulting from the Virden Acquisition, in the purchase of both wheat and canola, and the continuing presence of several effective remaining competitors in the markets. In brief, the aggregate impact of the limited anti-competitive effects that have been demonstrated to result from the Virden Acquisition does not constitute an actual or likely substantial lessening of competition in the relevant markets.

635 Stated differently, the Tribunal is not persuaded that the evidence regarding the absence of likelihood of additional entry and expansion, the minimal predicted price variations, and the loss of the Virden Elevator as a competitor are sufficient, cumulatively, to enable the Commissioner to discharge his burden under section 92, even in a context where P&H has some pre-existing market power. Without a link between, on the one hand, such evidence and, on the other hand, some material impact on the price or non-price dimensions of competition in a material part of the relevant markets (*Tervita FCA* at para 108), the Commissioner's evidence falls short of the mark. In this regard, when measured against factors such as the immaterial price variations, the effective competitors remaining, and the post-merger market shares below the 35% safe harbour threshold, the Tribunal agrees with P&H that the Commissioner's evidence does not provide clear and compelling evidence that there is, or would likely be, materially lower price or non-price competition "but for" the Acquisition.

636 Regarding scope, the Tribunal typically considers whether the merged entity would likely have the ability to impose the anti-competitive effects in a material part of the relevant market, or in respect of a material volume of sales. The evidence relied on by the Commissioner does not establish that it does.

637 The Tribunal looked more specifically at the evidence regarding farmers located in the corridor of concern, arguably the most affected by the Virden Acquisition as a vast majority of them sell their wheat and canola exclusively to the Virden, Moosomin, and Fairlight Elevators. However, as mentioned above, there was an absence of quantitative and qualitative evidence

regarding the predicted price changes in that specific part of the relevant geographic markets for the purchase of wheat and canola. Similarly, the Commissioner has not presented compelling evidence regarding the particular effects that the removal of the Virden Elevator as a vigorous and effective competitor would have in the corridor of concern. There is therefore insufficient quantitative and qualitative evidence to allow the Tribunal to determine the degree to which the price and non-price effects resulting from the Virden Acquisition would be different for the farmers located in the corridor of concern.

(4) Conclusion on substantial lessening of competition

638 In light of all of the foregoing, the Tribunal is not satisfied that the anti-competitive effects that could be attributable to the Virden Acquisition are, individually or in the aggregate, "substantial" as required by section 92 of the Act. The evidence does not allow the Tribunal to conclude that the Virden Acquisition has adversely affected or is adversely affecting price or non-price competition in the relevant markets, to a degree that is material, or that it is likely to do so in the future. True, the Virden Acquisition allows and is likely to allow P&H to increase its market power in the purchase of wheat; but the evidence does not support a finding that, on a balance of probabilities, it allows P&H to be able to exercise materially greater market power than in the absence of the merger. The Tribunal therefore concludes that the Commissioner has not demonstrated, on a balance of probabilities and with clear and convincing evidence, that the requirements of section 92 are met and that "but for" the Virden Acquisition, purchase prices paid by P&H for wheat and canola are or would likely be materially lower in the relevant markets, or that there are or would likely be materially greater non-price competition in those markets.

D. If the Commissioner has established that the Virden Acquisition lessens, or is likely to lessen, competition substantially, what is the remedy to be ordered?

639 Given the Tribunal's conclusion that the Virden Acquisition does not lessen, and is not likely to lessen, competition substantially in any relevant market, there is no remedy to be ordered.

E. Has P&H established, on a balance of probabilities, that the gains in efficiency will be greater than, and will likely offset, the effects of any lessening of competition pursuant to section 96 of the Act?

640 In light of the Tribunal's findings on the substantial lessening of competition, and since there will be no remedial order under section 92 of the Act, the Tribunal does not need to determine the issue of efficiencies claimed by P&H under section 96. However, considering the extensive submissions made by the parties on the issue of efficiencies and the nature of the issues raised, the Tribunal will address the matter.

(1) Analytical framework

641 The section 96 efficiencies defence is an exception to the application of section 92. It "prohibits the Tribunal from making an order precluding a merger when it finds that the merger is likely to bring about gains in efficiency that would be greater than and would offset the anti-competitive effects of the merger" (*Tervita SCC* at para 17).

(a) The statutory language

642 In the current case, P&H relies on both the general language of section 96 and the more specific provisions of subsection 96(2) to support its efficiency claims. Each will be discussed in turn.

(i) Section 96

643 Section 96 of the Act is reproduced in Schedule "A" to these Reasons. Subsection 96(1) provides in relevant part that the Tribunal shall not make an order under section 92 if it finds that the merger in respect of which the application is made has "brought about or is likely to bring about gains in efficiency that will be greater than, and will offset, the effects of any [...] lessening of competition that will result or is likely to result from the merger [...] and that the gains in efficiency would not likely be attained if the order were made." Subsection 96(3) further instructs the Tribunal not to find that a merger or proposed merger has brought about or is likely to bring about gains in efficiency "by reason only of a redistribution of income between two or more persons."

644 The analysis mandated by subsection 96(1) has three components: 1) an assessment of the anti-competitive effects of any lessening or prevention of competition resulting or likely to result from the merger; 2) an assessment of the gains in efficiency brought about or likely to be brought about by the merger, and that would not likely be attained if the contemplated remedial order is made by the Tribunal; and 3) a trade-off analysis (or balancing test) to determine whether the assessed gains in efficiency will be greater than, and will offset, the assessed anti-competitive effects. The analyses of anti-competitive effects and efficiencies analyses are both forward-looking estimations and are therefore associated with varying degrees of uncertainty.

645 In *Tervita SCC* and *Tervita CT*, the SCC and the Tribunal provided important guidance on the three elements of section 96.

• *Anti-competitive effects*

646 For the purpose of the efficiencies defence and section 96, the anti-competitive effects include all effects of "any" lessening of competition, as long they result or are likely to result from the merger in respect of which the application is made.

647 Anti-competitive effects include the likelihood of price increases, but they are not confined to such resource allocation effects, as the exercise of market power can manifest itself in ways other than an increase in price. Under both sections 92 and 96 of the Act, the anti-competitive effects encompass all relevant price and non-price effects that are likely to arise from a merger, including the following: negative effects on allocative, productive, and dynamic efficiency; redistributive effects; and effects on service, quality, and product choice (2011 MEGs at paras 12.21-12.22).

648 The main anti-competitive effect considered under section 96 is the DWL associated with a likely increase in price. The DWL represents the loss of allocative efficiency and reflects the reduction in total consumer and producer surplus within Canada resulting from a merger. As the SCC stated in *Tervita SCC*, the "total surplus standard involves quantifying the DWL which will result from a merger — 'the amount by which total surplus is reduced under certain market conditions that reduce the quantity of a good that is supplied' (*Facey and Brown* at pp 256-57)" (*Tervita SCC* at para 94). The DWL "results from the fall in demand for the merged entities' products following a post-merger increase in price, and the inefficient allocation of resources that occurs when, as prices rise, consumers purchase a less suitable substitute" (Canada (Commissioner of Competition) v Superior Propane Inc, 2003 FCA 53 (" at para 13). Estimates of the elasticity of demand (*i.e.*, the degree to which demand for a product varies with its price) are necessary to calculate the DWL (*Tervita CT* at para 244). Put differently, a price increase or decrease is not enough to determine the extent of the DWL, if there is no evidence on the price elasticity of demand (*Tervita SCC* at paras 132-133; *Tervita FCA* at para 124).

649 The focus of this DWL approach is on the magnitude of the total surplus. The degree to which total surplus is allocated between producers and consumers is not considered. In other words, the total surplus standard measures the total benefit flowing to the economy and is not concerned with whom the benefits flow to (*Tervita SCC* at para 95; *Superior Propane IV* at para 16).

650 A lessening or prevention of competition resulting from a merger can also lead to non-price effects in the form of a reduction in service, quality, product choice, incentives to innovate, or other dimensions of competition that customers value. While some indicators of quality may be translatable into dollar terms by making use of available statistical or survey data, others may not be expressible in that way. As such, it is not always possible to translate anti-competitive effects related to non-price factors into consumer or producer welfare terms, as can be more easily done with price effects.

651 Anti-competitive effects covered by both sections 92 and 96 are therefore not strictly limited to reductions in price and to the quantified or quantifiable DWL. They may also include unquantifiable non-price effects such as: reduction in service, quality, and product choice; loss of productive efficiency; and loss of dynamic efficiency (2011 MEGs at paras 12.29-12.31). If a non-price anti-competitive effect is not reasonably measurable, it may be assessed using qualitative evidence. The SCC recognized it in *Tervita SCC*, when it noted that "qualitative elements of a merger, including in some cases such things as better or worse service or lower or higher quality, may not be measurable as they are dependent on individual preferences in the market" (*Tervita SCC* at para 100, citing *Superior Propane I* at paras 459-460).

652 This qualitative assessment of anti-competitive effects may only be resorted to where such effects are not quantifiable: "[q]ualitative anti-competitive effects, including lessening of service or quality reduction, are only assessed on a subjective basis because this analysis involves a weighing of considerations that cannot be quantified because they have no common unit of measure (that is, they are "incommensurable")" (*Tervita SCC* at para 125). However, quantifiable effects which the Commissioner failed to quantify cannot be resurrected as qualitative effects (*Tervita SCC* at para 100). Anti-competitive effects should be quantified wherever reasonably possible, and the weight given to unquantifiable qualitative effects must be reasonable (*Tervita FCA* at para 148).

653 In some circumstances, the anti-competitive effects to be assessed under section 96 may further include redistributive effects, namely, wealth transfers from buyers to sellers which amount to a social loss. These are commonly referred to as a "socially adverse wealth transfer."

654 It may happen that the Tribunal finds a substantial lessening of competition under section 92, but no anti-competitive effects under section 96, as was the case in the *Tervita* matter, a situation characterized by Justice Rothstein as a "paradoxical" result (*Tervita SCC* at para 166). Depending on the evidence available, the statutory scheme under sections 92 and 96 does not bar a finding of likely substantial lessening or prevention of competition where there has been a failure to quantify the DWL. But the test under section 96 does require that quantifiable anti-competitive effects be quantified in order to be considered under the efficiencies defence. In *Tervita SCC*, the SCC determined that the failure to quantify the DWL barred consideration, under section 96, of the quantifiable effects that supported a finding of likely substantial prevention of competition under section 92.

• *Cognizable efficiencies*

655 With respect to efficiencies, section 96 provides that, to be recognized and be qualified as "cognizable," efficiencies must meet three different requirements. First, the gains in efficiency must be brought, or be likely to be brought, by "the merger or proposed merger in respect of which the application is made" (subsection 96(1)). Second, the gains in efficiency would not likely be attained if the order contemplated by the Tribunal to remedy the substantial lessening or prevention of competition were made. Third, the gains in efficiency must not result "by reason only of a redistribution of income between two or more persons" (subsection 96(3)).

656 As is the case for anti-competitive effects, cognizable efficiencies include both efficiencies that can reasonably be quantified as well as those that cannot reasonably be quantified and are therefore qualitative. Since it must be "likely" that the claimed gains in efficiency are achieved because of the merger, there must be evidence of the claimed savings and of the implementation process leading to the materialization of the claimed efficiencies (*Superior Propane I* at paras 347 - 348). As stated in the 2011 MEGs, "the parties must be able to validate efficiency claims to allow the Bureau to ascertain the nature, magnitude, likelihood and timeliness of the asserted gains, and to credit (or not) the basis on which the claims are being made" (2011 MEGs at para 12.3).

657 In *Tervita CT*, the Tribunal adopted five screens to standardize the methodology used to eliminate efficiencies that are not cognizable under subsections 96(1) and 96(3) (*Tervita CT* at paras 261-264). Those screens may be summarized as follows:

1. The claimed gains in efficiency must involve a type of productive or dynamic efficiency or be likely to result in an increase in allocative efficiency (*Tervita SCC* at para 102; *Tervita CT* at para 262).

2. The claimed gains in efficiency must *likely* be brought about by the merger (*Tervita SCC* at para 113; *Tervita CT* at para 262).

3. The claimed gains in efficiency must not be brought about by reason only of a redistribution of income, or amount to a simple wealth transfer between organizations in Canada. This screen serves to discard savings that result solely from a reduction in output, service, quality or product choice, reductions in taxes, and savings from increased bargaining leverage (*Tervita CT* at para 262).

4. The claimed gains in efficiency must not be achieved outside Canada and must instead flow back to Canadian shareholders. Under this fourth screen, savings from operations in Canada that would flow through to foreign shareholders are eliminated (*Tervita CT* at para 262).

5. The claimed gains in efficiency must not (a) be attainable through alternative means even if the Tribunal were to make an order to eliminate the substantial prevention or lessening of competition, or (b) be achievable through the merger even if the remedial order were made (*Tervita CT* at para 264). In sum, the gains in efficiency are evaluated in light of the order contemplated by the Tribunal (*Commissioner of Competition v* Superior Propane Inc, 2002 Comp Trib 16 (" at para 149), and gains that would have occurred irrespective of the merger are not cognizable (*Hillsdown* at p 83).

658 Implicit in these five screens is that, in order to be cognizable under section 96, the claimed gains in efficiency must accrue to the benefit of society — that is, to the Canadian economy (*Tervita SCC* at para 102; *Tervita CT* at para 262; *Superior Propane III* at para 196; *Superior Propane I* at paras 412-413, 429-430).

• *Trade-off analysis or balancing test*

659 Turning to the trade-off analysis, the SCC held that the requirement in section 96 according to which the efficiency gains must be "greater than" and "offset" the anti-competitive effects imports a weighing and balancing of both quantitative and qualitative aspects of the merger. The term "greater than" suggests a numerical comparison of the magnitude of the efficiencies versus the extent of the anti-competitive effects. The term "offset" implies a more subjective analysis related to qualitative considerations — i.e., things that cannot be quantitatively compared because they have no common measure (*Tervita SCC* at paras 144-145; *Superior Propane II* at para 95).

660 In *Tervita SCC*, the SCC also directed the Tribunal to use an analysis that is as objective as possible. As such, the SCC held that in most cases, the qualitative effects of a merger will be of "lesser importance." In addition, the SCC stated that "the statutory requirement that efficiencies be greater than *and* offset the anti-competitive effects would in most cases require a showing that the quantitative efficiencies exceed the quantitative anti-competitive effects as a necessary element of the defence" [emphasis in original] (*Tervita SCC* at para 146).

661 *Tervita SCC* adopted a two-step inquiry for the balancing test in subsection 96(1). First, the quantitative efficiencies of the merger at issue are compared against the quantitative anti-competitive effects to determine whether the quantitative efficiencies are "greater than" the quantitative anti-competitive effects. If the quantitative anti-competitive effects outweigh the quantitative efficiencies, this step will be dispositive in most cases, and the section 96 defence will not apply. Second, the qualitative efficiencies are balanced against the qualitative anti-competitive effects. The Tribunal then makes a final determination as to whether the total efficiencies "offset" the total anti-competitive effects of the merger at issue (*Tervita SCC* at para 147).

662 The SCC further held that the Tribunal should consider "all available quantitative and qualitative evidence" (*Tervita SCC* at para 100, citing *Superior Propane I* at para 461; *Superior Propane III* at para 335). For the Tribunal to give weight to qualitative elements in its analysis, they must be supported by the evidence, and the reasoning for the reliance on the qualitative aspects must be clearly articulated (*Tervita SCC* at para 147).

(ii) Interpretation of subsection 96(2)

663 In this matter, P&H also made specific submissions on the interpretation of subsection 96(2) and relied heavily on this provision in its consideration of the efficiency gains allegedly brought about by the Transaction. This subsection provides in part that in considering whether a merger or proposed merger is likely to bring about gains in efficiency described in subsection 96(1), the Tribunal shall consider whether such gains will result in "(*a*) a significant increase in the real value of exports."

664 P&H argued that the purpose and effect of the Transaction were to increase export sales by P&H and that increased throughput at export terminals was the "uncontroverted objective" of the Transaction. P&H further submitted that increased

throughput at an export facility is a "more efficient utilization of an asset in the purest sense," and that the Transaction as a whole clearly leads to a significant increase in the real value of exports of grain under subsection 96(2).

665 P&H maintained that there were three possible interpretations of subsection 96(2):

- The consideration of efficiencies related to exports is subsumed under the subsection 96(1) analysis, so that all of the tests applied under subsection 96(1) would be applied to exports;

- The consideration of exports under subsection 96(2) is a separate consideration that is not confined to the efficiencies arising in the local or domestic markets. Any efficiencies arising either domestically or in an export market that lead to a significant increase in exports must be separately considered. In this interpretation, the efficiency gains that lead to significant increases in the real value of exports would not be subsumed in the subsection 96(1) analysis including the offset test and the counterfactual but-for test; and

- Subsection 96(2) only deals with efficiency gains that lead to increases in the real value of exports, and exports *per se* should be considered under the broader analysis under sections 92 and 93 of the Act.

666 P&H took the position that the second and third interpretations described above are the correct ones to follow.

667 P&H submitted that the interpretation of subsection 96(2) must accord with Parliamentary intent, as seen in comments made in 1986 by the Parliamentary Secretary to the Minister of Agriculture, the Honourable Pierre Blais, during the House of Commons debates on Bill C-91 (which enacted the Competition Tribunal Act, RSC 1985, c 19 (2nd Supp) ("CTA") and the Act). P&H argued that mergers should be assessed, in Mr. Blais' words, "in such a way as to encourage competition between Canadian businesses at home in Canada, without putting them at a disadvantage when carrying out business dealings in international markets." P&H also referred to the objectives in section 1.1 of the Act, including its references to the expansion of opportunities for Canadian participation in world markets and the promotion of the efficiency of the Canadian economy. In addition, P&H submitted (again citing Mr. Blais) that "when a merger would greatly improve efficiency, thereby increasing exports or substitutions to imports, the Tribunal will have to authorize it." P&H argued that this reflected a focus on efficiencies that lead to increased exports.

668 The Commissioner made no written submissions on subsection 96(2). The Commissioner noted in oral argument that P&H made no reference to any reliance on that provision in its Response filed on February 3, 2020. The Commissioner submitted that P&H had acquired the grain volume at the Virden Elevator which LDC would have exported. In other words, these grain volumes were headed to the port at Vancouver for export, regardless of the Transaction. Therefore, P&H had not demonstrated any substantial increase in the real value of exports under paragraph 96(2)(a). The Commissioner also submitted that P&H had not analyzed why keeping the Virden Elevator in its possession (*i.e.*, if the Tribunal makes no order) would lead to a substantial increase in the real value of exports.

669 This is the first time that the Tribunal has been directly asked to interpret or apply paragraph 96(2)(a) of the Act.

670 Under modern principles of statutory interpretation, the words of paragraph 96(2)(a) must be read in their entire context and in their grammatical and ordinary sense, harmoniously with the scheme and the object of the Act, and the intention of Parliament (Pioneer Corp v Godfrey, 2019 SCC 42 at para 42; Canada Trustco Mortgage Co v Canada, 2005 SCC 54 (" at para 10; *Bell ExpressVu* at para 26; Rizzo & Rizzo Shoes Ltd (Re), [1998] 1 SCR 27 at para 21; *VAA CT* at para 257; The Commissioner of Competition v HarperCollins Publishers LLC and HarperCollins Canada Limited, 2017 Comp Trib 10 at paras 101, 118; Rakuten Kobo Inc v The Commissioner of Competition,2016 Comp Trib 11 at para 108). In *Canada Trustco*, the SCC also held that if the words of a provision are precise and unequivocal, their ordinary meaning plays a dominant role in the interpretive process. If the words can support more than one reasonable meaning, the ordinary meaning of the words plays a lesser role. However, in all cases, the Tribunal must seek to read the provisions of the Act as a harmonious whole (*Canada Trustco* at para 10; 9354-9186 Québec inc v Callidus Capital Corp, 2020 SCC 10 at para 60).

671 When the legislation that would become the Act was introduced in December 1985, the accompanying guide made the following observations:

> The existing merger provision is considered to be unsuitable for the Canadian economy, which is small and open. Canadian firms often have to compete with larger foreign rivals both at home and abroad. In these circumstances, they should not be prevented from obtaining economies of scale which improve their competitive position. An effective merger law for Canada must weight [*sic*] the advantages of economic efficiency against the disadvantages of a lessening of competition.
>
> [...]
>
> The new merger law will also provide a defence in situations where the gains in efficiency that would result from the merger would more than offset the costs due to the lessening of competition. It is important for the performance of the economy that significant cost savings brought about by mergers, for example, through scale economies or other efficiencies, be allowed. Moreover, the Tribunal will be invited to consider whether the gains in efficiency resulted in increased exports or increased import substitution.
>
> Minister of Consumer and Corporate Affairs, *Competition Law Amendments: A Guide*, (1985) at pp 16-17.

672 In *Tervita SCC*, Justice Rothstein, speaking for a majority of the court, observed the following at paras 87 and 167:

> [87] A stand-alone statutory efficiencies defence was considered "particularly appropriate for Canada because a small domestic market often precludes more than a few firms from operating at efficient levels of production and because Canadian firms need to be able to exploit scale economies to remain competitive internationally" (Campbell, [citation below] at p. 152; see also *House of Commons Debates*, vol. VIII, 1st Sess., 33rd Parl., April 7, 1986, at p. 11962; Minister of Consumer and Corporate Affairs, *Competition Law Amendments: A Guide* (1985), at p. 4). <u>In the context of the relatively small Canadian economy, to which international trade is important, the efficiencies defence is Parliamentary recognition that, in some cases, consolidation is more beneficial than competition</u> (*ibid.*, at pp. 15-17).
>
> [...]
>
> [167] While the efficiencies defence applies in this case under the terms of s. 96 as written, this case does not appear to me to reflect the policy considerations that Parliament likely had in mind in creating an exception to the general ban on anti-competitive mergers. As discussed above at para. 84 [*sic*: 87] in the historical examination of s. 96, <u>the evidence suggests that the efficiencies defence was created in recognition of the size of Canada's domestic market and with an eye toward supporting operation at efficient levels of production and the realization of economies of scale, particularly with reference to international competition.</u> [...]
>
> [Emphasis added.]

673 In section 1.1 of the Act, Parliament set out the overall purpose of the statute: "to maintain and encourage competition in Canada." Section 1.1 contains four objectives or benefits of maintaining and encouraging competition in Canada (*Superior Propane I* at paras 407-408, 410), which are listed in the provision:

> **Purpose of Act**
>
> **1.1** The purpose of this Act is to maintain and encourage competition in Canada in order to promote the efficiency and adaptability of the Canadian economy, in order to expand opportunities for Canadian participation in world markets while at the same time recognizing the role of foreign competition in Canada, in order to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the Canadian economy and in order to provide consumers with competitive prices and product choices.
>
> **Objet**

> **1.1** La présente loi a pour objet de préserver et de favoriser la concurrence au Canada dans le but de stimuler l'adaptabilité et l'efficience de l'économie canadienne, d'améliorer les chances de participation canadienne aux marchés mondiaux tout en tenant simultanément compte du rôle de la concurrence étrangère au Canada, d'assurer à la petite et à la moyenne entreprise une chance honnête de participer à l'économie canadienne, de même que dans le but d'assurer aux consommateurs des prix compétitifs et un choix dans les produits.

674 The FCA has held that section 96 as a whole gives primacy to the statutory objective of economic efficiency, because it provides that if efficiency gains exceed and offset the effects of an anti-competitive merger, the merger must be permitted to proceed even though it would otherwise be prohibited by section 92 (*Superior Propane II* at para 90).

675 The commentary on the proper interpretation of the language in subsection 96(2) has not been extensive, despite its presence in the Act since 1986.

676 The Competition Bureau's 1991 MEGs stated that the words "described in subsection (1)":

> make it clear that section 96(2) does not operate to expand the class of efficiency gains that may be considered in the trade-off analysis. Accordingly, this provision is simply considered to draw attention to the fact that, in calculating the merged entity's total output for the purpose of arriving at the sum of unit and other savings brought about by the merger, the output that will likely displace imports, and any increased output that is sold abroad, must be taken into account.

677 The principal drafter of the 1991 MEGs, now a judicial member of the Tribunal, set out the same point in a 1991 article, adding that, "[a]pparently, there was never any intention on the part of the drafters of subsection 96(2) that this section has any significant role in the trade-off assessment" (*Crampton 1991* at pp 967-968).

678 A book by the same author further explained:

> If an increase in the real value of exports [...] cannot be shown to lead to one or more of the types of "gains in efficiency" [in subsection (1)], there is nothing that can be found in subsection 96(2) that will change this fact. In short, this provision simply requires the Tribunal to assess whether any significant increase in the real value of exports [...] *that is attributable to the attainment of efficiencies, will give rise to further efficiency gains*.
>
> *Crampton 1990* at p 548 [Emphasis in original.]

679 On this view, the increased exports are a *source of efficiencies* that must be taken into account under subsection 96(1) and Parliament enacted subsection 96(2) to fulfil a "guidance function" (*Crampton 1990* at p 549).

680 While this approach would not give efficiencies that meet the requirements of subsection 96(2) an independent role, the *Crampton 1990* text offered additional analysis. It noted that there is a reasonable argument that Parliament intended subsection 96(2) to provide more than a guidance function, and that export-related efficiencies merit, and were intended to receive, additional *qualitative* weighting, that should be decisive only if the trade-off analysis under subsection 96(1) "yields an inclusive result." The text listed four possible reasons. The significant increase in the real value of exports may: 1) give rise to other important but unquantifiable benefits to the economy; 2) promote the adaptability of the Canadian economy; 3) expand the opportunities for Canadian participation in world markets; and 4) have been considered to be of such particular importance as to merit specific mention in the legislation. In a footnote, the author referred to remarks by the then-Director of Investigation and Research ("*Director*"), who noted in a speech that information provided by merging parties about efficiency gains that allow the firm to significantly increase the real value of exports would be given "additional weight" in favour of the merging parties under subsection 96(1) (*Crampton 1990* at pp 549-550).

681 At least one commentary has taken a more robust view of subsection 96(2). While recognizing the positions taken in the 1991 MEGs and by the Director, Dr. Neil Campbell remarked that in enacting the provision, Parliament appeared to be creating an "independent category of efficiencies" (*Campbell* at pp 155-156, citing a discussion of "national champions" in

A.N. Campbell and J.W. Rowley, *Industrial Policy, Efficiencies and the Public Interest—the Prospects for International Merger Rules*, (Center for Trade Policy and Law, 8 th Annual Conference on Trade, Investment and Competition, Ottawa, May 1993)).

682 The Competition Bureau's 2004 MEGs and 2011 MEGs both advised merging parties to provide the Bureau with information that "establishes that the merger will lead them to increase output owing to greater exports," noting in a footnote that "increased output in this context is generally only possible with an associated decrease in price" (see 2011 MEGs at para 12.12; 2004 MEGs at para 8.10).

683 The text of subsection 96(2) is situated within section 96. The chapeau language of subsection 96(2) provides that in considering whether a merger or proposed merger is likely to bring about gains in efficiency described in subsection (1), the Tribunal "shall" consider whether "such" gains "will result in" a significant increase in the real value of exports and a significant substitution of domestic products for imported products.

684 With respect to the language in subsections 96(1) and (2), the Tribunal notes that:

- In *Tervita SCC*, Justice Rothstein observed that subsection 96(2) is "logically subservient to" subsection 96(1) (*Tervita SCC* at para 152);

- The analysis of any claimed efficiencies that meet the requirements of paragraphs 96(2)(a) and (b) occurs during the Tribunal's consideration of whether the merger is likely to bring about the gains in efficiency described in subsection 96(1);

- The word "shall" is mandatory or directory, not permissive. The Tribunal is required to consider subsection 96(2) if the evidence supports its relevance in a proceeding;

- The words "*such* gains" [emphasis added] in subsection 96(2) refer to the gains in efficiency in subsection (1); and

- The words "will result in" suggest that the Tribunal consider the causal relationship between the gains in efficiency in subsection (1) and the existence of the two factors in paragraphs 96(2)(a) and (b). Parliament also chose to use "*will* result in" [emphasis added], which implies proof with greater certainty than, for example, "may result in."

685 Paragraph 96(2)(a) contemplates that the Tribunal consider the gains in efficiency in subsection (1) that will result in a significant increase in the "real value" of exports, which suggests that evidence must be adduced as to the quantum, in dollars, of the increase. To engage the provision, the increase must be shown to be "significant," not small, trivial or inconsequential.

686 In light of the foregoing, the Tribunal considers that the proper interpretation of subsection 96(2) should:

- Adhere to the language of subsection 96(2), read in tandem with subsection 96(1);

- Seek to implement the overall purpose and the objectives of the Act, as set out in section 1.1;

- Be compatible with the approach to the trade-off analysis established in *Tervita SCC*, including the two-step quantitative and qualitative assessments described by Justice Rothstein at paragraph 147; and

- Be compatible with the five screens established by the Tribunal in *Tervita CT* to implement the trade-off analysis in subsections 96(1) and (3).

687 The Tribunal further observes that, by creating the efficiency exception enabling parties to avoid the application of section 92 when the elements of section 96 are satisfied, Parliament has in fact "withdrawn efficiency consideration, or at the very least, consideration relating to efficiency *enhancement*, from eligibility in the determination of whether competition has been prevented or substantially lessened" [emphasis in original] (*Crampton 1990* at p 257). Gains in efficiency are thus excluded from the assessment of anti-competitive effects under section 92.

688 In view of the language in subsection 96(2) and the discussion in the various legal sources above, the Tribunal adopts the following framework for the interpretation and application of subsection 96(2):

1. The Tribunal recognizes that a merger may make a firm more competitive in international markets through proven efficiencies realized in Canada (*i.e.*, efficiencies that accrue to the Canadian economy).

2. Such proven efficiencies may be claimed and included in the Tribunal's trade-off analysis, as established in *Tervita SCC* and *Tervita CT*.

3. Efficiencies that are claimed to result in a significant increase in the real value of exports should be analyzed within the established trade-off analysis under subsection 96(1).

4. The language of subsection 96(2) does not alter or expand the types of gains in efficiency under subsection 96(1) that may be considered in the trade-off analysis.

5. If a respondent raises a claim that efficiencies will result in a significant increase in the real value of exports, that respondent has the same burden to prove such efficiencies as with any other claimed efficiencies.

6. Specifically, if such claimed efficiencies are quantifiable, they must be quantified or, at a minimum, estimated, as contemplated by *Tervita SCC*.

7. If proven and quantified, such efficiencies will then be assessed along with other proven quantitative efficiencies in the first step of the trade-off analysis.

8. If such efficiencies are proven but cannot be quantified or estimated, they may be considered and given weight by the Tribunal at step two of the trade-off analysis, as qualitative efficiencies.

689 Not resolved in this framework are the questions of whether and how the Tribunal should provide any *additional* recognition to efficiencies that result in a significant increase in the real value of exports under paragraph 96(2)(a).

690 The Tribunal does not have the benefit of recent legal, economic, or business commentary on the role that subsection 96(2) should play in the efficiencies trade-off analysis established by *Tervita SCC*. The Tribunal also believes that, since the Act came into force in June 1986, there have been material developments affecting the Canadian industrial policy and international trade policies, as well as significant changes in some sectors of the Canadian economy, that could affect the proper approach to paragraphs 96(2)(a) and (b).

691 Given the Tribunal's conclusions elsewhere in these Reasons under section 92 and subsection 96(1), it is not necessary to resolve all questions related to paragraph 96(2)(a) in this proceeding. The Tribunal nonetheless considers that, without limiting other possible options, the following approach to paragraphs 96(2)(a) and (b) could be contemplated.

692 As noted above, the Tribunal is of the view that the language of subsection 96(2) does not alter or expand the types of gains in efficiency under subsection 96(1) that may be considered in the trade-off analysis. However, in order to implement the objectives set out in section 1.1 of the Act and other indications of Parliamentary intent and objectives, the Tribunal could provide additional qualitative recognition to some claimed efficiencies in the trade-off analysis if a firm is able to demonstrate, with clear and cogent evidence, that the specified efficiencies achieved in Canada also meet the requirements of paragraphs 96(2)(a) or (b). Such proven efficiencies could achieve one or more of the objectives listed in section 1.1, *in addition to* the promotion of the efficiency of the Canadian economy inherent in any proven efficiencies under subsection 96(1).

693 For example, a merger could be proven to result in efficiencies that accrue to the Canadian economy which will also result in a significant increase in the real value of exports and expand the opportunities for Canadian participation in world markets. A merger might, for example, enable a firm to enter a new overseas market due to the lower costs of production in Canada that result from the merger. In that type of scenario, the Tribunal could give the proven efficiencies that achieve the

requirements of paragraph 96(2)(a) some *additional, qualitative* weight at stage two of the trade-off analysis under subsection 96(1). Specifically, at stage two, the Tribunal could give some qualitative weight to proven and quantified efficiencies that will result in a significant increase in the real value of exports; or the Tribunal could give additional qualitative weight at stage two to proven qualitative efficiencies. The weight could vary, for example, with the strength of the efficiencies' proven ability to achieve at least one of the objectives of the Act as set out in section 1.1 (other than promoting the efficiency of the Canadian economy). Regardless of how the Tribunal decides to proceed in a future case, the Tribunal will determine how such efficiencies may be weighed at stage two based on the evidence and the applicable law, including *Tervita SCC* and *Tervita CT*.

(b) Evidentiary burden on efficiencies

694 As discussed above, the Commissioner has an initial burden under section 96 to prove the anti-competitive effects, including both quantitative and qualitative effects (*Tervita SCC* at para 122, citing *Superior Propane I* at paras 399, 403, *Superior Propane II* at para 154 and *Superior Propane IV* at para 64; *Tervita CT* at para 232).

695 The SCC in *Tervita SCC* instructed that, to discharge his burden, the Commissioner must quantify any quantifiable anti-competitive effects, at least by estimate (*Tervita SCC* at paras 125, 126, 137, 165; *Tervita FCA* at para 127; *Tervita CT* at para 243). To meet that burden, the Commissioner must ground the calculations or estimates in evidence that can be challenged and weighed (*Tervita SCC* at para 125). If effects are realistically measurable, failure to at least estimate the quantification of those effects will not result in the effects being assessed on a qualitative basis (*Tervita SCC* at para 100, citing *Superior Propane III* at para 233 and *Superior Propane IV* at para 35). Instead, quantifiable effects that are not quantified are considered to be equal to zero and have no weight (*Tervita SCC* at paras 128-129, 137, 140, 142, 151, 157, 159, 165).

696 While the Commissioner has the burden to prove the anti-competitive effects, the merging parties bear the onus of proving the remaining elements of the defence under section 96 (*Tervita SCC* at paras 136, 165; *Superior Propane II* at paras 154, 157; *Tervita CT* at para 233). The merging parties' onus is to prove the extent of the efficiency gains and that those efficiency gains from the merger will be greater than and will offset the effects of any prevention or lessening of competition resulting from the merger (*Tervita SCC* at paras 89, 122; *Superior Propane I* at para 403).

697 In the Tribunal's view, the same requirements imposed on the Commissioner for proof of anti-competitive effects under section 96 should also be imposed on the merging parties (in this case, P&H) to discharge their onus to prove the remaining elements under section 96. Thus, if a claimed efficiency is quantifiable, it must be quantified or at least estimated. That quantification or estimate must be grounded in evidence that can be challenged and weighed. If the claimed efficiency is quantifiable but is not quantified or estimated, then it will be treated as a zero and given no weight. An unquantified claimed efficiency that could have been quantified, but was not, will not be considered as a qualitative efficiency (*Tervita SCC* at para 124; *Superior Propane IV* at para 35). Claimed qualitative efficiencies, if any, must also be supported by evidence that can be challenged and weighed.

(2) Tribunal's assessment

698 In the Tribunal's view, and for the following reasons, P&H has not met its burden of demonstrating, on a balance of probabilities, that the Virden Acquisition is likely to bring about cognizable gains in efficiency. As a result, such gains would not be greater than, and would not offset, the anti-competitive effects of any lessening of competition resulting from the Virden Acquisition.

(a) The anti-competitive effects of any lessening of competition

699 In light of the Tribunal's conclusions on efficiencies, there is no need to deal extensively with the anti-competitive effects of any lessening of competition resulting from the Virden Acquisition.

700 Suffice it to say that there is no fundamental dispute between Dr. Miller and Ms. Sanderson on the magnitude of the consumer surplus loss, suggested to be CAD $540,000 per crop year in wheat and less in canola according to Dr. Miller's model. This estimate is conditional on accepting the diversion ratios and mark-up used by Dr. Miller.

701 Ms. Sanderson only takes issue with Dr. Miller's producer surplus calculations. She claims that it should include profits captured by Elevators and Crushers falling outside the relevant geographic markets. Even accepting Ms. Sanderson's critique, when profits associated with all transfers to rival Elevators and Crushers are included, there is still some DWL in wheat, but not in canola. Taking into account the producer surplus transferred to rival Elevators and Crushers which do not belong to Dr. Miller's geographic market, Dr. Miller's DWL for wheat decreases to some CAD $30,000, while the DWL in respect of canola is eliminated.

702 In sum, no matter how it is defined or calculated, the DWL is certainly greater than zero for wheat.

(b) The gains in efficiencies

(i) P&H's claimed efficiencies

703 At the outset of this proceeding, P&H's Response claimed the following efficiencies from the Acquisition: improved FGT scale efficiencies and cost savings; elimination of the margin that LDC formerly paid to use the Vancouver export terminal owned by Kinder Morgan; output expansion and improved scale economies at the former LDC Elevators; and administrative efficiencies.

704 P&H did not elaborate on its claimed efficiencies during the discovery process.

705 Mr. Heimbecker's initial witness statement identified four areas of claimed efficiencies that became the focus of the parties' submissions at the hearing. They were as follows: 1) increased throughput at the Virden Elevator; 2) network logistics efficiencies arising from optimizing the shipment of grain to "freight-logical" terminals; 3) efficiencies at the Vancouver terminals, particularly the FGT; and 4) efficiencies related to the conversion of local Elevators to include the retail sale of crop inputs.

706 At the hearing, the Commissioner did not cross-examine Mr. Heimbecker on his evidence about these proposed efficiencies. Mr. Heimbecker was not qualified to provide expert evidence on efficiencies and acknowledged that he is not such an expert. He provided P&H's factual foundation for its efficiency claims. As discussed above, on a pre-hearing motion, some of his evidence was struck out (*Parrish & Heimbecker* at paras 72-73). Ultimately, P&H did not file an expert report to support or quantify its position on efficiencies, either initially or in reply to Mr. Harington's expert report. P&H solely relied on the initial and reply witness statements of Mr. Heimbecker.

• *Increased throughput at the Virden Elevator*

707 Regarding the increased throughput at the Virden Elevator, P&H offered Mr. Heimbecker's evidence comparing the throughput at the Virden Elevator in 2019 when it was operated by LDC with Virden's 2020 throughput when operated by P&H. Mr. Heimbecker also explained that P&H's Elevators had a higher "turn rate" than LDC's former Elevators. An Elevator's "turn rate" is calculated as the purchases of grain by an Elevator in a given period divided by the storage capacity. According to Mr. Heimbecker, P&H also forecast a higher turn rate for each of the former LDC Elevators during 2020. He attributed the higher turn rate to four factors: P&H's superior port access (particularly its access to the Superior terminal in Thunder Bay, Ontario, which LDC did not use); port storage and ship loading speed in Vancouver; its larger network of Elevators from which it could source grain; and the fact that P&H purchased a larger variety of grain than LDC did.

708 In his initial witness statement, to which Mr. Harington responded, Mr. Heimbecker compared the Virden Elevator's 2019 results with its actual results from January to July 2020 and P&H's forecast for the balance of 2020. He then applied P&H's grain margins for wheat and canola to the increased volumes to find an annual "efficiency," in dollars, for each of wheat and canola.

709 In his reply witness statement, Mr. Heimbecker reiterated his evidence about P&H's Elevator turn rates, its better port access at both Vancouver and Thunder Bay terminals, and its larger network of Elevators, all compared with LDC. He also updated his initial Virden throughput evidence with actual 2020 results up to October 31, 2020.

710 Mr. Heimbecker also addressed the overall increase in grain production from 2019 to 2020 raised by Mr. Harington in his expert report. He concluded that, even adjusting for the increased production, the Virden Elevator showed increased throughput for wheat and canola when comparing the period from January 1 to October 31, 2019 with the period from January 1 to October 31, 2020. Using the same wheat and canola margins from his initial evidence, Mr. Heimbecker then re-determined the "additional value" created, in dollars, from the increased Virden throughput through to October 31, 2020, adjusting LDC's 2019 numbers for grain industry developments.

• *Network logistics efficiencies*

711 Turning to network logistics efficiencies, Mr. Heimbecker explained in his initial witness statement that Elevators have a natural, "freight logical" terminal. Elevators operated by P&H fall into catchment areas depending on their physical location. Those catchment areas are for terminals in either Vancouver or Thunder Bay. The catchment area determines rail freight costs from an Elevator to a terminal. The Virden Elevator is in the Thunder Bay catchment area. As a result, the wheat and canola purchased from farms and delivered to the Virden Elevator will generally be shipped to P&H's Superior terminal in Thunder Bay for sale to its eastern grain customers.

712 Mr. Heimbecker testified that P&H decided that four of the Elevators it purchased in the Transaction could shift their grain from delivery to West Coast terminals in favour of delivery to the Superior terminal in the east. At the same time, some grain movement from Elevators already owned by P&H could be switched to delivery westward to Vancouver at P&H's two most efficient terminals, namely, AGT and FGT. According to Mr. Heimbecker, the additional eastbound throughput from the addition of the four new Elevators "will now allow P&H to increase the efficiency of its network." In particular, Mr. Heimbecker stated that P&H acquired the Virden and Rathwell Elevators in the Transaction and would shift their grain eastward, enabling additional tonnage to be shipped westward to Vancouver from other Elevators in the P&H network.

713 Mr. Heimbecker advised in his reply witness statement that the addition of the Virden Elevator and its additional volume was a "necessary addition to P&H's elevator network to achieve these logistics benefits" (Exhibits CA-R-121 and P-A-122, Reply Witness Statement of Mr. John Heimbecker ("*Heimbecker Reply Statement*"), at para 43).

• *Efficiencies at West Coast terminals*

714 Mr. Heimbecker also identified efficiencies at the West Coast terminals. He testified that the amount of grain that would be processed through P&H's terminals in Vancouver would increase as a result of the Transaction. In his reply witness statement, Mr. Heimbecker further noted that the FGT's location on Vancouver's South Shore bypasses the congested rail corridors to the West Coast, which move grain from the Prairies to the West Coast terminals. As a result of its location, FGT would provide significant rail cycle time of 50% which many other grain purchasers would not enjoy. Mr. Heimbecker did not provide any evidence supporting his claim in improved rail car cycle time, nor did he provide any explanation or operating plans from the railways that attest to those savings.

• *Crop inputs efficiencies*

715 With respect to crop inputs efficiencies, Mr. Heimbecker testified that the Transaction allows P&H to compete more effectively with rival grain companies by converting the Elevators acquired in the Transaction into dual-purpose facilities. Previously, they were purely grain facilities, whereas P&H would now create a "one-stop shop" location that would include both the delivery of grain for sale and also enable farmers to purchase crop inputs. The sales of crop inputs at the newly acquired Elevators would provide P&H with increased margins. Mr. Heimbecker provided evidence of the cost per Elevator to convert a location into a combined grain/crop inputs facility and, based on his past business experience, he estimated the increased margins at [text omitted]. Mr. Heimbecker acknowledged that some of the crop inputs sales to be made at the Virden Elevator would come from sales made by other grain companies and crop input retailers. Mr. Heimbecker also advised that the expansion of crop inputs would not only benefit P&H through increased sales and margin but would also increase overall grain production.

(ii) The Commissioner's response

716 The Commissioner's Reply filed on February 17, 2020 stated that the Transaction would not generate cognizable gains in efficiencies to the extent claimed by P&H. The Commissioner reminded that his Application to the Tribunal sought the divestiture of just one Elevator, leaving nine others acquired by P&H as part of the Transaction. The contemplated orders requested would therefore not impact P&H's ability to achieve the alleged efficiencies. The Commissioner further denied that any cognizable efficiencies would be greater than or offset the anti-competitive effects of the Virden Acquisition.

717 As already noted, the Commissioner filed Mr. Harington's expert report, which addressed each of the efficiencies claimed in Mr. Heimbecker's initial witness statement. Mr. Harington's report provided his analysis of how the five screens identified in *Tervita CT* applied to each of P&H's claimed efficiencies.

• *Increased throughput at the Virden Elevator*

718 The Commissioner submitted that this claimed efficiency was caught by four of the five *Tervita CT* screens, namely, screens 1, 2, 3, and 5, summarized above in these Reasons. On *Tervita CT* screens 1 and 2, the Commissioner submitted that the increased volumes at the Virden Elevator would have occurred irrespective of the Acquisition, given the overall upward trend in grain production (measured by delivery volumes to Elevators) from 2019 to 2020. The Commissioner also noted that at the end of 2019, inventory levels at the Virden Elevator were low and had to be replenished by P&H after it acquired that Elevator. According to the Commissioner, those additional purchase volumes could partially explain the increase in delivered volume to Virden.

719 The Commissioner further submitted that P&H had failed to demonstrate that the increased volumes at the Virden Elevator were not a redistribution of income between two persons under subsection 96(3) (*Tervita CT* screen 3). He argued that any increases in volume not attributable to the overall industry increase in grain production were merely a wealth transfer from other Elevators and did not represent a cognizable efficiency under section 96. According to the Commissioner, P&H also had not shown that its per unit variable operating costs of the Virden Elevator for the 10 months of 2020 were lower than LDC's operating costs at this Elevator the previous year.

720 The Commissioner further submitted that P&H had not shown that any increase in volume at the Virden Elevator could not have been achieved by an alternative purchaser of that Elevator (*Tervita CT* screen 5).

721 Mr. Harington's expert report concluded that increased throughput at the Virden Elevator was not a cognizable efficiency. In his view, any increase in throughput in P&H's Virden Elevator and terminal network would have to arise from increased Canadian grain production and not be a pecuniary redistribution of throughput between P&H's facilities and other facilities. To be a cognizable efficiency, any increased throughput would have to result from an increase in grain production brought about by the Virden Acquisition that was not "cannibalized" volume from other entities, and would not likely occur in the event of an order under section 92. Mr. Harington concluded that the claimed efficiencies based on an increase in throughput at the Virden Elevator did not qualify as a cognizable efficiency under these criteria.

• *Network logistics efficiencies*

722 Regarding the claimed logistics efficiencies, Mr. Harington noted in his report that P&H did not quantify the cost savings arising from shipping volumes to a more "freight logical" terminal and did not demonstrate that any of the savings would be lost in the event of a remedial order by the Tribunal. In addition, P&H did not show what proportion of any cost savings was attributable to the purchase of the Virden Elevator as opposed to the Rathwell facility.

• *Efficiencies at West Coast terminals*

723 Turning to the claimed efficiencies at the West Coast terminals, Mr. Harington's expert report found that increased volumes at more efficient Vancouver area terminals were not a cognizable efficiency that would be lost in the event of an order of the Tribunal, because the same volume was still going through the less efficient Superior terminal in Thunder Bay; that is, the "only difference is the Elevators from which these volumes to Thunder Bay are coming." Mr. Harington also noted that P&H

did not offer any proof of increased volume of grain production due to the Acquisition and did not provide a comparison of operating costs at the Vancouver terminals with similar costs at another terminal through which the grain previously travelled.

• *Crop inputs efficiencies*

724 On crop input efficiencies, Mr. Harington's expert report opined that the benefit of increased crop inputs sales would be a redistribution of income rather than a real resource saving. Any margin on crop inputs sales earned by P&H by the conversion of facilities was, in his view, a "pecuniary redistribution of income between P&H and farmers," even if some portion of those sales were new sales rather than sales that would otherwise be made by rival retail suppliers.

725 Mr. Harington noted the absence of any evidence (apart from Mr. Heimbecker's opinion) that an additional crop inputs retail location would increase crop inputs sales in the area of the Virden Elevator rather than redistribute sales within the area, or would lead to more use of crop inputs by farmers and increase grain production as a result.

(iii) The gains in efficiency under subsection 96(1)

726 For the following reasons, the Tribunal concludes that P&H has not proven cognizable efficiencies under section 96.

• *Increased throughput at the Virden Elevator*

727 P&H advanced the position that the Acquisition had caused an increase in throughput at the Virden Elevator, by an increase in volume of grain delivered to and processed by that Elevator between 2019 and 2020.

728 Mr. Heimbecker's evidence about Elevators' turn rates was not contradicted, nor did the Commissioner cross-examine him on it. Mr. Heimbecker testified that P&H had access to port terminals both in the Vancouver area and in Thunder Bay, compared with LDC which had no access to Thunder Bay and did not export from the Superior terminal. He also testified that the Virden Elevator is in P&H's catchment area for Thunder Bay and that grain from Virden will generally be shipped east by P&H to its Superior terminal for sale to its eastern grain export customers. He testified that P&H's most efficient port terminals are the AGT and the FGT.

729 The Tribunal accepts that there are likely some time and transportation (*i.e.*, rail) cost savings to move the Virden Elevator grain to the Superior terminal in Thunder Bay rather than to a Vancouver port terminal, which would presumably contribute to a higher turn rate at Virden for P&H than what existed when LDC sent its grain to Vancouver. However, P&H did not adduce evidence of any transportation cost savings. Having said that, Mr. Heimbecker's evidence was also that P&H's Superior terminal is not as efficient as the AGT or FGT in Vancouver. In light of that evidence, the Tribunal is unable to measure any benefits to the Canadian economy that would allegedly result from the change of the Virden Elevator grain being shipped west to the Vancouver port by LDC before the Transaction, to it being shipped east to the Superior terminal in Thunder Bay by P&H afterwards.

730 Mr. Heimbecker provided a forecast that P&H would increase the Virden Elevator's turn rate from historical rates of [text omitted] in 2017 and [text omitted] in 2018 while LDC operated Virden, to a turn rate of [text omitted] in P&H's fiscal year 2021. Mr. Heimbecker did not present turn rates (actual or forecast) for the years 2019 or 2020, as the Virden Elevator was emptied by LDC following the agreement on the Transaction, and P&H needed to replenish it. The Virden Elevator's forecast increase of [text omitted] from 2018 to 2021 ranks just [text omitted] of the 10 former LDC Elevators' forecast increases, and is relatively small compared with some increases at other Elevators (which went up by as much as [text omitted]). The Tribunal further observes that the Virden Elevator's turn rate of [text omitted] in fiscal year 2021 will be the lowest of any of the former LDC Elevators. The Tribunal does not find this evidence about increased turn rates at the Virden Elevator to be particularly compelling or persuasive.

731 The evidence about the relative inventory numbers between 2019 and 2020 must be assessed carefully. Mr. Harington testified that the abnormally lower inventory due to lower purchases by LDC in 2019, as well as the abnormally higher purchases by P&H in 2020 to make up the needed volume for inventory, would essentially have a "two-times" effect on the Tribunal's ability to compare the two years. To compare them, each year would have to be adjusted (2019 upward and 2020 downward).

732 In the Tribunal's view, there are several additional uncertainties and anomalies associated with P&H's evidence that undermine the reliability of any comparison of the change in throughput over these two years. These concerns prevent a sufficiently accurate quantification of any change in throughput following the Transaction and raise considerable doubt about the existence of any increase in throughput brought about by the Virden Acquisition.

733 First, there is uncertainty about the baseline volumes in 2019. Mr. Heimbecker testified that LDC diminished the inventory levels at its Elevators, including at the Virden Elevator, prior to the closing of the Transaction on December 10, 2019. P&H did not provide the Tribunal with the Virden Elevator's inventory level information as of that date. There was no evidence from LDC as to when it began to lessen its grain purchases (or if it simply stopped sometime before the closing), or about how much less grain it acquired at the Virden Elevator or decided not to store. The evidence also does not contain inventory levels or grain delivery volumes to the Virden Elevator in any prior years (*e.g.*, 2018, 2017, or 2016) for historical comparison to 2019.

734 Second, there is uncertainty about which product's inventory decreased in 2019. In his initial witness statement, Mr. Heimbecker testified that there was little or no *canola* inventory at most of the LDC locations, including at the Virden Elevator. He testified that, by summer of 2020, P&H had "significantly increased *canola* purchases at Virden over the levels purchased there previously by LDC." In his reply witness statement, Mr. Heimbecker explained that one reason why P&H missed its three-month throughput forecast for May to July 2020 was "low level of inventory left by LDC. LDC did not have *grain* in the pipeline when P&H purchased the assets which prevented P&H from selling *grain* in the beginning of the year" [emphases added] (Heimbecker Statement at para 51; Heimbecker Reply Statement at para 24).

735 At the hearing, Ms. Sanderson testified, having looked at the Virden Elevator's purchase data, that she did not see any sort of change on the canola side in December 2019 or January 2020 compared to the year prior. She attributed the running down of inventories just to *wheat*.

736 Third, there were anomalous monthly deliveries of both canola and wheat that make 2019 and 2020 harder to compare. Mr. Heimbecker provided monthly MT deliveries of canola to the Virden Elevator from January 1 to October 31, 2020. Of the approximately [text omitted] in those ten months, [text omitted] was delivered in September 2020. That month saw deliveries of [text omitted] in 2019, implying an increase of over [text omitted] comparing September 2019 with September 2020.

737 There was also an anomalous month in the data for wheat. Ms. Sanderson testified that November 2019 wheat purchases by LDC were more than twice larger than October 2019 and were "by far and away the largest" quantity purchased in any month from January 2019 to July 2020 (the period of available actual data when she prepared her report) (Consolidated Transcript, Confidential A, at p 1895). Ms. Sanderson's review of volumes from September to December 2019 allowed her to conclude that LDC increased purchases in November and may have run down inventories in December. As noted, the Transaction closed on December 10, 2019, and the parties did not provide the Tribunal with inventory level information at the Virden Elevator as of that date.

738 Fourth, in order to compare the 2019 and 2020 deliveries to the Virden Elevator, both parties agreed that the 2020 deliveries had to be adjusted for an overall industry increase in grain production over 2019. Mr. Heimbecker used the overall grain production increase in Canada of 13.1% for the crop years ending July 31, 2019 compared with July 31, 2020 to make adjustments. However, Mr. Harington's presentation of the industry evidence on increased deliveries indicated that the increases in both all-wheat production and all-grain production in Saskatchewan and Manitoba were each different from the 13.1% used in the calculations: higher for Saskatchewan (+15.8% and +17.9%, respectively) and noticeably lower for Manitoba (+6.8% and +7.0%, respectively). The Virden Elevator's purchases come from those two provinces.

739 Mr. Heimbecker's revised calculations in his reply witness statement continued to use the 13.1% Canada all-grain increase, referring to the Manitoba increases in all-wheat production and all-grain production and tendering his calculations as a "conservative" approach. However, Mr. Heimbecker acknowledged in cross-examination that overall canola deliveries in Manitoba increased by 18%, comparing January to October 2019 with January to October 2020. At the same time, Mr. Heimbecker was also careful to distinguish between grain or canola production and delivery.

740 The Tribunal finds that an adjustment of 13.1% to account for increased grain production in Canada does not account accurately for grain delivery increases to the Virden Elevator from farms in Saskatchewan and Manitoba from 2019 to 2020, and negatively affects the Tribunal's ability to quantify any increase in throughput at the Virden Elevator over the period.

741 In light of all this evidence, the Tribunal finds that there is considerable uncertainty about the existence and quantum of any actual increase in throughput at the Virden Elevator following the Acquisition. The Tribunal cannot conclude that any specific amount of increased throughput volume of wheat, or canola, or grain, has been demonstrated or satisfactorily quantified for 2020 after the Transaction.

742 The Tribunal is also unable to conclude that any increase or any quantifiable increase in throughput was *brought about by* the Virden Acquisition for the purposes of *Tervita CT* screen 2. P&H offered no expert assistance to assist the Tribunal in identifying and quantifying throughput increases brought about by the Virden Acquisition (if any) and to distinguish it from higher throughput caused by rising overall grain deliveries to replenish inventory (the quantum of which was itself debated, as discussed above).

743 In addition, while the monthly trend comparing 2019 to 2020 for canola was generally rising from March to September 2020, the spike in canola deliveries in September 2020 (comprising nearly half of the delivered volume for the calendar year) is inconsistent with P&H's position that there are sustainable, ongoing efficiencies in throughput at the Virden Elevator. As Mr. Harington testified, one month does not make a trend.

744 The Tribunal concludes that P&H has not demonstrated, with clear and convincing evidence, any section 96 efficiencies with respect to increased throughput at the Virden Elevator.

• *Network logistics efficiencies*

745 With respect to network logistic efficiencies, the Tribunal agrees with the Commissioner that P&H has not quantified its alleged efficiencies arising from the optimization of shipments to "freight logical" terminals in Vancouver. The evidence does not establish how much additional or incremental grain has been or will be diverted to the grain terminals in Vancouver (from other western terminals or from Thunder Bay), nor any of the cost savings that resulted from processing grain at the Vancouver terminals compared with the Superior terminal, nor any cost savings associated with processing and transporting grain a shorter distance from an Elevator to a terminal. While the possibility of a synergy or an efficiency arising from better network logistics has some intuitive attraction, the evidence does not support the existence or any quantification of such an efficiency for the purposes of section 96.

746 Applying the principles articulated in *Tervita SCC*, this proposed efficiency must be considered a zero.

• *Efficiencies at West Coast terminals*

747 The Tribunal also concludes that the evidence does not support any proven efficiencies arising from any additional grain flowing through the terminals in Vancouver used by P&H. Again, P&H did not offer any quantification of the incremental volumes of grain from the Virden Acquisition, or any cost savings as a result of processing such grain, in the Vancouver terminals or by a shift in volumes from other grain terminals to its terminals. Moreover, Mr. Heimbecker did not provide any evidence supporting his claim of improved rail car cycle time nor did he provide any explanation or operating plans from the railways that attest to those savings. Applying the principles set out in *Tervita SCC*, this proposed efficiency must also be considered a zero.

• *Crop inputs efficiencies*

748 Turning finally to the claimed crop inputs efficiencies, the Tribunal concludes that P&H has not proven any section 96 efficiencies related to crop inputs. An increase in margins accruing to P&H is not a benefit to the Canadian economy for the purposes of an efficiency under section 96. In addition, P&H has not measured, quantified, or even estimated any increase in output as alleged (*i.e.*, any increase in the sale of crop inputs in the area around the Virden Elevator, nor any increase in local grain production). Needless to say, such claims in efficiencies were, by their nature, clearly quantifiable.

749 The Tribunal therefore concludes that P&H has not demonstrated any cognizable efficiencies, whether quantitative or qualitative, under subsection 96(1) of the Act. Since P&H failed to meet its burden, the efficiencies are assigned a weight of zero.

(iv) The impact of subsection 96(2)

750 P&H submitted that the Tribunal should also apply subsection 96(2), since its objective in entering the Transaction was to increase its competitiveness in domestic and international export markets and to maximize the profitability of its export business. P&H emphasized that the Transaction served to enhance the return on its investment in the FGT through the expansion of its network, by acquiring access to increased throughput of grain sourced from the acquired LDC Elevators. P&H emphasized that it had no anti-competitive intention. Its intention was not to exercise monopsony power in local input markets, but rather to increase output in export markets.

751 P&H pointed to its focus — and the focus of the industry as a whole — on exporting canola and wheat. It noted that its pricing mechanism (*i.e.*, the Workback Algorithm) tied local prices in the input market to prices in the export market. The acquisition of the grain volumes represented by the LDC Elevators, including the Virden Elevator, enabled large increases in the volume processed by the FGT without displacing any planned volumes from pre-Transaction P&H Elevators. Those increased throughput volumes would be achieved quickly, rather than waiting for [text omitted] years as P&H originally anticipated and planned for the FGT.

752 P&H referred to Mr. Brooks' evidence and to a report from the Saskatchewan Wheat Development Commissioner (found in Exhibits CA-R-240 and P-R-241, Compilation of Miscelleaneous Documents) to support a submission that grain producers' (*i.e.*, farmers') interests in increased production were aligned with grain companies' interests in increasing export capacity.

753 P&H submitted that the Elevators acquired in the Transaction:

> [...] <u>will be capable at full utilization</u> to fill the [text omitted] metric tonnes of capacity at the FGT. This capacity utilization represents a 9% increase in export sales capacity at the West Coast and approximately 6.5% of total Canadian export capacity. The contribution of the LDC Elevators to export sales pre-acquisition was [text omitted] MT. <u>At full capacity</u>, within the P&H network, these elevators will add [text omitted] MT of export throughput to FGT for a net increase of [text omitted]. Hence <u>the transaction as a whole</u> clearly leads to a significant increase in the real [value] exports of grain within the meaning of section 96(2).
>
> [Emphasis added.]

754 The Commissioner responded that there was no evidence to indicate that the Transaction had actually led to a real increase in the value of exports under subsection 96(2). The Commissioner contended that P&H had acquired the grain volume that LDC was exporting through Vancouver terminals, so that P&H could export the same grain volume through its terminals in Vancouver. The grain was all headed for export, regardless of the Transaction. In addition, no analysis had been done to demonstrate that allowing P&H to keep one Elevator (*i.e.*, the Virden Elevator) would lead to a significant increase in the real value of exports.

755 The Tribunal disagrees with P&H's submission that the increase in the real value of exports from the Transaction "as a whole" may be considered under subsection 96(2). That provision refers to the gains in efficiency mentioned in subsection 96(1), which in turn refers to the efficiencies brought about by the merger or proposed merger "in respect of which the application is made." Consideration of a substantial increase in the real value of exports under paragraph 96(2)(a) must therefore focus on the specific merger being challenged by the Commissioner in the proceeding. In this case, the Commissioner's Application is solely made in respect of P&H's Acquisition of the Virden Elevator, not in respect of the Transaction as a whole.

756 During oral argument, the Tribunal asked whether there was anything in the evidence that parsed out the impact of the Virden Elevator on exports. P&H's answer was no. It advised that it would need access to third party information and data about

grain volumes from other grain companies at the port and their efficiencies there, as well as those companies' variable operating costs to reach the port facilities, in order to measure such impact.

757 During argument, the Tribunal requested that P&H specifically refer to the evidence on the additional (incremental) volume attributable to the Virden Elevator that would be exported through the FGT. P&H did not provide a satisfactory answer in substance, pointing to its evidence of increased throughput at the Virden Elevator. However, as noted above, this evidence does not support the quantification of any volume of increased throughput at the Virden Elevator. The Tribunal also notes that volumes of grain from the Virden Elevator were delivered to Thunder Bay (not Vancouver) and that the Superior terminal in Thunder Bay closed during the winter. Because P&H redirected the Virden Elevator grain eastward to Thunder Bay, any increased volume to the FGT that could (in theory) be attributable to the Virden Elevator would have to be sourced from another Elevator(s). P&H did not provide an analysis to support such an attribution.

758 Reduced to its essence, P&H's submission was that more of the FGT's capacity would be used, and sooner, as a result of the Transaction as a whole. The evidence of how much additional capacity would be used (or the value of that grain in dollars), and when, is insufficient to show a significant increase in the real value of exports resulting from the Virden Acquisition. The Tribunal agrees with the Commissioner that it is likely that most of the additional volumes anticipated to be processed at the FGT post-Transaction are volumes that would otherwise have been processed at other terminals but will now be diverted to the FGT because P&H now owns all of the source Elevators. Further, P&H confirmed during argument that the additional volumes are for all types of grains, not just wheat and canola. Lastly, the Tribunal appreciates the logic of Mr. Heimbecker's evidence concerning congested rail lines. Even accounting for that evidence and the general claim that the FGT would be a more efficient terminal (it was scheduled to become fully operational shortly after the hearing), the Tribunal is not satisfied that the evidence demonstrates a significant increase in the real value of exports for the purposes of paragraph 96(2)(a).

759 The Tribunal pauses to again note that P&H's intention or objectives in entering the Transaction are not relevant, or material, to the Tribunal's analysis.

760 Given the analysis above with respect to subsection 96(1), the Tribunal finds that P&H has not shown a causal connection between any proven efficiencies under subsection 96(1) and an increase in the real value of any exports. The Tribunal therefore concludes that the requirements of subsection 96(2) have not been met.

(c) The trade-off analysis

761 In light of the Tribunal' conclusions on efficiencies, there is no need to deal with the trade-off analysis in this case.

(3) Conclusion on efficiencies and section 96

762 For the reasons detailed above, the Tribunal concludes that P&H has not demonstrated, with clear and convincing evidence, its claimed efficiencies and that it would not have met its burden of demonstrating, on a balance of probabilities, that its claimed gains in efficiency would be greater than, and would offset, the anti-competitive effects of any lessening of competition resulting from the Acquisition.

VIII. CONCLUSION

763 For the above detailed reasons, the Commissioner's Application is dismissed. In light of this conclusion, no remedial action will be ordered.

IX. COSTS

764 The parties were unable to come to an agreement as to costs.

765 The Commissioner submits that he should be awarded a lump sum amount of CAD $2 million inclusive of counsel fees and disbursements if he is successful. If the Application is dismissed, then the Commissioner argues that P&H should be awarded CAD $2 million inclusive of counsel fees and disbursements. However, if the Application is dismissed and the Tribunal

finds that P&H's section 96 efficiencies defence would not have been successful, then the Tribunal should, in the Commissioner's view, deduct CAD $500,000 from the lump sum cost award, in recognition of the costs the Commissioner incurred in order to respond to that defence. While the Commissioner recognizes that P&H was entitled to rely on the efficiencies defence, he argues that if a respondent pleads the defence but does not adduce sufficient evidence to make it out, then the Tribunal should use a costs award to recognize the significant costs incurred by the Commissioner (and ultimately, Canadian taxpayers) to respond. If there is no financial deterrent associated with an unsuccessful efficiencies defence, the Commissioner submits that in the future, respondents will claim efficiencies as a matter of course, causing significant financial burden on the Commissioner regardless of whether raising the efficiencies defence was justified.

766 P&H, in turn, seeks costs payable as a lump sum in the amount of CAD $2,206,958.18, inclusive of fees, disbursements and taxes, if the Commissioner's Application is dismissed. This sum represents approximately CAD $209,000 for legal fees and approximately CAD $1,998,000 for disbursements (both inclusive of taxes). Should the Application be allowed, P&H indicates that it takes no position with respect to the Bill of Costs submitted by the Commissioner, save for one item — *i.e.*, the preparation and filing of the Commissioner's motion materials dealing with confidentiality designations — which P&H maintains is an ineligible cost in view of the Tribunal's order dismissing the Commissioner's confidentiality motion without costs. As for the matter of costs relating to the efficiencies defence, P&H submits that the merits of the efficiencies defence becomes moot if a substantial lessening of competition is not found under section 92, and that the result of the case must drive costs, not *obiter dicta*. According to P&H, this is not a case of divided success (citing Allergan Inc v Sandoz Canada Inc, 2021 FC 186 at paras 31, 43).

767 Both parties submitted bills of costs and affidavits in support.

A. Legal principles applicable to costs

768 In *VAA CT*, the Tribunal noted that section 8.1 of the CTA grants jurisdiction to the Tribunal to award costs of proceedings before it in accordance with the provisions governing costs in the FC Rules (*VAA CT* at para 817). Under subsection 400(1) of the FC Rules, the Tribunal has "full discretionary power over the amount and allocation of costs and the determination of by whom they are to be paid." A non-exhaustive list of factors that the Tribunal may consider when exercising its discretion is set out in subsection 400(3).

769 Costs ordinarily follow the outcome of the proceeding, in that the successful party is usually awarded costs (see, for example, Heiltsuk Horizon Maritime Services Ltd v Atlantic Towing Limited, 2021 FCA 26 at para 182; MacFarlane v Day & Ross Inc, 2014 FCA 199 at para 6; *VAA CT* at para 816; FC Rule 400(3)(a)).

770 The costs regime does not indemnify the successful party for all of its legal fees and disbursements, absent very unusual circumstances. Costs are only partial compensation for the actual costs incurred in litigation. As noted in *VAA CT*, an award of costs represents a compromise between compensating a successful party and not unduly burdening an unsuccessful party (*VAA CT* at para 817, citing Apotex Inc v Wellcome Foundation Ltd(1998), 159 FTR 233 (FCTD), 84 CPR (3d) 303, aff'd (2001), 199 FTR 320 (FCA)).

771 The objectives of a costs award include having the unsuccessful party make a "reasonable contribution" to the successful party's costs of litigation, having regard to the Tariff in the FC Rules (NOVA Chemicals Corporation v Dow Chemical Company, 2017 FCA 25 (“ at paras 13, 21). Although the Tariff amounts may be inadequate in complex litigation, nevertheless, an increased costs award cannot be justified solely on the basis that a successful party's actual fees are significantly higher than the Tariff amounts. The burden is on the party seeking increased costs to demonstrate why their particular circumstances warrant an increased award (*NOVA Chemicals* at para 13, citing Wihksne v Canada (Attorney General), 2002 FCA 356 at para 11).

772 The approximation of lump sum costs is a matter of judgment rather than an accounting exercise (Consorzio del Prosciutto di Parma v Maple Leaf Meats Inc, 2002 FCA 417 at para 8). While the costs awarded should have a fair relationship to the actual costs of litigation, the question for the Tribunal is what, in the circumstances, are necessary and reasonable legal costs and disbursements (Nadeau Ferme Avicole Ltée v Groupe Westco Inc, 2010 Comp Trib 1 at para 49).

773 Disbursements must be reasonable, necessary, and justified (*NOVA Chemicals* at para 26; *VAA CT* at para 821). Expert-related costs are not automatically recovered in their entirety and can be adjusted by the Tribunal if they do not appear reasonable (*VAA CT* at para 822).

774 In *VAA CT*, the Tribunal took into account that success on the issues in dispute, particularly the legal issues in dispute, was divided; although the respondent was successful overall, the Commissioner prevailed on certain issues (*VAA CT* at paras 819, 827). The Tribunal reduced the costs award to the respondent to reflect the time spent on issues on which the Commissioner prevailed but the respondent persisted in spending time, and based on the reasonableness and necessity of the disbursements.

775 As paragraph 400(3)(a) of the FC Rules contemplates, success overall in the proceeding remains a principal factor, subject to additional considerations relevant to the circumstances and claims made. The Tribunal may consider the factors in paragraphs 400(3)(b) to (n.1) of the FC Rules and any other matter it considers relevant under subsection 400(3)(o).

776 The Tribunal favours lump sum costs awards (*VAA CT* at para 825).

B. Tribunal's assessment

777 As the successful party, P&H is entitled to an award of costs. The Tribunal will fix the costs payable by the Commissioner in this proceeding.

(1) Legal fees

778 With respect to legal fees, P&H claimed approximately CAD $209,000 in respect of legal fees, calculated based on Tariff B, Column IV. Its claims included time spent for preparation of pleadings, affidavits of documents, preparing for and attending oral examinations for discovery, preparing for and attending case management conferences, preparation of witness statements, and the attendance of two counsel at the hearing. The Commissioner submitted that, if P&H is successful, its quantum of costs should be determined on the usual basis of the middle of column III, and should also be less than the amount fixed by the Tribunal in *VAA CT* (which was CAD $70,000) because the matter occupied fewer hearing days.

779 As noted, both parties took positions to increase or decrease an award of costs by large amounts beyond the Tariff. P&H increased its requested award based on its actual legal fees and the complexity of this proceeding. P&H advised that it believed that an award for legal fees in the amount of CAD $900,000 would be appropriate (its actual legal fees were approximately CAD $3.6 million), but only claimed CAD $209,000 under Tariff B, Column IV. For his part, the Commissioner sought to decrease an award to P&H if it did not succeed on section 96 issues. The Commissioner submitted that P&H's costs award should be reduced by CAD $500,000, which the Commissioner argued represented the amount he paid to respond to P&H's position under section 96 by having to quantify the anti-competitive effects (through Dr. Miller) and file Mr. Harington's expert report on efficiencies under section 96.

780 The parties also argued several novel points — i.e., issues that had not been argued to the Tribunal in previous litigated proceedings. The Commissioner's position on product market raised new issues for the Tribunal's consideration, while P&H raised issues under section 96 that had not been considered previously.

781 The most important overall factor in arriving at a costs award is which party succeeded. Here, the Tribunal dismissed the Commissioner's Application. In addition to the overall result, the Tribunal recognizes that this proceeding involves a public official with a statutory mandate to administer and enforce the Act; both parties are highly sophisticated with very experienced counsel; and the legislative setting contemplates significant pre-litigation disclosure through the merger review process and pre-hearing disclosure, as well as well known elements and burdens of proof under sections 92 and 96 of the Act. The Tribunal also finds that proceedings under section 92 involve complex legal and factual matters that support higher costs awards under the Tariff B, Column IV in the FC Rules (as claimed by P&H).

782 Although the Commissioner succeeded on several preliminary issues, the Tribunal does not find that those arguments diminish P&H's entitlement to an award of costs in this case.

783 The Tribunal does not agree with the Commissioner's position that the costs award to P&H should be reduced by an overall lump sum amount of CAD $500,000 because P&H would not have succeeded on its section 96 defence. Although the cost of Mr. Harington's services are known (*i.e.*, CAD $259,000), the balance to arrive at the claimed amount of CAD $500,000 is merely an assumption or guess without a sufficient evidentiary basis.

784 That said, however, the Tribunal finds it appropriate under FC Rule 400(3)(o) (and by analogy to other paragraphs in FC Rule 400(3)) to take into account the specific circumstances of this proceeding related to the section 96 evidence and arguments in its overall assessment of legal fees, as follows:

- The overall burden of proof under section 96 was on P&H;

- P&H raised efficiencies in its pleading. The Tribunal notes that P&H did not provide details of its position on efficiencies at examinations for discovery and did not file an expert report for the hearing — even though it advised it would do so during the discovery process. It only filed Mr. Heimbecker's fact evidence (which included some efficiencies arguments that P&H did not initially plead);

- The Commissioner did not waste time on section 96 issues during the fact portion of the hearing; he did not cross-examine Mr. Heimbecker on his evidence related to alleged efficiencies;

- The Commissioner prevailed on section 96 issues. Even if the Tribunal's conclusions on section 96 were, strictly speaking, unnecessary for the Tribunal to decide given the outcome of its analysis under section 92, the Commissioner had no practical alternative but to respond to the section 96 efficiencies defence raised by P&H and to do so with an expert report;

- The Commissioner had to prepare for and conduct discovery on section 96 issues, quantify the anti-competitive effects in accordance with the principles established in *Tervita SCC*, file an expert report, address section 96 issues at the hearing, and respond to issues related to the proper interpretation of subsection 96(2), all of which affected the time spent by legal counsel;

- The Tribunal considers that P&H's approach to the section 96 issues in this proceeding tended to unnecessarily increase the Commissioner's costs and increase the time spent on the proceeding. A considerable part of the Commissioner's legal costs in relation to section 96 and its disbursement for Mr. Harington's report could have been avoided.

785 Exercising its discretion, the Tribunal concludes that the appropriate costs award to P&H for legal fees in this matter should be fixed at CAD $157,000, which represents approximately 75% of P&H's legal fees as claimed under Tariff B, Column IV.

(2) Disbursements

786 The Tribunal has considered the positions of both parties with respect to each of the claims made by P&H for the disbursements it incurred in this litigation.

787 P&H claims expert fees in the amount of approximately CAD $1.61 million. Having regard to the Tribunal's positive treatment of Ms. Sanderson's evidence, but also to the overall reasonableness of the quantum claimed by P&H to be reimbursed by the Commissioner, the Tribunal finds CAD $1.2 million to be a reasonable sum in respect of expert fees.

788 The Tribunal recognizes that this hearing was conducted not only electronically (as is standard at the Tribunal) but entirely virtually, and in very unusual circumstances owing to the COVID-19 pandemic. P&H decided that its counsel would travel to Winnipeg, at or close to its witnesses (particularly Mr. Heimbecker), and presumably close to P&H's offices. For the hearing, P&H set up an operations centre at a hotel, necessitating the rental of a large room (to maintain physical distancing and set up the appropriate equipment for a virtual hearing with all the required computers and technical support).

789 P&H claims a disbursement of approximately CAD $126,000 for hotel conference rooms and audio visual display equipment used during examinations for discovery and, later, during the facts portion of the hearing. The Commissioner submitted that these amounts were excessive, noting his own claim for just CAD $2,200. The Tribunal does not accept the Commissioner's comparison of P&H's costs for four witnesses to testify in Manitoba, versus the 10 witnesses called by the Commissioner. Having decided that counsel would travel to Winnipeg (which the Tribunal does not find appropriate to question in this case), the Tribunal finds that the rental of space and equipment was reasonable given the COVID-19 restrictions in Manitoba at the time. Although some charges on the invoices related to food and package deliveries and the amounts charged for space and equipment appear quite high on a daily basis, the Tribunal finds it appropriate that the Commissioner make a reasonable contribution to this expense in the amount of CAD $50,000.

790 P&H claimed payments made for case law searches in third party legal databases in the amount of approximately CAD $32,000. The evidence reveals more than 300 searches, done mostly in the two months leading up to the hearing. It is unclear whether those searches related to two motions argued and decided during the same period, or to the legal issues arising in the hearing itself. (On one motion, costs were awarded in the cause whereas no costs were awarded in the other.) The Tribunal recognizes that most legal research is done online and at the time, the law firm personnel were likely working from home and without a law library. It is also clear that some of the legal issues raised by the Commissioner's position and by P&H (for example, preliminary issues and the interpretation of subsection 92(2)) required legal research. Although the Commissioner did not object in his submissions, the Tribunal finds that the high number of searches and absence of details as to what the searches concerned (motions as opposed to hearing; issues raised by each party) support a reasonable claim for CAD $8,000.

791 P&H sought reimbursement for air travel to and from Winnipeg in the amount of CAD $31,500. Its claim was based on 50% of the actual cost of a private jet for two counsel to travel to Winnipeg and back for discovery, and later for the fact portion of the hearing. Reviewing the invoices, it appears that at both the discovery and hearing stages, the aircraft flew from Winnipeg to Toronto (without passengers on board other than flight crew) to pick up P&H's counsel and returned the same day. The aircraft made a trip to return counsel to Toronto upon completion of both the discoveries or portion of the hearing, and then flew back to Winnipeg without passengers on board other than flight crew. The invoices reflect charges for round-trips even though counsel were on board one way only. The Tribunal will allow a claim for CAD $4,500, which (on the evidence) approximates a full fare economy air ticket for two counsel to fly between Toronto and Winnipeg for discovery and for the fact portion of the hearing.

792 P&H claims approximately CAD $31,600 for transcripts of the examinations for discovery and the hearing and approximately CAD $10,600 for data hosting, which was necessary for the virtual hearing at the Tribunal. The Tribunal allows these claims in their entirety.

793 The Tribunal allows claims for photocopies and printing in the amount of CAD $800 and for hotels and meals during examinations for discovery and at the hearing in the aggregate of the amount of CAD $8,000 (based on a contribution to the cost of hotel rooms for two counsel and a reasonable *per diem* for meals).

794 P&H claimed approximately CAD $6,000 in courier costs attributable, for example, to counsel working from home during the pandemic and materials sent by counsel to the panel members and the Tribunal Registry during the hearing. The Tribunal notes that most (approximately CAD $4,200) of P&H's claim in that regard relates to a single package sent from Winnipeg to Toronto to return materials and equipment after the fact portion of the hearing ended. The Tribunal considers CAD $2,000 as a reasonable contribution towards courier costs.

795 P&H claimed meals in the amount of approximately CAD $1,350 in addition to those claimed by hearing counsel, which the Tribunal notes was not an appropriate claim for costs purposes.

796 A claim for conference calls in the amount of CAD $127 is *de minimis* in this context. The Tribunal notes that certain calls occurred before the litigation began.

C. Conclusion on costs

797 In light of the foregoing, the Tribunal awards costs for legal fees in the lump sum amount of CAD $157,000, inclusive of applicable taxes. The total of all disbursements allowed is CAD $1,315,500, inclusive of applicable taxes.

798 The Tribunal therefore concludes that the Commissioner shall pay an all-inclusive aggregate lump sum amount of CAD $1,472,500 to P&H in respect of costs of this proceeding.

X. ORDER

799 The Application brought by the Commissioner is dismissed.

800 Within 30 days from the date of this Order, the Commissioner shall pay to P&H an amount of CAD $1,472,500.

801 These Reasons are confidential. In order to enable the Tribunal to issue a public version of the Reasons, the Tribunal directs the parties to attempt to reach an agreement regarding the redactions to be made to these Reasons in order to protect confidential evidence and information. The parties are to jointly correspond with the Tribunal Registry by no later than the close of business on November 14, 2022, setting out their agreement and any areas of disagreement concerning the redaction of the confidential version of the Reasons. If there is any disagreement, the parties shall separately correspond with the Tribunal setting out their respective submissions with respect to any proposed, but contested, redactions from these confidential Reasons. Such submissions are to be served and filed with the Tribunal Registry by the close of business on November 14, 2022.

Schedule"A" — Relevant provisions of the Act

Mergers

[...]

Order

92 (1) Where, on application by the Commissioner, the Tribunal finds that a merger or proposed merger prevents or lessens, or is likely to prevent or lessen, competition substantially

(a) in a trade, industry or profession,

(b) among the sources from which a trade, industry or profession obtains a product,

(c) among the outlets through which a trade, industry or profession disposes of a product, or

(d) otherwise than as described in paragraphs (a) to (c),

the Tribunal may, subject to sections 94 to 96,

(e) in the case of a completed merger, order any party to the merger or any other person

(i) to dissolve the merger in such manner as the Tribunal directs,

(ii) to dispose of assets or shares designated by the Tribunal in such manner as the Tribunal directs, or

(iii) in addition to or in lieu of the action referred to in subparagraph (i) or (ii), with the consent of the person against whom the order is directed and the Commissioner, to take any other action, or

(f) in the case of a proposed merger, make an order directed against any party to the proposed merger or any other person

(i) ordering the person against whom the order is directed not to proceed with the merger,

(ii) ordering the person against whom the order is directed not to proceed with a part of the merger, or

(iii) in addition to or in lieu of the order referred to in subparagraph (ii), either or both

(A) prohibiting the person against whom the order is directed, should the merger or part thereof be completed, from doing any act or thing the prohibition of which the Tribunal determines to be necessary to ensure that the merger or part thereof does not prevent or lessen competition substantially, or

(B) with the consent of the person against whom the order is directed and the Commissioner, ordering the person to take any other action.

Evidence

(2) For the purpose of this section, the Tribunal shall not find that a merger or proposed merger prevents or lessens, or is likely to prevent or lessen, competition substantially solely on the basis of evidence of concentration or market share.

Factors to be considered regarding prevention or lessening of competition

93 In determining, for the purpose of section 92, whether or not a merger or proposed merger prevents or lessens, or is likely to prevent or lessen, competition substantially, the Tribunal may have regard to the following factors:

(a) the extent to which foreign products or foreign competitors provide or are likely to provide effective competition to the businesses of the parties to the merger or proposed merger;

(b) whether the business, or a part of the business, of a party to the merger or proposed merger has failed or is likely to fail;

(c) the extent to which acceptable substitutes for products supplied by the parties to the merger or proposed merger are or are likely to be available;

(d) any barriers to entry into a market, including

(i) tariff and non-tariff barriers to international trade,

(ii) interprovincial barriers to trade, and

(iii) regulatory control over entry,

and any effect of the merger or proposed merger on such barriers;

(e) the extent to which effective competition remains or would remain in a market that is or would be affected by the merger or proposed merger;

(f) any likelihood that the merger or proposed merger will or would result in the removal of a vigorous and effective competitor;

(g) the nature and extent of change and innovation in a relevant market;

(g.1) network effects within the market;

(g.2) whether the merger or proposed merger would contribute to the entrenchment of the market position of leading incumbents;

(g.3) any effect of the merger or proposed merger on price or non-price competition, including quality, choice or consumer privacy; and

(h) any other factor that is relevant to competition in a market that is or would be affected by the merger or proposed merger.

[...]

Exception where gains in efficiency

96 (1) The Tribunal shall not make an order under section 92 if it finds that the merger or proposed merger in respect of which the application is made has brought about or is likely to bring about gains in efficiency that will be greater than, and will offset, the effects of any prevention or lessening of competition that will result or is likely to result from the merger or proposed merger and that the gains in efficiency would not likely be attained if the order were made.

Factors to be considered

(2) In considering whether a merger or proposed merger is likely to bring about gains in efficiency described in subsection (1), the Tribunal shall consider whether such gains will result in

(a) a significant increase in the real value of exports; or

(b) a significant substitution of domestic products for imported products.

Restriction

(3) For the purposes of this section, the Tribunal shall not find that a merger or proposed merger has brought about or is likely to bring about gains in efficiency by reason only of a redistribution of income between two or more persons.

Schedule"B" — List of Exhibits

Exhibit No.	***Description***
P-A-001	Witness Statement of Mr. Alistair Pethick
CA-R-002	Purchase Receipts from Pethick Farms (Confidential — Level A)
P-R-003	Purchase Receipts from Pethick Farms
CA-R-004	2018 Purchase Receipts from Pethick Farms (Confidential — Level A)
P-R-005	2018 Purchase Receipts from Pethick Farms
CA-R-006	Excel Table Summarizing Purchases of Grain by Pethick Farms (Confidential — Level A)
P-R-007	Excel Table Summarizing Purchases of Grain by Pethick Farms
CA-R-008	2019 Purchase Receipts from Pethick Farms (Confidential — Level A)
P-R-009	2019 Purchase Receipts from Pethick Farms
CA-R-010	Purchase Contracts from Pethick Farms (Confidential — Level A)
P-R-011	Purchase Contracts from Pethick Farms
CA-R-012	Grain Purchase Order Agreement of Mr. Pethick (Confidential — Level A)
P-R-013	Grain Purchase Order Agreement of Mr. Pethick
P-A-014	Witness Statement of Mr. Harvey Brooks
P-R-015	PDQ Update Notice from Alberta Wheat Commission
P-R-016	"Where's My Region?" Map from PDQ
P-R-017	Rosetown "Where's My Region?" Map from PDQ
P-R-018	Virden "Where's My Region?" Map from PDQ
P-R-019	Moosomin "Where's My Region?" Map from PDQ
P-R-020	Fairlight "Where's My Region?" Map from PDQ
P-R-021	Wheat Market Outlook and Price Webpages from Sask Wheat
P-R-022	FOB Wheat Prices and Export Basis Prices Calculation pdf from Sask Wheat
P-R-023	Sask Wheat Strategic Plan 2018-2020
P-R-024	Sask Wheat Port Capacity Article
CB-A-025	Witness Statement of Mr. Chris Lincoln (Confidential — Level B)
P-A-026	Witness Statement of Mr. Chris Lincoln
CA-R-027	Chris Lincoln Deliveries 2016-2019 (Confidential — Level A)
P-R-028	Chris Lincoln Deliveries 2016-2019
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P-A-081	Transcripts from "Lessons Learned in Marketing" - Phoenix Group Podcast, dated January 15, 2018
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CA-A-205	Ceres Compendium (Confidential — Level A)
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CA-R-230	Compilation of Documents re Chris Lincoln (Confidential — Level A)
P-R-231	Compilation of Documents re Chris Lincoln
CA-R-232	Compilation of Documents re [text omitted] (Confidential — Level A)
P-R-233	Compilation of Documents re [text omitted]
CA-R-234	Compilation of Documents re Tim Duncan (Confidential — Level A)
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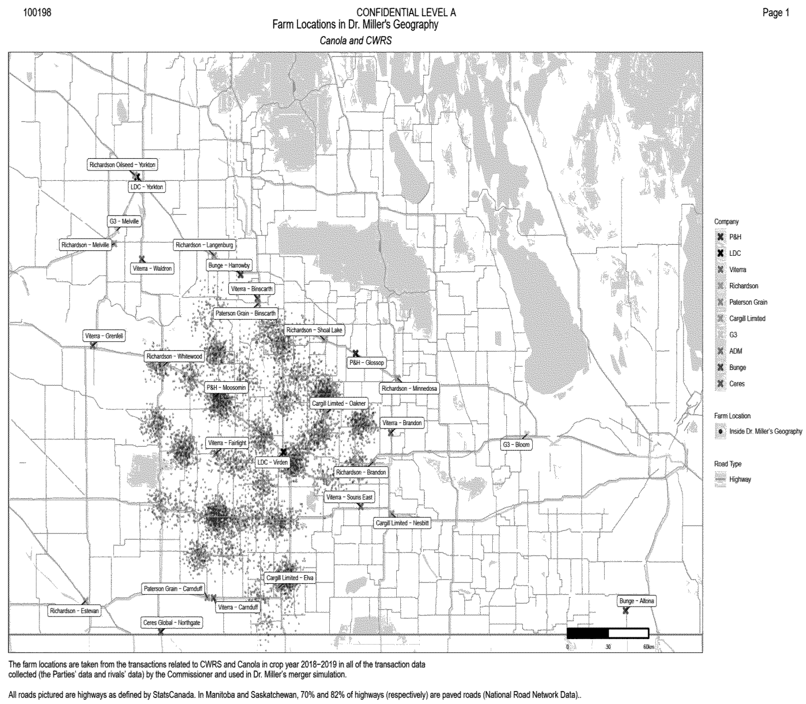
P-R-251	Map with Farmer Witnesses and Elevators and Crushers
P-R-252	Interactive Elevators and Crushers Map

P-A-253 List of Elevators

Schedule"C" — Map representing farm locations as well as Elevators and Crushers in Dr. Miller's geography



Graphic 1

Footnotes

1 Where the words "Tribunal" or "panel" are used and the decision relates to a matter of law alone, that decision has been made solely by the judicial members of the Tribunal.

2 The Tribunal pauses to note that the Commissioner is not claiming that the Acquisition substantially *prevents* competition. Hence, in these Reasons, the Tribunal's analysis will be limited to the Commissioner's alleged substantial *lessening* of competition.

3 In his oral and written submissions, the Commissioner often refers to the Basis as the "basis price."

4 In these Reasons, the word "*MEGs*" will also be used to refer to the Competition Bureau's merger guidelines more generally.

5 Throughout these Reasons, all references to a SSNIP are meant to include a SSNDP when the context requires it.

6 To assist the reader of these Reasons, the Tribunal reproduces at Schedule "C" a map representing the location of farms and the location and identity of the Elevators and Crushers operating in Dr. Miller's geography (Exhibit P-R-250, Map with Farm Locations in Dr. Miller's Geography).

7 In the corridor of concern, a total of 80 farms sold wheat, 77 farms sold canola, and 82 farms sold either wheat or canola.

8 In a situation involving the purchase of a product and potential monopsony power, the determination to be made is whether prices are or likely would be *materially lower* than in the absence of the merger. In this discussion on the analytical framework, all references to "price increases" or "material price increases" are meant to relate to mergers involving the sale of a product and potential monopoly power. For mergers involving the purchase of a product and potential monopsony power, all references would be to "price decreases" or "material price decreases."

2022 Comp. Trib. 3
Competition Tribunal

Canada (Commissioner of Competition) v. Secure Energy Services Inc.

2022 CarswellNat 321, 2022 Comp. Trib. 3

IN THE MATTER OF an application by the Commissioner of Competition for one or more orders pursuant to section 92 of the Competition Act, RSC 1985, c C-34 as amended

The Commissioner of Competition (Applicant) and Secure Energy Services Inc. (Respondent)

Michael J. Phelan Member

Heard: January 28, 2022
Judgment: February 15, 2022
Docket: CT-2021-002

Counsel: Jonathan Hood, Paul Klippenstein, Ellé Nekiar, for Applicant, Commissioner of Competition
Robert Kwinter, Nicole Henderson, Brian Facey, for Respondent, Secure Energy Services Inc.

***Michael J. Phelan Member*:**

REASONS FOR ORDER AND ORDER REGARDING THE RESPONDENT'S MOTION TO COMPEL THE COMMISSIONER TO PROVIDE PROPER AND COMPLETE ANSWERS TO REFUSALS ON DISCOVERY

I. NATURE OF MATTER

1 This is Secure Energy Services Inc.'s [Secure/Respondent] motion [Secure's Motion] following the discovery of the Commissioner's representative. It was heard along with the Commissioner's motion to compel Secure to answer certain questions. The Tribunal has ruled on the Commissioner's motion. Ultimately Secure's Motion comes down to whether some or all of the questions identified in Schedule A to Secure's Motion should be answered. This Order will address the specific questions to be answered as well as the applicable principles regarding the types of questions. Many of the disputed questions related to information arising from the Commissioner's investigation of the Tervita/Newalta merger previously described in the Tribunal's decision related to the Commissioner's discovery motion.

2 The Commissioner has taken the position that it is only required to answer questions about facts learned related to the Tervita-Newalta merger whereas Secure takes the position that the Commissioner has a broader obligation to answer questions based on the Commissioner's "information, knowledge and belief" — the usual discovery standard.

3 Secure recognizes, properly I add, that certain types of questions are improper to ask of the Commissioner including those seeking expert opinion and analysis — sometimes a difficult distinction. Secure does not ask for new analyses to be performed but says that the Commissioner's refusals relate to the Commissioner's existing knowledge, information and belief about a completed transaction involving one of the merging parties in (arguably) the same product and geographic market.

4 The Tervita/Newalta merger's relevance or potential relevance to the Secure/Tervita Merger [Merger] is obvious from the facts in issue and from the pleadings in the litigation. The Commissioner does not seriously dispute the relevance of the Tervita/Newalta merger to the issues in this case. It just seeks to shield itself from disclosing some of what it learned from its review of that merger.

II. CONSIDERATIONS

5 Generally Secure's position better reflects the discovery obligations of a party in a Tribunal matter — including the Commissioner's. The Tribunal has taken a broad approach to the discovery obligation and has provided guidance, which I adopt, in The Commissioner of Competition v Live Nation Entertainment, Inc et al, 2019 Comp Trib 3 [, and The Commissioner of Competition v Vancouver Airport Authority, 2017 Comp Trib 16 [.

6 The following quotes from *Live Nation* reflect the Tribunal's approach to the discovery obligation:

> [6] ... It is now well-recognized that a liberal approach to the scope of questioning on discovery should prevail (*Lehigh* at para 30). What the parties and the Tribunal are both trying to achieve with examinations for discovery is a level of disclosure sufficient to allow each side to proceed fairly, efficiently, effectively and expeditiously towards a hearing, with sufficient knowledge of the case each party has to meet (*The Commissioner of Competition v Vancouver Airport Authority*, 2017 Comp Trib 16 ("VAA") at para 46). If a party does not disclose relevant facts or information known to it until trial, the other side will be unfairly disadvantaged.
>
> [7] ... FC Rule 240 provides that a person being examined for discovery must answer, to the best of the person's knowledge, information and belief, any question that is relevant to the unadmitted facts in the pleadings.
>
> [8] ... At the discovery stage, relevance is a generous and flexible standard (*Apotex Inc v Sanofi-Aventis*, 2011 FC 52 at para 19). Doubts on the issue of relevance are to be resolved in favour of disclosure, and questions will typically need to be answered unless they are clearly improper.
>
> . . .
>
> [10] That being said, even when questions do meet the standard of relevance, courts have nonetheless delineated some boundaries to the type of questions that may be asked on examinations for discovery. A party can properly ask for the factual basis of the allegations made by the opposing party and for the facts known by such party, but it cannot ask for the facts or evidence relied on by the party to support an allegation (*VAA* at paras 20, 27; *Montana Band v Canada*, 1999 CanLII 9366 (FC), [2000] 1 FC 267 (FCTD) ("*Montana Band*") at para 27; *Can-Air Services Ltd v British Aviation Insurance Company Limited*, 1988 ABCA 341 at para 19). In *Apotex Inc v Pharmascience Inc*, 2004 FC 1198, aff'd 2005 FCA 144 ("*Apotex*"), the Federal Court further established that witnesses are not to testify on pure questions of law: a fundamental rule is that an examination for discovery may seek only facts, not law. Accordingly, the following types of questions have generally been found not to be proper subject matters for discovery: (i) questions seeking expert opinion, (ii) questions seeking the witness to testify as to questions of law, (iii) questions seeking law or argument, as opposed to facts, and (iv) questions where the witness is being asked "upon what facts do you rely for paragraph x of your pleading" (*Bard Peripheral Vascular, Inc v W.L. Gore & Associates, Inc*, 2015 FC 1176 at para 19).
>
> [11] ... The scope of permissible discovery will ultimately depend "upon the factual and procedural context of the case, informed by an appreciation of the applicable legal principles" (*Lehigh* at paras 24-25; see also *VAA* at paras 41 46).

7 In outlining the broad scope of discovery applicable to parties, it is important to recognize the somewhat unique status of the Commissioner. This was touched upon at *VAA*, paras 43-44:

> [43] **Other factors colour the examination for discovery process in Tribunal matters. First, the Commissioner is a unique litigant in proceedings before the Tribunal. The Commissioner is a non-market participant and his representatives have no independent knowledge of facts regarding the market and behaviour at issue. Rather, all of the facts or information in the Commissioner's possession, power or control arise from what he has gathered from market participants in the course of his investigation of the matter at stake. The Commissioner and his representatives do not have the direct and primary knowledge of the facts supporting the Application. This means that it may typically be more difficult and challenging for a representative of the Commissioner to exhaustively describe "all facts known" to the Commissioner.**

> [44] **Second, expeditiousness and considerations of fairness are two fundamental elements of the Tribunal's approach and proceedings.** Subsection 9(2) of the *Competition Tribunal Act*, RSC 1985, c 19 (2nd Supp) directs the Tribunal to conduct its proceedings "as informally and expeditiously as the circumstances and considerations of fairness permit". Ensuring both expeditious litigation and adequate protection of procedural fairness is thus a statutory exigency central to the Tribunal's functions. The Tribunal endeavours to make its processes quick and efficient and, at the same time, never takes lightly concerns raised with respect to the procedural fairness of its proceedings. Furthermore, as I have indicated in the *VAA Privilege Decision*, since proceedings before the Tribunal are highly "judicialized", they attract a high level of procedural fairness (*VAA Privilege Decision* at para 159). It is well-established that the nature and extent of the duty of procedural fairness will vary with the specific context and the different factual situations dealt with by the Tribunal, as well as the nature of the disputes it must resolve (*Baker v Canada (Minister of Citizenship and Immigration)*, [1999] 2 SCR 817 at paras 25-26; *VAA Privilege Decision* at paras 165-170).
>
> [Tribunal's emphasis]

8 The guiding principles for this discovery obligation are relevance and fairness as reflected in para 46 of *VAA*.

9 While the Tribunal has recognized the limits on the source of the Commissioner's knowledge, information and belief, the Commissioner has the obligation to meet the discovery disclosure standard subject to usual issues of relevance, privilege and proportionality to name a few.

10 In respect of relevance, discovery cannot be used as a tool to review the Commissioner's conduct of another merger investigation. The issue before the Tribunal is not the "reasonableness" of the Commissioner's decision to challenge this merger — it is not judicial review nor is it a review of the Commissioner's decision not to challenge the other related merger or any other merger. It is not about how the Commissioner conducted its investigations or the techniques used in those investigations. Whether they were proper and well conducted or botched is of no relevance to the Tribunal's consideration of the alleged substantial lessening of competition of this Merger.

11 That being said, recognition that the Commissioner is not a typical litigant does not support the proposition that the Commissioner can be insulated from the basic tenets of discovery or of the examination for discovery process (See Canada (Director of Investigation and Research) v NutraSweet, [1989] CCTD No 54 at para 35 []).

12 An important aspect of oral discovery is that of obtaining admissions from the opposing party. This process can involve probing inquiry of matters and issues (*VAA*, para 41).

13 As explained in *NutraSweet* and in *The* Commissioner of Competition v Direct Energy Marketing Limited, 2014 Comp Trib 17, Secure is entitled to be provided with the relevant factual information underlying the Commissioner's application and the allegations therein, to know the case it has to meet, to obtain sufficient information respecting specific facts in issue.

14 As with all motions regarding refusals, one must examine the questions at issue, the context, and their true nature. The Tribunal must determine the true nature of the question posed and ensure that questions are not a disguised manner of trying to obtain that which is not permitted. As acknowledged at para 63 of *VAA*, requiring the Commissioner to outline the facts and sources cannot be a disguised way to requiring disclosure of the "fact relied upon" by the Commissioner.

15 There is no magic formula for determining whether a question should be answered. It requires a review of the question as posed, the subject matter and the context.

16 In keeping with the underlying principles of discovery including that ultimate relevance and weight will be determined by the hearing tribunal, this stage of the litigation favours disclosure.

17 It is not a realistic premise that if there is true surprise by matters which should have been disclosed, an adjournment can be granted to allow the surprised party time to consider their position. While such remedy does exist, in these scheduled

and time managed proceedings, the process of stopping the hearing and restarting is inefficient, disruptive and difficult for the parties and the Tribunal itself. Adjournment is a last resort, not a "going in" proposition.

III. QUESTIONS IN ISSUE

A. Customer based approach

18 Q 156 asks whether the Commissioner used "the customer based" approach and more directly phrased, Secure is seeking an admission as to the Commissioner's knowledge which is a proper line of questions.

19 Q 157, on the other hand, seeks to question the Commissioner's decisions during the inquiry process which is not pertinent and need not be answered.

B. Product/Geographic Markets

20 Q 332 seeks an admission that the Tervita/Newalta merger involves the same products and market as the Secure/Tervita Merger. The question could have been approached in stages of identifying the products of each and then comparing the answers. The question posed is a more efficient way to secure an admission on a relevant issue.

21 Q 332 includes a follow-up question seeking any differences. Both aspects should be answered within the context of the Commissioner's knowledge, information and belief.

22 Q 332 asks questions directed at how the Commissioner dealt with product markets *internally*. As such, it seeks information about how the Commissioner conducted the Tervita/Newalta merger review. The Commissioner's manner of conduct is not the issue in this litigation and the question need not be answered.

23 Q 333: for the same reasons as Q 332, it need not be answered.

24 Q 334: as this relates to geographic markets in the same way Q 332 related to product markets, it must be answered.

25 Q 335 is directed at the internal workings of the Commissioner's office and is irrelevant.

C. Tervita/Newalta Merger

26 Q 339 asks about the Commissioner's post Tervita/Newalta closing conduct and is irrelevant.

27 Q 350 to 354 asks about how the Commissioner conducted his analysis of aspects of the Tervita/Newalta merger. It is not relevant. The current litigation is not a process of comparing investigative activities as between merger reviews.

D. Dead Weight Loss

28 Q 355-358: the series of questions focuses on dead weight loss analysis. Dead weight loss is a key defence in this litigation. Apparently the Commissioner has knowledge, information or belief of aspects of dead weight loss in what is arguably the same product and geographic markets. To the extent that the questions do not require the production of expert opinion or engage privileged communication, the information is producible.

E. Other

29 Q 359 - 361 raises similar questions in respect to demand elasticity and for the same reasons and subject to the same caveats as above, they are to be answered.

30 Q 362 inquires into how the Commissioner conducted the Tervita/Newalta merger review and is irrelevant.

31 Q 363 inquires into efficiencies considered in the Tervita/Newalta merger and to the extent that the Commissioner has knowledge, information and belief on this subject and Secure is seeking an admission, the Commissioner is to answer. The fact that there may be expert opinion on a topic does not, in and of itself, form a valid grounds of refusal.

ORDER

FOR THE REASONS GIVEN, the Tribunal orders the following questions to be answered:

Q 156, 332, 334, 355 to 358, 359 to 361 and 363

2000 Trib. conc. 15, 2000 Comp. Trib. 15
Competition Tribunal

Canada (Commissioner of Competition) v. Superior Propane Inc.

2000 CarswellNat 3449, 2000 CarswellNat 7142, 2000 Trib. conc. 15, 2000 Comp. Trib. 15, [2000] C.C.T.D. No. 15, [2001] S.C.C.A. No. 252, 7 C.P.R. (4th) 385

In the Matter of the Competition Act, R.S.C. 1985, c. C-34, and the Competition Tribunal Rules, SOR/94-290, as Amended

In the Matter of an Inquiry Pursuant to Subsection 10(1)(b) of the Competition Act Relating to the Proposed Acquisition of ICG Propane Inc. by Superior Propane Inc.

In the Matter of an Application by the Commissioner of Competition Under Section 92 of the Competition Act

The Commissioner of Competition, (Applicant) and Superior Propane Inc. ICG Propane Inc., (Respondents)

Lloyd Member, Nadon Member, Schwartz Member

Heard: September 23, 1999 - February 9, 2000
Judgment: August 30, 2000
Docket: CT1998002

Counsel: *William J. Miller*, *Jo'Anne Strekaf*, *Steven T. Robertson*, *Jennifer A. Quaid*, *James E.J. Bocking*, *Ken Davidson*, for Applicant, The Commissioner of Competition
Neil Finkelstein, Melanie L. Aitken, Russell Cohen, Brian Facey, Martha Cook (Student at Law) for Respondents, Superior Propane Inc. and ICG Propane Inc.

Per Curiam:

I. Introduction

1 An application is brought by the Commissioner of Competition ("Commissioner") pursuant to section 92 of the *Competition Act*, R.S.C. 1985, c. C-34, (the "Act") for an order to dissolve the merger of Superior Propane Inc. ("Superior") and ICG Propane Inc. ("ICG") or otherwise remedy the substantial prevention or lessening of competition that is likely to occur in the market for propane in Canada upon the implementation of the said merger.

2 The application arises by reason of Superior's acquisition of ICG on December 7, 1998. Prior to the acquisition, Superior submitted a short-form prenotification filing pursuant to section 121 of the Act to the Competition Bureau regarding its proposed acquisition of all of the shares of The Chancellor Holdings Corporation, a wholly-owned subsidiary of Petro-Canada. The Chancellor Holdings Corporation, in turn, owned ICG. An inquiry into this merger was commenced by the Commissioner on August 14, 1998, pursuant to section 10 of the Act. On December 6, 1998, following two days of hearing, the Tribunal dismissed the Commissioner's application of December 1, 1998 brought under section 100 of the Act for an order forbidding the closing of the transaction for a period of 21 days. Further, on December 11, 1998, a consent interim order was issued by the Tribunal to hold separate the assets of Superior and ICG, excluding the non-overlapping locations situated in areas where Superior had no market presence.

3 Superior is a corporation constituted under the laws of Canada and is engaged primarily in the retailing and wholesaling of propane, as well as in the sale of propane consuming appliances and equipment and related services in all 10 provinces and territories. All of the outstanding shares of Superior are owned by the Superior Income Trust Fund (the "Fund"), a limited

purpose trust established for the purpose of holding debt and equity of Superior. The Fund has issued trust units which are listed on the Toronto Stock Exchange.

4 ICG is a corporation constituted under the laws of Canada and is engaged in selling and distributing propane and providing related services to customers in all Canadian provinces and territories except Prince Edward Island, Newfoundland and to a lesser extent, Nova Scotia. ICG operates through a network of company-owned distribution outlets and independent dealers located throughout its sales and distribution areas. In 1990, Petro-Canada indirectly acquired ICG and combined Petro-Canada's retail propane operations with ICG's business.

5 The Commissioner alleges that the merger will create a dominant national propane marketer and in several markets, a dominant local propane marketer. Both Superior and ICG compete against each other in the same geographic and product markets through their operations of propane distribution systems and wholesale supply of propane to agents and dealers.

6 Interlocutory proceedings in this matter were lengthy and vigorously contested. Upon application by the Commissioner, an interim order was issued on December 11, 1998 to preserve ICG's business as independent and viable pending the Tribunal's decision on the application. Various orders regarding confidentiality of documents and the scope of discovery were issued by the Tribunal.

7 Following the illness and inability of a panel member, Lorne Bolton, to attend the hearing in this matter, an Order Regarding the Constitution of a New Panel was issued on December 13, 1999. This order terminated the hearing before the panel constituted of Mr. Bolton, Dr. Schwartz, and Nadon J. and further constituted a new panel composed of Ms. Christine Lloyd, Dr. Schwartz and Nadon J. pursuant to section 10 and subsection 12(3) of the *Competition Tribunal Act*. The evidence on the record of the previous proceedings, including all the orders and rulings made by the Tribunal, were entered into the record of the hearing before the new panel pursuant to section 70 of the *Competition Tribunal Rules*.

8 The hearing of this matter took 48 days, 91 witnesses including 17 expert witnesses were called and a large number of documents were entered as exhibits.

II. Propane Business

9 Propane is a chemical commodity produced as a by-product of natural gas extraction and of crude oil refining. In Canada, 85 percent of propane production is derived from natural gas and accordingly is produced in the Western Canadian Sedimentary Basin. Propane volumes from crude oil are produced at oil refineries that are generally closer to population centres where the consumption occurs (e.g., Edmonton, Southern Ontario, Montreal, Quebec City).

10 Propane sourced from gas production is extracted and transported mixed with other natural gas liquids to fractionation sites where separation into "specification propane" takes place. In Canada, raw natural gas liquids are transported from producing regions in Alberta and northeast British Columbia via pipelines to "hubs" at Edmonton/Ft. Saskatchewan and at Sarnia, Ontario, where fractionation takes place. Fractionation into specification propane also takes place at straddle plants along pipelines and gas field plants in Alberta for marketing to western Canada.

11 Approximately 63 percent of propane produced in Canada is exported to the United States (expert affidavit of G. Mathieson (18 August 1999): exhibit A-2073 at 15). According to Statistics Canada data which are themselves disputed, total domestic consumption of approximately 77 million barrels per day ("mbpd") in 1998 occurred in the segments of residential/commercial/agricultural for space and water heating, cooking, appliances, crop drying (32 mbpd); industrial uses, e.g., forklifts, heating (17 mbpd), collectively, the "traditional segments"; in transportation, primarily automobile fuel (18 mbpd); and petrochemical feedstock (10 mbpd). Consistent with industry usage, "retail propane" includes total propane consumption less propane consumed as petrochemical feedstock and propane consumed by producers.

12 Although it appears that there are discrepancies in the consumption data published by different sources, autopropane consumption seems to have peaked in 1994 at 23 mbpd, stimulated by government-supported fleet conversions, and then

declined steadily as those programmes of financial assistance were ended along with other factors including the improved efficiency of gasoline engines.

13 Consumption of propane used as a heating fuel is subject to seasonal fluctuation and dropped dramatically from 39 mbpd in 1997 to 32 mbpd in 1998 due to warmer weather. Consumption in the industrial and petrochemical feedstock segments appears to have levelled. It seems that Canadian propane consumption is characterized by stable demand or modest growth at best.

14 There is some dispute as to the number of propane marketers operating in Canada. ICG's amended preliminary prospectus claims approximately 75 propane marketers including Superior, while Superior claims a total of 189 independent propane distributors. These propane marketers obtain propane supplies at refinery racks and at storage facilities owned by the major propane producers at prices based on postings at the Edmonton or Sarnia hubs and varying with the distance between these hubs and the supply point. Large marketers typically purchase their supplies under contracts that specify volume and price, or a pricing formula in terms of price per litre. These buyers may own or rent storage space close to the supply points which allows them to enter into "keep dry" arrangements at lower prices from producers. A keep-dry arrangement requires the buyer to take propane sufficiently regularly so that the producer does not have to maintain storage and, therefore, sells at a lower price to a buyer capable of honouring its commitments.

15 These buyers transport propane by truck or rail to their local storage facilities (primary distribution). Secondary distribution occurs when delivery to customers is made, usually by truck, from these local storage facilities.

16 Smaller propane marketers purchase propane on spot markets from the producers or from the larger marketers. In some cases, a smaller marketer acts as an agent in a local area for a major marketer that does not have a local delivery capability. For such arrangements, the customer contract is held by the major marketer who determines the pricing. Another relationship is the "bulk dealer", whereby a local company purchases propane from a major marketer under an agreement that specifies a territory in which that local dealer will not face competition from the major marketer or any of its other bulk dealers.

17 Propane marketers tend to be local and regional in their operations. At present, only two companies, Superior and ICG, supply end-users across Canada, either directly or through agents and dealers. The merging parties are well suited to supply customers that demand propane at multiple locations across the country.

18 The customer relationship is most frequently contractual. Almost all propane marketers undertake to deliver propane on a regular basis to customer locations at the prevailing price established by the marketer from time to time for a specific term with agreements lasting up to five years. The customer is free to terminate the contract on sufficient notice, but as the contract will often contain "meet or beat" and/or "right of first refusal" clauses, the current supplier may be able to maintain the customer's business.

19 In addition to delivering the propane, particularly to residential customers, the marketer usually provides customer storage tanks on a rental basis and installs and services propane-related equipment. It appears that most marketers do not fill a residential tank that they do not own.

20 Propane delivery is a regulated activity in all jurisdictions. Propane storage tanks and customer tanks must meet various safety standards, and the individuals who handle the propane must be licensed.

21 Although specification propane is a well defined commodity, the propane marketing companies generally differ with respect to reputation, length of time in the business, the terms and conditions they offer to customers, the ability to meet a customer's needs at multiple locations, etc. In addition, some marketers specialize in serving certain segments, while others seek customers in all segments. The result is that the "product" provided by a propane marketer is often differentiated on these dimensions from the offerings of its competitors.

III. Market Definition

A. Product Market

22 With respect to product market definition, the Commissioner submits in final argument that the relevant product market is the supply and delivery of propane, propane equipment and related services to retail and wholesale customers. The Commissioner also submits that the relevant product market can be further broken down into various end-uses and customer classifications including: residential, agricultural, commercial, industrial (collectively, the "traditional" segment), automotive, national and major account customers. As propane and related equipment and services appear to be strong complements, it will be convenient to define one product market rather than consider the three separate business lines mentioned.

23 The Commissioner alleges, in effect, that retail propane constitutes, by itself, a market over which market power can be exercised. Such a market will be referred to as a "competition market". The respondents assert that it is not a competition market because alternate fuels exist and consumers can and do easily switch to these alternatives. Their position is that retail propane is part of a broad energy market and hence that any attempt to exercise market power over retail propane could not be successful.

(1) Commissioner's Position

24 The Commissioner's experts, Richard Schwindt and Steven Globerman, presented a report evaluating the competitive effects of the proposed merger between Superior and ICG. With respect to product market definition, they provided opinion evidence that retail propane is the relevant competition market (expert affidavit of R. Schwindt and S. Globerman (16 August 1999): exhibit A-2056). They conclude that switching from propane to alternate fuels is difficult. For example, regarding residential heating applications, Professors Schwindt and Globerman observe, at page 10 of their report, that while most propane appliances can be readily converted to natural gas, nevertheless "in residential households where the piping from the outside of the house to the furnace is sized for propane and not for natural gas, conversion costs can be quite high". Further, regarding electricity, they observe at page 11 of their report that "at this time and into the foreseeable future, the price of electricity is so high relative to propane in several parts of the country that it is an unlikely substitute".

25 Further, Professors Schwindt and Globerman observe that heating oil could be a substitute for propane although propane is superior to oil with respect to cleanliness, environmental impact and odour. Convenience, storage requirements and capital costs do not differ significantly between the two fuels. However, their estimated costs of converting a residence in the Lower Mainland of British Columbia from a propane to an oil fired forced air furnace range from $4,500 to $5,300. At pages 12 and A-2 of their report, they conclude that it would take very significant price increases, in the range of 50 to 60 percent, to justify a switch to fuel oil. At page A-3, they conduct a similar analysis regarding switching from propane to heating oil in commercial heating and from propane to electricity for forklift trucks which leads to the same conclusion.

26 Regarding autopropane, Professors Schwindt and Globerman note at page 19 of their report that substitutability of alternate fuels, particularly gasoline, depends upon whether the vehicle is dual-fuel or dedicated to propane. They infer from an Imperial Oil Limited ("IOL") document that 95 percent of conversions to propane in British Columbia in the early 1990's were for commercial vehicles and nearly all of those were "propane dedicated" rather than dual-fuel, suggesting that substitution is slight.

27 The Commissioner further submits that switching costs are high and "create a lock-in effect for customers" with the result that cross-elasticity of demand is low.

28 The Commissioner submits that the payback period for changing related equipment and appliances from propane to alternate fuels may be significant. He states that, for instance, the life-cycle for fuel related equipment and appliances for the traditional sector such as residential furnace is on average in the range of 15 to 25 years. Therefore, a customer facing a propane price increase would have to consider this factor before converting this equipment.

29 In this regard, the Commissioner cites a study commissioned by ICG and produced by M. Pass Consulting Ltd. in August 1999, dealing with locations and markets where alternative fuels may pose either a competitive threat or an opportunity for ICG (exhibit A-2099). The study measures customer payback to switching fuel types (i.e., the time it would take for the savings in fuel costs to match the initial outlay for switching) under two scenarios: (a) when the existing appliance has useful life remaining, and (b) where the appliance requires replacement. The study demonstrates that converting from propane to electricity or fuel

oil, for most of the seven end-uses analysed, involves long and, in many cases, infinite payback periods and hence does not make economical sense in the short to mid-term when factoring all the relevant switching costs and not only the cost of the fuel.

30 The Commissioner also called a number of factual witnesses who testified that switching to alternate fuels was impeded by the difficulty and inconvenience of breaking existing contracts for supply and equipment. The inconvenience includes the difficulty in coordinating the removal of existing equipment and the installation of new supplier's equipment in a timely fashion (e.g., to avoid plant shut down or loss of residential heating), the cost of removing the leased equipment and the delays associated with getting a refund for the propane left in the tank. Superior's own public share offering documents (exhibits A-10 at 03890 and A-202 at 03899) emphasize these barriers to customer switching.

31 With respect to conversion costs, the Commissioner presented the evidence of a factual witness, Marilyn Simons, a residential user of propane from Renfrew, Ontario, who evaluated the costs to convert her home furnace from propane to heating oil, her propane stove to an electric stove and to replace her propane fireplace with wood-burning equipment. The total conversion costs amounted to approximately $12,300. Some witnesses testified that conversion costs would prevent them from switching to alternate fuels while others testified that an increase in the price of propane would have to be very significant before such conversion was made.

32 The Commissioner submits that there is only imperfect substitutability of alternate fuels for propane. In particular, he concedes that propane consumers do switch from propane to natural gas when this option is available and that, therefore, natural gas displaces rather than competes with propane.

33 The Commissioner also introduced the expert evidence of David Ryan and André Plourde whose report provides "empirical evidence concerning the role, importance and substitutability of propane as an energy source in Canada" (expert affidavit of D. Ryan and A. Plourde (16 August 1999): exhibit A-2076 at paragraph 1(a)). They studied energy consumption for propane, electricity, natural gas, refined oil products and wood in three sectors (residential, industrial and commercial) for each province or region depending on data availability. Then, using Statistics Canada and other government data from 1982 to 1996, the last year for which all of the relevant data series were available, they estimated short-run and long-run cross-price elasticities and own-price elasticities of propane demand for the years 1990 and 1996.

34 At paragraph 6.3.4(a) of their report, Professors Ryan and Plourde find that in about 35 percent of the cases considered, the own-price elasticity of propane demand is negative and significant, while it is positive and significant in fewer than four percent of the cases. The own price elasticity of demand is the percentage change in quantity of the product consumed that results from a one percent price increase in its price. In all other situations considered, no significant relationship between the quantity of propane demanded and its price can be detected. They conclude that, in general, a change in the price of propane will lead to smaller than proportional reductions in propane consumption, i.e., that propane demand is inelastic.

35 Regarding cross-price elasticity, statistically significant responses to propane price changes were identified in approximately 45 percent of the cases considered with substitution relationships outnumbering complementarity by a factor of about two-to-one. However, with the exception of oil products in Saskatchewan/residential and Quebec/industrial for 1996, all cross-price elasticities reported were less than one in absolute value. Indeed, in only two cases do cross-price elasticities exceed 0.6 in absolute value. They conclude that changes in propane prices induce proportionally smaller changes in the consumption of other energy types and, therefore, that propane and other energy types form different markets in the provinces/regions in Canada.

36 Although arguing for an "all propane" product market, the Commissioner suggests through expert evidence that certain end-use segments constitute relevant markets in themselves. This would indicate that if, for example, market power could be exercised in residential propane but not in the other end-use segments, then it would properly constitute a relevant competition market, and total consumption and market shares would be calculated within that segment.

37 At page 1 of their report (exhibit A-2056), Professors Schwindt and Globerman conclude that "retail propane distribution does constitute a relevant product market", despite the fact that they find evidence of segmentation among suppliers and

customers and they suggest that this segmentation is strong enough to qualify theses segments as separate product markets. They conclude at page 23 of their report as follows:

> ... However, given the limited availability of data with respect to market structure by geographical market, application, and in some cases customer, it would not be possible to determine the differential effects of the merger on competitive conditions across more rigorously and narrowly defined product markets. Moreover, the analysis that follows *would not be fundamentally altered by adopting a more refined product market definition*. (emphasis added)

38 Finally, the Commissioner argues that "national accounts" are a separate category of business in which the merged entity will be in a position to exercise market power. According to the Commissioner, a significant component of the customer base of each of the merging firms is the national and major accounts which have multiple locations spanning one or more regions across Canada.

(2) Respondents' Position

39 The respondents' position on the relevant product market is that propane competes with alternative fuels in the energy market and for each end-use, different alternate fuels are substitutes. They assert that interchangeability of propane and alternate fuels together with the evidence of inter-industry competition and the views of industry participants strongly indicate that propane and alternate fuels compete in the same market.

40 On the matter of customer switching, the respondents referred to the evidence of William Katz, a senior executive of AmeriGas Propane Inc. ("AmeriGas"), who testified that customers would switch to propane when it could be demonstrated that switching was economically attractive for them and not only at the end of the useful life of the equipment (transcript at 15:2602-604 (19 October 1999)). Mr. Katz also indicated that AmeriGas had success in switching customers to propane well before the end of the useful life of their existing equipment.

41 Further, the respondents assert that every year, a substantial number of propane and alternate fuel customers replace their existing equipment or make an initial fuel choice and accordingly choose from among the "entire menu" of fuel choices. The respondents note that customers making an initial fuel choice or replacing existing equipment face no incremental switching costs and, therefore, that customers whose equipment is in mid-life cycle pay the same price as those who are at the end of the cycle.

42 The respondents argue that propane industry views support the substitutability of alternative fuels. They state as an example that Steven Sparling of Sparling's Propane Company Limited ("Sparling") testified that his company considered any energy provider a competitor. This includes electricity, natural gas, fuel oil and propane marketers.

43 The respondents also submit that the Tribunal in the context of denying an injunction to the Commissioner in this case (see *Canada (Director of Investigation & Research) v. Superior Propane Inc.* (1998), 85 C.P.R. (3d) 194, at 207, 208, (Competition Trib.)) acknowledged the statements made by Superior and ICG in their securities filings regarding competition between propane and alternate fuels. At the time, Rothstein J. accepted that they were competing in a wide energy market on the basis that the statements contained in the prospectus and annual reports and in ICG's preliminary prospectus were "of some significance" and something upon which he should "place weight".

44 The respondents also assert that supply substitution is possible and that the relevant market should take account of firms that can easily switch their facilities to propane marketing. They submit that it is appropriate to include upstream industry participants and industrial gas companies as well as other distributors of alternate fuels.

45 Finally, the respondents suggest that the analysis conducted by the Commissioner's experts, Professors Ryan and Plourde, explicitly recognizes that alternate fuels and propane are substitutes in various places at various times for various end-uses.

(3) Analysis

46 There is clearly no commonality in the positions of the parties before the Tribunal on the appropriate definition of the product market. Accordingly, the Tribunal must decide which evidence is the more convincing.

47 The purpose of defining the relevant product market is to identify the possibility for the exercise of market power. This purpose was clearly asserted in the two previous merger cases heard by the Tribunal. In *Canada (Director of Investigation & Research) v. Southam Inc.* (1992), 43 C.P.R. (3d) 161, at 177, 178, (Competition Trib.), the Tribunal reiterated:

> The general issues with respect to the definition of a market in a merger case have been set in the *Hillsdown Holdings (Canada) Ltd.* decision, *supra*. The relevant market for purposes of merger analysis is one in which the merging firms acting alone or in concert with other firms could exercise market power. Market power is the ability of a firm or group of firms to maintain prices above the competitive level. Market power may also be exercised by offering, for example, poor service or quality or by restricting choice. When used in a general context, "price" is thus a shorthand for all aspects of firms' actions that bear on the interest of buyers....
>
> The delineation of the relevant market *is a means to the end of identifying the significant market forces* that constrain or are likely to constrain the merged entity....
>
> The critical issue is to ensure that all factors have been considered that have a bearing on whether there has or is likely to be a prevention or lessening of competition to a substantial degree. (emphasis added)

48 While market definitions should be as precise as possible within the limit of reasonableness to provide a framework within which competition implications of a transaction can be analysed, the Tribunal should not be preoccupied with market definition to the point of losing sight of the purpose of the exercise under the Act which is to determine whether the merger is likely to lead to a substantial prevention or lessening of competition. As stated by the Supreme Court of Canada in *Canada (Director of Investigation & Research) v. Southam Inc.*, [1997] 1 S.C.R. 748 (S.C.C.), at 788:

> ... More generally, I notice that the Tribunal seems to have been preoccupied with the definition of the relevant market. It is possible that the members may occasionally have lost sight of the ultimate inquiry, which is whether the acquisition of the community newspapers by Southam substantially lessened competition.

49 In the Tribunal's view, the factual and expert evidence on substitutability is very important. The Tribunal distinguishes between "switching" in its common sense meaning and substitutability in the economic sense; it is the latter that is important in delineating a relevant product market. It may be, as the respondents claim, that at the end of the useful life of their heating or other energy-using equipment, consumers do switch to propane from alternate fuels depending, in part at least, on differences in fuel prices. However, this behaviour demonstrates *de novo* choice; at the end of their equipment life cycle, those consumers are in the same position as when they first chose a fuel. This behaviour is not evidence of substitutability, which refers to changing a consumption pattern in response to a price change with all other determinants of change, including the age of equipment, held constant.

50 Mr. Katz stated that AmeriGas was successful in attracting customers to propane from other fuels before the end of the useful life of their existing equipment. However, he provided no quantitative evidence as to AmeriGas's success in this regard and accordingly, it is difficult for the Tribunal to judge the extent of such success.

51 Mr. Sparling's testimony is that Sparling is seeking to attract new propane customers in the new housing developments. If Sparling is successful, it is evidence that such customers are making fuel choices as a consequence of a decision to relocate. While this residential location decision may involve a change in fuel, it does not demonstrate that the price of propane was the reason for the move and hence does not provide evidence of substitution.

52 In its 10-K securities filing in the United States, AmeriGas makes similar comments about competition from alternate fuels. However, in the absence of evidence showing significant customer switching during the life of the existing equipment,

the Tribunal is of the view that the evidence of AmeriGas does not support the substitutability of alternate fuels for competition market purposes.

53 As to the views of industry participants, Sparling may well be correct in some long-term sense in its view that propane competes with all alternate fuels. However, no evidence indicates that Sparling's behaviour is affected by inter-fuel competition. According to Mr. Sparling, the company is mainly concerned about "consistent pricing" from customer to customer and not with pricing in relation to alternate fuels (transcript at 12:1731 (14 October 1999)). Moreover, Sparling has not experienced customers switching to other fuels other than natural gas (*ibid.* at 1733).

54 Hence the Tribunal does not accept that propane industry views support the substitutability of alternate fuels in the mind of consumers. Indeed, witnesses consider alternate fuels for the most part at the end of equipment life cycle, rather than in a shorter period of time in which market power could be exercised and which is relevant for merger review.

55 As to the conclusions drawn by Rothstein J. in denying the injunction sought by the Commissioner, it suffices to note that he did not have the benefit of the extensive record and expert opinions that were produced during the 48-day hearing of the application under section 92.

56 The Tribunal notes that the Act does not require that markets be delineated. However, the Tribunal accepts that the delineation of competition markets is one way of demonstrating the likely competitive effect of a merger and that, where such an approach is valid, the competition market adopted must be relevant to the purposes and goals of the merger provisions of the Act, which focus on the creation or enhancement of market power. In this connection, the Tribunal notes that there could be many competition markets containing retail propane. For example, it might be found that market power could be exercised over a product market consisting of retail propane, fuel oil, natural gas and electricity or any sub-group thereof. The share of retail propane in a market becomes larger as products are removed from the definition of the market. It is not clear, however, that any such market is the relevant competition market.

57 The Tribunal believes that it is important to provide a principled basis in this regard in order to avoid gerrymandering of market boundaries. To determine which set of products is the relevant one for the purpose of merger review under the Act, the Tribunal agrees with the approach taken in the *Merger Enforcement Guidelines* ("MEG's") (Consumer and Corporate Affairs Canada, Director of Investigation and Research, *Merger Enforcement Guidelines*, Information Bulletin No. 5 (Supply and Services Canada, March 1991)), which seeks to identify the smallest competition market, in terms of the number of included products, over which market power could be exercised. Thus, if market power can be exercised over a market consisting only of retail propane, then that market is the competition market that is relevant for merger review.

58 In this matter, the Tribunal accepts the statistical evidence of Professors Ryan and Plourde. Their evidence on cross-elasticity of demand clearly establishes that there are only a few areas of the country where substitution has occurred. Moreover, where substitution was found, the extent thereof was found to be small.

59 The cross-price elasticity of demand concept is frequently used in market definition. This measure identifies a product as a substitute if its quantity demanded rises when the price of the good in question rises. For any pair of products A and B there will be two such elasticities (the percentage change in consumption of product A when the price of product B increases by one percent, and the percentage change in the consumption of product B when the price of product A increases by one percent). Absent direct evidence thereto, there is no reason to suppose that these two cross-price elasticities of demand will be equal or even that both will be positive; in short, there is no such thing as *the* cross-price elasticity of demand. Therefore, cross-elasticity evidence showing that B is a substitute for A does not establish that A and B are substitutes for each other and hence is not sufficient to place products A and B in the same competition market. To use cross-elasticity of demand for this purpose would require further evidence that A is also a substitute for B.

60 The respondents' expert witness, Dennis Carlton, agreed in his testimony that both cross-elasticities of demand would be needed in order to place two products in the same competition market. The Commissioner implicitly adopts this approach when stating that, because of its lower price, natural gas "displaces" propane in an area when natural gas becomes available. This

statement indicates the Commissioner's view that once propane users have switched to natural gas, they do not switch back; but since switching in the opposite direction does not occur, therefore, propane and natural gas cannot constitute a competition market. The Tribunal agrees that to show that natural gas and propane are in the same competition market would require evidence that propane customers switch to natural gas when the price of propane increases as well as evidence that natural gas customers switch to propane when the price of natural gas increases. In other words, reciprocal substitutability must be demonstrated. The displacement argument suggests only one-way substitutability between propane and natural gas. Therefore, the Tribunal is not convinced that natural gas and propane constitute a competition market.

61 The more important limitation on the use of the concept of cross-price elasticity of demand to delineate markets is its indirect relevance to the exercise of market power. The definition of the relevant competition market does not depend on identifying particular substitutes in some pairwise fashion. Rather, the important question is whether, on a price increase by a firm, enough of its sales would be lost to all competing products, regardless of their number or identity, to make the price increase unprofitable. If this were the case, then a relevant competition market would not be found; that firm would not be able to exercise market power. A cross-elasticity estimate may identify a substitute and can be helpful in delineating a market, but it does not directly measure the ability of a firm to raise the price.

62 As the Supreme Court of Canada stated in *Southam*, cited above at paragraph [48], at page 760, evidence of demand elasticities when available and reliable can be determinative for market definition. Thus, the Tribunal believes that the own price elasticity of demand is the correct elasticity for defining competition markets and should be preferred over cross-price elasticity of demand for the reasons above.

63 The Tribunal places greater weight on Professors Ryan and Plourde's evidence regarding the "own-price elasticity of demand" as this concept is directly related to the issue of market power and hence to market delineation. The evidence demonstrates that the demand for propane is inelastic with respect to changes in its price, i.e., that consumers reduce their consumption of propane only slightly when the price rises. Although the data did not permit Professors Ryan and Plourde to measure retail propane demand by local market, their results were not challenged on this basis and the Tribunal is satisfied that propane demand is inelastic with respect to price for time periods for which the Act is intended to apply.

64 Thus, consistent with the approach taken in the MEG's, cited above at paragraph [57], if retail propane were hypothetically monopolized, that monopolist would face an inelastic demand curve and, according to conventional monopoly theory, would raise the price at least to the point where demand became elastic. Once the monopolist was operating on the elastic portion of the propane demand curve, further price increases would be imposed only if they were profitable.

65 Accordingly, if retail propane demand is so price-sensitive (i.e., elastic) that a hypothetical monopolist that was the only current and future seller would not impose a significant and non-transitory price increase, then retail propane cannot be a relevant competition market and the market would have to be expanded to include another fuel. However, if the demand curve is sufficiently insensitive (i.e., inelastic) to price increases, then a monopolist would impose a significant price increase and the competition market would not be expanded. Therefore, there is a critical or "cutoff" level for the own-price elasticity of demand at the pre-merger price against which the measured own-price elasticity of the good under review could be compared in order to determine whether the relevant market has been identified. (For a general discussion of elasticities and market delineation, see G.J. Werden, "Demand Elasticities in Antitrust Analysis" (1998) 66 Antitrust L.J. at 363-414.)

66 To counter a claim that a hypothetical monopolist would raise the price would require evidence that the pre-merger price was already above marginal costs. However, the respondents did not present such evidence.

67 Other indicia such as functional interchangeability, inter-industry competition as well as the views of industry participants constitute indirect measures of substitutability and are often used to identify products in the relevant market, particularly when direct evidence on elasticities of demand is not available. However, it must be remembered that the relevant competition market is the smallest set of products over which market power can be exercised and these indirect measures do not identify that set of products for competition purposes. A competition market is defined for the express purpose of measuring market power and

may only loosely be related to markets as defined by business people whose definition is determined by profit maximisation considerations.

68 The respondents' definition of the product market relies heavily on the functional interchangeability of propane and alternate fuels (functional test) and the evidence of inter-industry competition of a few witnesses but does not consider the evidence of elasticities which had been considered by the Supreme Court in the *Southam* decision, cited above at paragraph [48], as determinative when available. While functional interchangeability can indicate something about the possibility of substitution between two or more products, it does not convey any information about the actual or likely consumer behaviour in response to the exercise of market power.

69 In that regard the evidence drawn from actual behaviour (i.e., the elasticities) and the opinions provided by expert witnesses such as Professors Ryan, Plourde, Schwindt and Globerman carry more weight in the Tribunal's opinion as to what products constitute the relevant competition market. Consequently, the Tribunal finds that the relevant competition market is "retail propane" and excludes other fuels.

(4) Segmentation

70 Evidence that propane consumers systematically pay different prices depending on their end-use, and that such differences are not justified on the basis of cost differences, is necessary to support a finding of separate competition markets by end-use. However, no such evidence has been provided. Professors Schwindt and Globerman examined individual end-use categories and seemed to suggest that since market power could be exercised in each segment, therefore, a monopolist of all segments would be able to price-discriminate. While this is certainly possible, one would need to be sure that the price elasticity of demand varied systematically across end-uses so that a monopolist could exploit those differences. Professors Schwindt and Globerman did not present evidence on such differences. Professors Ryan and Plourde's evidence was suggestive in that regard; however, they did not advocate end-use markets.

71 Indeed, Professors Schwindt and Globerman suggest at page 36 of their report (exhibit A-2056) that there are price differences among propane consumers within the same segment; this could reflect perfect price discrimination. However, since demand elasticities are unlikely to vary significantly by consumer in the same end-use segment and geographic market, it is possible that they have identified price dispersion reflecting lack of complete consumer information rather than perfect price discrimination by end-use by a seller with market power.

72 Finally, at page 2 of their report, Professors Schwindt and Globerman consider that supply side segmentation supports separate relevant competition markets by end-use. Their argument, which is premised on product differentiation, is confusing. Differences among suppliers do not indicate differences in price-elasticity of demand by end-use segment. In light of the evidence, the Tribunal is not satisfied that separate competition markets by end-use have been established.

(5) National Accounts

73 The Commissioner alleges that national accounts are a separate category of business in which the merged entity will be in a position to exercise market power and that the appropriate geographic market for analyzing national account competition is Canada.

74 The respondents submit that the Commissioner's experts, Professors Schwindt and Globerman, opined that national accounts did not constitute a separate product market.

75 In the Tribunal's understanding, a national account customer is a consumer of propane at several sites across the country, or at least across a number of widely-dispersed geographic markets, such that the consumer finds it more convenient to contract for propane supply from one marketer with national operations or capabilities rather than from several marketers in local markets. Witnesses indicated a variety of reasons for preferring to obtain supply from a national marketer. John Fisher of U-Haul Ontario stated that one reason was the ability to negotiate a single price, or price formula, that allows U-Haul to charge the same price for propane at all of its 376 locations across the country. Michael Stewart of Canadian Tire emphasized the need for consistency

of delivery, training and safety at all 96 store sites and 40 petroleum sites. Carole Bluteau of CN Rail noted the administrative problems of dealing with multiple local vendors given that propane represents such a small portion of CN's fuel purchases.

76 Claude Massé of CP Rail noted that dealing with several suppliers was inconvenient not only in terms of multiple invoices and cheque handling, but also in problem-solving. In addition to centralized billing, he valued the capability with a national supplier of dealing with only one person to resolve issues at all sites, rather than contacting the local manager for each. Indeed, he allowed that there might even be some savings in direct costs of propane supply by using multiple, lower-priced suppliers because the administration of invoices (currently 100 bills per month) could be handled by existing personnel. However, propane pricing was not his reason for preferring a national supplier:

> ... But the pricing, it's not an issue — it's not the first base of this, the plan to go with one. It was more the product itself, the service.
>
> I would hate to go to a small company who the staff, if it doesn't have the expertise and the training, and then would fuel up a propane tank and then it blows up. The safety of our people is also important. transcript at 10:1506, 1507 (8 October 1999).

77 It appears to the Tribunal that national account purchasers seek the management and administrative efficiencies that arise from doing business with a sole supplier. These efficiencies define a product that might be termed "national account coordination services", the price of which is difficult to observe because the product is bundled with the propane itself.

78 National account coordination services are provided only by those propane marketers with national capabilities, specifically Superior and ICG. Several witnesses noted that when they tendered for a national supplier, they sought bids only from these companies. In addition, when a national account customer had a problem with its national supplier, it approached the other for supply.

79 The evidence is that firms who use a national supplier do so for a variety of reasons largely unrelated to the price of propane. While the possibility exists that lower propane costs could be achieved through multiple suppliers, the evidence of several witnesses is that they did not even bother to investigate the prices and possible savings; Mr. Stewart of Canadian Tire was one such:

> MR. MILLER: Is the dealing with the one person and the one company across the country, is that of value to you?
>
> MR. STEWART: Absolutely.
>
> MR. MILLER: In what sense?
>
> MR. STEWART: Everything gets funneled through one person. I don't have to chase down the person who is responsible for different areas of the business. I can funnel all my questions through one and it gets distributed from there.
>
> MR. MILLER: Can you quantify this value in any fashion?
>
> MR. STEWART: I do not believe so.
>
> THE CHAIRMAN: I take it that you have never tried? Based on your answer, you've never tried to quantify it?
>
> MR. STEWART: No, we haven't.
>
> THE CHAIRMAN: Is that because it doesn't matter?
>
> MR. STEWART: At the time, it doesn't.
>
> THE CHAIRMAN: Very well.

MR. MILLER: In the event of a price increase, how much of a price increase would you sustain before moving to some other arrangement?

MR. STEWART: Well, it's hard to say at this point in time because it would take a lot of investigative work to ascertain costs and the costs involved with using alternate suppliers.

MR. MILLER: Have you examined that at all?

MR. STEWART: No.

MR. MILLER: Thank you, sir. Those are all my questions. transcript at 11:1572, 1573 (13 October 1999).

80 The evidence is that some large propane consumers with multiple sites acquire propane from multiple local suppliers, rather than from a national supplier. These consumers have decided to supply coordination services internally. In the Tribunal's view, it would not be unusual for firms to accomplish their propane supply objectives in different ways. Internal coordination may well be efficient for some firms but not for others. However, the key question is not whether internal coordination is available as an alternative in the event of a small but significant price increase but, rather, whether national account customers would switch to multiple suppliers and internal coordination in that event.

81 Although no expert witness has provided an opinion that national account coordination services constitute a relevant product market, the Tribunal is satisfied, in the light of the totality of the evidence, that national account coordination services constitute a product over which market power could be exercised.

82 In light of comments regarding national accounts by both parties, it should be noted that product markets are defined in terms of products alone. For example, does the market for retail propane include natural gas, electricity, wood, etc.? Neither competitors nor customers can be said to be "in" or "out of" a product market. For this reason, the Tribunal defined a product "national account coordination services" and considered whether market power could be exercised over such product.

B. Geographic Market

(1) Local Markets

83 The geographic market dimension of the relevant product is critical in this case because delivery is an important component of the product. Failure to define the proper geographic boundaries of retail propane markets would lead to the incorrect measure of market shares and hence of the ability to exercise post-merger market power. In this case, both parties submit that the geographic market is local in nature rather than provincial, national or international; but the dispute concerns the actual boundaries of these markets. The Commissioner presents a set of geographic markets based on Douglas West's spatial analysis approach which identifies joint service areas. The respondents criticize these markets as being too small when compared with Superior's actual travel patterns.

84 The geographic boundaries of a market are established by asking what would happen if a hypothetical monopolist at a particular location attempted to impose a small but significant non-transitory price increase. If this price increase would likely cause buyers at that location to switch sufficient quantities of their purchases to products sold at other locations as to render the price increase unprofitable, then the geographic market would be expanded by adding the location to which customers switched their purchases. This question would be asked in relation to the expanded market repeatedly until a set of locations was identified over which a hypothetical monopolist could profitably impose a small but significant and non-transitory price increase. That area would be the smallest area over which market power could be exercised and would constitute the relevant geographic market for competition analysis.

85 This area may bear little resemblance to service areas or trade areas as defined by particular sellers in the conduct of their business activities. These service or trade areas could be helpful in delineating relevant geographic markets but they do not define areas over which market power can be exercised.

86 Professor West states that Superior and ICG had approximately 130 and 110 branches and satellite locations respectively in 1997. Professor West's procedure grouped these locations into 74 local geographic markets. In his opinion, these markets are relevant for the purpose of computing market shares and inferring post-merger market power (expert affidavit of D. West (17 August 1999): confidential exhibit CA-2051).

87 Professor West's methodology, which is set out at pages 21-25 of his report, relies on set theory. First, he plots all branches and satellite locations of all propane dealers in operation in 1997. This accords with the view that the product of this merger is produced at the local storage facility and conforms with the approach that geographic markets should, in general, be delineated based at the point of production rather than at the point of consumption.

88 For an initial Superior location, Professor West finds the "nearest point set". The boundary between that location and another Superior location is the bisector of a straight line joining them. Bisectors for all adjoining Superior locations will completely specify the "market polygon" for that initial location. Similarly, Professor West determines the market polygon for each ICG location.

89 Then, starting with a Superior location, Professor West assumes that the market polygon is part of the relevant market served by the branch at that location. If that polygon contains an ICG branch, then the Superior branch's market polygon is expanded to include the ICG branch's polygon. In essence, the market is defined as the union of the two polygons. If that ICG polygon includes a Superior branch/satellite location, the market is expanded again to include the union of the three polygons. The market is expanded in this way until no further polygons can be added to the union; at that point, Professor West defines a "candidate local market". He then undertakes the analysis for another Superior location.

90 For each candidate local market, Professor West defines a buffer zone of 100 kilometers around the perimeter. He identifies all propane dealers with locations in that zone and considers, based on available information, whether those dealers can, in the event of a post-merger price increase, sell propane to customers located in the candidate market. Branches in the buffer that can compete with locations in the candidate market are included in the market for measuring market shares.

91 Professor West notes that, in densely populated areas with many competing dealers, markets may be difficult to distinguish, particularly where branches of Superior or ICG are found in the buffer zone of a candidate local market. Such markets may be "linked". Accordingly, Professor West combines linked markets and re-estimates the market shares and reports that his market share estimates are not significantly altered in these larger markets.

92 Professor West notes at page 3 of his report that:

> I have concluded that retail propane markets are local in geographic scope. They generally extend around 60 to 100 kms. from the locations of SPI/ICG branches and satellites, depending on specific local market characteristics.

93 The Commissioner further submits that Superior's own documents support Professor West's conclusion that the geographic market spans from 60 to 100 kilometers, as a general matter.

94 With respect to the economical delivery distance, the 1997 Superior Propane Income Fund Annual Report (exhibit A-712) reads at page 07699:

> ... The further propane is transported, the higher the delivered cost, therefore, the competitive operating area is limited to a reasonable radius of *70 to 80* kilometres around the branch or satellite locations. (emphasis added)

95 The 1998 Superior Propane Income Fund Annual Report (exhibit R-111, tab 1) reads at page 01189:

> ... The further propane is transported, the higher the delivered cost. Therefore, the competitive operating area is *generally* limited to a radius of *100 to 400* kilometres around branch or satellite locations. (emphasis added).

96 The Commissioner also notes that, subsequent to the 1998 Superior annual report, the respondents took the position in their response to the Commissioner's application that Superior's appropriate delivery range is 50 to 300 kilometers.

97 The respondents dispute that the relevant geographic market is 60 to 100 kilometers radius around Superior-ICG branches and satellites. They submit that Superior's trading areas have radii of 50 to 620 kilometers and that some competitors have even larger trading areas which contradict Professor West's conclusion that competition between propane distributors is limited to firms within a range of 60 to 100 kilometers of a given branch or satellite.

98 The respondents also submit that Professor West's model has never been used for this type of competition analysis and he has not determined whether his geographic markets "function as markets".

99 Mark Schweitzer, Superior's Chief Executive Officer, indicated that Superior's branches have been reorganized. For example, he testified that 10 branches have been closed, but most have been converted to satellite locations (transcript at 31: 5911, 5912 (3 December 1999)) so that other branches may serve now larger areas with a radius of 100 to 400 kilometers as stated in the 1998 Superior Propane Income Fund Annual Report (exhibit R-111, tab 1).

100 The Tribunal is of the opinion that Professor West's analysis, while it does not follow the hypothetical monopolist approach entirely, nevertheless is similar in certain respects to that approach and can be used to identify relevant geographic markets (transcript at 22:3914 (29 October 1999)). Moreover, the respondents have not demonstrated that Professor West's spatial methodology was flawed in any significant respects. The respondents noted that the computer algorithm produced certain anomalies which led certain market boundaries to extend to the Arctic Ocean, but these criticisms were not crucial to the value of Professor West's approach since these are functions of the computer mapping procedure. In addition, the respondents dispute some of his market share calculations.

101 As to the argument of the respondents that Professor West's markets may not function as markets, the Tribunal is of the view that there is no necessary correspondence between a competition market, which is an analytical construct, and a market defined by management for operational purposes.

102 Further, the Tribunal notes that the respondents did not present an alternate set of geographic markets for the purpose of competition analysis. Rather, they seemed to suggest that the business-service areas of their branches and satellites were appropriate for this purpose.

103 The Tribunal notes that Mr. Schweitzer testified that he knew of no branch which could provide service to customers only as far as 60 kilometers or under 90 kilometers, which contradicts Superior's own evidence in some of the 1998 branch templates (e.g., Calgary 50 kilometers). Further, the Tribunal does not find the explanation of Mr. Schweitzer convincing because many of the branches were converted into satellite locations. Therefore, the Tribunal does not understand why converting branches to satellites would modify the boundaries of a geographic market.

104 The Tribunal notes that there is no evidence that using the furthest distance travelled from a branch constitutes a valid method for defining a relevant geographic market. Further, even if referring to the furthest point of a trading area were appropriate for defining such a market, the Tribunal would be concerned about adopting a method that would be based on the delivery to the exceptional customer located at great distance rather than considering the typical distance travelled for the majority of customers. There is no evidence that a Superior branch whose furthest customer is located 620 kilometers away serves all customers within that distance. Therefore, even if the Tribunal accepted in principle that a branch trading area could be a competition market, it could still not conclude that this trading area would have a radius of 620 kilometers.

105 The respondents submit that some independent firms serve customers in many of Superior's trading areas and that their travel distances are longer because they have fewer branches. However, it is not clear that such firms serve the entire Superior branch trading area. In addition, serving adjacent Superior trading areas does not necessarily mean that these independent firms deliver propane over longer distances than Superior does. Also, if the respondents were correct in their submissions, it would

remain unclear whether these independent firms supply many customers at longer distances; that is, their trading areas may not be measured by the longest distance travelled.

106 As stated above, the Tribunal does not agree that areas over which market power can be exercised are necessarily coincident with existing business or service areas such as those of Superior. Accordingly, the Tribunal concludes that the "candidate local markets" produced by Professor West's methodology are reasonable and appropriate for the purpose of identifying the relevant geographic markets in order to determine whether the merged entity will have the ability to exercise market power.

(2) National Accounts

107 With respect to the geographic market relevant for national accounts, the Commissioner submits that the relevant geographic market for the analysis of the national accounts is Canada. The respondents do not address the relevant geographic dimension for national accounts.

IV. Substantial Prevention or Lessening of Competition

108 The Commissioner submits that there will be a likely substantial lessening of competition in many local retail propane markets, a likely substantial lessening of competition regarding national accounts and a likely prevention of competition in Atlantic Canada. The Commissioner also argues that there will be a likely substantial lessening of competition by virtue of the creation or enhancement of market power by the merged entity which he attempted to demonstrate with expert and factual witnesses. He argues that market power can be inferred from various factors such as high market shares and concentration, the high barriers to entry, the removal of ICG as a vigorous competitor, the lack of foreign competition and the fact that there is no effective remaining competition.

109 The respondents submit that the merger is not likely to result in a substantial lessening of competition. They argue that the terms "likelihood of a substantial lessening of competition" are synonymous with "likely price increase" and that the Commissioner failed to demonstrate a likely post-merger price increase. They dispute the Commissioner's definitions of geographic and product markets, rely on the growth of independents' market share, advocate that ICG is not a vigorous and effective competitor and that barriers to entry in the retail propane business are low.

A. Market Shares and Concentration

110 The Commissioner's expert witness, Professor West, studied the combined market shares of Superior and ICG in 74 local markets for 1997 as stated above. He concludes at page 29 of his report (confidential exhibit CA-2051) that in 17 such markets, the combined market share is between 95 and 100 percent, that 32 markets have combined market shares in excess of 80 percent, that 46 markets have combined market shares of 70 percent, and that 66 markets have combined market shares in excess of 60 percent. In order to get these results, Professor West relies upon a set of completed surveys for the year 1997 that the Commissioner has received from responding propane dealers (the competitor survey) as well as, *inter alia*, internal business plans and data regarding sales volume and market shares of Superior and ICG. Professor West states that he has relied on Superior's data in the absence of sufficient data provided from competitors.

111 The respondents criticize Professor West's market share estimates on the grounds that he uses volume information for 1997 and Superior and ICG branch locations for 1998. The Commissioner points out, however, that Professor West does not mix 1998 locations with 1997 volumes and further refers to page 21 of his report to demonstrate that he identifies all of Superior's, ICG's, and other propane dealers' satellite and branch locations in operation in 1997.

112 Further, the respondents suggested to Professor West during cross-examination that he should have done a "reality check" by aggregating the volumes consumed in his 74 local candidate markets in 1997 with other measures of total consumption for that year. In final argument, they state that there were 200 competitors, only 67 of whom responded to the 1997 competitor survey. They also state that the 1998 volumes of the approximately 140 non-responding competitors would likely be a good estimate of those firms' volumes in 1997 and should have been used. The Commissioner points out that the competitor survey

identified and sought responses from 118 competitors and that the figure of 200 is an internal estimate of Superior that includes agents of Superior and of ICG that Professor West specifically tried to eliminate. Moreover, the Tribunal heard evidence that 1998 volumes declined from 1997 levels due to warmer weather; thus, there would be no reason to assume that the volumes of the non-responding firms would have remained the same in 1998.

113 The respondents also criticize Professor West's estimates because the total of the 1997 volumes by market differs from the Statistics Canada data on total retail propane demand. During Professor West's cross-examination, the respondents pointed out that the aggregate volume calculated from Professor West's individual market analysis differed from the aggregate number provided by Statistics Canada, as cited by the Commissioner's expert witness, Mr. Mathieson. However, the Commissioner pointed out that the 74 markets identified by Professor West did not cover the entire country. For example, they did not include a large part of the Maritimes, Northern Manitoba or the Territories. In addition, Mr. Mathieson noted that errors in the Statistics Canada data meant that it should only be used to establish trends in propane demand rather than accurate annual estimates of consumption by end-use.

114 The respondents' experts, Dennis W. Carlton and Gustavo E. Bamberger, criticize Professor West's 1997 market share estimates as being less reliable than information provided to them by Superior. Professor West replies that Superior's share estimates contained in its 1998 branch templates are based on an internal survey prepared after the commencement of the proceedings and conducted by branch managers who have no actual sales volume information for independents for that year (expert affidavit in reply of D. West (20 September 1999): confidential exhibit CA-2052 at 2).

115 The respondents argue that Professor West does not allocate all of the various independents' volume of propane sold in the relevant geographic markets, as defined by him, and that the allocation is arbitrary. Professor West explained that he used Superior's own market share evaluation when he did not have the sales volume information from other independent competitors (transcript at 22:3931 (29 October 1999)) and that he reduced Superior and ICG's combined market share in some of the geographic markets by several percentage points to reflect the sales volumes of several small competitors for which he did not have specific volume information. The Commissioner states that if Professor West did not have adequate volume data to calculate market share, he did not attempt to invent one in order to allocate some volumes to the market.

116 Professor West's results, set out at page 29 of his report (confidential exhibit CA-2051), are very similar to a frequency distribution of Superior/ICG market shares that Superior has estimated, apparently based on its branch trading areas. For example, Superior's own analysis indicates that 15 out of 116 branches have a market share of between 95 and 100 percent. Although the methodology of the two studies differ, this result is common to both and gives the Tribunal further confidence in Professor West's analysis.

117 In addition, the Tribunal has reviewed the criticisms made by the respondents on a market by market basis of Professor West's market share estimates. After careful review of his explanations and methodology (and having examined certain markets in detail), the Tribunal accepts that Professor West's approach is appropriate for a competition analysis in this case and that his inferences and conclusions about market shares are reasonable given the available data and the limitations therein identified by him. The Tribunal is of the opinion that it can rely on these results and conclusions for the purpose of determining whether the merger will result in a likely substantial prevention or lessening of competition.

118 The Commissioner's experts, Professors Schwindt and Globerman, classify markets on the basis of post-merger market share in their expert report (exhibit A-2056 at 27-41). Using Professor West's relevant geographic markets and market share estimates, they identified 16 local markets in which the merged entity would have combined market shares of 95 percent and higher, which they referred to as "merger to monopoly" markets. At page 28 of their report, they indicate that the merger will substantially increase the probability of a unilateral price increase in these markets.

119 They further identify eight markets ("category 1"), in which the Superior or ICG pre-merger market share is relatively small. In these markets, the merger may have minimal impacts on competition between Superior and fringe competitors and, therefore, the main concern is the removal of ICG as a potential future competitor (*ibid.* at 37). In addition, the merger in these markets would eliminate competition for propane buyers who prefer to deal with one of the major companies.

120 A third set of markets ("category 3") identifies 16 markets in which ICG has a substantial market share prior to the merger but where there are at least three competitors including Superior and ICG. In these markets, Professors Schwindt and Globerman expect that the elimination of ICG is likely to enhance interdependence and reduce competition (*ibid.* at 38, 40).

121 The final set of markets ("category 2") includes 33 local markets in which a relatively fragmented fringe of firms compete against Superior and ICG and where the merging parties are the two largest sellers (*ibid.* at 40). They state that there is a substantial likelihood that the merger will significantly reduce competition in these markets by creating a dominant firm and enhancing interdependence.

122 The respondents criticize Professors Schwindt and Globerman's analysis of the anti-competitive effects of the merger. First, they submit that Professors Schwindt and Globerman provide no opinion regarding the likelihood of a price increase in any market. Secondly, they submit that even Professors Schwindt and Globerman have minimal concerns about the anti-competitive effects of the merger in their category 1 and 2 markets. Thirdly, they argue that existing competitors will continue to compete vigorously in category 3 markets. Finally, they indicate that entry will restrain the merged entity from imposing a unilateral price increase in merger to monopoly markets.

123 Further, the respondents' experts, Professor Carlton and Dr. Bamberger, state at page 4 of their report that Professors Schwindt and Globerman accept that the substantial presence of independent retailers can constrain the merged firm from raising retail propane prices (expert affidavit in reply of D.W. Carlton and G.E. Bamberger (14 September 1999): confidential exhibit CR-121). In the Tribunal's view, this is not an accurate characterization of Professors Schwindt and Globerman's opinion.

124 The Tribunal believes that the respondents have incompletely depicted the opinion evidence of Professors Schwindt and Globerman and it accepts that, although they have not provided a firm opinion on the likelihood or quantum of a price increase, their conclusions regarding the anti-competitive effects of the merger are important and significant for the purpose of determining the likelihood of a substantial lessening of competition. The Tribunal will discuss the entry argument below under the heading "Evidence on Entry".

125 A key issue in this case is the evaluation of the post-acquisition market share of the merged entity by market. The respondents argue strenuously that the post-merger market share on a national basis has been declining and may have reached between 50 and 60 percent in 1998. These national market shares were introduced to establish the significant growth of independent propane marketers over the period between 1990 to 1998. The Tribunal believes that since relevant geographic markets are local, evidence of high market shares on a local basis cannot be defeated by a trend of national market shares purporting to demonstrate that entry can overcome this substantial lessening of competition.

126 Information on high market shares is, therefore, relevant but not determinative in respect of a finding of a likely substantial prevention or lessening of competition. However, the Tribunal notes that these market shares must be measured with respect to relevant product and geographic markets. In this case, since no national product market for retail propane has been demonstrated, information on market shares for Canada as a whole are not informative as to the exercise of market power in local markets.

B. Barriers to Entry

127 As stated by the Tribunal in *Canada (Director of Investigation & Research) v. Hillsdown Holdings (Canada) Ltd.* (1992), 41 C.P.R. (3d) 289, at 324, (Competition Trib.):

> In the absence of significant entry barriers it is unlikely that a merged firm, regardless of market share or concentration, could maintain supra-competitive pricing for any length of time. An attempt to do so would cause competitors to enter the market and the additional supplies created in that manner would drive prices back to the competitive level.

128 This statement emphasises the economic effect of entry. Evidence of commencement of operations, per se, is insufficient to establish the competitive restraint on a supra-competitive price or a likely exercise of market power. Moreover, if the impact on price is delayed beyond a reasonable period, then entry for the purpose of the Act has not occurred even if new businesses

have started their operations. The appropriate length of time for judging the impact of entry is a matter of opinion; however, the Tribunal notes that the MEG's, cited above at paragraph [57], refer to a period of two years.

129 The Commissioner submits that there are high barriers to entry into the propane distribution business. The barriers include the nature and existence of customer contracts and tank ownership, switching costs, minimal required scale, reputation, maturity of the market, the competitive response to entry (including litigation threats), access to propane supply, capital requirements, sunk costs and the time to get the business profitable.

130 The respondents dispute the existence and/or significance of these barriers mainly on the basis of their evidence of alleged entry and expansion by independent retail propane marketers.

(1) Contracts

131 The Commissioner's expert, Michael D. Whinston, conducted an analysis of the customer contracts used by Superior and ICG and the likely competitive effects arising from the merger (expert affidavit of M.D. Whinston (18 August 1999): exhibit A-2063). Professor Whinston reviewed the standard form contracts offered by Superior and ICG and found several provisions that could limit entry and/or expansion. These provisions include long-term exclusivity, automatic renewal, termination fees, right of first refusal (Superior only), and tank ownership.

(a) Contract Duration and Exclusivity

132 It is not disputed that a high percentage of propane customers take delivery under contracts. For example, Superior has estimated that 90 to 95 percent of its customers are under standard form contracts with the remaining 5 to 10 percent under negotiated non-standard contracts (confidential exhibit CA-701 at 06976). The Commissioner's expert, Professor Whinston, provides the same number with respect to ICG. According to Mr. Schweitzer, 70 percent of Superior's propane customers are under five-year term contracts: "Well, our standard that we discussed earlier today has a five-year term in it. My understanding is that about 70 percent of our customers have standard contracts" (transcript at 31:5894 (3 December 1999)).

133 Professor Whinston notes that long-term exclusive contracts can have both efficiency-enhancing and anti-competitive effects. In the case of propane supply contracts, the term can be as long as five years. This duration limits customer switching and can lead the supplier to offer less competitive prices than it would absent the exclusivity provision. Although sophisticated consumers will take into account the impact of exclusivity and will insist on compensation for the lack of choice for the term of the contract, Professor Whinston suggests that most residential customers may not understand the limitation of choice and the impact of loss of competition for their custom.

134 Professor Whinston is more concerned about the entry-deterring effect of long-term exclusive contracts for propane supply. Nothing that economies of scale appear to characterize the propane delivery business, he suggests that a new entrant will have to acquire enough customers to achieve the minimum efficient scale of operation, failing which the entrant will operate at a cost disadvantage compared to incumbents. In light of the exclusive nature of propane contracts, a new entrant will seek to acquire customers whose contracts with incumbents are expiring, but the long terms may limit the number of such "free customers" in any year to a level at which new entry is not profitable. He notes that this problem will be more severe when the contract expiration dates are staggered and when the contract terms are longer.

135 Similar concerns will be raised for existing smaller firms that seek to invest in order to lower operating costs, expand capacity or improve quality. The "free customer" base may not justify such investment.

136 Professor Whinston adopts the observation made by the Commissioner's expert, Terry Kemp, that the minimum efficient scale for a propane marketer is three million litres per year in order to demonstrate, in a general way, the impact of long-term exclusivity on the profitability of entry and expansion. If the average duration of contracts in a market is four years, then 25 percent of the contracted volume can be expected to come off-contract every year. If one new entrant could attract all of these free litres, then the market would require 12 million litres of total annual consumption in order for that new entrant to enter at

the minimum efficient scale. Professor Whinston finds for example that the total consumption in 12 of 71 markets defined by Professor West is less than 12 million litres and concludes that entry will be difficult in these circumstances.

137 The respondents submit that contract exclusivity is not a significant barrier to entry in this merger because only five markets will have less than 2.25 million litres required to support one new entrant. However, this result flows from assumptions that Professor Whinston regards as unrealistic.

138 Professor Whinston recalculates the number of markets with minimum required volumes assuming that declining autopropane volumes will not be available to a new entrant in any markets as defined by Professor West, that the minimum efficient scale is six million litres per year and that all customers are on four-year contracts. On this basis, he finds that 37 out of 73 "West markets" will not be large enough to sustain one new entrant, even if right of first refusal clause and other contractual terms are not effective deterrents to switching.

139 The Tribunal is of the view that the respondents' submission does not represent Professor Whinston's opinion. According to Professor Whinston's estimates, entry and expansion at minimum efficient scale are unlikely in many West markets.

(b) Automatic Renewal

140 With respect to automatic renewal, Professor Whinston notes that the automatic renewal feature of propane customer contracts serves to increase the effective duration of these contracts, as the notice periods are long. For example, ICG's Fuel Supply and Equipment Agreement requires the customer to give notice of termination of 180 days, absent which the contract will be renewed at expiry for the original term of perhaps five years. Thus, in the event that a new entrant is successful in attracting an ICG customer under this contract, it would have to wait six months before commencing service.

(c) Right of First Refusal

141 The right of first refusal clause in Superior's contracts also deters entry in Professor Whinston's opinion. Under this provision, Superior has the right to match the price offered by a competing supplier and the customer is required to provide the name of the competitor and its price. The result is that Superior is fully informed of the identity of any rival who is bidding for its customers and is better able to retaliate against it selectively.

142 The right of first refusal clause greatly reduces the profitability of entry by new firms and expansion by existing firms. Since Superior can retain its customer by matching the new entrant's lower price (i.e., even if the entrant offers better quality service), a rival will have to offer a price that is below Superior's cost to make the offer unprofitable to Superior. Therefore, a rival with higher costs and quality may find a customer interested in switching but it cannot lower its price enough to avoid "matching" by Superior.

143 The respondents do not challenge Professor Whinston's opinion on this point. Accordingly, the Tribunal accepts Professor Whinston's opinion that right of first refusal clauses reduce the profitability of entry and expansion.

(d) Tank Ownership

144 Professor Whinston draws attention to the provisions in Superior and ICG contracts under which they retain ownership of the propane storage tank at the customers' site. This is a feature of all contracts except for Superior's Industrial Agreement to industrial customers and it is a feature of contracts offered by virtually all propane marketers. He concludes that the practice of not selling tanks greatly increases the costs of a customer switching to another supplier. The tank rental requirement makes the customer much less likely to switch than if the tank were owned. Professor Whinston concludes that the rental requirement effectively increases the duration of the long-term exclusive contracts and further reduces the likelihood of new entry or expansion.

145 Based on the evidence on the record, it appears that switching to an alternate propane supplier typically results in direct and indirect costs. The direct costs would include a restocking cost calculated by Superior at 15 percent of the total value of propane in the tank being removed. Indirect costs to switching include important delays between the time the existing supplier

removes its tank and the time when the new supplier installs its equipment. Commercial, industrial, or agricultural customers may have to reduce or stop operations during this period. Residential customers will generally be unwilling to risk the loss of heating, particularly in winter months.

146 The respondents submit that tank ownership by the marketer ensures proper tank inspection, maintenance and safety practices. They also allege that since independents are growing at the expense of Superior and ICG, tank ownership does not constrain independent entry or expansion.

147 The Tribunal notes that there is no evidence that tank inspection, maintenance and safety practices have to be tied to tank ownership. Such services could be provided to a customer that owned the tank. Therefore, the Tribunal is of the view that tank ownership by the propane supplier makes customer switching more difficult and costly, and it accepts that it constitutes a barrier to entry and expansion. As to the alleged entry and growth of independents, the Tribunal will discuss that point below.

(e) Voluntary Undertakings

148 Finally, Professor Whinston notes that Superior has indicated that if the merger is approved it will not enforce term provisions in its existing standard contracts for propane supply, that it will adopt 30-day notice periods in standard form customer agreements, that it will waive liquidated damages terms, and that it will waive right of first refusal provisions. He believes that these voluntary undertakings do not adequately address his concerns about the competition-reducing effects of Superior's and ICG's customer contracts. For example, he notes at paragraphs 97 to 104 of his report (exhibit A-2063) that Superior has not committed to actually advising its customers of these changes.

149 The respondents submit that Superior and ICG do not enforce the provisions of their standard form contracts. Further, the respondents submit that only a few letters have been sent to customers and competitors in the last seven years addressing Superior's and ICG's legal rights but that neither Superior nor ICG has commenced litigation in regard to the matters raised in these letters.

(f) Conclusion on Contracts

150 The Tribunal accepts that the provisions in the contracts, including long-term exclusivity, automatic renewal, termination fees, right of first refusal (Superior only), and tank ownership significantly raise the cost of entry and expansion and hence constitute a barrier to entry.

(2) Competitive Response to Entry

151 An important component in the decision to enter the market is the assessment of the likelihood of a competitive response from the incumbents in the marketplace. The Commissioner introduced evidence in support of his argument that retaliation constitutes a response to competitors who have taken business away from Superior. This competitive response is generally in the form of intense price competition targeted at the entrant in order to affect its ability to compete in the market.

152 The experience of Imperial Oil Limited ("IOL") demonstrates that even very large and sophisticated companies may not be able to enter the propane distribution business profitably. In 1990, IOL, the largest propane producer in Canada (following the Texaco merger), sought to expand its activities into propane distribution. The project manager, Meredith Milne, testified that IOL experienced a vigorous response from competitors following its attempt to enter the propane market. It found that margins were 30 percent lower than planned and 45 percent lower than in 1991. IOL found that incumbent marketers started to charge customers switching to IOL for tank removal and that they removed the tank rental charges.

153 In addition to the competitive price response, IOL also found that it was difficult to get customers to switch due to the multi-year contracts and the "last look on tenders" available to incumbents. These were all elements that either increased IOL's costs or made it difficult to gain new accounts with the result that IOL exited the market (transcript at 13:1976 (15 October 1999)). Based on the evidence, the Tribunal notes that no other entry by companies of similar size or stature has occurred in this industry.

(3) Reputation

154 The lack of a reputation for reliable supply and service can be an entry barrier. Reputation may be a crucial element in gaining customers, especially when services are an important element of the product.

155 The Commissioner submitted evidence that reputation constitutes a barrier to entry in the propane supply and delivery market. In addition, the Commissioner's expert, Professor Globerman, stated that the incumbents had reputational advantages, which means that the entrant is likely to take longer to establish that critical mass in demand. The Canadian Market Research Study commissioned by Superior in October 1997 (confidential exhibit CA-1485) reads at page 17416:

> ... commercial and residential markets display a significant lack of awareness and familiarity with alternative suppliers.

Further, at page 17437:

> Currently, four in ten (39%) Superior [commercial] customers are *not aware* of an alternative propane supplier on an unaided basis .... ICG is the most formidable competitor in Ontario and Quebec .... 64% of competitor customers have unaided awareness of the Superior brand and 29% designate it as the alternative supplier with which they are most familiar.

And at page 17527:

> Residential propane users also exhibit a fundamental lack of awareness and familiarity with the range of alternative suppliers (more pronounced than the commercial market)....
>
> In the shot [*sic*] term, competitive threats may be limited. Currently 58% of Superior customers are *not aware* of an alternative propane supplier on an unaided basis, and 74% say they are not familiar with an alternative.

156 The respondents submit that the existence of a "proven track record", as in the case of Superior and ICG, is not an impediment to competition; rather, it is the natural result of competition.

157 Loyalty is a related consideration. The Commissioner presented witnesses from cooperatives and credit union organizations whose sellers offer propane and give dividends to member customers based on such purchases. These customers have an incentive to continue to be loyal to their propane supplier. Based on the evidence submitted by factual witnesses, the Tribunal accepts that reputation is an important feature of propane suppliers to which customers attach value. It appears that this is particularly true for major account customers whose factual witnesses testified that the reputation of the companies capable of delivering propane is an important factor in their purchasing decision. The Tribunal notes that the time to gain a reputation may make profitable entry more difficult and hence delays the competitive impact that an entrant would have in the marketplace.

(4) Maturity of Market

158 The Commissioner called witnesses who testified that the market was mature and that the demand was flat (see testimony of John A. Osland from Mutual Propane, transcript at 6:833 (4 October 1999) and testimony of Luc Sicotte from Gaz Métropolitain, transcript at 18:3148 (25 October 1999)). Mr. Schweitzer testified that it was a relatively mature market (transcript at 31:5920 (3 December 1999)).

159 The Commissioner's experts, Professors Schwindt and Globerman, testified on the competitive impact of this mature market at page 48 of their report (exhibit A-2056):

> ... the industry is mature and has experienced slowly declining demand in recent years. As noted in the *Merger Enforcement Guidelines*, entry into start-up and growth markets is less difficult and time consuming than it is in relation to mature market.

160 In light of the evidence submitted, the Tribunal is satisfied that the traditional retail propane market place can be qualified as mature.

(5) Access to Propane Supply

161 The Commissioner refers to the opinion of many competitors that the ability to access propane supply is a "critical barrier to entry/expansion". Evidence in this regard consists of the disadvantages that independent firms face in obtaining supply that Superior and ICG do not face. For example, the respondents have established supply relationships and have invested in storage and transportation facilities that provide cost advantages over rivals who may be restricted to local pick-up from refinery racks. These arrangements are apparently valuable for serving branches particularly distant from refinery sites. Superior and ICG also have "scale demand" for propane which gives them an edge over traditional patterns of supply.

162 One of the Commissioner's experts, Terry S. Kemp, observes at pages 15 and 16 of his report (expert affidavit of T.S. Kemp (18 August 1999): exhibit A-2070) that:

> Sup-ICG with the exception of a few selective refineries, will have access to supply at virtually every producing location in the country. Sup-ICG will thus have an implied supply advantage and flexibility that cannot be matched by any other retail propane competitor.
>
> Sup-ICG should be able to selectively choose the most advantageous supply locations and drop others, thereby extracting the most out of supply arrangements. Sup-ICG will also be in a position to leverage supply from location to location for trades and exchanges and, will in essence, be able to create preferential access to supply and location adjustments. These advantages can be utilized in a number of ways:
>
> - Pressuring supplier price location arrangements
> - Using competitive advantages when bidding on new contracts
> - Servicing National accounts
> - Negotiating more favourable bulk transportation rates (volume discounts) with trucking and rail companies.

163 The Commissioner's expert, Mr. Mathieson, notes that the respondents have access to supply at prices more favourable than simply the posted or rack price.

Mr. Kemp pointed out that propane producers generally prefer to supply those who have the ability to lift product on a regular basis. A new entrant would not be able to immediately demonstrate this ability and would be at a disadvantage to the respondents. The Commissioner's witness, Peter Renton of Gulf Midstream Services Ltd., confirmed that his company prefers customers who perform very well over those customers who fail to take a significant portion of their product each year and to whom sales would be reduced and rack prices charged.

164 The Commissioner cites the Ontario Region 5 Year Strategic Plan from Superior (confidential exhibit CA-299) that indicates Superior's view that it creates barriers by "tying-up supply", specifically its ten-year supply arrangement with Shell. The respondents point out that the independent marketer, AutoGas, has a ten-year arrangement with IOL.

165 Mr. Kemp observes at page 15 of his report (exhibit A-2070) that Superior's propane cavern storage allows it to purchase spot volumes at low prices and Mr. Mathieson is concerned that Superior's supply transportation costs are the lowest in the industry.

166 The testimony indicates that in periods of tight demand, producers ration their supplies and give preference to their largest customers, causing some independents to deal with brokers. However, no independent testified that it could not obtain propane. The expert opinion evidence states that the merged entity will have advantages in acquiring propane that smaller competitors will not enjoy. The Tribunal accepts that new entrants and small firms seeking to expand bear the costs of investing in reputation with propane suppliers that incumbents do not have to bear and, to that extent, they face entry barriers. However, these costs are not a result of the merger and are not increased by it. Other advantages that reduce the cost of propane acquisition (such as

buying at low "off season" prices and storing) to the respondents and the merged entity reflect efficiencies and do not create barriers to propane acquisition. The Tribunal does not agree that the new entrants and expanding firms face significant barriers to obtaining propane supply.

(6) Capital Requirements/Sunk Costs and Time to Get Business Profitable

(a) Scale of Entry or Expansion

167 Several of the Commissioner's witnesses (Professors Globerman and Schwindt, Messrs. Kemp and Mathieson) note in their expert reports that entry into the propane business is costly. Mr. Kemp, for example, suggests at page 7 of his report (exhibit A-2070) that the capital costs for a start up greenfield retail propane operation are in the range of $675,000 to $920,000 to support initial sales of two million litres per year which he regards as minimally-required for success. He estimates operating costs, at page 9 of his report, at approximately $300,000 per year. Several fact witnesses mentioned the high costs involved in obtaining storage tanks, transport and delivery trucks and customer tanks, particularly when certain customers have requirements for on-site storage.

168 The respondents have submitted in their amended response that one can enter the propane distribution business for a total investment of $120,000 to $300,000. The Commissioner submits that even if entry of that scale is possible in certain geographic locations, the respondents have understated the costs for the most part. According to the Commissioner, such a small entrant would be an uncommitted entrant, unable to constrain Superior/ICG's market power.

169 The Commissioner argues therefrom that high capital costs are themselves a barrier to entry, ostensibly on the basis that few people had the required financial resources to enter the industry. Competitors in the industry testified to the effect that costs of entry may vary.

It cost Donald J. Edwards $935,000 to construct EDPRO Energy Group Inc.'s facility in London, Ontario, excluding the purchase of tanks for customer use (transcript at 6:1072, 1073 (6 October 1999)). Evidence was also submitted indicating that costs associated with meaningful entry might vary upon the end-use served.

170 The Tribunal does not accept that high capital costs are inherently a barrier to entry. If a potential entrant's equity is insufficient to cover capital costs of entry at minimum efficient scale, then the balance can be obtained through credit markets providing that lenders are satisfied that the project is viable. In the event that lenders deny credit because of their assessment of the project, their reluctance to lend does not indicate that capital is not available. In response to a question from the Tribunal, Professor Schwindt stated that high costs, per se, did not constitute an entry barrier.

171 On this latter point, the Commissioner accepts that high capital costs are not, in absolute dollars, an issue relevant to entry; rather, the relevant costs to be considered are the sunk costs because they represent what the entrant will lose in the event of failure.

(b) Sunk Costs

172 It is generally agreed that the portion of costs that are not recoverable in the event of exit (the sunk costs) can, where they are significant, constitute a barrier to entry. The Commissioner suggests that the retail propane market is characterized by significant sunk costs. There is a dispute between the Commissioner and the respondents as to the proportion of the costs that can be qualified as sunk costs. The extent of these costs depends on a variety of factors.

173 In the propane industry, the sunk costs would include the market development costs, site-preparation costs, and the discounts to purchase price that would be incurred on asset disposals. Mr. Milne of IOL estimated that 50 percent of its costs were non-recoverable when IOL entered the Camrose market. Mr. Katz from AmeriGas indicated that 30 to 80 percent of investment in propane operations would be non-recoverable. As well, salaries and other operating costs incurred to the date of exit would also be non-recoverable. The respondents' experts, Cole Valuation Partners Limited and A.T. Kearney (expert affidavit of C.O'Leary and E. Fergin (17 August 1999): confidential exhibit CR-112), recognize at page 202 of their report that

certain costs are sunk. For example, they assume decommissioning costs of $50,000 per site for locations to be closed, which costs would be non-recoverable.

174 The Commissioner's experts, Professors Schwindt and Globerman, emphasize the sunk cost of time required for a new entrant to develop a reputation for reliability, as well as for obtaining the necessary permits to install storage capacity. They also characterize at page 49 of their report (exhibit A-2056) as sunk the cost penalty of operating below minimum efficient scale.

175 The Tribunal is satisfied that sunk costs are meaningful in the industry and constitute a significant obstacle to a new entrant.

(7) Evidence on Entry

176 The respondents seek to demonstrate that barriers to entry are low by presenting evidence on actual entry over time by independent firms. The respondents have chosen to rely, for the most part, on evidence of growing market shares of independent firms rather than presenting evidence contrary to each of the Commissioner's submissions regarding barriers to entry.

177 The Commissioner submits that barriers to entry are high and that small scale entry is not an unusual event, but that entry occurs at a relatively low scale and expansion of entrants appears to be both modest and slow. Professors Schwindt and Globerman submit at page 53 of their report (exhibit A-2056) that small scale entry has occurred in the marketplace and that there is considerable turnover or "churn" among small scale entrants. They cite the membership list of the Propane Gas Association of Canada and state that there were 41 new memberships from 1994 to May 1999. They also find that 22 of those members had left the association by mid-1999. Further evidence from Superior also suggests that both entry and exit by small firms are high. Superior indicates that 45 new firms have entered the market since 1996. However, there is only one example of large scale entry, which is IOL's entry into the agricultural, commercial, industrial and automotive segment in western Canada. As noted above, this attempted entry failed.

(a) Basic Trend (1988-98)

178 The respondents submit that there have been 45 new entrants across the country in the past three years, that there is no evidence of business failure, and that ICG's volume has declined by 26 percent due to its inefficiency over a period of eight years when the national demand for propane increased and independent volume doubled. The respondents further assert, on the basis of Superior's best estimates, that independents have increased their share of retail propane sales from 17 percent in 1989 to 42 percent in 1998 (exhibit R-111, tab 5). They also submit that independents have grown from 24 percent in 1990 to 46 percent in 1998 based on Statistics Canada data.

179 At the hearing, the respondents introduced numerous calculations of Superior/ICG's combined market share, including a chart handed up in final argument ("Comparison of SPI Estimates Over Time with Statistics Canada Estimates Over Time") comparing Superior's internal market share estimates to market share estimates based on Statistics Canada data from 1988 to 1998. This chart demonstrates that Superior and ICG had a combined market share of 81 percent in 1988. This estimate arises from the market share estimates reported in the Minutes of Norcen Energy Resources Limited Board of Directors meeting on October 11, 1988 (exhibit R-88), in which Superior estimated its market share to be 41 percent, ICG to be 33.1 percent and Premier Propane Inc. ("Premier") to be 6.6 percent. The respondents submit that the Superior/ICG's combined market share was down to 60 percent in 1998 on the basis of market share estimates contained in the 1998 branch templates (exhibit R-111, tab 2).

180 In response to this chart, the Commissioner points out that the 1988 share of 81 percent includes the volumes of Premier despite the fact that Superior did not acquire Premier until 1993. It is not clear to the Tribunal why Premier's volume was included in the respondents' 1988 combined market share estimate as that volume could not have contributed to the market power of a combined Superior and ICG in that year. Excluding that volume would indicate a 1988 combined Superior and ICG volume of approximately 74 percent.

181 With regard to the 1998 estimate of 60 percent, the Commissioner submits that this estimate is not accurate. The Commissioner notes that in order to get to this estimate, the respondents calculated the total volume of each branch trading area

using the Superior branch manager's estimate of Superior's market share in that area and Superior's actual volumes for the branch from the 1998 branch templates. The respondents calculated the volumes of ICG and the independents by using that total volume number and the branch manager's volume estimates for competitors to calculate the market shares of ICG and the independents.

182 According to the Commissioner, in a further adjustment of this 60 percent estimate, the respondents added 133 million litres based on the difference between the total independents' volumes reported in the 1997 competitor survey compiled by the Commissioner and Superior's 1998 estimates of independents' volumes. Adding this 133 million litres to the total volumes estimated by the branch managers led to a combined market share of 58 percent for Superior and ICG in 1998. This adjustment of the estimate assumes that the independents sold as much in 1998 as in 1997 despite the warmer weather and other factors that allegedly depressed the industry wide volumes.

(b) 1998 Branch Templates

183 The Commissioner submits that the data supplied by the 1998 branch templates to arrive at approximately 58 percent are flawed and conflict with the historical and current position taken by Superior and ICG in their public disclosure statements, the industry practice and other data before the Tribunal.

184 The Commissioner submits that the 1998 branch templates are flawed for various reasons. The Tribunal notes that it remains unclear whether Superior's own estimated market share for a branch area includes sales to agents. Indeed, Mr. Schweitzer could not confirm at the hearing which approach was used by the branch managers who prepared the templates; he indicated that different approaches may have been used by Superior's branch managers. Further, according to him, the estimates were reviewed at Superior's corporate office and "followed up where inconsistencies arose" (transcript at 32:6109 (6 December 1999)). This part of the process also remains unclear.

185 In addition, Mr. Schweitzer testified that he expected that the branch managers estimated competitors' volumes by looking at the physical delivery equipment of the competitors which they could observe by driving down the road past the competitors' locations and estimating the number of litres "typically" delivered in a year by those types of vehicles (transcript at 35:7000-02 (9 December 1999)). These estimated volumes were then apparently used to estimate competitors' market shares.

186 The Tribunal is of the view that the apparent capacity of competitors does not provide an appropriate estimate of sales volumes as conditions change. As an example, a competitor with 15 percent of truck delivery capacity in the market would not necessarily reduce that capacity quickly in the event of warmer weather or reduced sales volumes. There is no evidence that there is a direct correlation between the equipment that a competitor may have and the actual volume of propane sold by that competitor in the marketplace. Further, looking at the equipment is not informative of the intensity with which the assets are used. For example, it does not reflect how much propane is contained in a truck or how often it is filled up in a given week.

(c) 1998 Actual Volumes

187 The Commissioner notes that actual volumes for 1998 for Superior and ICG were approximately 1.23 billion litres and 0.92 billion litres, respectively, for a combined total of 2.15 billion litres according to the Commissioner. According to internal Superior documents, Superior's management believed that its market share was unchanged at 40 percent since 1996. Using its stated approach, Superior management would have estimated total propane demand for 1998 as 3.08 billion litres (i.e., 1.23/0.4), and on this basis, would have concluded that the combined market share of Superior and ICG was 70 percent (i.e., 2.15/3.08). Internal Superior documents show that this was in fact the combined share that Superior management believed at the time when it was studying the acquisition of ICG.

188 However, after reviewing its branch templates in 1999, Superior's management concluded that the combined market share for 1998 had declined. For the first time apparently, Superior's management determined that the Statistics Canada estimate of total market demand, 3.95 billion litres in 1998, was the appropriate base for Superior's and ICG's combined share estimate and then calculated a market share of 54 percent using combined actual volumes (i.e., 2.15/3.95).

189 The Commissioner attributes the decline in the 1998 volume to industry-wide factors. Indeed, the 1998 Superior Propane Income Fund Annual Report (exhibit R-111, tab 1) reads at page 01194:

> Gross profits of $203.5 million in 1998 (16.6 cents per litre of propane sold) declined from 1997 levels by 3%. Propane sales volume in 1998 were 14% lower as a result of reduced heating demand due to weather that was on average 12% warmer than 1997, reduced demand for auto propane due to a declining number of propane powered vehicles, lower oil field activity given the dramatic fall in oil prices in early 1998, and lower crop drying volumes in 1998 due to dry weather and low crop prices.

On this basis, the Commissioner disputes the respondents' claim that the decline in volume in 1998 was due to a decline in combined market share.

190 In addition, the Commissioner's expert, Mr. Mathieson, estimated the 1998 retail demand to be three billion litres even though the Statistics Canada estimate for that year was 3.95 billion litres. Mr. Mathieson noted that Statistics Canada numbers were useful for establishing directional trends in demand in the industry, but that its annual consumption figures were distorted due to double counting. Until Superior management reviewed the 1998 branch templates in 1999, it did not accept Statistics Canada data and it believed that the combined market share was approximately 70 percent. Moreover, in the spring of 1999, Superior's management was of the view that Superior's market share was in excess of 40 percent of the estimated Canadian retail propane market and that there was no evidence at the time that Superior was losing market share to independents (see testimony of M. Schweitzer, transcript at 31:5861-84 (3 December 1999)).

191 The Commissioner submits that the respondents have manipulated various data to show that Superior and ICG have been respectively losing market shares since 1989. The Commissioner notes further that Superior did not report this significant decline in its market share to its investors through its quarterly reports. Indeed, in the Commissioner's view, other sources of information for the year 1997, including the competitor survey, the business case and figures prepared by the respondents in preparation for the acquisition of ICG by Superior suggest otherwise.

192 The Commissioner is critical of Superior's upward adjustment of 133 million litres to its estimate of independents' 1998 sales volumes in the 1998 branch templates summary. The Commissioner argues that an accurate estimate would reflect the decline in industry-wide demand in 1998, which was known when the templates were being prepared and analysed in 1999. The Commissioner argues that since the actual volumes of Superior and ICG has fallen by approximately 14 percent in 1998, the estimates of independents' volumes should be reduced by a similar percentage.

193 The Commissioner points out that branch managers estimated 1998 competitor sales volume and market share by observing competitor capacity (e.g., number and size of trucks) in 1999, which likely overestimated 1998 sales volumes. He asserts that, although propane demand generally declined, capacity likely did not.

194 Relying on Statistics Canada annual volume figures showing a decline in demand in 1998 of 511 million litres, the respondents reply that independents' aggregate volumes declined by only six percent. Further, these changes result in an increase in independents' aggregate market share of three percentage points that matches the equivalent decline in the combined market share of Superior and ICG.

195 The Tribunal accepts the expert evidence of Mr. Mathieson that Statistics Canada data do not reflect actual demand for a given year, and hence doubts that propane demand declined by 511 million litres in 1998. As a result, the Tribunal is not persuaded by the respondents' submission that the independents' aggregate market share increased by three full percentage points in 1998 or that the combined share of Superior and ICG declined by three percentage points.

(d) Other Sources Recognizing a Combined 70 Percent Market Share

196 Various sources state that Superior and ICG have had so far a combined market share of 70 percent, that the total Canadian retail propane market has been in the order of 3.5 billion litres per annum and that it has remained stable for about the last 10 years.

197 In 1996, Petro-Canada assisted by a consultant, Arthur D. Little, carried out a valuation of ICG's business. The study entitled "Petro-Canada — ICG Business Valuation" (confidential exhibit CA-1019), dated September 19, 1996, concludes at page 21997 that baseload propane equals 2.4 billion litres (Superior 45 percent, ICG 29 percent, regionals 16 percent, and independents 10 percent), and that autopropane equals 1.2 billion litres (Superior 45 percent, ICG 29 percent, regional 16 percent, and independents 10 percent).

198 In 1998, the ICG prospectus and the information circular all referred to ICG maintaining an approximate 30 percent market share (exhibit R-47, tab 65, at 04373):

> 4.2 Who are your major competitors in the markets you serve?
>
> Superior Propane Inc. is the largest Propane Company in Canada with approximately *40% market share*. Together, *ICG and Superior serve approximately 70% of the market*. In most geographic areas, *ICG has a 35-40% market share* or greater except for Ontario, where ICG is in the 15% range and the Maritimes where ICG is a small player. The rest of the market is served by 10 regional and 60 small independent competitors. Within the smaller participants the industry is very dynamic, with buyouts, startups and exits occurring regularly; however *ICG's and Superior's combined market share has not materially changed in the past five years*. (emphasis added)

199 With respect to Superior's estimates, the Tribunal notes that a detailed analysis of the propane market in 1995-96 was conducted by Superior ("SPI Market Assessment 1995/96": exhibit A-10). This study, which examines each geographic market and end-use across the country, concludes that Superior holds 43 percent, ICG, 29 percent and others, 28 percent of the Canadian retail propane market. This study also states at paragraph 2 on page 00251:

> ... The sum of these Market estimates, which should theoretically be equal to *total retail propane demand in Canada, was 3.45 billion litres, 13% lower than Statistics Canada's latest estimate of 3.95 billion litres*. (emphasis added)

200 In 1996, Mr. Schweitzer attended and participated in the due diligence process which led to the 1996 Superior Propane Income Fund Annual Report. The prospectus, dated September 25, 1996 (exhibit A-202), states at page 03899:

> ... Superior operates in all ten Canadian provinces and one territory and is the country's largest and only national retail propane marketer with *total sales volumes representing in excess of 40% of the total estimated Canadian propane retail market*. Although demand varies within market segments, *overall market demand for propane is stable and Superior's size and breadth have historically resulted in consistent sales volumes*. (emphasis added)

201 The 1997 Superior Propane Income Fund Annual Report (exhibit A-712), which was released in the spring of 1998, confirms at page 07697 that Superior generates sales volumes "in excess of 40 percent of the total estimated Canadian retail propane market".

202 Peter Jones, formerly Vice-President of Western Operations of Superior, prepared a business case document (confidential exhibit CA-193) when he was at Superior in May 1998 after the publication of the ICG prospectus. At pages 03374 and 03380, the document shows a 41 percent market share for Superior and a 32 percent market share for ICG, on the basis of national volumes of 3.321 billion litres of propane in 1997.

203 The 1998 Superior Propane Income Fund Annual Report (exhibit R-5, tab 161) also states at page 01693 that "[t]ogether, Superior and ICG serve approximately 300,000 customers through 250 branches and satellite units, representing *approximately 70 percent of the Canadian retail propane market*" (emphasis added).

204 The Tribunal also notes that even the quarterly report dated October 27, 1999 of Superior Propane Income Fund (exhibit A-3126), which was issued after Mr. Schweitzer became aware of the alleged drop in Superior's market share following Superior's review of the 1998 branch templates, does not report any change to that effect or any correction to the 1998 estimate previously presented. Indeed, page 1 of the quarterly report states:

> ...Results from the operations of Superior and ICG remained soft this quarter, largely due to *lower overall propane demand* experienced during the third quarter and pressure on margins, as wholesale propane costs continued to rise with the upsurge in crude oil pricing. Soft second and third quarter performance is not unusual in the propane business. Over 60% of cash flow is usually generated during the winter October through March heating season. As crude oil prices have recently moderated and economic conditions have improved, *the outlook for 1999 remains unchanged*. (emphasis added)

205 Therefore, it appears to the Tribunal that Superior chose not to report the alleged decline in Superior/ICG's historical 70 percent share of national propane sales to its investors through its quarterly reports.

(e) Conclusion on Market Shares

206 The evidence suggests that the retail demand for propane was approximately 3.5 billion litres per year up to and including 1997. Similarly all the evidence, except Superior's 1998 branch templates summary, indicates that Superior's and ICG's market shares were approximately 40 percent and 30 percent, respectively, up to and including 1998. In contrast to the evidence stated above regarding Superior's and ICG's market shares, the 1998 branch templates estimates suggest that Superior's and ICG's market shares were 34 percent and 26 percent, respectively, in 1998. This single estimate apparently caused Superior's management to conclude that the drop in the 1998 volume resulted from the penetration of independents in the retail propane business rather than to the warmer weather during that year.

207 The Tribunal has considerable doubt about the accuracy and validity of the information contained in the 1998 branch templates and hence in the branch templates summary for 1998. It appears to the Tribunal that the methodology for collecting and compiling the data was unsound. For example, errors by branch managers led particularly to double counting of propane volume sold by agents. Moreover, the branch managers' assessment of market shares of competitors were adjusted at Superior's corporate office so as to achieve agreement with Superior's total market size estimate. It appears that the branch templates and the summary thereof are flawed. Errors were made by some branch managers in completing the survey; the procedure for inferring competitor volume and market share from observed capacity likely overstates volume and sales. The Tribunal finds it surprising that Superior's branch managers were unaware until recently of the significant growth of independents' market shares over a ten-year period, but were able to provide accurate estimates of competitors' volume for 1998. Finally, the Tribunal is of the opinion that Superior's management did not properly design the questionnaires, collect the data, or ensure quality control to the extent needed to ensure reliability. Consequently, the Tribunal does not place any weight on the respondents' evidence regarding market shares from the branch templates.

208 The Tribunal is further concerned about the addition of 133 million litres for the year 1998 to the competitors' aggregate volume in the branch templates summary. This addition was apparently done in recognition that the branch templates summary understated competitor volumes for 1998 in comparison to 1997. The Tribunal believes that such adjustment was inappropriate given that industry-wide volumes declined in 1998.

209 As noted above, the decline appears due to warmer weather and reduced economic activity in certain propane end-use segments. Given its concern about the branch templates, the Tribunal cannot attribute Superior's and ICG's decline in volume to the suggested increased penetration of independents. Indeed, aside from the 1998 branch templates, there is no evidence to support the changes in market shares claimed by the respondents. The evidence submitted for the period 1988 to 1998 and even for the year 1999 supports the stability of Superior and ICG's combined market share.

210 As mentioned earlier, the Tribunal accepts that relevant geographic markets are local. Therefore, evidence of high market shares on a local basis can only be rebutted by evidence that entry on a local basis can constrain the exercise of market power.

No evidence of that nature has been adduced in this case. Instead, the respondents rely for their evidence on entry and expansion on an alleged declining trend in the combined market share of the merging parties.

211 In light of the evidence, the Tribunal cannot accept the assertion of the respondents regarding entry and expansion. The Tribunal is of the view that there have been no significant changes in Superior's and ICG's market shares that would suggest such a penetration by independents.

C. Removal of a Vigorous and Effective Competitor

212 The Commissioner submits that the merger will result in a loss of an effective and vigorous competitor in the market. The Commissioner points out that Superior's own view is that ICG is an important competitor. Based on its internal documents, Superior refers to ICG as its "key-most" important competitor, to ICG's low prices and its low costs, that ICG uses discounted price to acquire new customers, etc. In addition, the Commissioner refers to the affidavit sworn by Mr. Jones in support of the section 100 application in which he said that under his management, ICG would continue as a vigorous competitor to Superior. In his testimony, Mr. Schweitzer also testified that ICG was Superior's most frequent competitor (transcript at 35:6925, 6926 (9 December 1999)).

213 The Commissioner also refers to the prospectus of September 25, 1996 for the 1996 Superior Propane Income Fund (exhibit A-202) which states at page 03897:

> In addition to Superior, ICG Propane Inc. ("ICG"), which is wholly-owned by Petro-Canada, is the only other retail propane marketer with substantial interprovincial operations. Superior and ICG share approximately three quarters of the Canadian retail market with the balance of the market served by local and regional marketers.

214 Finally, the Commissioner submits that innovative programs such as the Cap-It program and the Golf-Max program are not offered by any other competitor. The Commissioner argues that the Cap-It program has given ICG a competitive edge over its competitors, including Superior.

215 The respondents argue that ICG is an ineffective and inefficient competitor. They refer to the testimony of Mr. Sparling who stated that "[i]n the markets where we are we have not seen them as an effective competitor" in support of that argument (confidential transcript at 6:122 (14 October 1999)). They also rely on Mr. Jones's evidence, who described ICG's inefficiency by reference to various cents per litre ("cpl") measures tied to ICG's declining volumes such as operating costs generally and administrative, fleet and delivery costs in particular (transcript at 35:7056-67 (9 December 1999)). They also rely on the expert evidence of Professor Carlton and Dr. Bamberger, who testified that their research was consistent with the evidence that independents, not ICG, constrain Superior's pricing.

216 The Tribunal is not persuaded that ICG is an ineffective competitor. First, Professor Carlton's analysis of gross margin and earnings before interest, taxes, depreciation and amortization ("EBITDA") in his report (expert affidavit of D. Carlton (17 August 1999): confidential exhibit CR-120) shows at table 2 that from 1994 to 1998, ICG's average gross margin, as a percentage of total revenue, was 44.7 while Superior's was 44.5. Similarly, table 3 of his report shows that ICG's average EBITDA, as a percentage of total revenue, was 11.2 and Superior's was 12.9 over the same period. These numbers may indicate that Superior's financial performance was somewhat better than ICG's but do not indicate that ICG was an ineffective competitor.

217 Secondly, at page 12 of their report in rebuttal (expert rebuttal affidavit of R. Schwindt and S. Globerman (15 September 1999): confidential exhibit CA-2078), the Commissioner's experts, Professors Schwindt and Globerman, reviewed Professor Carlton's analysis of customers gained and lost which tends to show that Superior loses more or gains fewer customers to or from independents than to or from ICG. They challenge that conclusion noting the case of Bromont, Quebec, where the average size of an account challenged by ICG is three times greater than the average size of an account challenged by an independent. Thus, while ICG may figure in fewer competitive challenges with Superior compared to independents, it is a strong and aggressive competitor for large volume accounts. Accordingly, what appears to Superior as weak competition from ICG may simply be ICG's strategy of competing more intensively for larger accounts which are smaller in number than smaller accounts.

218 Thirdly, the Tribunal reviewed the answer to undertaking 150 given by ICG on its examination for discovery. It provides a list of 18 services provided by ICG such as the Cap-It program, the Golf-Max program, the Auto-fill program, the SOS Cylinder Delivery and the Aquaculture program. This list also shows which competitors offer or do not offer such services by region. The Tribunal concludes that ICG is an important and aggressive competitor seeking to attract customers with these specialised services.

219 It appears to the Tribunal that the respondents' submission concerns ICG's alleged financial performance rather than ICG's presence as an effective competitor in the market. The evidence before the Tribunal shows that ICG actively solicits customers from among the largest consumers and through specialised programs, that consumers from various end-uses recognize ICG as an alternative, that consumers use ICG to negotiate prices with Superior and that ICG's market share continues to be approximately 30 percent as indicated above. This evidence does not support the argument that ICG is an ineffective competitor. Professor Carlton's remaining evidence in this regard will be reviewed below.

D. Foreign Competition

220 The Commissioner suggests that foreign competitors do not provide effective competition. The respondents' expert, Professor Carlton, suggests at paragraph 21 of his report (confidential exhibit CR-120) that propane distributors in border states can enter the Canadian market in the event of a post-merger price increase and that the 10 largest propane retailers in the United States have over 1,500 retail locations in states that border Canada. However, as the Commissioner points out, entry by propane marketers from the United States has been virtually non-existent in the past.

221 There are three ways in which a propane marketer from the United States could enter the Canadian propane industry: (1) by serving border locations from existing storage points in the Unites States; (2) by establishing branches in Canada; and (3) by acquiring a Canadian propane marketer. The only evidence of any of these alternatives is that of Professor West's reference to the American company, Lake Gas, located in International Falls, Minnesota, which sells a small volume (50,000 litres of propane) directly across the border in Fort Frances, Ontario.

222 There is no evidence that a propane marketer from the United States has ever established a branch in Canada. In early 1998, Gaz Metropolitan Inc. indicated its interest through a partnership with AmeriGas, one of the largest propane marketers in the United States, in acquiring ICG. No transaction was concluded and there is no other evidence of successful entry through acquisition by an American propane distributor.

223 In addition to the barriers to entry discussed above, and for a variety of reasons including billing systems, foreign currency, language and different measurement systems, it appears to the Tribunal that American firms are unlikely to provide effective competition to the merged entity in the Canadian retail propane market.

E. Effective Remaining Competition

224 The Commissioner alleges that competition following this merger will be weak and ineffective. The Commissioner refers in particular to evidence that shows that Superior and ICG are the price leaders and that the independent firms typically follows the prices set by Superior and ICG. Hence the disappearance of ICG would remove the only significant constraint on Superior's ability to set prices.

225 Regarding the effectiveness of independent competitors and the constraining role of ICG, the respondents present the expert testimony and report of Professor Carlton, which will be addressed below. Other evidence suggests that the Commissioner's concern for effective remaining competition is well founded. For example, the merged firm will be the only one in Canada with the capability to serve national accounts at the level of service currently offered by Superior or ICG. None of the remaining firms can offer that level of service effectively and hence will not be effective competitors to the merged firm for the business of national accounts.

226 According to Superior, there are up to 200 independent firms. The Commissioner points out that many of these firms are agents of the merging firms or are associated with them as "bulk dealers". A bulk dealer purchases propane, takes title to the product, and agrees with either ICG or Superior to market in well defined territories. With respect to its bulk dealers, ICG determines the price, holds the customer contract, and bills the client directly. The Tribunal does not regard these agents and bulk dealers as strong competitors to the merging parties, particularly with respect to existing customers.

227 The Commissioner contends that fringe and regional competition exists in some local propane markets, but that sustained or significant competition exists only between the merging parties. The evidence for this submission is that independent propane marketers are price followers, they are in many cases unknown to consumers in their own markets, they differentiate their products and locations to avoid direct competition with the merging parties and they compete mainly among themselves. The latter point leads to Professors Schwindt and Globerman's reference to "churn". For example, Mr. Sparling submitted that Sparling does not actively solicit customers from rivals, particularly from Superior. He testified:

> MR. MILLER: Do you actively solicit customers from your rivals?
>
> MR. SPARLING: No.
>
> MR. MILLER: Do you have any instructions or directions to represent —
>
> MR. SPARLING: We discourage that. We refer to that as cold calling. It's not to say it doesn't happen in this industry, but we certainly discourage it, and we would define that as a sales person driving up and down a given road and wherever they see a tank they simply go in and cold call the customer. We discourage that. transcript at 12:1731 (14 October 1999).

228 He also testified that Sparling does not seek to be a price leader; rather, Sparling emphasizes "consistent pricing" from customer to customer (transcript at 12:1728 (14 October 1999)). In the Tribunal's view, this comment can reflect consciously parallel behaviour that characterizes some oligopoly markets; possibly it reflects only that Superior and Sparling have highly differentiated marketing strategies and hence do not compete directly for this reason. In either case, it suggests that Sparling cannot be viewed as an effective competitor to Superior or to the merged entity.

229 Further evidence of weak remaining competition is provided by Mr. Edwards of EDPRO Energy Group Inc. ("EDPRO") who established his company in June 1997. Mr. Edwards said that he established the business in London, Ontario, because of its proximity to the Sarnia propane supply source and to avoid competing in a market with a dominant firm. Based on his experience in the Maritimes, Mr. Edwards felt that competing with a dominant propane marketer was not likely to yield success. Further, Mr. Edwards explained that after two years in the business, EDPRO's top three customers represent 75 percent of EDPRO's total volume.

230 Moreover, EDPRO's own organization, effectively a franchise, indicates that its own dealer-associates operate as bulk dealers rather than as competitors. The dealer-associates purchase propane from EDPRO and operate under the EDPRO name in exclusive territories established by agreement with EDPRO.

231 It appears to the Tribunal that residential customers are not well informed about alternate propane marketers serving their areas other than the merging parties. For instance, one of the Commissioner's factual witnesses, Ms. Simons, was unable to determine which suitable propane companies were delivering propane in Renfrew, Ontario. During cross-examination by the respondents, she stated that when building her house in Renfrew, she was aware only of Superior and ICG and selected ICG on the basis of price. She had not been solicited by any other propane suppliers and was only familiar with one other propane supplier, Rainbow Propane, which supplies 100-pound tanks to cottages (transcript at 19:3304 (26 October 1999)).

232 The Tribunal also heard evidence that residential customers learn about competitors by word-of-mouth from neighbours. This lack of information regarding competitors suggests to the Tribunal that the independent firms do not market their services as aggressively as ICG or Superior and that customer awareness is weak as the Commissioner asserts.

233 The respondents claim that certain firms could easily enter the retail propane business, and they twice quote part of paragraph 3.2.2.7 of the MEG's, cited above at paragraph [57], which indicates that, under certain conditions, potential competitors are considered at the stage of market delineation. On this basis, the respondents advocate including upstream propane producers, suppliers from distant locations, and suppliers of alternate fuels in the relevant market and they identify certain such firms by name. The respondents' quotation from paragraph 3.2.2.7 of the MEG's includes the following:

> ... Where it can be established that such a seller would likely adapt its existing facilities to produce the relevant product in sufficient quantities to constrain a significant and nontransitory price increase in the relevant market, this source of competition will generally be included within the relevant market.

234 The Tribunal notes that the respondents have not provided any information on the sales of retail propane that the named potential competitors might reasonably be expected to make and, thus, have not established that such sales could exercise a constraining influence on the pricing of products sold within the relevant market.

235 Claiming support from footnote 22 of the MEG's, the respondents also argue that, although market shares could not reasonably be attributed to these potential competitors, the existence of these firms implies that the market shares of actual propane retailers overstate the market position of the actual retailers. In effect, the respondents ask the Tribunal to place less weight on estimated market shares of Superior, ICG and presumably the independent firms because of the presence of potential competitors.

236 In this regard, the Tribunal notes that the respondents have incompletely quoted from the MEG's which, immediately following their quoted passage, also state:

> ... However, potential competition from sellers who could produce the relevant product by adapting facilities that are actually producing another product will not be assessed at the market definition stage of the assessment of the merger where:
>
> > (i) such a seller would likely encounter significant difficulty distributing or marketing the relevant product; or,
> >
> > (ii) new production or distribution facilities would be required to produce and sell on a significant scale.
>
> In these circumstances, this source of competition will instead be considered subsequent to the delineation of the relevant market, in assessment of the likelihood of future entry pursuant to section 93(*d*) of the Act.

237 On the basis of the evidence in this case regarding, *inter alia*, customer contracts and scale economies, the Tribunal believes that the output of the potential entrants cited by the respondents would not be included in the relevant market if the MEG's were applied. As a consequence, there is no reason to believe that the market shares of actual competitors overstate their market positions.

238 On the basis of the evidence submitted, the Tribunal believes that there is insufficient evidence to demonstrate that there will be effective remaining competition capable of constraining the exercise of market power by the merged entity.

239 The respondents' main piece of evidence in this area is Professor Carlton's statistical analysis of Superior's margin. He concludes that, whereas a substantial presence by ICG in Superior's market area does not constrain Superior's pricing, the aggregate of the independents' volumes in that market does provide a competitive restraint on Superior's pricing. The Tribunal will discuss this opinion evidence below.

F. Prevention of Competition

240 In addition to the alleged substantial lessening of competition pursuant to sections 92 and 93 of the Act, the Commissioner submits that the merger will lead to a prevention of competition in the Maritimes that will be substantial.

241 ICG serves the Maritimes provinces from its branch located in Moncton, New Brunswick. The Commissioner points out that ICG had extensive plans, prior to its acquisition by Superior, to expand its business in the Maritimes by establishing branch operations in Sydney, Nova Scotia.

242 The Commissioner submits that Irving Oil Limited and Superior were the principal alternate competitors in this region and that the merger terminates ICG's activity as a competitor in Atlantic Canada. He submits that Superior and Irving Oil had a duopoly in the Maritimes. The Commissioner argues that ICG has developed and pursued competition in the Maritimes and has evident capability and plans to expand its presence in order to increase competition in the Maritimes. He introduced ICG's plans to obtain Canadian Tire's business where ICG stated clearly that they would dedicate a $200,000 tractor-trailer to service the Canadian Tire dealer network in the Atlantic provinces (exhibit A-851 at 10980). The Commissioner submits that the acquisition of ICG by Superior will substantially prevent competition in Atlantic Canada.

243 The respondents did not call any evidence nor made any submissions regarding the Commissioner's allegation that a substantial prevention of competition is likely to occur in Atlantic Canada.

244 The Tribunal recognizes that the concept of prevention of competition has not received much attention in Canadian jurisprudence. In *R. v. Howard Smith Paper Mills Ltd.* (1957), 8 D.L.R. (2d) 449 (S.C.C.), the Supreme Court of Canada had to consider the meaning of the word "prevent" in relation to the word "unduly" and concluded that, when used together, the word "prevent" means "hinder or impede" in contrast to absolute elimination.

245 The MEG's, cited above at paragraph [57], explain the expression "prevention of competition" at paragraph 2.3 as follows:

> Similarly, competition can be **prevented** by conduct that is either unilateral or interdependent. Competition can be prevented as a result of unilateral behaviour where a merger enables a single firm to maintain higher prices than what would exist in absence of the merger, by hindering or impeding the development of increased competition. For example, the acquisition of an increasingly vigorous competitor in the market or of a potential entrant would likely impede the development of greater competition in the relevant market. Situations where a market leader pre-empts the acquisition of the acquiree by another competitor, or where a potential entrant acquires an existing business instead of establishing new facilities, can yield a similar result.
>
> Competition can also be prevented where a merger will inhibit the development of greater rivalry in a market already characterized by interdependent behaviour. This can occur, for example, as a result of the acquisition of a future entrant or of an increasingly vigorous incumbent in a highly stable market.

246 In light of ICG's plans to vigorously expand its activities in Atlantic Canada and in the absence of any evidence to the contrary, the Tribunal is of the view that there will likely be a substantial prevention of competition in Atlantic Canada as a result of the merger.

G. Statistical and Econometric Evidence

(1) Commissioner's Expert Evidence

247 Michael R. Ward, one of the Commissioner's experts, provided econometric evidence about the likely effects of the merger on Superior's ability to exercise market power. He used the well established approach of "merger simulation", a method developed specifically for analysing the competitive effects of mergers in differentiated product industries. In such industries, the potential for a unilateral price increase is high when the merging parties place competitive constraints on each other by virtue of a high degree of substitutability between their products prior to the merger. Prior to a merger, a unilateral price increase by one firm may lead to a loss of sales to its closest competitors. However, a unilateral price increase following a merger among close competitors may lead to a reduced loss of sales when the products of the merging companies are closer substitutes for each other than for the products of other firms in the industry (see generally exhibit R-108, J.A. Hausman and G.K. Leonard, "Economic Analysis of Differentiated Products Mergers Using Real World Data" (1997) 5:3 George Mason L. Rev. 321).

248 In the first part of his report (expert affidavit of M.R. Ward (30 August 1999): exhibit A-2059), Professor Ward estimates the structure of demand for propane. He then uses these estimates to simulate the instant merger's likely effects. In order to determine the degree of substitution between the products of the merging parties, Professor Ward obtained data on ICG and Superior branches in 46 out of 74 of Professor West's geographic markets for a period of 54 months up to 1998 for which data was available. He used Superior data on prices, sales, and product groupings, and ICG data on litres sold, dollar sales, gross profits, and product groupings to establish volumes and prices for each firm in four product segments: residential, industrial, autopropane, and "other" which includes construction, commercial, government and agriculture end-uses.

249 With this data set, Professor Ward measures the extent to which consumers substitute between ICG and Superior using a linear approximation to the Almost Ideal Demand System, a widely-accepted approach to demand estimation. He finds that an increase in ICG's price results in a statistically significant increase in Superior's market share in the residential and industrial segments, and that an increase in Superior's price reduces its market share significantly in those segments. Professor Ward interprets these findings as evidence for consumer substitution between the products of ICG and Superior, i.e., that they compete directly and their products are close substitutes for each other in the eyes of consumers. His report shows at page 21 that the results for the autopropane segment have the expected signs but are not statistically significant; results for the "other" segment are not reported due to lack of significance or implied upward-sloping demand curves.

250 Professor Ward's evidence at page 26 of his report also demonstrates that Superior reacts strategically to ICG's pricing behavior. He finds that when increases in ICG's unique costs result in a price increase of one percent, Superior increases its price by approximately two-thirds of a percent in the residential, industrial and automotive categories. He expects that ICG would respond to Superior's price increases but does not have the data to estimate that strategic relationship. In his simulation analyses, he makes the assumption that ICG will react to Superior's price changes in the same way as Superior reacts to ICG's pricing decisions as stated at page 27 of his report.

251 Using the statistical results obtained with the Almost Ideal Demand System, Professor Ward estimates the own-price and cross-price elasticities of demand in order to estimate the impact of the merger on product prices, a step referred to as simulation. Since he did not know the price elasticity of demand for propane, he estimated firm-level elasticities with three different assumptions for that key measure. At table 6 on page 29 of this report, he finds, for example, that if the price elasticity of demand for propane is -1.5, then the price elasticity of demand for ICG propane is -2.40 in the residential segment and the corresponding Superior price elasticity is -1.97 with regional and discount dealers in the market. He assumes that substitutability between the merging parties and independent firms is exactly half as large as that between ICG and Superior.

252 Combining the firm-level price elasticities with the evidence on strategic pricing (which would no longer occur post-merger), Professor Ward estimates the change in price due to the merger assuming there are no changes in marginal costs, i.e., no efficiency gains and no entry or supply-substitution by product segment. Depending on the elasticity assumed for propane demand, on the presence or absence of regional and discount dealers, and on the product segment, the average estimated price increases are between 1.4 percent and 15.1 percent. Table 7 on page 30 of his report shows that, using propane demand elasticity of -1.5, the average price increases are 8 percent in residential, 8.9 percent in industrial and 7.7 percent in automotive taking regional and discount dealers into account. He concludes at page 36:

> ... Fifth, ignoring possible price reductions from merger efficiencies, entry or supply-side substitution, the incorporation of these estimates into a merger simulation implies prices will increase due to the merger. The size of the price increase depends primarily on the demand for propane. Specifically, if propane demand is relatively inelastic, the merger is likely to raise average prices by 8% or more.

253 At the time of his analysis, Professor Ward did not have the statistical results of Professors Ryan and Plourde regarding the price elasticity of demand for propane. When this information was made available, he re-calculated the effects of the merger on prices using a propane demand elasticity of -1.0, based on their conclusion that the demand for propane was price-inelastic. In those calculations, he also relaxed his assumption that substitutability between independent firms and ICG and Superior was half that of the estimated substitutability between ICG and Superior. Instead, he assumed that they were equally substitutable.

Table 2 on page 8 of his report in reply (expert reply affidavit of M.R. Ward (4 October 1999): confidential exhibit CA-2060) shows that he estimates that the average price increases for residential, industrial and automotive are 11.7 percent, 7.7 percent, and 8.7 percent, respectively, when independent firms are in the market.

254 The respondents' experts, Professor Carlton and Dr. Bamberger, in their report in rebuttal (expert rebuttal affidavit of D.W. Carlton and G.E. Bamberger (27 September 1999): confidential exhibit CR-123), argue that Professor Ward's estimated price increases are overstated because he does not include the effects of efficiencies, entry or supply-side substitution in his analyses. They also criticize Professor Ward for not justifying his assumptions in this regard. They also consider that he has not adequately recognized the constraining effects of independent firms on Superior and ICG pricing. The respondents argue strenuously that Professor Ward did not provide an opinion as to the quantum of any likely price increases post-merger and, therefore, did not provide a basis for finding a substantial lessening of competition.

255 Noting its earlier comments regarding the evidence of entry and of supply substitution, the Tribunal does not accept the criticisms of Professor Carlton and Dr. Bamberger in these areas.

256 In reply to their criticism, Professor Ward re-calculated the price impacts including the effects of efficiencies and reported virtually identical price increases at all levels of efficiency gains up to and including $40 million per year, as shown at tables 3 to 5 on pages 10 to 12 of his report in reply (confidential exhibit CA-2060). In a further re-calculation, at the request of the respondents, that incorporated the approach to cost savings as outlined by Hausman and Leonard, cited above at paragraph [247], Professor Ward found that efficiencies had a stronger impact but resulted in price reductions of -0.9 percent in residential, -1.1 percent in industrial and -1.9 percent in automotive only at the $40 million level and then only if 100 percent of these efficiency gains resulted in variable-cost savings (Ward Undertaking (16 November 1999): exhibit A-2079, tables 3-5). As discussed below, no one including the respondents' experts on efficiency gains has suggested that this merger will produce $40 million of annual savings in variable costs.

257 In the Tribunal's view, Professor Ward's analysis, even though it does not take efficiencies into account, is highly relevant to a determination as to whether there is a likely substantial lessening of competition.

258 The Tribunal concludes that evidence of an actual or likely price increase is not necessary to find a substantial lessening of competition. What is necessary is evidence that a merger will create or enhance market power which, according to paragraph 2.1 of the MEG's, cited above at paragraph [57], is "the ability to profitably influence price, quality, variety, service, advertising, innovation or other dimensions of competition". There is no requirement under the Act to find that the merged entity *will* likely raise the price (or reduce quality or service). The only requirement under section 92 is for the Tribunal to decide whether the merged entity has the ability to do so.

259 For this reason, Professor Ward's simulations both in his report in reply and his undertaking which take efficiencies into account to address the respondents' criticism are irrelevant. The Tribunal infers from the results of his other simulations that the merged entity would have the ability to raise the price of propane.

260 As to the respondents' claim that Professor Ward has not offered an opinion on the extent and likelihood of a price increase, the Tribunal notes that his initial simulation results at table 7, on page 30 of his report (exhibit A-2059), provided six sets of estimates that were calculated based on three assumed values for the price elasticity of propane demand and on two scenarios concerning the presence or absence of regional and discount dealers in the market. He concluded that the merger would lead to higher prices under all assumed conditions. In his re-calculations in reply at table 2, on page 8 of his report in reply (confidential exhibit CA-2060), Professor Ward further varied his assumptions and obtained similar results.

261 The fact that Professor Ward simulated the merger's effects under a variety of assumptions and reached the same conclusion gives the Tribunal more confidence in his opinion than it would have if he had restricted his simulations to a narrowly defined set of assumptions. The Tribunal views Professor Ward's conclusion in his initial report, that average prices would rise by eight percent or more as a result of the merger assuming that propane demand is relatively inelastic, as a valid opinion, particularly given his further simulation results in reply.

(2) Respondents' Expert Evidence

262 The respondents' experts, Professor Carlton and Dr. Bamberger, were asked to evaluate the Commissioner's claim that Superior's proposed acquisition of ICG would result in a substantial prevention or lessening of competition in the market for propane in Canada. They concluded that there was no systematic evidence that the proposed merger would have such effect. They considered the competitive restraint on Superior, customer gains and losses, gross profit margin and EBITDA.

(a) Competitive Restraint

263 Professor Carlton presented econometric evidence that ICG has not provided a competitive restraint on Superior's pricing but that the independent propane dealers, in aggregate, have provided such constraint. This evidence contradicts the Commissioner's assertion that where significant competition takes place in the propane business, it is between ICG and Superior. If Professor Carlton is correct, then the removal by this merger of ICG as a competitor should not allow Superior to raise its price.

264 In his econometric models, Professor Carlton posits a relationship between Superior's gross profit margin and the "substantial presence" of ICG and of the remaining firms in aggregate. A substantial presence is measured in four separate ways. In the first model, the presence of ICG and of the other firms in aggregate are deemed substantial if their respective market shares are at least 15 percent. In the second and following models, a deemed substantial presence requires a market share of at least 20 percent, 25 percent and 30 percent, respectively.

265 Professor Carlton measures these hypothesized relationships by applying the regression analysis technique of ordinary least squares ("OLS") to 1998 monthly data on Superior's prices, costs, margins and volumes at the branch level, hence pooling time-series and cross-sectional data. These data come from Superior's internal records as do the proxies for secondary distribution costs. The prices of alternative fuels come from Statistics Canada databases. The 1998 market share data used to define the dichotomous substantial presence variables are taken from the branch templates prepared by Superior's branch managers in 1999. Professor Carlton controls for a variety of other exogenous variables and conducts additional OLS regression analyses for 1997 (using 1998 market shares) and also by profit margin in various end-uses. His results in these latter OLS analyses appear to use similar models and definitions of variables and to support his 1998 results; accordingly, the 1998 OLS results will be the focus of the Tribunal's review.

266 Professor Carlton finds that Superior's gross profit margin is higher where ICG has a substantial presence. Selecting model 1 as an example, Superior's margin is 1.47 cpl higher at locations where ICG has a substantial presence (i.e., 15 percent or greater market share) than where it does not. In all four models, the margin impact is positive and statistically significant.

267 The results for the independent firms show that the aggregate substantial presence of those firms decreases Superior's margin. Where the aggregate market share of the other firms is at least 15 percent, Superior's margin is 0.80 cpl lower than where the aggregate market share is less than 15 percent. Similarly, where the aggregate market share of the other firms is at least 30 percent, Superior's margin is 0.56 cpl lower than where the aggregate market share is less than 30 percent. The effect on margin is negative and statistically significant in all four models.

268 On the basis of these econometric results, Professor Carlton concludes that ICG does not constrain Superior's pricing behaviour, and that the merger will not enable Superior to increase prices, principally because of the discipline exerted by independent firms. At footnote 31, on page 15 of his report (confidential exhibit CR-120), Professor Carlton suggests that his results are consistent with the alleged "inefficiency" of ICG (i.e., that it has been badly managed).

269 The Tribunal notes that Professor Carlton's finding that Superior's gross margin is higher at locations where ICG has a substantial presence is an unexpected and unusual result and it is perhaps his most important result. Several criticisms were offered; the Tribunal will comment on the ones that seem most significant.

270 The Commissioner suggests that substantial presence variables may be proxies for market concentration. If this were the case, then Professor Carlton's results would tend to show that Superior's gross profit margin is higher in areas where

concentration is higher, rather than demonstrating that ICG is a weak competitor. Despite Professor Carlton and Dr. Bamberger's reply on this point, when taken in conjunction with various internal Superior reports of challenging behaviour by ICG, the Tribunal believes that the better view is that Professor Carlton's results reflect concentration.

271 The specification of the substantial presence of the independent firms is also problematic. Professor Carlton aggregates the volumes of all independent firms into one market share. Thus, as Professors Schwindt and Globerman point out at page 9 of their affidavit in rebuttal (confidential exhibit CA-2078), the statistical result would be the same whether the substantial presence variable combined market shares of many independent firms or represented the market share of one large independent firm. The Tribunal would expect different competitive effects if there were many independent firms with a certain combined share than if there were just one with that share. Hence the substantial presence variable that Professor Carlton used may not be a good measure of the competitive effect of independent firms.

272 Professor Carlton's models posit that Superior's margin is affected by ICG's and the independents' substantial presence. The Commissioner suggests that the opposite relationship may also hold simultaneously and criticizes Professor Carlton's statistical results for failing to take account of the simultaneous relationship between Superior's profits and the substantial presence variables. Such simultaneity is known to lead to biassed statistical estimates when the OLS method is used.

273 Replying to a similar criticism of his OLS results from Professor Ward (expert rebuttal affidavit of M.R. Ward (14 September 1999): exhibit A-2080), Professor Carlton repeats his analysis using the method of two-stage least squares ("2SLS") in order to take simultaneity into account. This further work indicates to the Tribunal that Professor Carlton gives some credence to this criticism. Footnote 15 on page 12 of his report in reply (expert reply affidavit of D.W. Carlton and B.E. Bamberger (19 September 1999): confidential exhibit CR-122) states that the results therefrom:

> ... provide no systematic support for the Commissioner's claim that ICG significantly constrains Superior's retail propane prices. Full regression results are reported in Appendix G.

274 It is instructive to compare Professor Carlton's 2SLS results with his OLS results. All four OLS models demonstrated that Superior's profit margin was higher where ICG had a substantial presence and that the positive relationship was statistically significant. With the method of 2SLS, one model results in a positive coefficient for ICG's substantial presence, three of the models now show negative coefficients for this relationship, and none of these four coefficients is statistically significant. These differences suggest to the Tribunal that Professor Carlton's OLS results are statistically biassed and not reliable.

275 For example, where substantial presence is defined at the 15 percent level, Professor Carlton's OLS results indicate that Superior's margin is 1.47 cpl higher where ICG's presence is substantial than where it is not, and that the relationship is statistically significant. However, the 2SLS results indicate that Superior's margin is 1.60 cpl lower where ICG's presence is substantial than where it is not; the relationship is not statistically significant.

276 Thus, while Professor Carlton is correct to claim that his 2SLS results do not provide systematic support for the Commissioner's claim, it also appears that they do not provide support for his own conclusions. In particular, the 2SLS results support neither the conclusion that Superior is more profitable at locations where ICG has a substantial presence nor the suggestion that ICG is an ineffective competitor. Indeed, the lack of statistical significance for ICG's substantial presence indicates that no relationship has been found.

277 With respect to the presence of independents, Professor Carlton's 2SLS results for the aggregate effect thereof also differ from his OLS results. In all four models, the substantial presence of independents has a much stronger statistically significant effect on Superior's margin than with OLS methods. For example, with a 15 percent substantial presence, the OLS impact of independents is -0.80 cpl; with 2SLS, the impact is -3.49 cpl. Similar differences are found across all four models.

278 The Tribunal observes that the measures of substantial presence for independent firms in aggregate depend on the market share data from Superior's branch templates, the limitations of which have already been noted. Simply put, the Tribunal believes that the substantial presence of independent firms has been measured with error and that the resulting coefficient estimates, whether OLS or 2SLS, are unreliable.

279 The Tribunal regards Professor Ward's criticism regarding simultaneity as appropriate and, therefore, places greater weight on Professor Carlton's 2SLS results. The Tribunal rejects Professor Carlton's OLS results and the implications which he draws therefrom. Moreover, since Professor Carlton's 2SLS results provide no information on the relationship between Superior's margin and ICG's substantial presence, the Tribunal can only conclude that Professor Carlton's econometric results are not useful in this case.

(b) Acquisition of Premier

280 To determine whether the merger is likely to result in a price increase, Professor Carlton examined the price effects of Superior's acquisition of Premier, which was completed in 1994. Premier had been a strong competitor in British Columbia and Alberta. After studying Superior's prices in those provinces before and after the acquisition, Professor Carlton finds, at paragraph 47 of his report (confidential exhibit CR-120), that Superior's average margin is statistically lower after the acquisition and that end-use margins are significantly lower for three end-uses — agent, automotive and residential.

281 Apart from the statistical and interpretive problems which Professors Schwindt and Globerman find with Professor Carlton's evidence, they note at page 14 of their report in rebuttal (confidential exhibit CA-2078) that Premier's sales were more heavily oriented to autopropane than were Superior's and suggest that this is why the average margin declined post-merger. That the Premier merger lowered Superior's profit margin is surprising. Together with the differing circumstances of the instant merger and the absence of reply by Professor Carlton to Professors Schwindt and Globerman's rebuttal points, the Tribunal believes that Professor Carlton's analysis of the Premier merger does not provide a good indication of the likely effects of the merger under consideration here.

(c) Customer Gains and Losses

282 Professor Carlton reports at paragraph 42 and table 12 of his report (confidential exhibit CR-120) his analysis of Superior's customer gains and losses. For 1996, his customer count data show that Superior experienced a net loss of 149 customers to ICG and 1,862 customers to independent firms. In 1997, Superior enjoyed a net gain of 157 customers from ICG but a net loss of 2,435 customers to independents. In 1998, Superior also had a net gain of 448 customers from ICG and a net loss of 995 customers to independents. He concludes that "Superior systematically loses more, or gains fewer, customers to or from independents than ICG. These results are consistent with my regression findings that independents, and not ICG, constrain Superior's propane prices" (*ibid.* at paragraph 42).

283 The Tribunal finds Professor Carlton's conclusion somewhat difficult to understand. It is not the case that Superior gained fewer customers from independents than from ICG. In each of the three years, his data show that Superior gained more customers from independents than from ICG (1,298 from independents versus 793 from ICG in 1996; 1,201 versus 1,115 in 1997; and 1,207 versus 1,116 in 1998). On a net basis, Superior gained more customers from ICG than it lost in two of those years and lost more customers than it gained from ICG in one year. It is not clear to the Tribunal what systematic solutions can be drawn from these numbers.

284 Professors Schwindt and Globerman, at page 12 of their report in rebuttal (confidential exhibit CA-2078), point out that the counting of actual customer gains and losses does not measure the number of customers that ICG challenged. Moreover, as they point out, counting customers will not reflect the size of those customers or the volumes won or lost. It may be, for example, that ICG's business strategy is more focussed on large-volume customers and hence, it may not challenge many small accounts that would likely be of interest to independent marketers. Referring to ICG's experience in Bromont, Quebec, they state that a simple counting of customers gained and lost is misleading.

285 As Professor Carlton does not challenge these criticisms in reply (confidential exhibit CR-121), the Tribunal is of the view that counting actual customers gained and lost does not, in itself, establish the ineffectiveness of ICG as a competitor to Superior.

(d) Gross Profit Margin

286 In Professor Carlton's view, as stated at paragraph 12 of his report (confidential exhibit CR-120), the Commissioner's claim is that retail propane prices depend on the number of national suppliers in a country. If the Commissioner were correct, he argues, then gross profit margins of propane dealers should be higher in Canada where the industry is more concentrated than in the United States where there are more "national retail suppliers" competing in a local market. He presents evidence for the period 1994-98 showing that the average gross profit margin (i.e., gross profits as a percentage of revenues) was lower for Superior (44.5) and ICG (44.7) than for a sample consisting of the seven largest American propane dealers with multi-market operations on which he could collect such data (47.9). This evidence, he argues, suggests that profitability is not a function of industry concentration and hence the merger of ICG and Superior will not present a problem for competition.

287 The Commissioner's experts, Professors Schwindt and Globerman, criticize this statistical finding for failing to take differences in product mix into account. The overall gross margins of propane dealers might vary because of profitability differences in the end-use markets they serve. Accordingly, they argue, the lower gross profit margins of ICG and Superior reflect the fact that they are more heavily involved with low-margin autopropane supply and less involved with residential propane than their American counterparts. Once the gross margins are corrected for differences in product mix, the margins of ICG and Superior are higher than the ones of the dealers in the United States.

288 At page 2 of his report in reply (confidential exhibit CR-122), Professor Carlton recalculates Superior's gross margin for 1998 assuming it had the same business mix as each of the three American propane dealers. The resulting average profit margin is higher than Superior's margin for that year and tends to support Professors Schwindt and Globerman's citation. Professor Carlton does not report such calculations for ICG. In the Tribunal's opinion, Professor Carlton has not shown that the Commissioner's business mix criticism is mistaken.

(e) EBITDA

289 Professor Carlton's evidence at table 3 of his report (confidential exhibit CR-120) is that EBITDA as a percentage of revenues are lower for ICG (11.2) and Superior (12.9) than for his sample of American dealers (15.6) for the 1994-98 period. He interprets these data as further support for his view that profitability is not related to industry concentration.

290 In the propane business, EBITDA equal gross profit less secondary distribution and other administrative costs, and hence, is a measure of net cash flow from operations. As a profit measure, it has the advantage of not being distorted by the arbitrary treatment of depreciation/amortization under generally accepted accounting rules, by the choice of capital structure which influences interest expense or by tax planning opportunities. Accordingly, EBITDA may be preferred to other profitability measures (such as net income) that measure profit with such distortions and are unreliable when making inter-firm comparisons.

291 The Commissioner takes issue with Professor Carlton's interpretation, stating that differences in EBITDA can be due to differences in "net margin" across applications. He notes, for example, that net margins can differ due to differences in capital investment across end-uses with the resulting differences in depreciation expense across end-uses. This argument is similar to the business mix argument discussed above with respect to differences in gross profit margins across firms.

292 In fact, Superior's own estimate of its 1996 net margins was 0.1118 cpl in the residential segment and -0.0032 cpl in auto. In 1995, those net margins were 0.1065 cpl and 0.0044 cpl, respectively (confidential exhibit CA-16 at 00923). The Commissioner appears to suggest that such differences in net margin account for differences in EBITDA/revenue between Canadian and American propane dealers as the former are more heavily involved in autopropane than are the latter.

293 However, the definition of net margins is not clear. If, as it appears, it includes depreciation and other costs such as head office costs, interest expense and taxes that are not measured by end-use, then any attempt to allocate such expenses to end-uses served by a propane dealer will require arbitrary allocation rules that make the results similarly arbitrary, if not meaningless. For example, how should the depreciation on a delivery truck that serves both agricultural and residential customers be allocated between these end-uses? Should it be done proportionately to litres delivered, to the number of customers, to distances, to time involved? Each such allocation procedure is as good as any other, and equally arbitrary. Moreover, it is not clear how depreciation should be measured. Certainly, the accounting treatment of depreciation does not attempt to measure the "wear and

tear" that takes place; accounting rules attempt only to spread the purchase price of an asset over some period of time in order to match the cost of the asset against the revenue it generated in a particular period of time as required by accounting principles.

294 The allocation procedures adopted by Superior illustrate the problem. Overhead costs were allocated to market segments and to geographic markets according to volumes, and operating costs according to the number of deliveries. The stated justification for these procedures is that "they appear to produce the best results" (confidential exhibit CA-16 at 00923).

295 At paragraph 9 of his report in reply (confidential exhibit CR-122), Professor Carlton suggests that although gross margins differ according to business mix, they reflect differences in secondary distribution costs across end-uses. Presumably, he means that a firm requires a higher gross profit margin in an end-use with higher secondary costs than in an end-use with lower secondary costs in order to operate profitably. However, he presents no evidence that this relationship holds in the propane business. Indeed, he simply states that "[t]here is no reason to believe that prices for residential and auto end-uses differ substantially after *all* (not just primary distribution) costs are accounted for".

296 The evidence cited above on Superior's net margins appears to provide a reason for such a belief. However, these margins depend crucially on the allocation procedures adopted.

297 The Tribunal is not bound by the allocation procedures that Superior used, and it cannot be sure that other equally reasonable procedures would not produce very different net margins. The Tribunal believes that it cannot attribute differences in EBITDA to differences in margins across end-uses as suggested by the Commissioner. However, it cannot accept without evidence that gross profits reflect higher secondary costs across end-uses as Professor Carlton suggests. It may be that, as with gross profit margins, differences in business mix and secondary distribution costs account for some, possibly large, portion of the EBITDA differences between large Canadian and American dealers. Hence the Tribunal is not prepared to accept Professor Carlton's conclusion that ICG and Superior are less profitable than his sample of large American propane dealers.

H. Conclusion

298 The Commissioner submits that this merger will lead to a substantial lessening of competition in local markets other than "category 1" markets referred to by Professor Schwindt and Globerman, the linked market number one (markets numbers 3, 4, 6, 9, and 7, 27, 40, 50, and 53, as defined by Professor West) and the Sechelt-Powell River market of British Columbia; he also submits that the merger will lead to a prevention of competition in the Maritimes. The Commissioner also submits that national accounts are a separate category of business over which the merged entity will be in a position to exercise market power. In addition to the evidence of high market shares and the difficulty of entry, the Commissioner relies on the expert opinion of Professors Schwindt, Globerman and Ward as to the merger's impact on market structure and the ability of the merged entity to raise price unilaterally.

299 The respondents argue that the impact of the merger on market structure will be minimal because ICG has not been a strong competitor. In particular, they rely on the expert opinion evidence of Professor Carlton who claims, on the basis of his statistical analysis, that ICG has not constrained Superior's prices in markets where they compete. On this basis, the respondents argue that the removal of ICG by this merger will have no significant competitive impact.

300 The legal test to be applied under section 92 of the Act is whether the merger or proposed merger prevents or lessens, or is likely to prevent or lessen, competition substantially.

301 In *Hillsdown*, cited above at paragraph [127], at page 314, the Tribunal held that a finding of a substantial lessening of competition depends on whether the transaction will result in additional market power:

> ... In assessing the likely effects of a merger, one considers whether the merged firm will be able to exercise market power additional to that which could have been exercised had the merger not occurred. A merger will lessen competition if it enhances the ability of the merging parties to exercise "market power" by either preserving, adding to or creating the power to raise prices above competitive levels for a significant period of time. One considers the degree of any such likely increase and whether by reference to the particular facts of the case it should be characterized as substantial.

302 The Tribunal is largely in agreement with this statement; however, it does not agree that a merger which merely preserves existing power over price should be seen as lessening competition. The objective of merger review is to determine whether market power is increased at the margin.

303 In *Southam*, cited above at paragraph [47], at page 285, the Tribunal states:

> ... Most simply, are advertisers *likely* to be faced with significant higher prices or significantly less choice over a significant period of time than they would be likely to experience in the absence of the acquisitions? (emphasis added)

304 Subsection 92(2) of the Act makes it clear that market shares and concentration, per se, cannot lead to a finding that a merger will likely prevent or lessen competition in a substantial way. It reads:

> For the purpose of this section, the Tribunal shall not find that a merger or proposed merger prevents or lessens, or is likely to prevent or lessen, competition substantially solely on the basis of evidence of concentration or market share.

305 Although evidence of his market share or concentration is not sufficient to justify for finding that a merger is likely to prevent or lessen competition substantially, it is no doubt a relevant factor. This evidence will be particularly useful in identifying mergers that are likely to result in greater interdependence among the remaining firms in the market.

306 In light of the evidence, the Tribunal is of the view that the merger is likely to lessen competition substantially in many local markets. The Tribunal accepts the opinion of Professors Schwindt and Globerman regarding the 16 local markets in which the merged entity will have post-merger combined market shares of 95 percent or more and which they referred to as "merger to monopoly". The Tribunal's concern in these markets is that the merged entity will have the ability to exercise market power by imposing a unilateral price increase.

307 The Tribunal accepts the Commissioner's conclusion regarding the eight markets referred to as "category 1" because the merger is expected to have minimal impact on competition between Superior and fringe competitors.

308 The Tribunal also finds that the merger is likely to lessen competition substantially in a set of markets referred to as "category 3" which identifies 16 markets in which ICG had a substantial market share prior to the merger but where there were at least three competitors including Superior and ICG. In these markets, the Tribunal expects that the elimination of ICG will enhance interdependence and reduce competition.

309 Finally, the Tribunal finds that the merger is likely to lessen competition substantially through the creation of a dominant firm in the 33 local markets referred to as "category 2". In these markets, the Tribunal is concerned about the increased interdependence effects that the merger is likely to produce.

310 The Tribunal finds that the merger is likely to lessen competition substantially in coordination services offered to national account customers. It is uncontested that only the merging firms provide these services across Canada. The merger will leave one remaining firm in Canada offering coordination services and there is no evidence to suggest that anyone capable of offering coordination services across Canada will commence those operations. The Tribunal recognizes that not all national account customers rely on these two companies for coordination services. However, the issue is to determine whether the merged firm will be able to exercise market power over its national account customers by imposing a unilateral price increase. The Tribunal is of the view that the merged entity will have the ability to do so as some witnesses indicated that they would be willing to pay more for these services in order to avoid the higher costs of internal coordination.

311 In coming to the conclusion that the merger will likely result in a substantial lessening of competition, the Tribunal considered the evidence of market shares and concentration provided by Professors West, Schwindt and Globerman and the econometric evidence of Professor Ward on the ability of the merged entity to impose unilateral price increases.

312 The Tribunal also considers that barriers to entry in the retail propane business are high based on the evidence of Professor Whinston and of several factual witnesses. The Tribunal also notes that entry has occurred in the past but that no

evidence demonstrates that it would occur within a reasonable period of time to prevent the exercise of market power. The Tribunal is of the view that Superior's and ICG's respective market shares have remained relatively constant through the last decade. Therefore, the Tribunal believes that Superior and ICG' combined market share constitutes approximately 70 percent of the market on a national basis despite entry by relatively small competitors.

313 The Tribunal also finds that the merger is likely to prevent competition substantially in Atlantic Canada. In making this finding, the Tribunal relies on the evidence of ICG's plans to vigorously expand its activities in Atlantic Canada. In this respect, the Tribunal also considered the evidence of high market shares, the evidence of high barriers to entry and the lack of evidence that entry did occur in the past.

V. Remedy

314 In light of the Tribunal's finding pursuant to section 92 of the Act that the merger is likely to lessen competition substantially in many local markets and for national account customers and that the merger is likely to prevent competition substantially in Atlantic Canada, the Tribunal is of the view that the sole remedy appropriate in this case would be the total divestiture by Superior of all of ICG's shares and assets (including those of the previously integrated branches thereof).

315 We take note of the Supreme Court's direction in *Southam*, cited above at paragraph [48], at pages 789 and 790, regarding the appropriate remedy:

> The evil to which the drafters of the *Competition Act* addressed themselves is substantial lessening of competition. See Competition Act, s. 92(1). It hardly needs arguing that the appropriate remedy for a substantial lessening of competition is to restore competition to the point at which it can no longer be said to be substantially less than it was before the merger.

Further, the Supreme Court stated at page 791:

> ... If the choice is between a remedy that goes farther than is strictly necessary to restore competition to an acceptable level and a remedy that does not go far enough even to reach the acceptable level, then surely the former option must be preferred. At the very least, a remedy must be effective. If the least intrusive of the possible effective remedies overshoots the mark, that is perhaps unfortunate but, from a legal point of view, such a remedy is not defective.

316 The Tribunal is of the view that since the merger between Superior and ICG is likely to prevent or lessen competition substantially in many local markets across Canada, an order for total divestiture is the sole effective remedy available to the Tribunal. Indeed, the Tribunal is of the view that any order for partial divestiture remedy, while less intrusive, would not effectively restore competition in these markets to the level at which it can no longer be said to be substantially less than it was prior to the merger.

317 The Tribunal will now turn to the respondents' argument under section 96 of the Act in order to determine whether an order for total divestiture can be made.

VI. Efficiencies

A. Summary of Efficiency Gains

318 The respondents submit that the merger will allow Superior to achieve substantial gains in efficiency. They presented the opinion of Cole Valuation Partners Limited ("Cole") stating that the aggregate of such gains ("efficiency value") falls in the range of $381 million to $421 million measured in constant dollars over 10 years. Cole also opines that these efficiency gains cannot be achieved through other means common to industry practice (expert affidavit of C. O'Leary and E. Fergin (17 August 1999): confidential exhibit CR-112 at 2).

319 Cole's report entitled "Quantification of the Efficiency Value Resulting from the Merger of Superior Propane and ICG Propane" is exhibit A. Appendix 1 to Cole's report is the report of A.T. Kearney Ltd., a management consulting firm with

expertise in, *inter alia*, logistics and operations management. The two reports and opinions therein constitute the "Cole-Kearney report".

320 The Cole-Kearney report is lengthy and detailed, but its main conclusions are the efficiency gains in each of the three major areas of operation: corporate centre, customer support and field operations. The corporate centre comprises the functions of corporate management and includes, *inter alia*, head office management activities, personnel and facilities, information systems technology, wholesale propane dealing and purchasing. The Cole-Kearney report projects that the merged entity will require 44 fewer employees in the head office functions than in the two companies separately, that the head office rent will decline, as will public company costs, legal, and marketing expenditures. The report states that estimated annualized savings of $15.4 million will arise from the elimination of redundancies and that, over 10 years, total projected savings will be $141.5 million taking into account certain one-time gains (e.g., on asset disposals) and costs (such as severance) of achieving those savings (*ibid.* at 9-12 and appendix 1 at section A).

321 Customer support functions include sales force and related management, customer service and administration, and regulatory and safety. The Cole-Kearney report expects cost savings arising from the duplication of facilities and redundant personnel in areas where both merging companies operate and from the adoption of Superior's decentralized "business model" in which branches are supported by a centralized branch support centre and regional branch support centres. ICG's five customer care centres will be eliminated. Annualized savings of $7.2 million are projected, resulting in $65.7 million in savings over 10 years after including one-time items (*ibid.* at 13-16 and appendix 1 at section B). The Cole-Kearney report notes that its estimates of cost savings exclude the expected savings from restructurings that Superior and ICG had already planned independent of the merger (*ibid.* appendix 1, tab B1 at 135, 136).

322 Field operations consist of field sites, branches and plant operations, delivery and service fleets, propane and tank inventory, and supply and transportation. Cost savings are anticipated to result from redundancies due to overlapping geographic markets and from the larger delivery volumes in each territory that will enable the merged entity to reduce supply and transportation costs. For example, the Cole-Kearney report projects 157 eliminated positions, a reduction of 17,694 tanks, and the elimination of 5.9 million litres of propane inventory. Annualized savings of $16.7 million are expected, for a total of $193.6 million over 10 years taking one-time items into account (*ibid.* at 17-20 and appendix 1 at section C).

323 The aggregate cost savings identified in the Cole-Kearney report amount to $400.8 million (with a margin of approximately $20 million) over 10 years, for a projected efficiency gain of $40.08 million (with a margin of approximately $2 million) per year. The Cole-Kearney report asserts a very high level of confidence in its realization, in part because (a) $13 million to $21 million of savings that would likely be realized in the absence of the merger were excluded; (b) identified efficiency gains from the merger were included only if they could be realized with a high degree of confidence; and (c) the efficiency gains are based on cost savings that are held to be more likely to be realized than revenue gains that are more speculative.

324 For greater certainty, the Tribunal notes the distinction between "annualized savings" as used in the Cole-Kearney report and "annual savings". The former term is a representative amount of one-year savings in an item when that item's cashflows are measured year by year over 10 years, before taking one-time related cashflows (e.g., due to severance payments, or asset disposals) into account. Accordingly, the savings for that item over 10 years need not equal the annualized savings multiplied by 10. Adding the annualized savings from the three categories discussed above leads to annualized savings of $39.3 million when rounded to one decimal. The latter term refers to all cashflows; for example, if the total savings over 10 years are $400.8 million, then the annual savings are $40.08 million.

B. Efficiency Net Present Value

325 The Cole-Kearney report also provides estimates of the discounted present value of the efficiency gains, the "efficiency net present value", which falls in the range of $291 million to $308 million (*ibid.* at 24). This calculation depends on the discount rate chosen and the particular set of cashflows evaluated (*ibid.*, appendix 4 at 318). Cole adopts the midpoint of $300 million for the point estimate of the efficiency net present value.

C. Tribunal's Summary and Evaluation

326 The Commissioner argues, based on the report in rebuttal of Professors Schwindt and Globerman and Mr. Kemp (expert rebuttal affidavit of R. Schwindt, S. Globerman, and T. Kemp (15 September 1999): confidential exhibit CA-3131), that $38.51 million claimed annual savings overstate what the merger is likely to generate and that only $21.2 million thereof are appropriately considered. The Commissioner argues that many of the claimed gains in efficiency are cost savings that are pecuniary in nature and should, therefore, be disregarded because they do not represent savings of real economic resources that would be redeployed by other sectors of the economy. Similarly, the Commissioner asserts that certain real economic costs have been classified as pecuniary and hence ignored when they should be deducted from claimed efficiency gains.

327 The Commissioner also asserts that the magnitudes of certain properly included efficiencies are overstated, and that costs incurred as a result of the merger have been inadequately treated.

328 In reply, the respondents dispute several of the Commissioner's criticisms and they submit that the Commissioner's claims in these areas should be disregarded. As many of the Commissioner's concerns are not challenged (for example, the elimination of the "wellness programme" as pecuniary savings), the Tribunal is concerned only with those points of disagreement.

(1) Corporate Centre

329 The Commissioner asserts that claimed cost savings in corporate centre are overstated by approximately $11.9 million per annum. Of these, the respondents defend their treatment of the Management Agreement, procurement, and public company costs which amount to $11.4 million per annum of the Commissioner's sought-after reduction in corporate centre cost savings.

(a) Management Agreement

330 Superior is managed by Superior Management Services Limited Partnership ("SMS") which acquired the obligations and benefits (the "Management Agreement") of managing Superior from the previous manager, Union Pacific Resources Inc., in May 1998 for $5 million (Cole-Kearney Report Compendium Binder: confidential exhibit CR-114, tab A1, appendix B). Superior Incentive Trust ("Incentive Trust"), which holds the class A units of SMS, receives distributions thereon of the management fees which Superior pays to SMS pursuant to the Management Agreement. The management group of Superior (Grant Billing, Mark Schweitzer and Geoff Mackey) owns 28 percent of Incentive Trust's units and hence is entitled to 28 percent of the distributions made by Incentive Trust. A group of investors, Enterprise Capital Management Inc. (the "Enterprise investors"), owns the remaining 72 percent of Incentive Trust's units.

331 The Commissioner asserts that the schedule of management fees in the Management Agreement provides incentives to SMS to increase (a) the profitability of Superior, and (b) the cash distribution to unitholders of the Superior Income Fund ("cash distribution") which owns Superior. The schedule provides no entitlement to SMS when the cash distribution per unit is less than $1.27. For cash distributions between $1.27 and $1.45, SMS is entitled to an amount equal to 15 percent of those cash distributions and to 25 percent when the cash distribution per unit is between $1.45 and $1.89. Above $1.89, SMS receives an amount equal to 50 percent of the cash distributions.

332 Accordingly, if the management group could achieve efficiencies that resulted in increased cash distributions, SMS would be entitled to the management fees in respect of such efficiency-based cash distributions. Assuming that the management group achieves the $40 million of efficiencies claimed in the Cole-Kearney report, the Commissioner estimates that SMS would receive management fees in respect thereof of approximately $7.5 million per annum. This amount is an average based on differing assumptions about Superior's future tax position given that management fees are a tax-deductible expense.

333 In summary, the Commissioner asserts that the management fees arising from achieving efficiencies attributed to the instant merger are payments that compensate SMS for providing the additional management services that are required to achieve these efficiencies. Viewed in this light, these fees are a cost of achieving the efficiencies and should therefore be deducted from the $40 million per annum of efficiencies claimed by the respondents. The Commissioner submits that the full amount of

these fees should be deducted, not just the 28 percent thereof that would be distributable to the management group, because the Enterprise investors have management obligations and involvement through representation on Superior's or ICG's boards.

334 The respondents offer several objections (expert reply affidavit of S. Cole, C. O'Leary, J.P. Tuttle, and E. Fergin (5 October 1999): confidential exhibit CR-113 at 9-13), the main one being that the fees do not call forth additional management efforts by the management group because the managers were fully engaged prior to the merger and because there will be no material change in the level of services provided by the managers; hence, no increase in economic costs will arise (*ibid.* at 10). As a result, the respondents argue that no deduction of the fees against claimed efficiencies is warranted.

335 The respondents indicate that the managers received interest-free, non-recourse loans from the Enterprise investors in order to facilitate the purchase of their 28 percent share in the Management Agreement (confidential exhibit CR-113, appendix B at 56).

336 It appears to the Tribunal that the respondents' position is that the managers are being paid more for providing the same amount of management services and hence that the fees they receive in the form of distributions from Incentive Trust are a pecuniary cost only. In simpler terms, the Management Agreement redistributes some of Superior's profit to the managers at the expense of Superior's owners since no additional management effort is provided. If the respondents' view is correct, the Tribunal finds it a strange argument to make, as it amounts to a statement that, in effect, the management group will be overpaid for the services they provide.

337 The respondents further argue that the Management Agreement is an investment made and paid for by the managers and that the payments they receive from Incentive Trust are distributions of profit rather than compensation for management services. They point out that the owners of the Management Agreement have the right to sell their interests therein. They also submit that since the Management Agreement predates the merger and has not been amended in this respect, the level of management services to be provided has not changed since 1996 when the terms of the agreement were established. Hence, the respondents argue that any change in payment must be a pecuniary transfer (confidential exhibit CR-113 at 11, 12).

338 The Tribunal does not agree that the Management Agreement is solely an investment, although it may have aspects thereof. In view of the fact that the management fees paid to SMS pursuant to the Management Agreement are tax-deductible expenses to Superior, they cannot be distributions of after-tax profits. While the managers purchased for their interests in the Management Agreement supported in part by interest-free non-recourse loans, the Tribunal finds that the acquisition price they paid only provides further incentive to them to supply additional services that increase their remuneration. Moreover, it appears to the Tribunal that the managers' ability to transfer their interests in the Management Agreement is highly circumscribed by section 6.1 of the Unitholders Agreement (confidential exhibit CR-113, appendix G, tab 3).

339 The Tribunal observes that managers of for-profit enterprises often receive compensation in the form of investments or investment-related vehicles, such as shares of the managed company, stock options on company shares, low-interest loans to acquire shares of the managed company, etc. Although the payments that they receive from these investments may be in the form of dividends or capital gains, these forms of managerial compensation are nonetheless techniques for improving the quality and quantity of managerial effort. In particular, these methods seek to align the interests of managers with those of owners so that managerial decisions benefit the latter group. Thus, even when the incentive payments are in the form of distributions on company securities held by the managers, their purpose is to provide incentive to managers to achieve corporate goals and those payments are properly viewed as compensation for effort.

340 The Tribunal agrees with the Commissioner that, in all relevant respects, the Management Agreement provides additional compensation to the managers for supplying additional managerial effort. Thus, these additional management fees are a true economic cost of achieving the efficiencies claimed by the respondents and hence are properly deducted from those efficiencies.

341 However, the Tribunal disagrees with the Commissioner regarding the appropriate amount of that deduction. The proper quantum is that amount that compensates the managers for additional effort and hence must be less than the total fees paid to SMS under the Management Agreement because 72 percent thereof accrues to the Enterprise investors. There is no

evidence that Enterprise investors or their board representative are or will be involved in active management or in achieving the claimed efficiencies. Accordingly, they benefit from the additional efforts provided by the management group but supply none themselves.

342 The Tribunal views the distributions on SMS's class A units by Incentive Trust to the Enterprise investors as a pecuniary redistribution of Superior's pre-tax profit from Superior's owners, particularly because those owners receive nothing from the Enterprise investors when the Management Agreement changed hands.

343 The respondents calculate the payments to the managers under the Management Agreement under different assumptions about Superior's future tax position and conclude that the managers will receive between $1.5 million and $2.8 million per annum if $40 million of efficiencies are properly claimed and achieved. Following the Commissioner's approach, the Tribunal adopts the average thereof, $2.2 million as the deduction from the claimed efficiencies (confidential exhibit CR-113 at 13 and appendix B at B1).

344 The Tribunal notes that the $7.5 million deduction claimed by the Commissioner is the Commissioner's estimate of the management fees payable to SMS in respect of this merger when the efficiency gains are $40 million per year. Since the Commissioner asserts that this amount is itself overstated for a variety of reasons, the amount of the management fees and hence any deduction in respect thereof must necessarily be lower if the Commissioner's assertion is correct.

345 The Tribunal notes further that the Commissioner's amount of $7.5 million average estimated management fees equals 18.75 percent of the $40 million claimed efficiency gain. The $2.2 million average fees resulting from the respondents' calculations are 5.5 percent of those efficiencies. Since the Tribunal agrees with the respondents as to exclusion of amounts received by the Enterprise investors, in determining the proper amount to deduct when efficiencies are less than $40 million, the Tribunal will use the latter percentage.

(b) Procurement

346 The Cole-Kearney report indicates that suppliers to the merged company will experience cost savings as a result of the combination of purchasing activities in one company rather than two. The merged company will be able to demonstrate these savings and negotiate discounts in truck freight and rail freight rates, among other areas (confidential exhibit CR-112, tab A9 at 115). The Cole-Kearney report had claimed approximately $2.84 million per year in savings to the merged company, but revised its estimate to $3.28 million per year in reply to the report prepared by the Commissioner's experts in rebuttal to include cost savings at Superior's transportation affiliate, Energy Transportation Incorporated (confidential exhibit CR-114, tab 6).

347 The Commissioner submits that the procurement savings of $3.28 million per year are largely pecuniary and not well documented. Indeed, in their report in rebuttal, the Commissioner's experts, Professors Schwindt and Globerman and Mr. Kemp, note that the estimates are based solely on A.T. Kearney's experience in negotiating transportation contracts for other clients (confidential exhibit CA-3131 at 19).

348 The Tribunal finds that there is insufficient evidence to support the claimed savings in the Cole-Kearney report. The Tribunal accepts the Commissioner's criticisms and consequently concludes that no savings have been established.

(c) Public Company Costs

349 The respondents claim an annual saving due to the merger of $660,000 in avoided public company costs. Such avoided costs include stock exchange listing fees, costs of outside directors, trustee's fees, regulatory filing costs, legal and audit fees, etc. Absent the merger, the respondents argue that ICG would have gone public and incurred these costs (confidential exhibit CR-112, tab A-8 at 111).

350 The Commissioner's experts criticize these savings on the basis that ICG could plausibly have been acquired by another company and could have avoided these costs. As a result, they argue that the cost savings are not properly attributed to the instant merger (confidential exhibit CA-3131 at 18).

351 The evidence of witness Henry Roberts, vice-president of Petro-Canada, is that arrangements had already been put in place to take ICG public through an offering of trust units when Superior made its offer to acquire ICG; ICG had already issued a preliminary prospectus and was promoting the offering via road shows. According to Mr. Roberts, Petro-Canada had received expressions of interest by a few potential buyers and had discussions with them; however, no such buyer made a binding offer to purchase ICG.

352 History aside, will these savings likely be attained if the Tribunal orders total divestiture. At the present time, the Tribunal does not and cannot know how the ordered divestiture would take place. However, since Superior is claiming the savings in public company costs as efficiencies, it has the burden of demonstrating to the satisfaction of the Tribunal that those savings are properly included in the analysis under subsection 96(1). Thus, Superior must establish that it would or would likely take ICG public in the event of a total divestiture order. It has not done so, and the efficiency claim is therefore denied.

(2) Field Operations

(a) Fleet and Driver Reductions

353 The Cole-Kearney report estimates that the merged entity will require fewer trucks of all types in the overlapping trade areas of the merging firms, so that a number of trucks and related delivery driver positions in overlapping areas can, therefore, be eliminated. The efficiencies in these categories arise from the elimination of certain planned vehicle purchases, the elimination of the operating costs on vehicles removed from service, proceeds of disposal of certain delivery vehicles (confidential exhibit CR-112, section C, tab C4), and the savings in driver remuneration (*ibid.*, tab C-5).

354 The Cole-Kearney report uses statistical regression methods (as subsequently presented during the hearing in confidential exhibit CR-113, appendix G, tab 5) to determine the relationship between operating hours per bulk truck and three determinants thereof, a trade area proxy measure of distance travelled, volumes delivered, and number of calls. Based on this statistical analysis (Predictive Regression Model Results: exhibit A-3122 at 2), a reduction of 13.27 percent in operating hours was found to be achievable. With this relationship, they conclude that the merged firm will require 661 trucks of all types and that 80 trucks (75 bulk trucks and 5 cylinder trucks) currently serving the overlapping trade areas of the merging parties can be eliminated (confidential exhibit CR-112, tab C4 at 236, 237). Correspondingly, 80 fewer delivery drivers would be needed (*ibid.*, tab C5 at 244).

355 As a result of this analysis, the Cole-Kearney report estimates annualized savings of $2.6 million ($33.4 million over 10 years) through the elimination of these trucks, and annualized savings of $3.9 million ($36.3 million over 10 years) through eliminating delivery driver positions (confidential exhibit CR-112 at 18). These cost savings account for approximately 17 percent of the ten-year, total gains in efficiency claimed by the Cole-Kearney report.

356 The Commissioner's experts, Professors Schwindt and Globerman, have criticized the methodology used by the Cole-Kearney report to predict the fleet and driver position reduction and the results therefrom (Evaluation of Appendix D of the Cole/Kearney Reply: exhibit A-3132). They note that the key variable for assessing savings is the average distance between customers, which is not measured by the Cole-Kearney report's trade area proxy. Moreover, they point out that while the Cole-Kearney report measures the relationship between operating hours per bulk truck in their sample and three determinants thereof including volume, their measure of that volume is total branch volume (including volumes delivered by cylinder trucks) rather than actual volumes delivered by those bulk trucks. Other problems include a poor statistical "goodness of fit" measure which the Commissioner's experts were able to improve on by using a different model.

357 The Commissioner's experts recalculated the analysis of the Cole-Kearney report with the correct data and concluded that the estimated reduction in operating hours was 3.62 percent (exhibit A-3132, table A-4) versus the estimate of 13.27 percent in the Cole-Kearney report. Accordingly, 30 trucks (28 bulk trucks and 2 cylinder trucks) could be eliminated as compared with the estimate of 80 in the Cole-Kearney report. On this basis, the Commissioner submits that cost savings will be $1.69 million per year less than the annualized estimate in the Cole-Kearney report.

358 Professors Schwindt and Globerman and Mr. Kemp note that since the truck reduction estimate in the Cole-Kearney report is too high, so accordingly is its estimated reduction in the number of delivery drivers (confidential exhibit A-3131 at 7). Assuming cost savings of $48,500 per driver (confidential exhibit CR-112 at 246) eliminated, the overstatement by 50 trucks means that Cole-Kearney's annualized cost savings from delivery driver elimination should be reduced by $2.43 million (i.e., 50 × $48,500). The Tribunal notes that the Commissioner's approach fails to consider the reduction in one-time severance costs that would result from terminating fewer drivers.

359 In response, the respondents emphasize that the Commissioner's experts, Professors Schwindt and Globerman, have no experience in the propane business and have never adjusted distribution routes or implemented a merger of this type.

360 In claiming a reduction of 28 bulk trucks in overlapping areas, the Commissioner's experts advocate a reduction of only 5.8 percent of the combined 481 bulk vehicles over 10 years, as compared with Cole-Kearney's estimated 15.6 percent reduction. In claiming a reduction of two cylinder trucks in overlapping areas, they advocate a 4.4 percent reduction over 10 years in the 45-vehicle cylinder fleet, as compared with Cole-Kearney's estimate of 11.1 percent.

361 The Tribunal cannot endorse the truck reduction estimates of the Commissioner's experts. Although they have demonstrated that the Cole-Kearney's approach to estimating truck reductions is flawed by a serious data problem, the Tribunal recognizes that some gains in efficiency are likely to result from truck reduction, especially in light of the overlapping routes of the merging parties. In the Tribunal's view, the truck reductions estimated by the Commissioner's experts are, at best, the bare minimum of what might be achievable. Accordingly, the Tribunal is of the view that the Commissioner's claimed reduction of $1.69 million in Cole-Kearney's estimated savings from truck reductions is likely too high.

362 The Tribunal believes that $1 million per year is a more realistic estimate of the savings from bulk truck reductions than the $770,000 calculated by the Commissioner's experts; a similar adjustment to their cylinder truck savings yields approximate annual savings of $150,000. With total estimated annual savings of $1.15 million, the Tribunal believes that Cole-Kearney's estimated annualized savings should be reduced by $1.43 million rather than by the Commissioner's figure of $1.69 million.

363 Applying the same percentage adjustment to savings in delivery drivers, the Tribunal believes that the savings will be approximately $1.9 million, rather than the $1.46 million claimed by the Commissioner. Accordingly, the Cole-Kearney's estimate of savings of $3.88 million per year should be reduced by $1.98 million, rather than by the Commissioner's figure of $2.43 million.

(b) Propane Supply and Transport

364 The Commissioner submits that Cole-Kearney's estimated cost savings of $1.39 million per year in this category are overstated. The Commissioner claims that cost savings due to bringing idle equipment into use rather than continue purchasing transport from independent haulers are pecuniary (i.e., that the idle capacity will be transferred from the merged entity to the private haulers that were formerly used). The Commissioner also submits that the savings attributed to reduction in the backup rail car fleet have not been established.

365 The respondents do not challenge the Commissioner's submissions, except to point out an apparent difference in amounts claimed between the text of the Commissioner's memorandum at page 222 and the corresponding data in table E2. According to the Commissioner, the text error is typographical and the data in table E2 are correct.

366 On this basis, the Tribunal accepts the Commissioner's criticisms of Cole-Kearney's cost savings.

(3) Other

(a) One-Time Items

367 The Commissioner states that Cole-Kearney's "annual claimed savings" of $38.51 million are overly optimistic, unrealistic and exaggerated. The Commissioner claims that this figure should be reduced by $17.3 million to produce annual estimated savings of $21.21 million, a figure that would still be too high for lack of a contingency factor.

368 The Cole-Kearney report claims cost savings of $400.8 million over 10 years with a contingency factor of approximately five percent, for a range of $381 million to $421 million. Thus, on an annual basis, claimed savings are approximately $40 million, the midpoint of the range of $38 million to $42 million, for 10 years.

369 It appears to the Tribunal that table E2 in the Commissioner's memorandum lists and aggregates Cole-Kearney's "annualized savings" and rounds such items and their sum to two decimals; hence the Commissioner's figure of $38.51 million per year omits one-time expenditures and receipts. Accordingly, the Commissioner's estimate of $21.21 million in annual cost savings from the merger does not include the one-time costs and receipts that result from achieving efficiencies.

370 In final argument, the Commissioner defended this exclusion in table E2 on the basis that it would be arbitrary to express any one-time cost or receipt as an annual amount by dividing by 10 years in order to add it to the recurring amounts. Indeed, dividing by any other number of years would be equally arbitrary. The Tribunal agrees that it is arbitrary to express a one-time cost or receipt as an annual amount over 10 years. However, the Tribunal does not agree that excluding these one-time amounts is appropriate.

371 In the Tribunal's view, the appropriate way to value all costs and receipts resulting from the merger, whether one-time or recurring, is through discounting the cashflows at the time of disbursement or receipt at an appropriate discount rate to a present value. Cole-Kearney did this in calculating the efficiency net present value discussed above. The Commissioner did not question the methodology or the results of that calculation or offer corresponding calculations. Moreover, it appears to the Tribunal that the respondents abandoned this approach by the time the hearing started:

> DR. SCHWARTZ: No, I don't. I thought you had discounting in your report.
>
> MR. COLE: Yes. In the original report the $40 million, or the $39 million, and the $400 million are nominal dollars, and in all our discussions with you we have used that paradigm. So while here in Calgary, we have not discussed discounted dollars or net present values.
>
> In our original report there is discussion of that, if need be, but we have not discussed it with you here today or yesterday. transcript at 34:6863, 6864 (8 December 1999).

372 Absent this approach, the Tribunal adopts as the basis for its consideration of cost savings the respondents' estimate of $400.8 million in total cost savings over 10 years or $40 million per annum, rather than $38.51 million per annum in annualized savings. This is done to recognize the one-time costs and receipts, although the Tribunal is well aware that a one-time cash receipt is more valuable the earlier it is received, while a one-time cost is more valuable the later the disbursement is made.

(b) Miscellaneous

373 The Commissioner submits that the Cole-Kearney cost savings in several other areas are overstated by approximately $620,000 per year in aggregate. The respondents do not challenge the Commissioner's submissions. On this basis, the Tribunal accepts the Commissioner's claims in these areas.

(c) Property Tax

374 The respondents claim that property tax payments saved by the merger are savings in user-based payments for local services that will not be needed after the merger and hence represent real savings to the municipalities. They say that the local property tax differs from income taxes in this respect. However, they also appear to recognize that not all of the municipal services supported by the property tax payments will be reduced. They claim that, absent a principled way to determine which resources will be saved, the full amount of property tax savings should be viewed as gains in efficiency.

375 The MEG's, cited above at paragraph [57], refer to merger-based tax savings as redistribution of income from taxpayers to firms; hence tax-savings are pecuniary gains rather than true cost savings. The MEG's at paragraph 5.3 do not distinguish between income taxes and other taxes. At the local level, many services supported by the property tax will not be reduced by the merger (e.g., local spending on education, health, social assistance, road maintenance, councillors' salaries).

376 At the hearing, the Tribunal suggested a principled way of distinguishing between pecuniary and real savings in the area of local services and taxes. If the firm receives an invoice for products or services provided by local government (e.g., the water bill from the local authority) and if the merged entity will use less of that product or service, then the savings are appropriately regarded as resource savings. Where it is not possible to determine whether property tax savings represent real resource savings or a pecuniary redistribution, the Tribunal agrees with the Commissioner that no claimed efficiency savings should be allowed. However, in this case, as the amount claimed by the respondents is relatively small, the Commissioner does not seek to reduce the efficiencies by that amount.

(d) Integration Costs

377 The Commissioner submits that the costs of the Cole-Kearney report should be deducted from claimed efficiencies as should the costs of management in planning the merger. The respondents dispute this submission regarding the Cole-Kearney report on the basis that the cost of retaining the consultants was incurred to satisfy the Commissioner.

378 In the Tribunal's view, the costs of the Cole-Kearney report and pre-merger planning costs should not be deducted from claimed efficiencies. The reason is that these costs have already been incurred and do not depend on whether the merger is allowed to proceed or on whether the efficiencies will be achieved. These costs are sunk costs and hence differ from the costs (e.g., severance payments) that will only be incurred as a result of implementing the merger. Thus, as an economic matter, it would be appropriate to deduct the consultants' fees only, for example, if they were contingent on the outcome of the instant hearing, for in such case they would not be sunk.

379 In any event, on the evidence before us, the Cole-Kearney consultants were only retained by the respondents after the December 1998 merger. Hence, it cannot be said that the costs of the Cole-Kearney report are costs which relate to the planning of the merger by management.

(4) Net Efficiencies

380 As noted at paragraph [372], the Tribunal includes one-time items in its analysis and, therefore, accepts $40 million per annum as the starting point to assess efficiency claims. In view of our findings and conclusion regarding the Commissioner's criticisms of the Cole-Kearney report, we conclude that the efficiencies and deductions therefrom are as follows:

Table 1: Deductions in Efficiencies

			Sought by Commissioner	**Allowed by Tribunal**
				($million/year)
	Deductions			
	i)	one-time items	$ 1.50	$ 0.00
	ii)	procurement	$ 3.28	$ 3.28
	iii)	public company costs	$ 0.66	$ 0.66
	iv)	delivery fleet	$ 1.69	$ 1.43
	v)	delivery drivers	$ 2.43	$ 1.98
	vi)	propane supply	$ 1.12	$ 1.12
	vii)	other (excl. management fees)	$ 0.62	$ 0.62
(a)	Total deductions before management fees		$ 11.30	$ 9.09

(b)	Gross efficiencies claimed by respondents	$ 40.00	$ 40.00
(c)	Net efficiencies before management fees (b-a)	$ 28.70	$ 30.91
(d)	Deduction regarding management fees	$ 7.50	$ 1.70
(e)	Net efficiencies (c-d)	$ 21.20	$ 29.21

Notes: * 5.5% of $30.91

381 Apart from the specific adjustments to the gains in efficiency claimed in the Cole-Kearney report, the Commissioner states that even after reducing the efficiency gains to $21.2 million, that figure is still unrealistically high, in part because it allows for no contingency factor. The Commissioner submits that the Tribunal should keep this overstatement in mind when balancing claimed efficiencies against the anti-competitive effects of the merger.

382 The Cole-Kearney report does not contain a deduction from claimed aggregate efficiency gains as a provision for the possibility that those gains may not be achieved. In this sense, there is no provision for contingency. Mr. Cole testified that the efficiency gains were estimated conservatively and were expressed in aggregate with a margin of approximately five percent. He also stated that, as described in the Cole-Kearney report (confidential exhibit CR-112, appendix 5), between $12 to $21 million of efficiency gains over 10 years were excluded because they could not be quantified precisely (transcript at 33: 6365-67 (7 December 1999)). The Tribunal is satisfied that there is a buffer zone around the estimated efficiency gains and is, therefore, of the view that the absence of an explicit contingency provision is immaterial.

383 In this case, the Commissioner chose not to lead evidence on efficiency gains and, therefore, was limited to rebutting the expert opinion evidence of Cole-Kearney. On its view of the evidence concerning the respondents' efficiencies, the Tribunal is satisfied that these efficiencies of $29.2 million per year will likely be brought about by the merger.

D. Legal Analysis

(1) Section 96 of the Act

384 Section 96 provides that:

> 96.(1) *The Tribunal shall not make an order under section 92* if it finds that the merger or proposed merger in respect of which the application is made has brought about or is *likely to bring about gains in efficiency* that will be *greater than*, and will *offset, the effects of any prevention or lessening of competition* that will result or is likely to result from the merger or proposed merger and that the gains in efficiency *would not likely be attained if the order were made*.
>
> (2) In considering whether a merger or proposed merger is likely to bring about gains in efficiency described in subsection (1), the Tribunal shall consider whether such gains will result in
>
> > (a) a significant increase in the real value of exports; or
> >
> > (b) a significant substitution of domestic products for imported products.
>
> (3) For the purposes of this section, the Tribunal shall not find that a merger or proposed merger has brought about or is likely to bring about gains in efficiency by reason only of a redistribution of income between two or more persons. (emphasis added)

385 Section 96 states, in unequivocal terms, that the Tribunal is not to make an order under section 92 if efficiency gains are greater than and offset the effects of any prevention or lessening of competition. As stated above, the respondents claim that significant efficiencies will result from this merger. The Commissioner, however, disputes the efficiencies claimed and further argues that section 96 is not available, as a matter of law, to the respondents in this case.

(2) Position of the Parties

(a) Commissioner

386 The Commissioner argues that section 96 is not available, as a matter of law, in cases where a merger eliminates competition and results in the creation of a monopoly in a relevant market. Further, he submits that in assessing the trade-off analysis in section 96, the Tribunal has a statutory responsibility to exercise its judgment as to the weight to be accorded to the transfer from consumers to producers, hence that applying a standard with a fixed predetermined weight is contrary to section 96.

387 The Commissioner suggests that the balancing weight standard as introduced by his expert, Peter G.C. Townley, is consistent with a proper interpretation of section 96. He submits that the efficiency gains do not offset the anti-competitive effects caused to the economy as a whole by this merger.

388 The Commissioner further submits that the respondents bear the onus of demonstrating all of the elements of the efficiency defence stated in section 96.

(b) Respondents

389 The respondents claim that significant efficiencies in the range of $40 million per annum will result from the merger between Superior and ICG. They argue that the test to be met under section 96 is that the efficiencies must offset any substantial lessening of competition. They further argue that a substantial lessening of competition is permitted provided it is outweighed by the efficiencies attributable to the merger. They also submit that the effects of the substantial lessening are measured by the deadweight loss to the economy and exclude wealth transfers between producers and consumers which are neutral to the economy.

390 Further, the respondents submit that the Commissioner is distancing himself from the MEG's, cited above at paragraph [57], by adopting a "distributional weights" approach articulated by his expert, Professor Townley. The respondents submit that the efficiencies will not be realized in the absence of the merger and that there is no evidence of any existing alternative proposals which could reasonably be expected to generate these efficiencies if a divestiture order were made under section 92.

391 With respect to the burden of proof, they argue that the Commissioner has not met his burden of establishing the effects of the substantial lessening of competition and that the efficiencies might be achievable in some other way.

(3) Status of the MEG's

392 The parties referred to the MEG's, cited above at paragraph [57], in their written submissions and in oral argument.

393 Although the Tribunal and the Federal Court of Appeal have held in *Canada (Director of Investigation & Research) v. Tele-Direct (Publications) Inc.* (1997), 73 C.P.R. (3d) 1 (Competition Trib.), at 37 and in *Canada (Director of Investigation & Research) v. Southam Inc.* (1995), 63 C.P.R. (3d) 1 (Fed. C.A.), at 41, that the MEG's are not sacrosanct nor legally binding, the Tribunal notes that they provide important enforcement guidelines reflecting the Commissioner's view on how the Act should be interpreted. The MEG's, which were published in 1991, were prepared to inform the business community and the public as to how the Competition Bureau analyzes the competitive impact of mergers including how it considers efficiencies.

394 The Tribunal takes notes that, since their adoption in 1991, no changes as to the interpretation of section 96 have been made to the MEG's. Indeed, even after the issuance of the decision in *Hillsdown*, cited above at paragraph [127], where Reed J. questioned whether the wealth transfer should be treated as neutral, the Commissioner continued, without amending his position, to apply the MEG's. Howard Wetston, the Director of Investigation and Research at the time, stated that he saw no need to revise the guidelines as the comment made by Reed J. in the *Hillsdown* decision was in *obiter dictum*.

395 The total surplus standard was reiterated on July 14, 1998 with the publication of *The Merger Enforcement Guidelines as Applied to a Bank Merger* by the Competition Bureau at paragraph 109, online: Industry Canada <*http://strategis.ic.gc.ca/SSG/ct01280e.html*> (last modified: 5 July 1998):

> Where a merger results in a price increase, it brings about both a neutral redistribution effect and a negative resource allocation effect on the sum of producer and consumer surplus (total surplus) within Canada. Ordinarily, the Director measures the efficiency gains described above against the latter effect, i.e., the deadweight loss to the Canadian economy. (reference omitted)

396 It is only after the Commissioner decided to file the application against the respondents in this case that changes to his position became apparent. Indeed, two recent speeches by Gwillym Allen, Assistant Deputy Commissioner of Competition, Economics and International Affairs, demonstrate a change in the Commissioner's interpretation of the efficiencies exception. In these speeches, Mr. Allen suggests that in some cases "it is more appropriate for the Competition Tribunal to determine whether the merger increases aggregate welfare or not" ("The treatment of Efficiencies in Merger Analysis": remarks given at "Meet the Competition Bureau" conference, Toronto, 3 May 1999) and that "given the evidence presented in a particular merger case, total surplus may not be an all-inclusive measure of the anticompetitive effects that are likely to arise from the merger". Hence, "other qualitative and quantitative subjective comparisons need to be performed in order to determine if the efficiency gains offset the anticompetitive effects" ("The Enforcement of the Efficiency Exception in Canadian Merger Cases": remarks given to the Competition Law Group, Stikeman Elliott, Barristers and Solicitors, Toronto, 25 June 1999).

397 This change in position is quite surprising. It must not be forgotten that the point of view put forward in the MEG's represents the considered opinion of the Commissioner, the official appointed by the Governor in Council to administer and enforce the Act. That view, it goes without saying, is the view arrived at by the Commissioner following careful advice given to him by his legal and economic advisers regarding the meaning of the various provisions of the Act. Although the Commissioner is not bound by the MEG's nor are they binding upon this Tribunal, the MEG's should be given very serious consideration by this Tribunal. Needless to say the Tribunal can disagree and in fact should disagree if it is of the opinion that the interpretation proposed in the MEG's is wrong. However, when referring and considering the MEG's, one should bear in mind the comments in the preface to the MEG's made by Howard Wetston, then Director of Investigation and Research. He stated that the Merger Guidelines were published to promote a better understanding of the Director's merger enforcement policy and to facilitate business planning. He also noted the extensive consultation process which was followed in their preparation.

(4) Efficiency "Exception"

398 The Commissioner submits that section 96 provides *a defence* to an otherwise anti-competitive merger to the respondents if they can demonstrate that the efficiency gains from the merger will be greater than and will offset the effects of any prevention or lessening of competition resulting from the merger. The respondents, on the other hand, argue that section 96 constitutes rather a limitation on the Tribunal's jurisdiction to make an order under section 92.

399 In *Canada (Director of Investigation & Research) v. Canadian Pacific Ltd.* (1997), 74 C.P.R. (3d) 55, at 63, (Competition Trib.), the Tribunal held that section 96 was a defence available to the respondents. The Tribunal further held that the onus of alleging and proving the material facts which form the basis of the defence fell upon the respondents:

> In my view, the Director's request for particulars is reasonable. Under the Act, the existence of efficiencies essentially constitutes *a defence* to the Director's application. Just as it is improper for the Director to plead bald allegations without pleading the material facts upon which he relies, so too must the respondents plead the material facts which form the basis of a "defence" of efficiency gains. (emphasis added)

The Tribunal can see no reason to disagree with the above statement.

(5) Burden of Proof

(a) Commissioner

400 The Commissioner submits that the respondents bear the burden of proving all the elements of the efficiency defence on a balance of probabilities and that, once a substantial lessening competition is established pursuant to section 92, the Tribunal

should proceed to make an appropriate order unless the respondents are successful with their defence under section 96. The Commissioner suggests that the respondents must bear the onus of establishing all the elements because they have the best knowledge of what strategies are available to them to generate the efficiency gains that they claim and what, if any, alternate means would or would not be available to achieve those gains. Further, the Commissioner submits that the section 11 powers provided by the Act do not place the Commissioner in a position as knowledgeable as the respondents about their business strategies. In support of his argument, the Commissioner relies on two Tribunal decisions: *Canada (Director of Investigation & Research) v. Canadian Pacific Ltd.*, cited above at paragraph [399], at page 63, and *Hillsdown*, cited above at paragraph [127], at pages 332-34, where the Tribunal recognized that the burden of proving the elements of the "efficiency defence" falls on the respondents.

401 The Commissioner also asserts that the respondents must show not only the likely efficiency gains but must also demonstrate the scope and extent of the anti-competitive effects of the merger, absent which the Tribunal is not in a position to determine whether the gains in efficiency are greater than and offset those effects and whether "the defence" has been established.

(b) Respondents

402 Relying on the *Hillsdown* decision, cited above at paragraph [127], the respondents submit that they bear the onus of proving the existence of the efficiencies claimed or the likelihood of their existence if the merger has not been implemented. They claim that the Commissioner bears the burden of establishing the effects of the substantial lessening of competition (i.e., the deadweight loss) and that the efficiencies might be achievable in some other way (e.g., a sale to third party). Indeed, the respondents submit that the Commissioner is in a good position, in view of his investigatory powers pursuant to section 11 of the Act, to obtain third party information.

(c) Conclusion

403 The Tribunal is of the view that the respondents bear the burden of proving all of the elements of section 96 on a balance of probabilities, except for "the effects of any prevention or lessening of competition", which must be demonstrated by the Commissioner.

(6) Role of Efficiencies under the Act

404 The Commissioner reminds us that section 1.1 states that the purpose of the Act is to "maintain and encourage competition in Canada" and that competition is not seen as an end in itself, but rather as a means to achieve the four objectives identified in section 1.1. The Commissioner further submits that no hierarchy is established among those "potentially conflicting" objectives. The Commissioner argues that it becomes clear when sections 96 and 1.1 are read together, that a section 96 defence will prevail only when a merger enhances the objectives of competition policy more than it diminishes them. The Commissioner argues that the Tribunal must decide whether Canadians and the Canadian economy are better off with or without the merger.

405 The respondents submit that the Commissioner's interpretation of section 96 is wrong since section 96 is not subordinate to the purpose clause of section 1.1. Further, the respondents suggest that where there is a conflict between a purpose clause statement and a substantive provision, the latter must prevail.

406 There are significant differences in the positions of the parties as to the proper interpretation of sections 1.1 (the purpose clause) and 96 (the efficiency exception) of the Act. Many of the issues raised are of long standing, in part because there have been so few litigated mergers in Canada since the Act was amended. In particular, no decision in a litigated merger has turned on the question of efficiency gains and hence it appears to the Tribunal that there is considerable confusion over the meaning of certain key terms. Before dealing with the positions of the parties, the Tribunal will set out its understanding of the relevant sections of the Act.

407 The Act seeks to obtain the benefits of a competitive economy. As set out in the purpose clause, these benefits, which we have characterized as the objectives of competition policy, are economic efficiency and adaptability, the expansion of opportunities for Canadian participation in world markets and openness to foreign competition at home, opportunities for small

businesses to participate in economic activity, and competitive consumer prices and product choices. Under the purpose clause, the Act seeks to achieve these objectives by maintaining and encouraging competition. To this end the Tribunal may, pursuant to section 92 of the Act, order divestiture where a merger is found to prevent or lessen competition substantially.

408 There was some discussion at the hearing concerning the status that should be given to the stated objectives, particularly whether the ordering of objectives in the list contains any useful information in interpreting the Act. Such discussion is misdirected; the true goal specified in the purpose clause is the maintenance and encouragement of competition. It is noteworthy that the Act does not give the Tribunal the powers to achieve the objectives individually.

409 For example, small businesses are not protected under the Act. The purpose clause indicates only that the opportunities for small businesses to participate in economic activity will result from maintaining and encouraging competition. Hence, no other powers are needed to realize this objective.

410 Accordingly, the listing of objectives of competition policy simply presents the rationale for maintaining and encouraging competition. No hierarchy among the listed objectives is indicated and hence no meaning can be taken from the order in which the listed objectives of competition policy appear in the purpose clause. Under the purpose clause, all of the objectives flow from competition.

411 There are, of course, other objectives that could be sought, one such being the proper distribution of income and wealth in society. It is clear, however, that when competition is maintained and encouraged, the resulting distribution of income and wealth may not be the proper one depending on one's political or social outlook. By not including distributional considerations in the list of objectives in the purpose clause, Parliament appears to have recognized this. Indeed, if distributional issues were a concern, Parliament might have felt it necessary to restrict or place limits on competition in order to achieve the proper distribution of income and wealth in society. However, such limits would place competition policy at war with itself.

412 Turning to section 96 of the Act, the "efficiency exception", the Tribunal notes that this section contains the only provision in the Act which limits or restricts the pursuit of competition. As noted above, section 1.1 states that competition should, in and of itself, promote efficiency; normally there will be no conflict between the statutory means (encouraging competition) and the desired end (efficiency). However, the existence of section 96 makes it clear that if competition and efficiency conflict in merger review, the latter is to prevail. Thus, an anti-competitive merger that created or increased market power but also increased efficiency could be approved. Addressing this possibility, the MEG's, cited above at paragraph [57], state at paragraph 5.1:

> One such circumstance is highlighted in section 96 of the Act, where it is recognized that some mergers may be both anticompetitive and efficiency enhancing. When a balancing of the anticompetitive effects and the efficiency gains likely to result from a merger demonstrates that the Canadian economy as a whole would benefit from the merger, section 96(1) explicitly resolves the conflict between the competition and efficiency goals in favor of efficiency.

The Tribunal cannot but agree with this view of section 96.

413 The existence of section 96 signals the importance that Parliament attached to achieving efficiency in the Canadian economy. Indeed, in the view of the Tribunal, section 96 makes efficiency the paramount objective of the merger provisions of the Act and this paramountcy means that the efficiency exception cannot be impeded by other objectives, particularly when those other objectives are not stated in the purpose clause. To be more explicit, if, pursuant to the purpose clause, the pursuit of competition is not to be limited by distributional concerns, then as a matter of both law and logic, the attainment of efficiency in merger review cannot be limited thereby when competition and efficiency conflict.

(7) Commissioner's Position that Section 96 Does Not Apply to a Merger to Monopoly

414 The Commissioner submits, as a matter of law, that section 96 does not apply in the circumstances of a merger-to-monopoly. The Commissioner's position is based on the underlying purpose of the Act stated in section 1.1 which is to "maintain and encourage competition". He submits that when a merger creates an absolute monopoly, competition is eliminated which runs counter to the underlying purpose of the Act. Further, the Commissioner submits that when one of the effects of a merger is

the creation of a monopoly, that monopoly can never be offset or "neutralized" by efficiency gains regardless of how substantial they are. The Commissioner also argues that if section 96 were intended to allow mergers that eliminate competition to be saved, Parliament would have used some very specific language to so provide.

415 The Commissioner argues that there is a distinction to be made between sections 92 and 96 of the Act. Subsection 92(2) means that one would not be able to find that a merger, for example, substantially lessens competition simply by virtue of it being a monopoly. That subsection specifically states:

> *For the purpose of this section*, the Tribunal shall not find that a merger or proposed merger prevents or lessens, or is likely to prevent or lessen, competition substantially solely on the basis of evidence of concentration or market share. (emphasis added)

416 According to the Commissioner, subsection 92(2) is very specific and only applies for the purposes of that particular section, hence that a substantial lessening of competition leading to a 100 percent market share constitutes an elimination of competition which is not covered by section 96. In other words, the argument is that if a merger eliminates competition, the efficiency defence contemplated in section 96 should not apply.

417 The Commissioner conceded at the hearing that, as a matter of law, a respondent could invoke the section 96 exception as long as its market share did not attain 100 percent:

> MS STREKAF: Our submissions are that there is a different standard in the legislation that we read into the Act in Section 96 in the case of 100 percent that would not apply in your example in the case of a 96 percent situation.
>
> If you had a 96 percent market share, we would say that it would be very difficult, in those cases, for the Respondents to demonstrate that you could offset the effects of a 96 percent market share. But that's a question where we nonetheless recognize and acknowledge that in those kind of situations the Section 96 balancing needs to be performed. Our position is different for 100 percent.
>
> THE CHAIRMAN: A 98 percent market share and a 100 percent market share, the difference may simply be theoretical. Practically, it may not mean anything insofar as consumers are concerned.
>
> But you are saying, in the case of the 98 market share, they could at least attempt to have resort to 96?
>
> MS STREKAF: That's correct.
>
> THE CHAIRMAN: And you are saying, when they reach 100, they shouldn't be entitled to stop at the barrier and go back home.
>
> MS STREKAF: Yes. transcript at 41:8234, 8235 (1 February 2000).

418 The position taken by the Commissioner cannot be right. A merger that leads to a monopoly (i.e., where a merged entity has a 100 percent market share) is not, per se, a merger in regard to which the Tribunal may make an order under section 92. Subsection 92(2) requires, in effect, the Commissioner to adduce further evidence in order to show that the merger in question prevents or lessens or is likely to prevent or lessen competition substantially.

419 If the Tribunal concludes that the merger is likely to prevent or lessen competition substantially, it may make an order under section 92, subject to sections 94 to 96. Section 96 clearly provides that the Tribunal is not to make an order under section 92 if the gains in efficiency resulting from the merger are greater than and will offset the effects of any prevention or lessening of competition. Section 96 does not make any distinction between the "elimination" and the "substantial lessening" of competition. The section applies to any merger in respect of which the Tribunal may make an order under section 92. A merger leading to monopoly and in respect of which the Tribunal has concluded that there will be a substantial lessening of competition, is without doubt a merger to which section 96 applies.

(8) Effects of a Merger

420 In order to decide whether the efficiencies are greater than and offset the effects of any prevention or lessening of competition under section 96, the Commissioner suggests that the Tribunal should adopt the balancing weight standard described by his expert, Professor Townley. The Commissioner submits that using predetermined weights to the transfer would, as a matter of law, be contrary to section 96. According to the Commissioner, applying a predetermined weight would constitute an abrogation by the Tribunal of its statutory responsibility to exercise judgment. Professor Townley explained the reasons why the various approaches (price standard, the consumer surplus standard and the total surplus) are not consistent with a proper interpretation of section 96. In the Commissioner's view, only the balancing weight approach is consistent with a sound interpretation of section 96.

421 The respondents submit that the total surplus standard, as stated in the MEG's, cited above at paragraph [57], is the proper standard. They note that the Tribunal's decision in *Hillsdown*, cited above at paragraph [127], dated March 9, 1992, where Reed J. in her *obiter dictum*, questioned the appropriateness of the total surplus standard, has not led to any change to the MEG's. Indeed, at page 343, Reed J., in response to the submission made by both parties that the wealth transfer from consumers to producers was neutral, raised as a question whether the transfer is always neutral and suggested that it might be appropriate to include redistributional concerns when conducting the analysis required by subsection 96(1):

> One other consideration arises with respect to the arguments concerning the efficiency defence. The parties both rely on the judgment that the wealth transfer is a neutral one. A question posed during argument and which will be repeated here is: is this always so? If, for example, the merging parties in question were drug companies and the relevant product market related to a life-saving drug would economists say that the wealth transfer was neutral. The Tribunal does no more than raise this as a question. Another question respecting the alleged neutrality of the wealth transfer is: if the dominant firm which charges supra-competitive prices is foreign-owned so that all the wealth transfer leaves the country, should the transfer be considered neutral?

(a) Efficiency Effects and Redistributive Effects

422 An anti-competitive horizontal merger is a transaction that creates or enhances market power in the merged entity, the exercise of which leads to a higher price for the same good or reduced quality therein at the same price. If competitive conditions prevailed before the merger, the exercise of market power has several effects.

423 The economic effects of an anti-competitive merger are the effects on real resources, that is, the changes in the way the economy deploys those resources as the result of the merger. When market power results in an increase in the price of a product, allocative efficiency is reduced as consumers acquire less of the product and switch to lower-valued substitutes. Technical or productive efficiency is reduced because, with less consumption of the product, industry output falls and economic resources are diverted to the production of more costly substitute goods. A reduction in dynamic efficiencies as defined in the MEG's could also be an effect of an anti-competitive merger.

424 Since consumers pay more for the quantity of the product at the higher price, they lose some of the surplus they had when they paid the competitive price. A portion of this loss in consumer surplus is realized by the firm and its shareholders in the form of higher profits. Such loss is not a social loss, but rather a redistribution of gains from the merger; real resource use is not affected by this transfer of income.

425 However, the remaining loss of consumer surplus, beyond that realized by the shareholders in the form of increased profits, is a social loss and is often referred to as the "deadweight loss" because there are no offsetting gains. The lost value of output and consumption associated with the deadweight loss measures the allocative and technical inefficiency caused by the exercise of market power and represents the economic effect of the merger.

426 As we have already stated, the Tribunal is of the view that nothing in the Act allows us to consider distributional goals in merger review. Had this been Parliament's intention, surely the Act would have been worded differently. Robert H. Bork,

in his seminal work *The Anti-Trust Paradox* (New York: The Free Press, 1993), albeit in the American context, puts forward the view that income distribution and its effects are not to be considered in antitrust matters. The Tribunal agrees entirely with the following extract from pages 110 and 111:

> The model outlined addresses the total welfare of consumers as a class. It says nothing of how shares of consumption should be allocated through changes in the distribution of income. Yet all economic activity has income effects and, in particular, restriction of output by the exercise of monopoly power has income effects not taken into account by weighing only changes in allocative and productive efficiency. If the reader will look once more at Figure 4 he will see that at the competitive price, P_1, there is a large area under the demand curve that lies above the market price. This area represents the amount above the actual price that consumers would be willing to pay rather than go without the product; it is generally called the "consumer's surplus," perhaps on some notion that the consumer gets surplus value for his money.
>
> Those who continue to buy after a monopoly is formed pay more for the same output, and that shifts income from them to the monopoly and its owners, who are also consumers. This is not dead-weight loss due to restriction of output but merely a shift in income between two classes of consumers. The consumer welfare model, which views consumers as a collectivity, does not take this income effect into account. If it did, the results of trade-off calculations would be significantly altered. As Williamson notes, referring to his diagram: "The rectangle ... bounded by P_2 and P_1 at the top and bottom respectively and o and Q_2 on the sides represents a loss of consumers' surplus (gain in monopoly profits) that the merger produces. ... Inasmuch as the income distribution which occurs is usually large relative to the size of the dead-weight loss, attaching even a slight weight to income distribution effects can sometimes influence the overall valuation significantly."
>
> The issue is not crucial, perhaps, since most antitrust cases do not involve trade-off. The law's mistake has generally consisted of seeing restriction of output where there is none, and in such cases there will be no loss of consumer surplus. But even in cases where the trade-off issue must be faced, it seems clear the income distribution effects of economic activity should be completely excluded from the determination of the antitrust legality of the activity. It may be sufficient to note that the shift in income distribution does not lessen total wealth, and a decision about it requires a choice between two groups of consumers that should be made by the legislature rather than by the judiciary. (reference omitted)

(b) Standard for Merger Review

427 Assessing a merger's effects in this way is generally called the "total surplus standard". As discussed by the Commissioner's expert, Professor Townley (expert affidavit (16 August 1999): exhibit A-2081), and in a recent article by Michael Trebilcock and Ralph Winter, transfers from consumers to shareholders are not counted as losses under the total surplus standard. The anti-competitive effect of the merger is measured solely by the deadweight loss (M. Trebilcock and R. Winter, "The State of Efficiencies in Canadian Merger Policy" (1999-2000) 19:4 Canadian Competition Record 106). Under the total surplus standard, efficiencies need only exceed the deadweight loss to save an anti-competitive merger.

428 Other standards have been proposed. Under a "price standard", efficiencies are not recognized as a justification for a merger which results in a price increase to consumers. Under a "consumer surplus standard", efficiencies can be considered in merger review only if they are sufficiently large as to prevent a price increase. Effectively, this means that transfers of income are considered as losses; hence efficiencies must exceed the sum of the transfer of income and the deadweight loss.

429 From an economic point of view, the cost to society of an anti-competitive merger is the deadweight loss which measures lost economic resources. If, on the other hand, the merger generates efficiencies, it creates economic resources and hence the net economic effect of the merger in terms of resources may be much less than the deadweight loss. Indeed, the merger could be economically positive if efficiencies were sufficiently large, in which case society would benefit economically from allowing the merger.

430 This possibility is the basis for considering efficiencies in merger review. It is not to determine whether shareholders will be better off at the expense of consumers, but rather whether the economy gains more resources than it loses through the transaction. For this reason, it is important to distinguish true efficiencies, those savings that enable the firm to produce the

same amount with fewer inputs, from "pecuniary" economies, those savings that increase shareholder profits but do not allow the firm to be more productive. This distinction is recognized in subsection 96(3) which excludes pecuniary efficiencies from consideration. The only standard that addresses solely the effects of a merger on economic resources is the total surplus standard.

(c) Reasons for Total Surplus Standard

431 Professor Townley offers an approach ("balancing weights") in which the members of the Tribunal are invited to use their individual judgment and discretion to evaluate whether the gains to shareholders are more or less important to society than the losses of surplus imposed on consumers by the exercise of market power. However, the members of the Tribunal are selected for their expertise and experience in order to evaluate evidence that is economic or commercial in nature, not to advance their views on the social merit of various groups in society. As noted by Iacobucci J. in the Supreme Court's decision in *Southam*, cited above at paragraph [48], at pages 773 and 774:

> As I have already said, the Tribunal's expertise lies in economics and in commerce. The Tribunal comprises not more than four judicial members, all of whom are judges of the Federal Court — Trial Division, and not more than eight lay members, who are appointed on the advice of a council of persons learned in "economics, industry, commerce or public affairs". See *Competition Tribunal Act*, s.3. The preponderance of lay members reflects the judgment of Parliament that, for purposes of administering the *Competition Act*, economic or commercial expertise is more desirable and important than legal acumen.

432 First, the Tribunal is of the view, as already stated, that distributional concerns do not fall within the ambit of the merger provisions of the Act. If Parliament had intended that transfers from consumers to shareholders be considered, it would no doubt have clearly stated this intent in the Act.

433 Second, merger review must be predictable. Adopting Professor Townley's approach would result in decisions that vary from case to case depending on the views of the sitting members of the Tribunal regarding the groups affected by the mergers.

434 Third, the deadweight loss resulting from a price increase is typically quite small as Professors Trebilcock and Winter note in their article, cited above at paragraph [427]. On the other hand, as the Commissioner observes, the transfer is much larger than the deadweight loss resulting from the instant merger. This being the case, a standard that includes the transfer as an effect under subsection 96(1) would effectively result in the unavailability of the section 96 defence.

435 Professor Ward's evidence makes this clear. Using the calculations in table 8 of his initial report (exhibit A-2059 at 34), consider a large price increase of 15 percent. The resulting deadweight loss is 1.7 percent of sales but the transfer is 11.6 percent of sales when the price-elasticity of demand is -1.5. Accordingly, a merger that offered gains in efficiency of at least 1.7 percent of sales would be approved under a total surplus standard. However, under a consumer surplus standard, the efficiency gains would have to be at least 13.3 percent of sales.

436 When the elasticity of demand is -2.5, the deadweight loss and transfer are 2.8 percent and 9.4 percent of sales respectively. Accordingly, the total surplus standard would approve a merger if efficiency gains were at least 2.8 percent of sales. However, a consumer surplus standard would reject a merger unless efficiency gains were at least 12.2 percent of sales.

437 In an *obiter dictum* in the *Hillsdown* decision, cited above at paragraph [127], Reed J. appeared to favour the consumer surplus standard. However, as the above numbers indicate, applying a consumer surplus standard would lead the Tribunal to reject many efficiency-enhancing mergers on distributional grounds. As noted above, efficiency was Parliament's paramount objective in passing the merger provisions of the Act and it intended the efficiency exception in subsection 96(1) to be given effect. Accordingly, the Tribunal is not prepared to adopt a standard that frustrates the attainment of that objective.

438 Fourth, omitting income and wealth redistributional concerns from merger review does not mean that these concerns are to be ignored by public policy. Indeed, governments at all levels have adopted specific tax and social policy measures to address their distributional objectives. The Tribunal regards these measures as more effective ways of meeting a social policy goals. Blocking efficiency-enhancing mergers to achieve the same ends is, in our view, contrary to the Act.

439 Fifth, the MEG's, cited above at paragraph [57], endorse the total surplus standard. Although the Tribunal is not bound by these guidelines, it recognizes that they contain a substantial degree of economic expertise and it agrees with the observation at footnote 57 therein that "[w]hen a dollar is transferred from a buyer to a seller, it cannot be determined *a priori* who is more deserving, or in whose hands it has a greater value".

(d) Other Effects

440 The Commissioner submits that the ordinary meaning of "effect/effet", that is, something which flows causally from something else, is the most logical to apply to interpret that language used in section 96. The parties referred to *The Shorter Oxford Dictionary*, 3rd ed. (Oxford: Clarendon Press, 1973) at 631, which defines "effect" as "[s]omething caused or produced; a result, consequence. Correl. w. cause." Similarly, they referred to the *Larousse de la Langue Française* (Paris: Librairie Larousse, 1979) at 605, which defines "effet" as "[c]e qui est produit, entraîné par l'action d'une chose."

441 The Commissioner further submits that, provided the effects flow from a prevention or lessening of competition resulting from the merger, section 96 does not place any other limitations upon the scope or range of "effects" to be considered, which includes detrimental effects of a merger that will affect consumers such as an increase in prices, a decrease in service, product choice or quality.

442 The respondents submit that the test to be met under section 96 is that the efficiencies must offset any *substantial lessening of competition*. They further argue that a substantial lessening of competition is permitted provided it is outweighed by the efficiencies attributable to the merger. They also submit that *the effects of the substantial lessening of competition* are measured by the deadweight loss to the economy and exclude wealth transfers between consumers and producers, which are neutral to the economy.

443 The Tribunal observes that an anti-competitive merger may well have other important economic and social effects. Job terminations and plant closures are often emphasized in the press, presumably because of their immediacy and significance to the people and communities involved.

444 While not seeking to minimize the importance of these effects on those affected, the Tribunal wishes to point out that they are not restricted to anti-competitive mergers. Layoffs and closures often result from mergers and business restructurings that are not offensive and the Commissioner may take no notice thereof under the Act. Accordingly, the Tribunal is of the view that these effects are not to be considered when they result from anti-competitive mergers.

445 As a result, the Tribunal cannot accept the Commissioner's submission that section 96 does not place any other limitations upon the scope or range of "effects" to be considered.

(e) Conclusion

446 In final argument, the Commissioner refers to the "anti-competitive effects" of the merger as including the redistributive effects of the transfer. The Tribunal does not regard the redistributive effects of a merger as anti-competitive.

447 The Tribunal further believes that the only effects that can be considered under subsection 96(1) are the effects on resource allocation, as measured in principle by the deadweight loss which takes both quantitative and qualitative effects into account. Accordingly, the Tribunal believes that the total surplus standard is the correct approach for analysing the effects of a merger under subsection 96(1).

448 As a practical matter, the effects of an anti-competitive merger include effects that are difficult to quantify and may not be captured through statistical estimation of the deadweight loss. Subsection 96(1) specifically provides that gains in efficiency must both be greater than and offset the effects of any lessening of competition. Thus, it may be that, in a strict quantitative comparison of efficiencies and the estimated deadweight loss, the former exceeds the latter, yet the requirement to be "greater than" may not be met because of unmeasured qualitative effects.

449 If the word "offset" (or in French, "neutraliseront") were taken to mean "prevent" or "neutralize", this would imply that efficiency gains had to prevent the estimated deadweight loss and the other effects of prevention or lessening of competition from occurring or to neutralize these effects. Such interpretation would be inconsistent with the existence of the efficiency exception which clearly allows such effects. The Commissioner submits that "offset" (in French, "neutraliseront") must be interpreted to mean "compensate for" rather than "prevent" or "neutralize". The Tribunal agrees with this submission.

450 Whether, in a given case, the efficiency gains "offset" the effects of any prevention or lessening is a matter which the Tribunal must assess and decide in light of the available evidence. However, the requirement to "offset" cannot be used to justify consideration of qualitative or other effects which are not open for consideration under the Act.

(9) Deadweight Loss

451 In final argument, the Commissioner presented several estimates of deadweight loss, the transfer, and the balancing weights resulting from the calculations undertaken to apply Professor Townley's approach. Certain of these estimates were based on information provided in final argument that was excluded. Moreover, since the total surplus standard is, in our view, the correct standard to use in the trade-off analysis under subsection 96(1), the Tribunal will discuss only the deadweight loss estimate calculated from properly introduced information.

452 The Commissioner adopts the approach presented in evidence by Professor Ward, whose expert report (exhibit A-2059) provides at table 8, on page 34, estimates of deadweight loss and consumer surplus transfer as percentages of initial sales under various assumed values of the price elasticity of demand. In that table, Professor Ward presents those percentage estimates for each of three values of the elasticity between -1.5 and -2.5 only, because at the time of his initial report, he did not have the evidence of Professors Plourde and Ryan that showed that demand for propane was inelastic and hence could not have a price-elasticity of less than -1.0.

453 The Commissioner adopts Professor Ward's estimated price increases shown at table 2 on page 8 of his affidavit in reply (confidential exhibit CA-2060) for the residential, industrial, and automotive end-use segments of 11.7 percent, 7.7 percent and 8.7 percent respectively, and reduces each by 0.7 percent to take account of the pass-through of cost savings. Professor Ward obtained his estimates after the results of Professors Plourde and Ryan became available and, accordingly, he assumed an elasticity of -1.0 in obtaining those estimates. Since Professor Ward was not able to estimate the price increase for his "other" segment, the Commissioner adopts seven percent as appropriate for that segment because it was the smallest increase that Professor Ward found.

454 The Commissioner presents estimates of 1998 combined sales of the merging companies in each of those segments: $94 million, $239 million, $139 million, and $113 million respectively, accounting for the combined total volumes sold by Superior and ICG. Thus, the Commissioner's segmented sales estimates are for combined total sales, not just the combined sales of the merging parties in overlapping areas. Since, according to Professor Ward's table, the deadweight loss varies directly with sales, the Commissioner's estimates thereof likely overstate the deadweight losses by segment in overlapping areas.

455 The Commissioner obtains estimates of deadweight loss by segment by taking the segment sales and price increase information and applying them to Professor Ward's table where the assumed demand elasticity is -1.5. The resulting deadweight loss estimates based on 1998 sales data are as follows:

residential	$0.8 million
industrial	$1.0 million
automotive	$0.7 million
other	$0.5 million
total	$3.0 million

456 The respondents point out that the estimates of deadweight loss would be lower had they been calculated at an industry demand of -1.0, as suggested by the work of Professors Plourde and Ryan. They also note the inconsistency in calculating deadweight losses assuming an elasticity of demand of -1.5 while using price increases estimated with an elasticity of demand of -1.0.

457 The Commissioner submitted in final argument Table R1 which calculates the deadweight loss assuming a nine percent price increase across all segments in overlapping markets and a price elasticity of demand of -1.0. The resulting estimate of deadweight loss is $3.43 million, although the sales revenue figure used ($572 million) was among the materials submitted in final argument that were excluded.

458 Even though it is probably overstated, the Tribunal is prepared to accept the deadweight loss estimate of $3.0 million put forward by the Commissioner, since the overstatement is inconsequential in view of our finding that the merger is likely to bring about gains in efficiency in the order of $29.2 million.

(10) Trade-off Analysis

459 Pursuant to subsection 96(1), the Tribunal must ask whether the gains in efficiency exceed and offset the effects of any prevention or lessening of competition that the merger has brought about or is likely to bring about. The Tribunal observes that while the gains in efficiency claimed by the respondents have been measured and reduced to dollar figures, efficiency gains could also include qualitative elements such as, for example, better service and higher quality. No evidence of qualitative efficiency gains has been produced.

460 Similarly, the effects of any lessening of competition can also have both measurable and qualitative elements. The estimated value of the deadweight loss, while measuring the effect of the higher price on resource allocation, may not capture lessening of service or quality reduction.

461 For greater certainty, the Tribunal is of the view that all of the gains in efficiency must be compared with all of the effects of any prevention or lessening of competition, even though this requires judgment when combining measured gains (effects) with qualitative gains (effects).

462 The Commissioner submits that subsection 96(1) requires the Tribunal to consider whether the efficiency gains would likely be realized absent the merger. The Commissioner criticizes the Cole-Kearney report for not considering whether claimed efficiencies could have been achieved through less anti-competitive means than a full scale merger. Following the decision on this point in *Hillsdown*, cited above at paragraph [127], at page 332, the Tribunal is of the view that the test to be applied is whether the efficiency gains would likely be realized in the absence of the merger. In dealing with this issue in *Hillsdown*, the Tribunal stated:

> The Director's position is that cost savings that do not arise *uniquely* out of the merger are not to be considered as efficiency gains. The respondents' position is that the test to be applied is whether the efficiency gains would *likely* have been realized in the absence of the merger. The tribunal accepts the respondents' position.

463 The Tribunal finds that the estimated gains in efficiency from this merger are $29.2 million per year over 10 years and these gains in efficiency would not likely be attained if the order for total divestiture were made. The Tribunal finds that the estimated deadweight loss is approximately $3.0 million per year over the same ten-year period.

464 The Commissioner submits that qualitative effects include distributional impacts and other qualitative elements including changes to levels of service, product quality and product choice, increased probability of coordinated behaviour, and innovation. For the reasons already given, the Tribunal will not consider distribution impacts.

465 The Tribunal took into account the increased probability of coordinated behaviour in its consideration of the evidence regarding a substantial lessening of competition. To the extent that the effect of such anti-competitive behaviour is a higher price, then it has already been reflected in the deadweight loss estimate. If there are other effects of coordinated behaviour to

be considered under section 96, further and better evidence about those effects is required. It cannot suffice simply to restate the concern under section 92.

466 A decline in service levels, holding quality of service constant, is also reflected in the deadweight loss estimate. However, the evidence indicates that ICG had established certain services and pricing arrangements (e.g., the Golf-Max program) that Superior and other propane marketers did not offer. Their removal or reduction would reduce the real output of the industry. Although no evidence was given on the likelihood or scope of the reduction or removal of these product offerings following the merger, the exercise of market power might take such forms together with, or instead of, a direct increase in price.

467 The Tribunal must determine whether all of the gains in efficiency brought about or likely to be brought about by the instant merger are greater than the estimated deadweight loss and the negative qualitative effects resulting or likely to result therefrom. As noted above, this determination requires that the latter two components be combined and then compared with total efficiency gains. The Tribunal views the impact on resource allocation of the negative qualitative effects as minimal and as most unlikely to exceed in amount the estimated deadweight loss. Thus, the combined effects of lessening or prevention of competition from the instant merger cannot exceed, in the Tribunal's opinion, $6 million per year for 10 years. On this basis, the Tribunal finds that the gains in efficiency are greater than those effects.

468 The Tribunal must also determine whether all of the gains in efficiency will offset those effects. Gains in efficiency exceed those effects by at least $23.2 million per year for 10 years and, in the Tribunal's opinion, adequately compensate society for those effects. Accordingly, the Tribunal finds that the gains in efficiency will offset those effects.

469 For these reasons, the Tribunal is of the view that the Commissioner's application for an order under section 92 of the Act should be denied.

VII. Dissent Opinion (Ms. Christine Lloyd)

470 There are several areas with respect to the appreciation of the facts underlying the efficiency defence and the legal interpretation of section 96 of the Act stated by the majority of the Tribunal with which I strongly disagree. The majority accepted for the most part the evidence on efficiencies claimed by the respondents, Superior and ICG. The respondents relied on the Cole-Kearney report; this expert report was prepared by two consulting firms whose mandate was to provide an opinion as to the value of the efficiencies that are likely to result from the merger. I have great concerns with certain aspects of the methodology and assumptions adopted by the experts that led to their calculations and resultant conclusions. Consequently, I am not satisfied, on a balance of probabilities, that the gains in efficiency as claimed by the respondents are *likely* to be brought about by the merger as required by subsection 96(1) and that the claimed efficiencies would not likely be attained if the order for total divestiture were made. Finally, when conducting the trade-off analysis in section 96, I conclude that even if $29.2 million of efficiencies were likely to be realized (as accepted by the majority), the proposed gains in efficiency will not be greater than and will not *offset* the effects of any prevention or lessening of competition that will result or is likely to result from the merger.

A. Quantum of Efficiencies

(1) Problematic Aspects of the Methodology Used

471 The respondents submit that the merger between Superior and ICG will allow them to achieve substantial gains in efficiency in the range of $40 million per annum based on the opinion of Cole-Kearney. They state that the aggregate of such gains is approximately $381 to $421 million measured in constant dollars over 10 years. I have great concerns regarding the respondents' efficiencies claimed in this proceeding as certain aspects of the methodology used to conduct the analysis are problematic.

472 The efficiencies claimed by the respondents depend largely on the elimination of costs at the level of field operations, i.e., redundant branches and trucks and other related cost savings. Professors Schwindt and Globerman and Mr. Kemp state at page 23 of their report in rebuttal (confidential exhibit CA-3131) the following:

C. Total Field Operations ($193.6 million, 48.3% of savings)

Projected efficiencies generated at the field operations level are very significant, accounting for *nearly half of the anticipated total*. These efficiencies are largely attributable to the rationalization of the branch system and the improvement of delivery logistics. (emphasis added)

473 These cost savings identified by Cole-Kearney are based on a definition of Superior's trade area size and overlaps with ICG's trade areas. The size of each trade area of Superior is defined on the basis of the farthest customer located from each respective branch as reported in the 1998 branch templates. This farthest distance then constitutes the radius of the trade area for each specific branch. The extent of the trade areas and trade area overlaps, in turn, constitute the framework on which the experts calculated the efficiencies claimed to result from the implementation of the merger of Superior and ICG.

474 As stated above at paragraph [207] when assessing the validity of the 1998 branch templates, the Tribunal concludes that these templates are suspect and unreliable. Therefore, it appears that since Superior's trade areas may not be as large as 620 kilometers, relying on these estimates to determine the extent of the overlaps may well overstate the cost savings that can be realized. Consequently, the impact on the results of the calculated efficiencies remains unknown.

475 Further, I have noted that the experts estimate trade area overlaps through a manual process which was not verified in a way to assure accuracy. In response to a question asked by the Tribunal, Eric Fergin, one of the respondents' experts responsible for this process, explained how these overlaps were identified:

MS LLOYD: Getting back to the trade area size, Mr. Fergin, do you have any sort of scatter map or anything that indicates the customers so that we can actually see on a map indicating where the overlap is?

MR. FERGIN: No, we don't. I don't have one with me. I know one was constructed — *sketches were constructed, because they were based on rough estimates looking at the two areas, the overall area that they overlaid, and based on the raw data that we had which was actually provided to the Bureau*. I don't have a reference number for the documents.

We did that, but unfortunately, no, I don't have a scatter map.

MS LLOYD: It would be nice to see what that overlap is.

MR. FERGIN: *I'm afraid I don't have something like that*. (emphasis added). transcript at 34:6722 (8 December 1999).

476 As I mentioned earlier, the methodology to define the trade areas and their resultant overlaps raise significant concerns for errors that would impact on the quantum of the efficiencies claimed. By using the farthest point to establish the radius as opposed to a defining line around the greatest density of customers, the respondents could have overstated the number of branches that could potentially be closed as well as the number of trucks and related equipment that could be eliminated. In fact, using smaller trade area definitions dictated by customer density may have resulted in no overlap between certain branches.

477 Further, no mechanism or tools were used (other than the alleged review by Andrew Carroll of Superior, a process that remains unclear) to verify the validity of the analysis conducted by the respondents' experts. I am of the view that a thorough *reality check* should have been conducted. For instance, the respondents could have used a Geographic Information System (commonly referred to as "GIS") to create a scatter map to plot customer locations in relation to each of their respective branches. This system would have produced accurate trade area overlaps to assist the experts in determining the number of redundant branches and accurate drive time patterns. The fact that the experts did not have recourse to an equivalent safeguard, in my view, undermines greatly the validity of the findings made by the experts. They were discussed with Mr. Fergin at the hearing:

MR. FERGIN: ...In fact, *we don't have information of granularity to show where all the branches were in each particular area*.

I believe it was Ms Lloyd who asked us last Wednesday, in fact, if we had maps that plotted out the delivery sites relative to the branches, and as I stated at that time, we did not have that information.

MS LLOYD: I thought you told me that you did it in lead-up to the analysis.

MR. FERGIN: I'm sorry?

MS LLOYD: I though I understood that you actually did have it, but that was in the lead-up to the analysis, that you had done it. I must have misunderstood you.

MR. FERGIN: *We had done it for the areas that we rode along in during our ride-alongs, but we hadn't done it for all the particular customers that were served by a particular branch*.

MS LLOYD: I misunderstood you.

MR. FERGIN: Okay. The other comment I have is: *Mr. Schwindt indicated that our methodology in terms of determining the area served for Superior was based solely on the radius of the trade area as determined by the farthest customer*.

Now, *that was the initial basis*, but we didn't strictly use that information without going back to Andrew Carroll of Superior Propane, who was our key liaison on this project in terms of giving us information and validating information as to what areas, particular branches, particular satellites served to determine that would in fact be a valid area or it should be adjusted accordingly somewhat because of the fact that a situation like this might exist or there might be one far outlying branch.

So the point I am trying to make is that: *We did not simply use the branch radius as the only factor for determining the trade areas served by Superior for a given branch*. (emphasis added) transcript at 37:7782, 7783 (14 December 1999).

478 The only validation process presented by the respondents is that of the "ride-alongs", which were conducted to validate the model used to predict reduction in fleet and driver personnel and other results therefrom. They submit that these ride-alongs, which consist of spending a day with a driver delivering propane to customer locations, allow them to validate the model that they have developed. Yet, in cross-examination by the Commissioner, Mr. Fergin conceded that he had participated in only two ride-alongs in Sudbury (with Superior) and Stratford (with ICG) where a detailed analysis was done as to time spent on various activities (i.e., comparing time spent driving, pumping propane, delivering and generating delivery receipts). He mentioned that ride-alongs were also conducted without tabulating the data in Moncton, Lloydminster, Concord, Vimont, Coquitlam and Burnaby (transcript at 37:7795 (14 December 1999)).

479 I am of the view that the validation process that was conducted in this case is insufficient to provide the assurance that the quantum of the efficiencies claimed is accurate. Further, the validation process was only performed with respect to the efficiencies claimed at the field operations level, most particularly with respect to the fleet reduction (annualized savings of $2.6 million which represents $33.4 million over 10 years) and related costs. In addition, inadequacies are further demonstrated by the fact that ride-alongs were conducted and reported using a sample of only two locations, one Superior and one ICG. As well, no allowance for regional differences was accounted for in this analysis.

(2) Highly Optimistic Assessment (That Does Not Account for Any Costs)

480 The Commissioner's experts point out that the evaluation made by Cole-Kearney of the efficiencies is highly optimistic not to say unrealistic because their projection of the efficiencies does not account for any costs resulting from the integration of the two companies. They point out at pages 9 and 10 of their report in rebuttal (confidential exhibit CA-3131) that Cole-Kearney did not account for transition and integration costs and some volume losses. As they stated:

The projected efficiencies of this transaction are largely driven by the integration of customer support (the second tier of administration) and field operations. These two broad categories of activities account for nearly two-thirds of the estimated cost savings, and both are complex. The proposed integration would involve the merging of ICG's 100,000 customers with

SPI's 200,000 customer base, the integration of and rationalization of ICG's 110 distribution sites with SPI's 140 sites, the integration of a substantial number of ICG's 700 employees into SPI's workforce of 1,300 people, and the integration and rationalization of an extensive delivery fleet. The business involves the distribution of propane, so integration will require the meshing of two complex networks. Moreover, the two enterprises have adopted fundamentally different operating philosophies. One, ICG, is moving towards a more centralized, information technology dependent model, while the other, SPI, continues to operate a more decentralized system. Given these facts, the integration of these two firms would appear to be a daunting task. However, the Kearney Report identifies very few costs attributable to the actual process of integration.

481 It is indubitable that the rationalization of the two site networks will generate real resource savings. However, the respondents' experts did not account for any increases in operating expenditures or ongoing capital expenditures that will result from additional costs related to volumes, staffing levels and number of customers. I am in agreement with Professors Schwindt and Globerman and Mr. Kemp when they state in their report in rebuttal (confidential exhibit CA-3131) at page 24 that:

> ... Volumes in all rationalised trade areas will increase, and, at some, volumes will more than double. Staffing will increase at the branches .... [C]ustomers per branch will increase significantly, and this will increase the number of administrative staff required to serve these customers....[M]any tasks will be reallocated to branch employees .... This will also increase staffing.... [I]ncreased volumes will require more delivery and service staff ....

482 Further, Professors Schwindt and Globerman and Mr. Kemp point out that equipment located at the branch or operating from the branch (including storage tanks and trucks) will increase, which, in turn, will require more space and expanded infrastructure and further storage space for inventories (parts and customers tanks). This will result in increased costs that have not been accounted for by the respondents' experts. In support of their criticism, the Commissioner's experts examined changes to operations and used the example of the Peterborough branch (a branch where the rationalization is straight forward) to demonstrate the effects that the integration will have on costs, as shown at table 7 on page 26 of their report in rebuttal (confidential exhibit CA-3131). They conclude at page 26 that:

> *The staffing level will increase by 60 percent*. Cylinder operations will be consolidated at this site which will increase cylinder truck traffic. *The bulk delivery fleet will double*. The increased fleet will require additional maintenance capacity on the site as well as general access and parking area. This could require reconfiguration of the site to handle the step change in delivery equipment. *Bulk delivery volumes are projected to increase by 220 percent*. Such a large increase will mean that *both primary deliveries and bulk truck daily liftings will also increase proportionately*. This suggests that the *site will have to be reconfigured* to handle the significant increase in load factors. (emphasis added)

483 The expert opinion of Professors Schwindt and Globerman and Mr. Kemp, as stated above, supports the Commissioner' submission that the efficiencies claimed by the respondents are overstated and hence, have not been demonstrated on a balance of probabilities:

> Secondly, we reiterate that the efficiency gains that were used for the purposes of this calculation of 21.2 million, on an annualized basis, is overstated for the reasons that we set out in the quantitative section of our materials.
>
> While that represents taking off the deductions that we were able to specifically identify in the evidence of Professors Schwindt and Globerman and as detailed in the argument, *we have pointed out many instances where the Respondents' efficiency gains are excessively optimistic, exaggerated, or don't meet the standard, in our submission, of being established on a balance of probabilities*. (emphasis added) transcript at 44:8737 (4 February 2000).

484 As stated in paragraph 5.7.2 of the MEG's, cited above at paragraph [57], and as discussed by the author A. Neil Campbell in *Merger Law and Practice, The Regulation of Mergers under the Competition Act* (Scarborough: Carswell 1997) at 162, I am of the view that efficiencies should be measured net of the implementation costs that would be incurred in obtaining them. Therefore, "retooling" and other costs necessary to achieve efficiency gains should be deducted from the total value of the efficiencies.

485 In light of my remarks on the methodology used by the experts and the insufficient consideration being given to additional costs that will result from the integration of field sites, I am of the view that the respondents have not demonstrated *on a balance of probabilities* the existence of the claimed $40 million of efficiencies per annum. As I have explained earlier, some problems identified with the methodology undermines greatly the validity of the efficiencies claimed by the respondents. There is no question that efficiencies can be realized in any merger or most particularly in this merger. However, the requirement under section 96 of the Act is to demonstrate the existence or the likelihood that the gains in efficiency will be brought about by the merger, hence the quantum of the claimed efficiencies on a balance of probabilities. In my view, the respondents have not met their burden of proof on that crucial element of their efficiency defence. As a result, I do not accept the respondents' efficiencies claim of $40 million per annum nor the reduced quantum of $29.2 million of efficiencies as accepted by the majority. Since I am not able to measure the degree to which these errors have affected the results nor able to quantify the inevitable costs that will result from this merger, I am not in a position to assess the real value of the efficiencies that will result or is likely to result from the merger and, therefore, will not speculate on their quantum.

B. The Merger has Brought About or is Likely to Bring About Gains in Efficiency (i.e., Likely to be Realized Post-Merger)

486 The respondents have not convinced me on a balance of probabilities that the $40 million of efficiencies claimed will be realized for the reasons stated above. In addition, regardless of the quantum of efficiencies that *theoretically* could be realized, the Tribunal has not been provided, in my opinion, with any evidence that they are likely to *materialize* post-merger.

487 In my view, the term "likely" used in section 96 requires more than the sole demonstration of the quantum of possible efficiencies. Rather, I believe that the term "likely" requires some evidence of the implementation process leading to the materialization of the claimed efficiencies. It is my opinion that evidence of this nature is necessary to provide the Tribunal with a *level of assurance* necessary to conclude that the efficiencies are *likely* to be realized post-merger (i.e., implemented by management).

488 Evidence before the Tribunal stresses the importance of the merging parties having a detailed plan to ensure success of the merger. On that point, Paul Inglis, one of the respondents' experts on efficiencies, discussed a study that examines 115 mergers that took place between 1993 and 1996 in North America and which identifies the factors contributing to a successful merger. In that regard, Mr. Inglis explained that the *existence of a business plan* was one of the key factors leading to a successful merger:

> Success in a merger is, in large part, *determined during the planning stage, but of course is* ***executed after the merger happens****. You have to make sure that you follow through on the good plans that are made up front*. And so I would like to talk about, once again, ***the post-merger factors***; and that is once the deal has consummated, once the agreement has been made.
>
> What are the things that allow us to believe that there is ***a good chance that the merger will be executed***? Again, there are five things that we believe correlate. ***Is there a clear vision and strategy for the company? Do they know who the management is going to be? Do they have a good plan for putting that management in place? Have they got the capabilities to show results early and to gain momentum from developing those results? Have they recognized that there are cultural differences and do they have a plan to break through those cultural differences and meld the two organizations together***? And finally, have they got a communications plan in place that will help them to execute that change in the cultures?...
>
> Let me turn next to determine the *management responsibility* point. Now, already there has been an identification of how many people will be in the management team. They plan to go forward with *ten senior management positions*. And they have a pool of senior resources to draw from. And that pool includes the likes of Geoff Mackey and Peter Jones and the other people that are the senior managers at ICG, as well as the people inside Superior. (emphasis added) transcript at 33:6347, 6348, 6350 (7 December 1999).

489 Mr. Inglis was touching upon a crucial point when addressing the importance of having an implementation plan in order to assure that the claimed efficiencies are executed. In the absence of such a plan, there is no assurance or any indication as to the degree of probability that this merger will achieve the efficiency gains identified by the experts.

490 A business plan setting out the implementation process/action plan outlining time frames for each step of the integration of the merger is necessary to achieve the claimed efficiencies. I take note that Mr. Inglis mentioned that Superior had a plan that was well *articulated* and that had been scrutinized over a long time frame. Unfortunately, the Tribunal was not presented with that alleged plan or any other plan. In fact, no such evidence was presented at the hearing. Mr. Schweitzer, Superior's Chief Executive Officer, the sole representative of Superior's management who testified at the hearing, did not provide evidence of the existence of a post-merger plan. It appears to me that a detailed business plan which expresses clearly the commitment and accountability of Superior's management (including the commitment of the Chief Executive Officer) should have been demonstrated. Further, there is no evidence that any study or due diligence was conducted to determine the cost effectiveness of merging the two companies prior to the decision by Superior to acquire ICG. Had this exercise been undertaken, the cost savings presented by Cole-Kearney would have had more credibility. Consequently, it appears to me that the realization of the efficiencies claimed strictly remain *possibilities and not probabilities* hence, the respondents have not demonstrated on a balance of probabilities that the efficiencies are likely to be realized.

491 One could argue that the Management Agreement referred to at paragraphs [330]-[345], which provides incentives to SMS to increase the profitability of Superior and the cash distribution to unitholders of the Superior Income Fund (cash distribution), further supports the view that the efficiencies are likely to be realized. However, since the additional profits, which lead to SMS's entitlements can come from either an increase in price resulting from the exercise of market power and/or from cost reductions, I am of the view that the Management Agreement does not offer the level of assurance necessary to conclude that extra profits will be generated from the realization of the claimed efficiencies and hence, that these efficiencies are *likely* to be achieved.

492 In the absence of any provision under the Act regarding the enforcement of the outcome, (i.e., the realization of the claimed efficiencies), it is even more critical that the respondents demonstrate that the merger is *likely* to bring about gains in efficiency *not solely on a theoretical level* through experts but also through direct evidence that *this is the direction that management is committed to seriously undertake with some assurance of completion post-merger*. Without such a crucial piece of evidence, it appears to me that the efficiencies claimed remain only a *theoretical* exercise that may never be implemented by management. This demonstration that the merger is *likely* to bring about gains in efficiency is an important element of the efficiency defence that they had to demonstrate in order to meet their burden of proof.

493 In light of my previous comments regarding the efficiencies claimed by the respondents' experts and the lack of information regarding the alleged commitment of management to the actual implementation, including time frames dedicated to each step of the implementation process, I am of the view that the requirement that the respondents must demonstrate that the merger has brought about or is *likely* to bring about gains in efficiency has not been met.

C. "That the Efficiencies Would Not Likely Be Attained If the Order Were Made"

494 Subparagraph 96(1) of the Act provides that:

> 96.(1) The Tribunal shall not make an order under section 92 if it finds that the merger or proposed merger in respect of which the application is made has brought about or is likely to bring about gains in efficiency that will be greater than, and will offset, the effects of any prevention or lessening of competition that will result or is likely to result from the merger or proposed merger ***and that the gains in efficiency would not likely be attained if the order were made***.
>
> (2) In considering whether a merger or proposed merger is likely to bring about gains in efficiency described in subsection (1), the Tribunal shall consider whether such gains will result in
>
> > (a) a significant increase in the real value of exports; or
> >
> > (b) a significant substitution of domestic products for imported products.

(3) For the purposes of this section, the Tribunal shall not find that a merger or proposed merger has brought about or is likely to bring about gains in efficiency ***by reason only of a redistribution of income between two or more persons***. (emphasis added)

495 While the Commissioner bears the onus of proving the effects of any prevention or lessening of competition resulting from the merger on a balance of probabilities, it is the respondents' burden to prove all the elements of their defence in order to be successful. These elements are: the existence of the claimed efficiencies, the likelihood that they will be brought about by the merger (realized post-merger through their actual implementation), *the fact that they would not likely be attained if the order for total divestiture were made* and that they are not pecuniary in nature. Once a determination has been made of what gains (both quantitative and qualitative) should be considered in the trade-off analysis, then the balancing process can take place.

496 Indeed, section 96 limits the efficiency gains that can be considered in the trade-off analysis to those that *would not likely be attained if the order were made* and to those that do not constitute a *redistribution of income between two or more persons*. While I agree with the majority that only efficiencies that constitute "real" resource savings must be considered and not those that are pecuniary in nature, I disagree with their appreciation of the requirement set out in subparagraph 96(1) *and that the gains in efficiency would not likely be attained if the order were made*.

497 This requirement of subparagraph 96(1) that they would not likely be attained if the order were made leads to this question: would the gains in efficiency likely be realized if the order for total divestiture were made? In other words, if the order for total divestiture were made, would the two companies independently likely realize gains in efficiency in some other way? The burden of proving this element also falls on the respondents and, in my view, has not been met on a balance of probabilities.

498 Indeed, *only those gains* which would not likely be attained if the order were made can be claimed by the respondents. This requirement is to ensure that gains that would likely be obtained absent the merger for instance as a result of internal growth, merger or joint venture with a third party, *restructuring*, or contractual arrangements (e.g., specialization agreement) are excluded from efficiencies claimed. Therefore, it appears that the merging parties had the onus of providing a reasonable explanation as to why efficiencies would not likely be sought through an alternative mean if the order for total divestiture were made.

499 In this case, the respondents have not, in my view, proved that the claimed efficiencies would not likely be attained if the order for total divestiture were made. Cole-Kearney's mandate was to provide *an opinion as to the value of efficiencies* that were likely to result from a merger of Superior and ICG. Their report states that alternative means were explored within the context of common industry practice such as internal growth, merger or joint venture with a third party or specialization agreement or licensing lease or other contractual arrangements. On that basis, they concluded that the merger is the only means by which to achieve efficiencies. No comparative evidence was provided on the results arising from the value of efficiencies from alternative means to assure the Tribunal that a merger was the *only* means by which to achieve the efficiencies. Surprisingly, restructuring was not mentioned by the experts.

500 Further, no evidence in support of their conclusions was provided to the Tribunal nor any explanation as to why measures such as restructuring would not likely be undertaken by Superior to reduce its costs in order to achieve efficiencies in some other way, absent the merger. Indeed, while evidence was provided regarding ICG's transformation process (a process that led to efficiencies which were properly not claimed by the experts), no evidence was provided as to what Superior would or would not likely undertake to achieve efficiency gains if the order were made. The Tribunal does not have evidence to conclude that Superior, on its own, had already "cut-out the fat" within its organization before undertaking the merger with ICG. Consequently, the efficiencies claimed by the respondents could include cost savings that Superior would likely achieve on its own, absent the merger. Such efficiencies resulting from Superior's own restructuring would have been discounted from the efficiencies claimed. Indeed, as stated in the MEG's, cited above at paragraph [57], where *some or all* of the claimed efficiency gains would likely be attained through other means if the order were made, they cannot be attributed to the merger and hence, must not be considered in the section 96 trade-off analysis. For these reasons, I am of the view that the respondents failed to prove that the gains in efficiency would not likely be attained if the order were made.

D. Issues Regarding the Trade-Off Analysis

501 As stated above, the respondents argue that the test to be met under section 96 of the Act is that the efficiencies must be greater than and offset any substantial lessening of competition and that the effects of such are measured by the deadweight loss to the economy and exclude wealth transfers between producers and consumers which are neutral to the economy.

502 The Commissioner submits that in conducting the trade-off analysis set out in section 96, the Tribunal has a statutory responsibility to exercise its judgment as to the weight to be accorded to the transfer from consumers to producers. Hence, he submits that applying a standard with a fixed predetermined weight would be contrary to section 96. Further, the Commissioner submits that the efficiency gains do not *offset*, i.e., "neutralize" or "compensate for", the anti-competitive effects caused to the economy as a whole by this merger.

503 The majority accepted that $29.2 million of efficiencies per annum is likely to be realized and is satisfied that the gains in efficiency are greater than and offset the effects of any prevention or lessening of competition that is likely to result from the merger. In their view, these quantitative efficiencies are greater than and offset the deadweight loss to the economy evaluated at $3 million per annum and the qualitative effects of any prevention or lessening of competition.

504 I agree with the majority that the trade-off analysis must be conducted through a single test where quantitative (productive) and qualitative (dynamic) efficiency gains together must be greater than and offset the quantitative (deadweight loss) and qualitative (e.g., reduction in non-price dimensions of competition) effects of any prevention or lessening of competition resulting from the merger. While I agree with the single test approach (i.e., as opposed to two tests, one quantitative and one qualitative), I disagree with their interpretation of the word "offset" in subsection 96(1) and with the weight that they attach to the effects of this merger.

505 It is clear to me that Parliament intended the members of the Tribunal to exercise their judgment when assessing the trade-off set out in section 96 of the Act. During the proceedings of the Legislative Committee on Bill C-91, there were several references to the fact that the terms used in that section should not be so precise as to restrict the Tribunal's interpretation and discretion. Rather, there was an agreement that the Tribunal should have the jurisdiction to exercise its discretion based on the merits of a specific case. It appears that the legislator intended that the Tribunal should not become so rigid when applying the law as to prevent some mergers that would benefit the economy and conversely allowing others that would clearly not benefit the economy. Therefore, the legislator decided not to provide a specific list of factors in addition to those already stated in subsection 96(2); the increase in the real value of exports and substitution of domestic products for imported products. Instead, the legislator preferred to rely on the discretion of the Tribunal members who have expertise to hear competition law matters.

506 While I recognize that efficiencies are given special consideration under section 96 and may constitute a defence to an otherwise anti-competitive merger, it appears to me that section 96 is an *exception to the application of section 92 of the Act* and not an *exception to the Act itself*. As Parliament stated, the trade-off set out in section 96 involves a balancing process and does not constitute, in my view, an *absolute* defence where the effects of the anti-competitive merger ought to be ignored. By that, I mean while the section 96 trade-off gives precedence to the gains in efficiency likely to result from the merger, this section must be interpreted in accordance with the objective and goals of the Act. This objective is to maintain and encourage competition in Canada in order to achieve the *goals* of the Act (i.e., the promotion of the efficiency and adaptability of the Canadian economy, the expansion of opportunities for Canadian participation in world markets, the equitable opportunity for small and medium-sized enterprises to participate in the Canadian economy and the provision of competitive prices and product choices to consumers). Therefore, it appears to me that the effects of any prevention or lessening of competition, which are contrary to the goals stated in the purpose clause of the Act, ought to be considered (for instance, the reduction or loss of consumer choice) in the trade-off analysis in order to determine whether the gains in efficiency are greater than and offset those effects.

507 In my view, if the analysis under section 96 were so simplistic as to only require the comparison between quantitative efficiency gains and the deadweight loss to the economy, this could lead to distorted outcomes. For instance, such a narrow interpretation would mean that an anti-competitive merger would more easily meet the test set out in the section as the demand

for the relevant product becomes less elastic (i.e., less price-sensitive). This perverse result arises from the fact that the calculated deadweight loss is proportional to the elasticity of demand. Therefore, following the interpretation of the majority, smaller gains in efficiency are required to outweigh and offset the deadweight loss to the economy when the demand is inelastic. In my view, there is no obvious reason to explain why Parliament would have written section 96 to give preference to anti-competitive mergers involving products for which demand is relatively inelastic (e.g., commodities).

508 Consequently, I am of the view that the qualitative effects must be given appropriate consideration in the trade-off analysis. Indeed, while the deadweight loss can simply be depicted on a matrix and quantified, a matrix does not take into account the peculiar effects of the merger under review. As it is recognized by authorities in the field and by the MEG's, cited above at paragraph [57], some effects of a merger cannot be valued in dollar terms, for instance reduction in service, quality, variety, innovation and other non-dimensions of competition. Therefore, these effects must receive a weight that is qualitative in nature. Accordingly, as certain effects in this merger cannot be quantified, I am of the view that they must be considered as qualitative and given an appropriate weight in the trade-off analysis.

509 As I explained earlier, I do not accept the quantum of efficiencies as adopted by the majority. However, I will use that amount in table 2 (contained in paragraph [512]) simply for the purpose of illustration. As seen in table 2, which compares the efficiency gains claimed in this merger to the effects of any prevention or lessening of competition, the respondents have not claimed any qualitative effects that will benefit society as a whole. For instance, they do not claim any dynamic efficiencies or that the efficiencies will result in a significant increase in the real value of exports as stated at subsection 96(2) of the Act. Therefore, I cannot conclude that this merger will generate *qualitative* gains in efficiency that will benefit the economy as a whole.

510 As to the qualitative effects of any prevention or lessening of competition, I have identified some that have not been given, in my view, sufficient weight in the analysis conducted by the majority. These effects are the loss of a vigorous competitor, which reduces consumer choice generally, particularly for national account customers and the absence of choice due to the elimination of competition in 16 markets. Further, the merged entity will have the ability to exercise market power which may result in the imposition of unilateral *price increases* and/or a *reduction or elimination of programs* such as the Cap-It and Auto-fill offered to customers. Conversely, the merged entity could use its market power to reduce prices for a period of time in order to squeeze competitors out of the market. This latter effect would be contrary to one of the goals stated at section 1.1 of the Act which seeks to provide an equitable opportunity for small and medium businesses to participate in the Canadian economy.

511 Finally, I am of the opinion that consideration must be given to the significant wealth transfer from consumers to producers that will result from a price increase. Controversy surrounds the issue as to whether the wealth transfer is an effect that should be considered in the analysis stated at section 96. While a wealth transfer resulting from a merger is deemed to be neutral from a pure economic standpoint, it is not neutral in the context of the purpose clause of the Act which states that the objective is to promote and encourage competition in order to, among other goals, *provide consumers with competitive prices and product choices*. I am of the view that if Parliament's intention were that gains resulting from higher profits (due to a reduction in competition) and achieved at the expense of consumers should be viewed as neutral, surely it would have stated so in the Act. Indeed, if this had been the intention of the legislator, no references would have been made to consumers in section 1.1 and further, the term "effects" in section 96 would have been defined as to exclude any consideration of that nature. Therefore, I agree with the *obiter dictum* of Reed J. in *Hillsdown*, cited above at paragraph [127], at page 337, that the word "effects" should not be given such a restrictive interpretation as to exclude the transfer from consumers to producers.

512 I am of the opinion that the wealth transfer from consumers to producers should not be viewed as a quantitative effect. There are no provisions in the Act suggesting that the effects must be quantified. It is my opinion that the transfer should be given qualitative consideration in the balancing process, which requires an exercise in judgment. A qualitative consideration allows for flexibility in the evaluation of each individual case under review.

TABLE 2: Trade-off Analysis

	Quantitative	Qualitative
Positive	$29.2 million as accepted by the majority (see my dissenting opinion above)	The respondents provided no evidence of any qualitative "positive" effects.
Negative	$3 million (deadweight loss)	Loss of a vigorous competitor which *reduces* consumer choices. *Absence* of choice for consumers in 16 markets and for national account customers. Ability to exercise market power that may result in: — the imposition of a *unilateral price increase or price decrease* ("to squeeze competitors out" of the market); — the *reduction or elimination of programs* offered to customers (i.e., Cap-It, Auto-fill, etc.); — the *reduction or elimination of services* (e.g., delivery services in certain areas); and — significant wealth transfer from consumers to producers.

513 I am of the view that when assessing the gains in efficiency against the effects of any prevention or lessening of competition, the claimed efficiencies are not greater than and do not *offset* these effects.

514 As stated by the Commissioner, I am of the view that in order for the defence to be successful, the respondents must demonstrate that the efficiencies will be greater than and *will offset* (i.e., compensate for) the effects of a merger. The respondents provided no evidence that the efficiencies claimed will *compensate for* the detrimental effects that will result from the merger. For example, the respondents could have claimed that the merger is likely to bring about dynamic efficiencies arising from innovation that will benefit the Canadian economy. Such qualitative efficiency gains could have been assessed in the trade-off analysis as ways to compensate for the detrimental effects caused to the economy as a whole. However, the respondents did not even attempt to present any such *beneficial* effect to the economy that will result from the merger.

E. Conclusion

515 In light of my dissenting reasons, I conclude that the respondents have not met their burden of proof of demonstrating, on a balance of probabilities, that the merger has brought about or is *likely* to bring about gains in efficiency that will be greater than and will offset the effects of any prevention or lessening of competition. Therefore, the Tribunal should make the order for total divestiture by Superior of all of ICG's shares and assets (including those of the previously integrated branches thereof) formulated pursuant to section 92 of the Act.

VIII. Order

516 The Tribunal hereby orders that the Commissioner's application for an order under section 92 of the Act is denied.

Application dismissed.

2001 FCA 104
Federal Court of Canada — Appeal Division

Canada (Commissioner of Competition) v. Superior Propane Inc.

2001 CarswellNat 2092, 2001 CarswellNat 702, 2001 FCA 104, [2001] 3 F.C. 185,
104 A.C.W.S. (3d) 857, 11 C.P.R. (4th) 289, 199 D.L.R. (4th) 130, 269 N.R. 109

THE COMMISSIONER OF COMPETITION (Appellant) and SUPERIOR PROPANE INC. and ICG PROPANE INC. (Respondents)

Stone J.A., Létourneau J.A. and Evans J.A.

Heard: January 9-11, 2001
Judgment: April 4, 2001
Docket: A-533-00

Proceedings: reversing in part *Canada (Commissioner of Competition) v. Superior Propane Inc.* (2000), 7 C.P.R. (4th) 385, 2000 Comp. Trib. 15, 2000 CarswellNat 3449 (Federal Court of Canada — Appeal Division); refused leave to appeal *Canada (Commissioner of Competition) v. Superior Propane Inc.* (2001), 2001 CarswellNat 1905, 2001 CarswellNat 1906, 278 N.R. 196 (note) (Federal Court of Canada — Appeal Division); refused leave to appeal *Canada (Commissioner of Competition) v. Superior Propane Inc.* (September 13, 2001), 28593 (Federal Court of Canada — Appeal Division)

Subject: Intellectual Property; Property; Corporate and Commercial
Related Abridgment Classifications
Business associations
VI Changes to corporate status
VI.1 Amalgamations and takeovers
VI.1.a Amalgamations
VI.1.a.iii Miscellaneous
Commercial law
VI Trade and commerce
VI.5 Competition and combines legislation
VI.5.d Abuse of dominant position (monopolies) and mergers
Commercial law
VI Trade and commerce
VI.5 Competition and combines legislation
VI.5.g Investigation and prosecution
VI.5.g.x Appeals
Headnote
Trade and commerce --- Competition and combines legislation — Abuse of dominant position (monopolies) and mergers
Corporations --- Amalgamations and takeovers — Amalgamations — Miscellaneous issues
Trade and commerce --- Competition and combines legislation — Investigation and prosecution — Appeals — Standard of review
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Canada (Director of Investigation & Research) v. Hillsdown Holdings (Canada) Ltd. (1992), 41 C.P.R. (3d) 289 (Competition Trib.) — referred to

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s. 92(1)(a) [en. R.S.C. 1985, c. 19 (2nd Supp.), s. 45] — considered

s. 92(1)(b) [en. R.S.C. 1985, c. 19 (2nd Supp.), s. 45] — considered

s. 92(1)(c) [en. R.S.C. 1985, c. 19 (2nd Supp.), s. 45] — considered

s. 92(1)(d) [en. R.S.C. 1985, c. 19 (2nd Supp.), s. 45] — considered

s. 92(1)(e)(i) [en. R.S.C. 1985, c. 19 (2nd Supp.), s. 45] — considered

s. 92(1)(e)(ii) [en. R.S.C. 1985, c. 19 (2nd Supp.), s. 45] — considered

s. 92(2) [en. R.S.C. 1985, c. 19 (2nd Supp.), s. 45] — considered

s. 96 [en. R.S.C. 1985, c. 19 (2nd Supp.), s. 45] — considered

s. 96(1) [en. R.S.C. 1985, c. 19 (2nd Supp.), s. 45] — considered

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Competition Tribunal Act, R.S.C. 1985, c. 19 (2nd Supp.)

s. 2 "judicial member" — considered

s. 3 — considered

s. 3(2)(a) — considered

s. 3(2)(b) — considered

s. 3(3) — considered

s. 10(1) — considered

s. 12(1) — considered

s. 12(1)(a) — considered

s. 12(1)(b) — considered

s. 13 — considered

s. 13(1) — considered

s. 13(2) — considered

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Statutes considered by *Létourneau J.A.*:

Competition Act, R.S.C. 1985, c. C-34

s. 1.1 [en. R.S.C. 1985, c. 19 (2nd Supp.), s. 19] — considered

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s. 96 [en. R.S.C. 1985, c. 19 (2nd Supp.), s. 45] — considered

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APPEAL by Commissioner of Competition from judgment reported at(2000), 7 C.P.R. (4th) 385, 2000 Comp. Trib. 15, 2000 CarswellNat 3449 (Competition Trib.) dismissing application by Commissioner for order dissolving merger of two corporations engaged in selling and distributing propane.

***Evans J.A.*:**

A. INTRODUCTION

1 This is an appeal from a decision of the Competition Tribunal ("the Tribunal"), dated August 30, 2000, dismissing an application by the Commissioner of Competition ("the Commissioner") for an order to dissolve the merger of the respondents, Superior Propane Inc. and ICG Propane Inc., or otherwise to remedy the lessening of competition likely to occur in the propane delivery market in Canada as a result of the merger.

[1]

2 The appeal raises a question of fundamental importance to the administration of the *Competition Act* that has been the subject of vigorous debate among economists and lawyers in Canada and elsewhere. Indeed, the issue is one on which the Commissioner, and his predecessor, the Director of Investigation and Research, Bureau of Competition Policy, have at different times propounded more than one view. However, the volume of the literature to which it has given rise far exceeds that of the jurisprudence and, prior to the decision under appeal, the question had been the subject of judicial comment in only one case.

3 The question concerns the scope of the so-called "efficiency defence". Under this statutory defence, a merger must be permitted, even though it is likely to prevent or substantially lessen competition in a particular market, if the efficiency gains flowing from the merger are greater than, and offset, the effects of the lessening of competition.

4 The precise issue raised by this appeal is whether, for the purpose of the efficiency defence, the "effects" of an anti-competitive merger are limited as a matter of law to the loss of resources to the economy as a whole (the deadweight loss), or whether they include a wider range of the effects of a substantial lessening of competition. The latter would include the wealth transfer from consumers to producers that occurs when the merged entity exercises its market power to increase prices above competitive levels, the elimination of smaller competitors from the market, and the creation of a monopoly.

5 The Tribunal held that the merger would substantially lessen or prevent competition in nearly all local propane markets in Canada, as well as in the market for national account coordination services associated with the delivery of propane. The total divestiture by Superior of all of ICG's shares and assets was found to be the only appropriate remedy to prevent this. However, by a majority the Tribunal also concluded that, since the merger was likely to result in efficiency gains of $29.2 million, and would result in only $3.0 million of quantitative deadweight loss and $3.0 million of qualitative deadweight loss, the merger was saved by the efficiency defence contained in the *Competition Act.*

6 Using the "total surplus standard", the Tribunal concluded that the deadweight loss was the sole "effect" of the lessening of competition that must be balanced against the efficiency gains. Accordingly, the Tribunal treated as irrelevant all other effects, including the size of the wealth transfer from consumers to Superior as a result of the higher than competitive market prices that Superior was likely to charge for propane as a result of the merger.

B. LEGISLATIVE FRAMEWORK

7 The statutory provisions relevant to this appeal are as follows:

Competition Act, R.S.C. 1985, c. C-34

1.1 The purpose of this Act is to maintain and encourage competition in Canada in order to promote the efficiency and adaptability of the Canadian economy, in order to expand opportunities for Canadian participation in world markets while at the same time recognizing the role of foreign competition in Canada, in —order to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the Canadian economy and in order to provide consumers with competitive prices and product choices.	1.1 La présente loi a pour objet de préserver et de favoriser la concurrence au Canada dans le but de stimuler l'adaptabilité et l'efficience de l'économie canadienne, d'améliorer les chances de participation canadienne aux marchés mondiaux tout en tenant simultanément compte du rôle de la— concurrence étrangère au Canada, d'assurer à la petite et à la moyenne entreprise une chance honnête de participer à l'économie canadienne, de même que dans le but d'assurer aux consommateurs des prix compétitifs et un choix dans les produits.
92. (1) Where, on application by the Commissioner, the Tribunal finds that a merger or proposed merger prevents	92. (1) Dans les cas où, à la suite d'une demande du commissaire, le Tribunal

or lessens, or is likely to prevent or lessen, competition substantially——(*a*) in a trade, industry or profession,—(*b*) among the sources from which a trade, industry or profession obtains a product,—(*c*) among the outlets through which a trade, industry or profession disposes of a product, or—(*d*) otherwise than as described in paragraphs (*a*) to (*c*),—the Tribunal may, subject to sections 94 to 96,—(*e*) in the case of a completed merger, order any party to the merger or any other person—(i) to dissolve the merger in such manner as the Tribunal directs,—(ii) to dispose of assets or shares designated by the Tribunal in such manner as the Tribunal directs, or—...—————————(2) For the purpose of this section, the Tribunal shall not find that a merger or proposed merger prevents or lessens, or is likely to prevent or lessen, competition substantially solely on the basis of evidence of concentration or market share.

conclut qu'un fusionnement réalisé ou proposé empêche ou diminue sensiblement la concurrence, ou aura vraisemblablement cet effet_:—*a*) dans un commerce, une industrie ou une profession;—*b*) entre les sources d'approvisionnement auprès desquelles un commerce, une industrie ou une profession se procure un produit;—*c*) entre les débouchés par l'intermédiaire desquels un commerce, une industrie ou une profession écoule un produit;—*d*) autrement que selon ce qui est prévu aux alinéas a) à c),—le Tribunal peut, sous réserve des articles 94 à 96_:—*e*) dans le cas d'un fusionnement réalisé, rendre une ordonnance enjoignant à toute personne, que celle-ci soit partie au fusionnement ou non_:—(i) de le dissoudre, conformément à ses directives,—(ii) de se départir, selon les modalités qu'il indique, des éléments d'actif et des actions qu'il indique,—...——(2) Pour l'application du présent article, le Tribunal ne conclut pas qu'un fusionnement, réalisé ou proposé, empêche ou diminue sensiblement la concurrence, ou qu'il aura vraisemblablement cet effet, en raison seulement de la concentration ou de la part du marché.

96. (1) The Tribunal shall not make an order under section 92 if it finds that the merger or proposed merger in respect of which the application is made has brought about or is likely to bring about gains in efficiency that will be greater than, and will offset, the effects of any prevention or lessening of competition that will result or is likely to result from the merger or proposed merger and that the gains in efficiency would not likely be attained if the order were made.————(2) In considering whether a merger or proposed merger is likely to bring about gains in efficiency described in subsection (1), the Tribunal shall consider whether such gains will result in——(*a*) a significant increase in the real value of exports; or—(*b*) a significant substitution of domestic products for imported products.———(3) For the purposes of this section, the Tribunal shall not find that a merger or proposed merger has brought about or is likely to bring about gains in efficiency by reason only of a redistribution of income between two or more persons.—

96. (1) Le Tribunal ne rend pas l'ordonnance prévue à l'article 92 dans les cas où il conclut que le fusionnement, réalisé ou proposé, qui fait l'objet de la demande a eu pour effet ou aura vraisemblablement pour effet d'entraîner des gains en efficience, que ces gains surpasseront et neutraliseront les effets de l'empêchement ou de la diminution de la concurrence qui résulteront ou résulteront vraisemblablement du fusionnement réalisé ou proposé et que ces gains ne seraient vraisemblablement pas réalisés si l'ordonnance était rendue.——(2) Dans l'étude de la question de savoir si un fusionnement, réalisé ou proposé, entraînera vraisemblablement les gains en efficience visés au paragraphe (1), le Tribunal évalue si ces gains se traduiront_:—*a*) soit en une augmentation relativement importante de la valeur réelle des exportations;—*b*) soit en une substitution relativement importante de produits nationaux à des produits étrangers.——(3) Pour l'application du présent article, le Tribunal ne conclut pas, en raison seulement d'une redistribution de revenu entre

plusieurs personnes, qu'un fusionnement réalisé ou proposé a entraîné ou entraînera vraisemblablement des gains en efficience.

Competition Tribunal Act, R.S.C. 1985, c. 19 (2nd Supp.)

2. "judicial member" means a member of the Tribunal appointed under paragraph 3(2)(a).

2. *juge+ Membre du Tribunal nommé en application de l'alinéa 3(2)a).

3. (1) There is hereby established a tribunal to be known as the Competition Tribunal.——(2) The Tribunal shall consist of—(*a*) not more than four members to be appointed from among the judges of the Federal CourtCTrial Division by the Governor in Council on the recommendation of the Minister of Justice; and(*b*) not more than eight other members to be appointed by the Governor in Council on the recommendation of the Minister.——(3) The Governor in Council may establish an advisory council to advise the Minister with respect to appointments of lay members, which council is to be composed of not more than ten members who are knowledgeable in economics, industry, commerce or public affairs and may include, without restricting the generality of the foregoing, individuals chosen from business communities, the legal community, consumer groups and labour.————(4) The Minister shall consult with any advisory council established under subsection (3) before making a recommendation with respect to the appointment of a lay member.

3. (1) Est constitué le Tribunal de la concurrence.———(2) Le Tribunal se compose_:—*a*) d'au plus quatre membres nommés par le gouverneur en conseil sur recommandation du ministre de la Justice et choisis parmi les juges de la Section de première instance de la Cour fédérale;—*b*) d'au plus huit autres membres nommés par le gouverneur en conseil sur recommandation du ministre.———(3) Le gouverneur en conseil peut constituer un conseil consultatif chargé de conseiller le ministre en ce qui concerne la nomination des autres membres et composé d'au plus dix personnes versées dans les affaires publiques, économiques, commerciales ou industrielles. Sans que soit limitée la portée générale de ce qui précède, ces personnes peuvent être des individus appartenant à la collectivité juridique, à des groupes de consommateurs, au monde des affaires et au monde du travail.——(4) Avant de recommander la nomination d'un autre membre, le ministre demande l'avis du conseil consultatif constitué en application du paragraphe (3).

10. (1) Subject to section 11, every application to the Tribunal shall be heard before not less than three or more than five members sitting together, at least one of whom is a judicial member and at least one of whom is a lay member.

10. (1) Sous réserve de l'article 11, toute demande présentée au Tribunal est entendue par au moins trois mais au plus cinq membres siégeant ensemble et, parmi lesquels il doit y avoir au moins un juge et un autre membre.

12. (1) In any proceedings before the Tribunal,—(*a*) questions of law shall be determined only by the judicial members sitting in those proceedings; and—(*b*) questions of fact or mixed law

12. (1) Dans toute procédure devant le Tribunal_:—*a*) seuls les juges qui siègent ont compétence pour trancher les questions de

and fact shall be determined by all the members sitting in those proceedings.——13. (1) Subject to subsection (2), an appeal lies to the Federal Court of Appeal from any decision or order, whether final, interlocutory or interim, of the Tribunal as if it were a judgment of the Federal CourtCTrial Division.——(2) An appeal on a question of fact lies under subsection (1) only with the leave of the Federal Court of Appeal.	droit;—*b*) tous les membres qui siègent ont compétence pour trancher les questions de fait ou de droit et de fait.———13. (1) Sous réserve du paragraphe (2), les décisions ou ordonnances du Tribunal, que celles-ci soient définitives, interlocutoires ou provisoires, sont susceptibles d'appel devant la Cour d'appel fédérale tout comme s'il s'agissait de jugements de la Section de première instance de cette Cour.—(2) Un appel sur une question de fait n'a lieu qu'avec l'autorisation de la Cour d'appel fédérale.

C. THE TRIBUNAL'S DECISION

8 The Tribunal heard this matter over 48 days; 39 days were devoted to hearing from 91 witnesses, including 17 experts, at least 10 of whom have a Ph.D. in economics, while submissions from counsel took another 9 days. The reasons for decision of the majority of the Tribunal (the presiding judicial member, Nadon J., and one of the lay members, Dr. Schwartz, an economist) run to some 469 paragraphs. There are also substantial dissenting reasons by the second lay member, Ms. Lloyd, covering, in part, issues that lie at the heart of this appeal.

9 The first 317 paragraphs of the majority's reasons, written by Nadon J., deal at length with whether the merger would prevent or substantially lessen competition within the meaning of section 92 of the *Competition Act*. The Tribunal was unanimous in concluding that it would and, since the Tribunal's conclusion on this is not the subject of appeal, I can deal with its findings relatively briefly.

10 First, the Tribunal found that the merger would not substantially lessen competition in only 8 of 74 local markets for the supply of propane: paragraph 307 of the Reasons. At the other extreme, in 16 markets the merged entity would have a monopoly or near monopoly, that is, a market share ranging from 97% to 100%: paragraph 306. And, in another 16 markets, where there was already substantial market concentration, the merger would remove healthy competition: paragraph 308. The remaining 33 markets were in an intermediate category in that, while Superior and ICG were the largest sellers of propane, and the merger was likely to lessen competition substantially, competition from other suppliers would continue after the merger: paragraph 309. Finally, the Tribunal found that the merger would lessen competition substantially in the coordination services offered to national account customers, leaving the merged entity as the only firm in Canada serving this market: paragraph 310.

11 Second, the demand for propane is fairly inelastic, that is, consumers are relatively insensitive to price increases. Although some consumers purchase propane for less than essential purposes, such as heating their swimming pools, most purchase it for home heating, automotive fuel and industrial purposes. Consequently, propane is not a discretionary item that most consumers can choose to forego.

12 Moreover, the cost of switching from propane to an alternative form of fuel is relatively high. For example, consumers who purchase propane to heat their homes will normally be deterred from substituting oil as a heating fuel by the considerable expense of converting to an oil burning furnace unless, for instance, their furnace is at the end of its useful life: paragraphs 24-25.

13 Third, relatively high barriers to entry face potential competitors in the market and hence increase the ability of the merged entity to raise prices above the competitive level. For example, consumers are often required to sign exclusive supply contracts stipulating that for five years they will purchase propane exclusively from the supplier and that, in the case of Superior, when the contract expires, consumers will give the supplier the right of first refusal. These supply contracts often contain lengthy notice of termination clauses that, in the case of ICG, require consumers to give 180 days notice prior to the termination date of the contract. In the absence of such notice, the contract is automatically renewed: paragraphs 132-146.

14 Another factor that makes switching suppliers difficult and costly is that the supplier, rather than the consumer, typically owns the propane tank: paragraph 147. In addition, a reputation for reliable delivery is an important factor in this market and consumers are therefore reluctant to switch to a new supplier with no established reputation: paragraph 154. Finally, new entrants are also likely to be discouraged by the maturity of the market; that is, there is little potential for growth in the demand for propane: paragraph 158.

15 In support of these findings on market entry barriers, the Tribunal noted that, when Imperial Oil Limited, a very large corporation, entered the market for propane distribution in 1990, it withdrew after nine years because market barriers made the venture uneconomic. Since then, no other entrants of comparable size or stature have materialized: paragraph 153.

16 On the basis of considerations of the kind noted above, the Tribunal concluded that, as a result of the merger, the merged entity was likely to increase the price of propane by an average of 8%: paragraphs 252-253. Having found that the merger would lead to a substantial lessening of competition contrary to section 92, the Tribunal concluded that only a total divestiture by Superior of all ICG's assets and shares would restore competition to the pre-merger level: paragraphs 314 and 316.

17 The Tribunal then proceeded to a consideration of the efficiency defence under section 96. It held that the merging parties had the burden of proving the efficiencies that would not have been generated but for the merger, while the Commissioner bore the burden of proving the anti-competitive effects, since he was in the better position to do so by virtue of the investigative powers conferred on him by the Act: paragraph 403. The merging parties had the burden of establishing that the resulting efficiencies would be greater than and offset the anti-competitive effects of the merger.

18 The majority calculated the net efficiency savings that would result from the merger, and could not have been achieved by other means, to be $29.2 million in each of the next ten years: paragraph 383. Ms. Lloyd dissented from the majority's view on this issue and held that the evidence before the Tribunal was insufficient to support this figure: paragraph 470. However, there is no appeal from this aspect of the Tribunal's decision and it is unnecessary to say more about it here.

19 Having made its entry on the "efficiency" side of the ledger, the Tribunal then considered the "effects" that would result from the "lessening or prevention of competition" if the merger was approved. The submissions and evidence before the Tribunal on this question went to two issues: the definition of "effects" for the purpose of section 96 and their quantification. The principal question in this appeal concerns the Tribunal's conclusion on the first of these issues.

20 The Tribunal had before it evidence describing various methodologies developed by economists for determining the effects of an anti-competitive merger. I should make it clear that the various standards considered by the Tribunal are, for the most part, the work of economists in the United States, and have been used as a basis for competition policy prescriptions. However, antitrust law in the United States does not have an efficiency defence comparable to section 96, although efficiencies are taken into consideration by the Federal Trade Commission when scrutinising a merger, along with other factors, including the likely wealth transfer from consumers to producers likely to result from it.

21 Two of the methodologies for determining when efficiency gains offset the adverse effects of an anti-competitive merger are likely to give a narrow scope to the efficiency defence. For example, under the "price standard" efficiencies will only justify an anti-competitive merger if they result in price decreases or, at least, do not increase prices. This is the most difficult standard for the parties to a merger to satisfy, and is the standard normally applied by the Federal Trade Commission as the basis for approving an anti-competitive merger: *Horizontal Merger Guidelines* (Department of Justice and Federal Trade Commission; April 2, 1992, revised April 8, 1997), pages 148-50.

22 The "consumer surplus standard" posits that a merger should be permitted only if the resulting efficiency gains exceed the sum of the wealth transferred to the producers and the deadweight loss occasioned by increases in price charged by the merged entity. In practice, this standard will also be difficult to establish and consequently will tend to narrow the availability of the efficiency defence.

23 On the basis of a report prepared for the Commissioner by an expert witness, Dr. Peter Townley, a professor of economics at Acadia University, counsel for the Commissioner submitted that the Tribunal should adopt a "balancing weights standard" as the basis for determining whether the efficiency gains from the merger of Superior and ICG were greater than, and offset, its anti-competitive effects.

24 Using this methodology, the Tribunal would determine the anti-competitive effects of a merger by taking into account a range of factors, but would not assign to each a fixed, *a priori* weight. The factors include: the deadweight loss; the wealth transfer from consumers resulting from the increase in prices through the exercise of market power; the loss of product choices and services currently associated with the product; and the prevention of competition and the creation of a monopoly or near monopoly in some or all of the relevant markets: paragraphs 386-387 and 431.

25 The Tribunal rejected this approach in favour of the "total surplus standard" which looks only at the overall loss to the economy as a result of the fall in demand for the merged entity's products following a post-merger increase in price, and the inefficient allocation of resources that occurs when, as prices rise, consumers purchase a less suitable substitute. The resulting loss of resources to the economy constitutes deadweight loss.

26 The Tribunal relied on the analyses of leading economists and of "law and economics" scholars, mainly from the United States, but also from Canada, in support of the "total surplus standard". Under this standard, an anti-competitive merger is allowed to proceed when efficiency gains exceed deadweight loss. Its rationale is that this standard measures the net increase or loss in general welfare as a result of the merger. In addition, it provides a predictable standard for merger review, and hence firms are not deterred from effecting mergers that will increase total economic resources by an inability to predict whether their merger will receive regulatory approval.

27 Under the total surplus standard, the wealth likely to be transferred from consumers to producers as a result of the merger is not considered to be an anti-competitive effect, because such a transfer is neutral: that is, it neither increases, nor decreases total societal wealth. Proponents of the total surplus standard argue that there is no economic reason for favouring a dollar in the hands of consumers of the products of the merged entity over a dollar in the hands of the producers or its shareholders, who are, after all, also consumers. Moreover, in the absence of complete data on the socio-economic profiles of the consumers and of the shareholders of the producers, it would be impossible to assess whether the redistributive effects of the wealth transferred as a result of the higher prices charged by the merged entity would be fair and equitable: paragraphs 423-425.

28 The Tribunal concluded that, properly interpreted, section 96 of the *Competition Act* mandates a methodology for determining the effects to be balanced against efficiency gains that ignores wealth transfers, or distributive effects, and focusses exclusively on the extent to which the merger increases net wealth in the economy as a whole. The reasons that the Tribunal advanced for its conclusion can be summarized as follows.

29 First, even if the necessary data were available, an assessment of the merits, or otherwise, of the distributive effects of a merger is a political task best performed by elected politicians, not by members of the Tribunal, who are appointed for their expertise in economics or commerce: paragraphs 431-432 and 438.

30 Second, since section 96 allows an anti-competitive merger where the efficiencies gained thereby are greater than, and offset, the effects of the lessening of competition, efficiency "was Parliament's paramount objective in passing the merger provisions of the Act": paragraph 437. Therefore, "effects" in section 96 should be interpreted in a way that best attains that objective. This excludes an interpretation that requires, or permits, distributive or other effects of a merger to be considered that are unrelated to the maximization of total societal wealth: paragraphs 411-413, 426 and 432.

31 Third, if business people are unable to predict whether the Commissioner or the Tribunal is likely to conclude that the efficiencies to be gained from a proposed merger will exceed, and offset, the adverse effects of the merger as calculated by the balancing weights standard, they will be deterred from merging, to the detriment of the economy as a whole: paragraph 433.

32 Accordingly, in the Tribunal's view, the difficulty of applying the balancing weights standard advanced by the Commissioner militates against its adoption. Indeed, even though Professor Townley favoured this approach he conceded in his evidence that, as an economist, he could not advise the Tribunal what weights to assign to the various factors to be considered. Hence, he could not say whether the efficiency gains from the merger of Superior and ICG were greater than and offset its effects.

33 Fourth, the Tribunal noted that in the *Merger Enforcement Guidelines* ("*MEG*") (Director of Investigation and Research, Information Bulletin No. 5, March 1991 (Supply and Services Canada, 1991)), which had been in force since 1991, the Commissioner had indicated that the effects of an anti-competitive merger were to be assessed for the purpose of section 96 by the total surplus standard.

34 Indeed, even after the appropriateness of the total surplus standard had been questioned by Reed J. when sitting as the judicial member of the Tribunal in *Canada (Director of Investigation & Research) v. Hillsdown Holdings (Canada) Ltd.* (1992), 41 C.P.R. (3d) 289 (Competition Trib.), the predecessor of the current Commissioner publicly reaffirmed the position taken in the *MEG*. In *Hillsdown*, *supra*, Reed J. had doubted (at page 339) whether an interpretation of "effects", such as that contained in the MEG, that omitted from consideration the wealth transferred from consumers to producers was consistent with the purposes of the Act.

35 Fifth, the Tribunal stated that the purpose and objectives section of the *Competition Act*, section 1.1, should not be read as requiring each of the objectives listed in it to be considered in the context of identifying the effects of a merger for the purpose of section 96. Rather, the references in section 1.1 to the Act's objectives, such as promoting "the efficiency and adaptability of the Canadian economy", ensuring that "small and medium-sized enterprises have an equitable opportunity to participate in the Canadian economy", and providing "consumers with competitive prices and product choices" should be regarded as no more than statements of the beneficial results of attaining the stated purpose of the Act, namely "to promote and encourage competition in Canada". Further, to the extent that there was a conflict between the general provision, section 1.1, and the specific, section 96, the latter should prevail: paragraphs 408-410.

36 The dissenting member of the Tribunal took issue with much of the majority's reasoning on the meaning of "effects" in section 96. In Ms. Lloyd's view, any interpretation of section 96 that excluded from "effects" the wealth transfer from consumers to producers likely to result from an anti-competitive merger was inconsistent with the objectives of the Act: paragraph 506.

37 She concluded that a flexible approach that enabled the Tribunal to take into account, along with other factors, the wealth transfer, both quantitatively and qualitatively, was more compatible with the statutory scheme, particularly in so far as its objectives include "to provide consumers with competitive prices and product choices": paragraph 511. Ms. Lloyd summarized (at paragraph 506) her position as follows:

> While I recognize that efficiencies are given special consideration under section 96 and may constitute a defence to an otherwise anti-competitive merger, it appears to me that section 96 is an *exception to the application of section 92 of the Act and not an exception to the Act itself.* (Emphasis added)

D. THE ISSUES

[38] The appeal raises three issues for the Court to decide.

[1]

(1) What standard of review is applicable to the Tribunal's determination of the "effects" of a merger to be considered under section 96?

(2) Did the Tribunal err in law when it interpreted "effects" as limited to those identified by the total surplus standard?

(3) Did the Tribunal err in law when it imposed on the Director the legal burden of proving the effects of the merger?

E. ANALYSIS

Issue 1: The Standard of Review

39 It was common ground between counsel that, in view of the Supreme Court of Canada's decision in *Canada (Director of Investigation & Research) v. Southam Inc.*, [1997] 1 S.C.R. 748 (S.C.C.), if the Tribunal's interpretation of the word, "effects", was entitled to any deference, the less deferential standard of reasonableness *simpliciter* would be appropriate.

40 The disputed question was, of course, whether any deference was due at all. In my view, the answer is to be found, for the most part, in the reasoning in *Southam, supra*, which also concerned the Tribunal, and in *Pushpanathan v. Canada (Minister of Employment & Immigration)*, [1998] 1 S.C.R. 982 (S.C.C.), which is an important, comprehensive and general elaboration of the pragmatic and functional analysis for determining the standard of judicial review of administrative action.

41 I turn, then, to an examination of the elements of the pragmatic and functional analysis as they apply to the case before us. A consensus seems to have emerged in the jurisprudence that the expertise of the tribunal under review, and the relevance of that expertise to resolving the issues in dispute, will normally be the most important of the pragmatic or functional factors considered in determining the standard of review: *Pushpanathan* , *supra*, at pages 1006-07, paragraph 32. I deal first with the nature of the issue decided by the Tribunal in this case.

(i) The nature of the issue decided by the Tribunal

42 In holding that the meaning of the word, "effects", in section 96 is limited to the deadweight loss resulting from an anti-competitive merger, the Tribunal was clearly interpreting the Act and was thereby deciding a question of law.

43 This is because the Tribunal's ruling purports to be of general application to all cases in which the efficiency defence is invoked. The Tribunal did not confine itself merely to identifying the factors to be considered or not considered in this case, nor to prescribing a methodology for determining only the "effects" of Superior's merger with ICG. Instead, the Tribunal makes it abundantly clear in its reasons that, as a matter of interpretation, the word, "effects", means *only* deadweight loss and that the efficiency defence is, *in all cases*, simply a codification of the total surplus standard.

44 For instance, based on its conclusion that section 96 encapsulates the total surplus standard, the Tribunal made the following findings with respect to the meaning of "the effects" of an anti-competitive merger:

[423] The economic effects of an anti-competitive merger are the effects on real resources, that is, the changes in the way the economy deploys those resources as the result of the merger.

[427] Assessing a merger's effects in this way is generally called the "total surplus standard". ...transfers from consumers to shareholders are not counted as losses under the total surplus standard. The anti-competitive effect of the merger is measured solely by the deadweight loss ... Under the total surplus standard, efficiencies need only exceed the deadweight loss to save an anti-competitive merger.

[430] ... The only standard that addresses solely the effects of a merger on economic resources is the total surplus standard.

[447] The Tribunal further believes that the only effects that can be considered under subsection 96(1) are the effects on resource allocation, as measured in principle by the deadweight loss which takes both quantitative and qualitative effects into account. Accordingly, the Tribunal believes that the total surplus standard is the correct approach for analysing the effects of a merger under subsection 96(1).

Since none of these statements was made with reference to the particular facts of the case, the Tribunal must have intended its view of the meaning of the word, "effects", to apply whenever the section 96 efficiency defence is raised.

45 Referring to the task of distinguishing the *interpretation* of a statutory standard (normally a question of law) from its *application* to the facts of a case (often a question of mixed fact and law), Iacobucci J. said in *Southam*, *supra* (at page 768, paragraph 37):

Of course, it is not easy to say precisely where the line should be drawn; though in most cases it should be sufficiently clear whether the dispute is over a general proposition that might qualify as a principle of law or over a very particular set of circumstances that is not apt to be of much interest to judges and lawyers in the future.

In a similar vein (*supra*, at page 767, paragraph 36), he had characterised a question as one of law "because the point in controversy was one that might potentially arise in many cases in the future."

46 Applying these observations to this case, I am of the view that, since the Tribunal's determination of what can be considered as an "effect" of the merger of Superior and ICG was intended to be of general application, it would be of "much interest to judges and lawyers", because other panels of the Tribunal will regard it as a legal proposition having considerable persuasive authority whenever they have to consider the efficiency defence under section 96. To use another of Iacobucci J.'s felicitous phrases (*Southam*, *supra*, at page 771, paragraph 45), the Tribunal in this case clearly "forged new legal principle".

(ii) The expertise of the Tribunal

47 Since the ultimate issue in determining the standard of review is whether the legislature should be taken to have intended the specialist administrative tribunal or the courts to bear primary responsibility for determining the question in dispute, it must be understood that "expertise" is a relative, not an absolute concept: *C.J.A., Local 579 v. Bradco Construction Ltd.*, [1993] 2 S.C.R. 316 (S.C.C.), at page 335. In assessing the relative expertise of the Tribunal and the Court, I have had regard to the following considerations.

48 First, the Tribunal is an adjudicative body. Just as it has done with the administration of human rights legislation, Parliament has divided responsibility for administering the *Competition Act* between the Competition Bureau, the policy-making, investigative and enforcement agency, headed now by the Commissioner, and the Tribunal, the adjudicative agency. In this respect, the Tribunal is different from multi-functional administrative agencies, such as securities commissions in many provinces, which typically have wide powers that match their regulatory mandate. The absence of broad policy development powers is a factor that limits the scope of the Tribunal's expertise: *Pezim v. British Columbia (Superintendent of Brokers)*, [1994] 2 S.C.R. 557 (S.C.C.), at page 596.

49 Second, expertise may be assessed by reference to the composition of an administrative tribunal. Hearings of the Tribunal are conducted before three to five members, at least one of whom must be a judicial member and one a lay member: *Competition Tribunal Act ("CTA")*, subsection 10(1). This case was heard by three members: the presiding judicial member and two lay members.

50 The judicial member is one of the maximum of four judges of the Trial Division of the Federal Court whom the Governor in Council may appoint to the Tribunal on the recommendation of the Minister of Justice: *CTA,* paragraph 3(2)(*a*). In addition to presiding at hearings of the Tribunal, the judicial member alone decides any questions of law that arise before the Tribunal: *CTA*, paragraph 12(1)(*a*).

[1]

51 I note that in the *Hillsdown* case *(supra*, at page 337, note 21), Reed J. made it clear that the validity of the definition in the *MEG*of "effects" involved the interpretation of section 96, and was thus a question of law alone. Hence, the Tribunal's reasons on this issue expressed her view as the judicial member of the Tribunal.

52 In contrast, Nadon J. does not state that his determination of the meaning of "effects" is solely his decision. However, since the Act gives to the judicial member sole responsibility for deciding questions of law, the standard of review cannot depend on whether, in a particular case, the lay member's participation in the decision on the legal issue extended beyond consultation.

53 A maximum of eight lay members are also appointed to the Tribunal by the Governor in Council on the recommendation of the Minister of Industry: *CTA*, paragraph 3(2)(*b*). No qualifications are prescribed for lay members. However, before making a recommendation, the Minister must consult with an Advisory Council comprising not more than ten members, who, the *CTA*, subsection 3(3) provides, are appointed from those

[1]

...who are knowledgeable in economics, industry, commerce or public affairs and may include, without restricting the generality of the foregoing, individuals chosen from business communities, the legal community, consumer groups and labour.	... personnes versées dans les affaires publiques, économiques, commerciales ou industrielles. Sans que soit limitée la portée générale de ce qui précède, ces personnes peuvent être des individus appartenant à la collectivité juridique, à des groupes de consommateurs, au monde des affaires et au monde du travail.

54 It is reasonable to infer from this provision that the Council was expected to recommend the appointment of lay members with a breadth of experience similar to that of the Advisory Council members themselves. Thus, members' fields of expertise need not be limited to economics, but may extend more broadly to public affairs. Further, their perspectives may include not only those of the business communities, including small and medium-sized business, but also of consumer groups and labour.

55 Questions of fact, and of mixed fact and law, are decided by all of the members of the panel of the Tribunal hearing a matter: *CTA*, paragraph 12(1)(*b*). In addition, even though the judicial member alone decides questions of law, the judicial member may well make his or her rulings after discussing the issues with the lay members and benefiting from whatever contribution they are able to make to the resolution of the legal issue from their perspective and on the basis of their expertise. After all, questions of law are rarely decided in the abstract, and generally require that careful consideration be given to the likely practical consequences and implications of deciding them one way rather than another.

56 In short, the composition of the Tribunal indicates a considerable level of expertise. This Court does not defer to decisions of the Trial Division of this Court on questions of law: *Harvard College v. Canada (Commissioner of Patents)*, [2000] 4 F.C. 528 (Fed. C.A.), at paragraph 180 (F.C.A). However, the fact that no more than four members of the Court may be appointed as judicial members suggests that, when sitting as the judicial member of the Tribunal and having the assistance of the lay members, a judge of the Trial Division can be expected to have a level of expertise or experience in this area of the law over and above that acquired by a judge in the ordinary course of judicial work. Nor do I disregard the importance of the understanding of the issues in dispute in this case that the Tribunal would have obtained after conducting 48 days of hearings.

57 Indeed, on more than one occasion, the Supreme Court of Canada has recognized (*Southam, supra,* at pages 772-73, paragraph 49) that the Tribunal

> is especially well suited to the task of overseeing a complex statutory scheme whose objectives are peculiarly economic.
>
> Iacobucci J. also noted in that case that, since the aims of the *Competition Act* are "more 'economic' than 'legal' (*supra*, at page 772, paragraph 48), it was appropriate to conclude that "the Tribunal's expertise lies in economics and commerce" (*supra*, at page 773, paragraph 51).

(iii) A question of law within the Tribunal's expertise?

58 Counsel for the respondents submitted that characterising a question decided by an administrative tribunal as one of statutory interpretation, and therefore one of law, is not necessarily determinative of the standard of review: see *Pushpanathan*

, *supra*, at page 1008, paragraph 34. However, it seems to me an obvious inference from the reasons for judgment of Iacobucci J. in *Southam, supra,*that, when all the factors in the pragmatic or functional mix are weighed together, the fact that the Tribunal in the case before us was deciding a question of law with a high degree of generality tips the scale in the direction of correctness as the applicable standard of review.

59 Thus, speaking at the level of principle, Iacobucci J. said (*supra*, at page 769, paragraph 39) that, if a decision-maker fails to consider all the factors that the legislature required to be considered, "then the decision-maker has in effect applied the wrong law, and so has made an error of law." And, turning to the Tribunal in particular, he said (*supra*, at page 769, paragraph 41): "If the Tribunal did ignore evidence that the law requires it to consider, then the Tribunal erred in law."

60 In my view, there is nothing about the word, "effects", to exclude the general principle that, in the absence of indicators to the contrary, statutory interpretation is a question of law that is reviewable on a standard of correctness. As Bastarache J. said in *Pushpanathan* (*supra*, at page 1012, paragraph 38):

> Without an implied or express legislative intent to the contrary ... legislatures should be assumed to have left highly generalized propositions of law to courts.

61 Thus, as a linguistic matter, the word, effects, does not suggest an implicit delegation of authority to the Tribunal to determine what factors must, and must not, be considered in determining what they are. If, as seems to be the case on the basis of the reasoning in *Southam, supra*, Iacobucci J. would have regarded a general proposition advanced by the Tribunal about the meaning of the word, "market", as subject to review for correctness, the same would seem equally true of the phrase, "the effects of any prevention or lessening of competition". Nor am I persuaded by counsel for the respondents that in *Southam* (*supra*, at pages 789-90, paragraphs 83-85) Iacobucci J. applied a standard other than correctness to the Tribunal's determination that the test for the remedy was the restoration of the parties to the pre-merger competitive position.

62 Moreover, an important element of the Tribunal's reasoning was its view of the statutory objectives provision of the *Competition Act*, section 1.1, and the relationship of that section to section 96. This is an issue of statutory interpretation of a kind with which courts are accustomed to dealing in the course of their ordinary work.

63 In short, I am not satisfied that Nadon J.'s expertise in competition law in general, and in the complexities of the merger of Superior and ICG in particular, gave him such a significant interpretative advantage over members of this Court as clearly to indicate Parliament's intention that the standard of review on the issue in dispute here should be that of unreasonableness. At the end of the day, the question of what count as "the effects of any prevention or lessening of competition" must be decided within the parameters of the Act, including its stated objectives. While economic expertise undoubtedly elucidates the strengths, weaknesses and consequences of the various choices available, it cannot be determinative of which of them, if any, is compatible with the *Competition Act*.

(iv) The Tribunal's constitutive statute and the scope of judicial review

64 Finally, the provisions of an administrative tribunal's constitutive statute respecting the grounds of judicial review, or the existence and scope of any right of appeal, may give some indication of the legislature's intention on the standard of review to be applied by a court to the tribunal's decisions.

65 At the one extreme, a strong preclusive clause, such as the bundle of exclusive jurisdiction, finality and "no *certiorari*" clauses typically found in the statutory schemes administered by labour relations boards, is indicative of a legislative intent to keep judicial review to a minimum. Hence, patent unreasonableness is generally the standard of review applied to labour boards' interpretation of the legislation that they administer.

66 At the other end of the spectrum are statutory rights of appeal that empower the appellate court to exercise any of the powers of the tribunal, direct the tribunal to take any action that the court considers proper and, for this purpose, to substitute its opinion for that of the tribunal. Rights of appeal from decisions of discipline committees of professional regulatory bodies are often of this kind.

67 There is a right of appeal from any decision of the Tribunal to this Court "as if it were a judgment of the Federal Court B Trial Division", except that, when the appeal is on a question of fact, leave of the Federal Court of Appeal is required: *CTA*, subsections 13(1) and (2). Section 27 of the *Federal Court Act*, R.S.C. 1985, c. F-7, imposes no limitations on the scope of the right of appeal from final judgments of the Trial Division to the Court of Appeal.

68 In my opinion, although expeditious decision-making is undoubtedly important in the review of mergers, the existence of an unrestricted right of appeal on questions of law, and of a modified right of appeal on questions of fact, must be entered as a factor indicative of Parliament's intention that the Tribunal's determinations of questions of law should be reviewable on appeal on a correctness standard.

(v) Conclusion

69 After weighing the factors to be considered in the pragmatic or functional analysis, and carefully examining the reasons for judgment in *Southam*, *supra*, I have concluded that it is the Court's function to determine whether the Tribunal was correct to decide that the effects of an anti-competitive merger that may be considered under section 96 are limited to the loss of resources to the economy as a whole resulting from the merger, to the exclusion of effects that relate to other statutory objectives, such as the wealth transfer from consumers to producers as a result of price increases, and the impact on competing small and medium sized businesses. A proposition of such generality is, to my mind, clearly a question of law.

70 I am not persuaded that, on an appeal to this Court, either the expertise of the Tribunal, or the degree of indeterminacy inherent in the word, "effects", indicates that the Court should review the Tribunal's decision on this issue on a standard other than that of correctness.

71 As Iacobucci J. noted in *Southam*, (*supra*, at pages 774-75, paragraph 53) with respect to the statutory requirement for, and to the role of, a judicial member of the Tribunal:

> Clearly it was Parliament's view that questions of competition law are not altogether beyond the ken of judges.
>
> This comment seems applicable also to the judges of this Court.
>
> [72] The composition of the Tribunal, and the rights of appeal from its decisions, reflect a carefully constructed compromise between assigning competition law exclusively to the domain of the judiciary, and entrusting it to a "non-judicial" regulatory agency, such as the Federal Trade Commission of the United States, which would operate subject to minimal judicial supervision: *Canada (Director of Investigation & Research) v. Southam Inc.*, [1995] 3 F.C. 557 (Fed. C.A.), at page 604 (*per* Robertson J.A.).

Issue 2: The Meaning of Effects in Section 96

73 The issue here is whether the Tribunal was correct in its interpretation of the phrase, "the effects of the prevention or lessening of competition ...", when it limited the relevant effects of the anti-competitive merger to those determined by the application of the total surplus standard. In my view, by so limiting the factors to be considered as "effects", the Tribunal erred in law because it failed to ensure that all the objectives of the *Competition Act*, and the particular circumstances of each merger, could be considered in the balancing exercise mandated by section 96.

74 With respect, I do not agree with the Tribunal's view that the list of objectives in section 1.1 of the *Competition Act* is merely a legislative rationale for the statutory purpose of maintaining and encouraging competition or that, if it is more than that, it should be read subject to the specific and contrary provisions of section 96. My reasons for these conclusions are as follows.

(i) The statutory text

(a) subsection 96(1)

75 Subsection 96(1) directs the Tribunal to consider whether the efficiencies produced by an anti-competitive merger are greater than, and offset, its anti-competitive effects. This is, in substance, a balancing test that weighs efficiencies on one hand, against anti-competitive effects on the other.

76 Writing of another provision in the *Competition Act* that called for the balancing of various factors, namely the determination of the scope of the relevant market, Iacobucci J. said in *Southam* (*supra*, at page 770, paragraph 43):

A balancing test is a legal rule whose application should be subtle and flexible, but not mechanical. It would be dangerous in the extreme to accord certain kinds of evidence decisive weight. [...] A test would be stilted and impossible of application if it purported to assign fixed weights to certain factors.

Hence, since the efficiency defence requires the Tribunal to balance competing objectives, its operation should remain flexible and not stilted by an overarching and restrictive interpretation.

77 In referring to "the effects of any prevention or lessening of competition", subsection 96(1) does not stipulate what effects must or may be considered. When used in non-statutory contexts, the word, "effects", is broad enough to encompass anything caused by an event. Indeed, even though it does not consider the redistribution of wealth itself to be an "effect" for the purpose of section 96, the Tribunal recognizes, as all commentators do, that one of the *de facto* effects of the merger is a redistribution of wealth: paragraph 446.

78 In addition, section 5.5 of the *MEG* explicitly recognises that a merger may have more than one effect:

Where a merger results in a price increase, it brings both a neutral redistribution effect and a negative resource allocation effect on the sum of producer and consumer surplus (total surplus) within Canada.

The *MEG* concluded, however, that:

The efficiency gains described above are balanced against the latter effect, i.e., the deadweight loss to the Canadian economy.

79 Thus, it is not doubted that the redistribution of resources is an effect of an anti-competitive merger, in the sense that it is caused by the exercise of market power created by the merger. Nevertheless, the Tribunal's interpretation of the word, "effects", as it is used in section 96, narrows it to a single effect, namely the loss or inefficient allocation of resources in the economy as a whole as measured by the deadweight loss.

80 Moreover, the statutory requirement that, for the section 96 defence to succeed, the efficiency gains must be greater than, *and offset*, the effects of a lessening of competition suggests a more judgmental assessment than is called for by the largely quantitative calculation of deadweight loss that the Tribunal held was statutorily mandated.

81 Of course, the precise meaning to be given to a word when it appears in a statute, especially if it is commonly used in everyday speech, must be determined by reference to its context. Hence, it was not necessarily an error of law for the Tribunal in this case to give to the word, "effects", a narrower meaning than would normally be ascribed to it in other contexts. The pertinent enquiry is whether, in the context of the *Competition Act*, the Tribunal was correct to narrow its meaning to the single effect of deadweight loss.

(b) subsection 96(3)

82 I attach some weight to subsection 96(3) of the *Competition Act*, which provides that the Tribunal shall not find that a merger or a proposed merger "is likely to bring about gains in efficiency by reason only of a redistribution of income between two or more persons." Hence, subsection 96(3) expressly *limits* the weight accorded to redistribution in assessing the *efficiencies* generated by a merger.

[1]

83 No similar limitation is imposed by the Act on the *effects* side of the balance. If Parliament had intended redistribution of income to be *excluded altogether* from the "effects" of an anti-competitive merger, as the Tribunal held, the drafter might well have been expected to have made an express provision, similar to that contained in subsection 96(3) with respect the efficiencies side of the balance. The absence of such a provision suggests that, contrary to the Tribunal's conclusion, Parliament did not intend to impose such a limitation on the "effects" side.

(ii) Statutory purposes and objectives

(a) section 1.1

84 I turn now to section 1.1 of the *Competition Act* which, for convenience's sake, I set out again.

[1]

The purpose of this Act is to maintain and encourage competition in Canada in order to promote the efficiency and adaptability of the Canadian economy, in order to expand opportunities for Canadian participation in world markets while at the same time recognizing the role of foreign competition in Canada, in order to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the Canadian economy and in order to provide consumers with competitive prices and product choices.	La présente loi a pour objet de préserver et de favoriser la concurrence au Canada dans le but de stimuler l'adaptabilité et l'efficience de l'économie canadienne, d'améliorer les chances de participation canadienne aux marchés mondiaux tout en tenant simultanément compte du rôle de la concurrence étrangère au Canada, d'assurer à la petite et à la moyenne entreprise une chance honnête de participer à l'économie canadienne, de même que dans le but d'assurer aux consommateurs des prix compétitifs et un choix dans les produits. —

85 I see nothing in the wording of this provision to indicate that it is anything other than a typical statutory purposes clause, and should be construed accordingly. As is not uncommon in such clauses, not all of the stated purposes or objectives can be served at the same time, nor are all necessarily consistent.

86 For instance, the objective of expanding "opportunities for Canadian participation in world markets" may be irrelevant when the merged entity is unlikely to compete abroad. Further, as is the case here, there may be a conflict between the aim of promoting "the efficiency and adaptability of the Canadian economy" and providing consumers with "competitive prices and product choices." In addition, of course, the wording of a particular provision in a statute may be so clear and precise that it must be regarded as overriding an ambiguous purpose clause.

87 Nonetheless, despite the typically indeterminate quality and inherent inconsistencies of purpose or objectives clauses, including section 1.1, statutory provisions containing general statements of legislative purpose are integral to the statute and can carry as much weight as its other sections: Ruth Sullivan, *Driedger on the Construction of Statutes*, 3rd edition (Butterworths Canada Ltd. 1994), pages 263-68.

Thus, a purpose clause serves as a guide to the court or tribunal in its interpretation of other statutory provisions: *R. v. T. (V.)*, [1992] 1 S.C.R. 749 (S.C.C.), at page 765, and may establish the parameters within which it must interpret the provisions of the statute: *C.A.I.M.A.W., Local 14 v. Canadian Kenworth Co.*, [1989] 2 S.C.R. 983 (S.C.C.), at page 1028.

88 In my view, section 1.1 suggests that an interpretation of "effects" should not focus exclusively on *one* of the objectives of promoting competition, namely, promoting the efficiency and adaptability of the economy. Rather, the "effects" to be considered under section 96 should also include the other statutory objectives to be served by the encouragement of competition that an

anti-competitive merger may frustrate, such as the ability of medium and small businesses to participate in the economy, and the availability to consumers of a choice of goods at competitive prices.

89 Indeed, in moving the second reading of Bill C-91, *An Act to Establish the Competition Tribunal and to amend the Combines Investigation Act and the Bank Act and other Acts in consequence thereof*, 1 st Session, 33 rd Parliament, 1984-85-86, which became the *Competition Act* and *Competition Tribunal Act*, the Minister of Consumer and Corporate Affairs and Canada Post noted *(House of Commons Debates* (April 7, 1986) at 11927):

> The fourth but not the least objective is to provide consumers with competitive prices and product choices. As such, this objective becomes the common denominator in what we are trying to achieve. *This is the ultimate objective of the Bill*. (Emphasis added)

90 In spite of the existence of the multiple and ultimately inconsistent objectives set out in section 1.1, in certain instances the Act clearly prefers one objective over another. Thus, section 96 gives primacy to the statutory objective of economic efficiency, because it provides that, if efficiency gains exceed, and offset, the effects of an anti-competitive merger, the merger must be permitted to proceed, even though it would otherwise be prohibited by section 92. In this sense, the Tribunal was correct to state that section 96 gives paramountcy to the statutory objective of economic efficiency.

91 However, it does not follow from this that the only effects to be weighed against efficiency gains are limited to potential losses to the economy as a whole. Indeed, in the same Parliamentary speech referred to above, the Minister indicated (*Debates*, *supra*, at 11928) that the question posed to the Tribunal is:

> Would a particular merger result in efficiency gains which would offset *any* negative effects on competition? (Emphasis added)

> [92] Thus, although section 96 requires the approval of an anti-competitive merger where the efficiencies generated are greater than, and offset, its anti-competitive effects, the ultimate preference for the objective of efficiency in no way restricts the countervailing "effects" to deadweight loss. Instead, the word, "effects", should be interpreted to include all the anti-competitive effects to which a merger found to fall within section 92 in fact gives rise, having regard to *all* of the statutory purposes set out in section 1.1.

(b) "economic"purposes

93 In support of the position that the only effects of a merger that can be considered under section 96 are the resources lost to the economy as a whole, the respondents argued that the Supreme Court of Canada in *Southam* (*supra*, at page 772, paragraphs 48 and 49) authoritatively characterized the aims and objectives of the *Competition Act* as "more 'economic' than strictly 'legal' and as "peculiarly economic". In my opinion, however, these statements are not dispositive of the issue under consideration here, namely, whether the Tribunal's interpretation of "effects" was correct.

94 First, while these statements were clearly directed to the purposes of the *Competition Act* administered by the Tribunal, they were made in the context of the pragmatic or functional analysis conducted to determine the appropriate standard of review. When he used the words quoted above, Iacobucci J. was characterising the purpose of the Act in order to delineate the areas of expertise of the Court and the Tribunal respectively. Hence, they are not decisive in the context of the issue at stake here, namely, determining which effects of an anti-competitive merger may be considered as "effects" under section 96.

95 Second, a characterisation of the objectives of the *Competition Act* as economic does not necessarily lead to the conclusion that it is only permissible to consider as "effects" under section 96 the resources likely to be lost to the economy as a whole. I would have thought that the extent to which a merger is likely to result in the elimination of small and medium sized businesses from a market, or to cause consumers to pay more than competitive prices, are sufficiently "economic" to fall within Iacobucci J.'s characterisation of the aims and objectives of the Act.

96 Third, I have already noted the inclusion of persons with a wide range of backgrounds on the Advisory Council that the Minister of Industry must consult before making recommendations to the Governor in Council on the appointment of lay members to the Tribunal. The statutory inclusion of Council members from a wide range of backgrounds, including consumer groups and labour, suggests that the perspectives of those appointed are likely to extend beyond general welfare economics. This, in turn, is an indication that the Act itself is not concerned with "economics" so narrowly conceived as to exclude from consideration under section 96 the redistributive effects of higher prices that consumers will have to pay as a result of the merger, or its impact on small and medium sized businesses.

97 The Tribunal stated that taking into account a broader range of anti-competitive effects of a merger than the deadweight loss would license members of the Tribunal "to advance their views on the social merit of various groups in society" or "to achieve the proper distribution of income in society". These "political" tasks, the Tribunal stated, cannot be regarded as mandated by the Act, because they are not within the expertise of the members of the Tribunal, who "are selected for their expertise and experience in order to evaluate evidence that is economic and commercial in nature": paragraph 431.

98 In my view, this conclusion gives insufficient weight to the range of experience and perspectives that the Act contemplates that the members of the Tribunal may possess, and overstates the degree of "social engineering" involved in considering a broad range of anti-competitive effects under section 96. Like other regulatory administrative tribunals, the Tribunal is charged with the responsibility of protecting the public interest, which it does by striking a balance among conflicting interests and objectives in a manner that respects the text and purposes of the legislation, is informed both by technical expertise and by the judgment that comes from its members' varied experiences, and is responsive to the particularities of the case.

99 Of course, balancing competing objectives in order to determine where the public interest lies in a given case requires the exercise of discretion. However, the procedure and composition of the Tribunal equip it for this task no less well than those of other independent, specialized, administrative tribunals that are required to perform similar balancing exercises in the discharge of their regulatory functions.

100 Finally, I also find it difficult to accept the Tribunal's interpretation of the Act for the following two reasons. First, when Bill C-91 was introduced in Parliament it was widely regarded as a consumer protection measure. Thus, the Minister responsible stated in the House of Commons *(Debates*, *supra*, at 11927) that the Consumers' Association of Canada saw the Bill as promising "real progress for consumers". Indeed, the guidebook introduced when the legislation was first tabled states (Consumer and Corporate Affairs Canada, *Competition Law Amendments: A Guide* (December, 1985), page 4):

> Consumers and small business are among the prime beneficiaries of an effective competition policy.

101 In addition, the background document released when the amendments were previously tabled (Consumer and Corporate Affairs Canada, *Combines Investigation Act Amendments 1984: Background Information and Explanatory Notes* (April, 1984), page 2), states that:

> the Bill is concerned with fairness in the functioning of markets B fairness between producers and consumers, fairness between businesses and their suppliers, and suppliers and their customers.

102 It thus seems to me unlikely that Parliament either intended or understood that the efficiency defence would allow an anti-competitive merger to proceed, regardless of how much the merged entity might raise prices, provided only that the efficiencies achieved by the merger exceeded the resulting loss of resources in the economy at large. As Reed J. noted in the *Hillsdown* case, *supra*, at pages 337-38, differences in the drafting of the efficiency defence in the precursors to Bill C-91, which were not enacted, point in the same direction, and are considered in paragraphs 129-131, *post*.

103 Second, the result of applying the total surplus standard has some consequences that are so paradoxical in light of the consumer protection objectives of the Act that Parliament should not be regarded as having intended to limit the "effects" of the merger for the purpose of section 96 to deadweight loss. For example, use of the total surplus standard for calculating the anti-

competitive effects of a merger makes it easier to justify a merger between suppliers of goods for which demand is relatively inelastic than of goods for which demand is relatively elastic.

[1]

104 This is because, where the demand for particular goods is inelastic, as it is for propane, the goods cannot be substituted as cost-effectively as where the demand is elastic. Hence, price increases that result from the exercise of market power are tolerated more by purchasers of goods for which the demand is inelastic than by purchasers of those where the demand is elastic. Thus, since purchasers of goods for which demand is inelastic are relatively insensitive to price, fewer will purchase substitute goods despite increases in price. Therefore, a significant price increase will result in a smaller deadweight loss in a product where demand is inelastic than where it is elastic.

105 Thus, on the Tribunal's interpretation of section 96, the more inelastic the demand for the goods produced by the merged entity, the smaller will be the efficiencies required from the merger in order to offset its anti-competitive effects. It follows on this reasoning that, for the purpose of balancing efficiencies and effects, a potentially large wealth transfer from consumers of goods for which demand is inelastic to producers is to be ignored.

106 It is certainly not obvious how an interpretation of "effects" that creates a differential treatment of mergers by reference to the elasticity of demand for the goods produced by the merged entity is rationally related to any of the statutory aims of the *Competition Act*.

107 Another consequence of limiting the anti-competitive "effects" of a merger to deadweight loss is that it is irrelevant that the merger results in the creation of a monopoly in one or more of the merged entity's markets. According to the Tribunal, the fact that the merged entity of Superior and ICG will eliminate all consumer choice, and remove all competition, in the propane supply market, as it is likely to do in Atlantic Canada, for example, is not an "effect" that legally can be weighed under section 96 against the efficiency gains from the merger.

108 Again, such a conclusion seems to me so at odds with the stated purpose of the Act, namely "to maintain and encourage competition", and the statutory objectives to be achieved thereby, as to cast serious doubt on the correctness of the Tribunal's interpretation of section 96.

109 Given the purposes historically pursued by competition legislation and, in particular, the expressly stated purpose and objectives of the *Competition Act*, it is reasonable to infer from Parliament's failure to state expressly that only deadweight loss is to be considered as an "effect" of a merger for the purpose of section 96, that other effects related to the statutory purpose and objectives, including the interests of the consumers of the merged entity's products, must also be taken into account when the trade-off is made between efficiencies and anti-competitive effects.

(iii) Predictability

110 It was strenuously argued by counsel for the respondents that, since one of the objectives of the *Competition Act* set out in section 1.1 is to "promote the efficiency and adaptability of the Canadian economy", it was important for business people to be able to predict whether or not a proposed merger was likely to receive regulatory approval. Otherwise, they might be deterred from entering into a merger that would violate section 92 by substantially lessening competition, but would increase wealth in the Canadian economy as a whole by producing substantial efficiency gains.

111 Hence, it was argued, it is consistent with the purpose of section 96 to interpret the efficiency defence as requiring the use of the total surplus standard to determine the anti-competitive effects of a merger, because the use of this standard makes the result of the section 96 balancing exercise much more predictable. While far from self-applying, the total surplus standard will generally make it much easier than the balancing weights approach favoured by the Commissioner to predict what will be the "effects" of a merger.

112 While not without some attraction, this argument when considered alone is far from dispositive in a regulatory context. And, when assessed with the stronger arguments pointing in the opposite direction, it does not in my view significantly buttress the Tribunal's interpretation of section 96.

113 First, discretionary decision-making in the regulation of economic activity is commonplace and predictability of outcome is a matter of degree. Indeed, since discretion is essential to the efficacy of most regulatory regimes, the interest of individuals in being able to arrange their affairs in the more or less certain knowledge of how they will be regarded by agencies of the state is not so highly valued as in other areas (such as taxation or criminal law) where the state impinges on individual conduct.

114 Hence, even if true, the submission that the total surplus standard may make the result of the balancing exercise more predictable than the balancing weights approach must be assessed in the context of the administration of a public programme of economic regulation.

115 Second, one should not exaggerate the differences in the degrees of predictability inherent in the total surplus and balancing weights standards for determining the "effects" of an anti-competitive merger. Given the difficulties of, for example, assessing both the relative elasticity of demand for the goods produced or supplied by a merged entity, and the qualitative aspect of deadweight loss, the application of the total surplus standard is far from mechanical. Indeed, while section 5.5 of the *MEG* has adopted the total surplus standard, it also states that the "calculation of the anti-competitive effects of mergers is generally very difficult to make." See also Roy M. Davidson, "When Merger Guidelines Fail to Guide" (1991) 12 *Canadian Competition Policy Record* 44, at 46-47.

116 Conversely, it is in my view far from a fatal objection to the balancing weights approach that its proponent at the hearing before the Tribunal, Professor Townley, testified that, as an economist, he was unable to determine what were the effects of the merger of Superior and ICG and whether the efficiencies likely to be produced thereby were greater than, and offset, them. I take his point simply to have been that he was called as a witness expert in economics and that the balancing exercise called for by section 96 required broader public policy judgments that were outside his area of expertise, but were for the Tribunal to make as it thought would best advance the public interest within the parameters of the Act.

117 Third, there are various tools available to administrative agencies that enable them to give more precision, and hence predictability of application, to the discretionary statutory standards that they must apply to particular fact situations: speeches by members of the administrative agency detailing agency thinking on an issue, and more formal published policy guidelines that can be elaborated and tailored from time to time to take account of agency experience with administering the regulatory scheme, for example. I discuss below the *MEG* issued by the Commissioner, in so far as they deal with the Competition Bureau's view of the interpretation of section 96.

118 In addition, parties contemplating a merger may submit details to the Commissioner at an early stage of the process in order to obtain an initial indication of whether approval is likely to be forthcoming and, if the Commissioner thinks that there may be problems, what they are and how they may be addressed. Administrative adjudication is only the rarely seen, though important, tip of the regulatory process iceberg.

119 Hence, even if the total surplus standard provides more predictability to prospective merging parties, when compared, for instance, to the balancing weights approach, the predictability argument is not sufficiently compelling to persuade me that it is the methodology mandated by section 96 for determining the "effects" of an anti-competitive merger in all cases.

(iv) *Merger Enforcement Guidelines*

120 Both the Tribunal and, on appeal, counsel for the respondents, gave considerable weight to the *MEG*, issued in 1991 by the Director of Investigation and Research, Bureau of Competition Policy.

121 Section 5.5 of the *MEG* state that efficiency gains are to be balanced only against "a negative resource allocation effect on the sum of producer and consumer surplus (total surplus within Canada)"; in other words, "the deadweight loss to the Canadian

economy." It also states that the redistribution of wealth as a result of price increases stemming from the merger is "neutral", noting in footnote 37 that:

When a dollar is transferred from a buyer to a seller, it cannot be determined *a priori* who is more deserving or in whose hands it has a greater value.

122 In a speech given in Toronto on June 8, 1992 to the Canadian Institute, the then Director of Investigation and Research responded to the doubts expressed by Reed J., as the judicial member of the Tribunal that decided the *Hillsdown*case, *supra*, about whether the *MEG* were consistent with the *Competition Act* to the extent that they adopted total surplus standard as the basis for determining the "effects" of an anti-competitive merger. The Director saw no need to amend the *MEG* at that time, since economists advocated that wealth transfers to producers from consumers should be treated as a neutral effect of a merger, Reed J.'s expressions of doubt were only *obiter* and the Tribunal endorsed no other methodology for determining the "effects" to be taken into account under section 96.

123 In 1998, the approach to the determination of the anti-competitive effects of a merger adopted in the *MEG* was essentially endorsed in the Competition Bureau's publication, *The Merger Guidelines as Applied to a Bank Merger*.

124 The simple answer to the respondents' reliance on the *MEG* is that they are not law because they are not made under a grant of statutory authority, and cannot determine the meaning of the Act. Indeed, to the extent that they are inconsistent with the Act, they should be ignored. Further, the limited nature and intent of the *MEG* is clearly set out at the beginning of the document under the heading "Interpretation":

[1]

This document is intended solely to provide enforcement guidelines. As such, it sets forth the general approach that is taken to merger review, and is not a binding statement of how discretion will be exercised in a particular situation. Specific guidance regarding a specific merger may be requested from the Bureau through its program advisory opinions. The Guidelines are not intended to be a substitute for the advice of merger counsellors. They do not represent a significant change in enforcement policy or restate the law. *Final interpretation of the law is the responsibility of the Competition Tribunal and the courts.* (Emphasis added)

125 Of course, it may do little to inspire public confidence in the administration of the *Competition Act* that, in the context of the merger of Superior and ICG, the present Commissioner has apparently disavowed the interpretation of section 96 advanced in the *MEG*, which have still not been replaced. However, there was no allegation by the respondents that they had relied to their detriment on the *MEG*when they agreed to merge. While there was no evidence in the record about any discussions that may have taken place between the merging parties and the Bureau, it would not be surprising if such discussions had occurred and it had been indicated to the respondents that the Commissioner no longer thought that deadweight loss, measured both quantitatively and qualitatively, was the only "effect" that could ever be taken into account under section 96.

126 In addition, the possibility that a reviewing court may not agree with an agency's view of the law is an inevitable risk associated with the administrative practice of issuing non-binding guidelines and other policy documents to shed light on agency thinking and to assist those subject to the regulatory regime that it administers. This risk should deter neither the courts from deciding what the law is, nor agencies from engaging in the often useful exercise of administrative rule-making.

(v) The authorities

127 Finally, I consider whether existing authorities demonstrate the correctness of the Tribunal's interpretation of section 96. I turn, first, to the only other judicial pronouncement on the issue, namely, the decision of Reed J. in the *Hillsdown* case, *supra.* I agree with the respondents' position that what Reed J. said in that case is not dispositive of this case: not only is it, like the case before us, a decision of the Tribunal, but Reed J.'s statements did not form part of the *ratio* and, in some respects at least, she expressed herself more in the form of a doubt than of a definitive assertion that the interpretation in the *MEG* of "effects" was wrong in law.

128 Nonetheless, I find myself largely in agreement with the reasons given by Reed J. for querying whether the Tribunal was permitted to look only at deadweight loss when determining the effects to be balanced against any efficiency gains that, without the merger, were unlikely to be achieved.

129 In particular, I adopt her analysis of the legislative history of section 96: *Hillsdown*, *supra*, at pages 337-39. She observed that, unlike the present section 96, the previous, unenacted versions of the efficiency defence contained in both Bill C-42, *An Act to amend the Combines Investigation Act and to amend the Bank Act and other Acts in relation thereto or in consequence thereof*, 2nd Session, 30th Parliament, 1976-77, and in Bill C-29, *An Act to amend the Combines Investigation Act and the Bank Act and other Acts in consequence thereof*, 2nd Session, 32nd Parliament, 1983-84, did not require that the efficiencies gained from an anti-competitive merger be balanced against its effects.

130 Thus, Bill C-42 would have permitted an anti-competitive merger to proceed, provided only that substantial efficiency gains could be proved "by way of savings of resources for the Canadian economy" that would not otherwise have been attained: clause 31.71(5). Bill C-29 called for a determination of whether "the gains in efficiency would result in a substantial real net saving for the Canadian economy": clause 31.73(*c*). Neither of these provisions calls for a balancing of efficiencies against effects. Instead they focus on resource maximization in the economy as a whole in the same way as the total surplus standard.

131 I agree with Reed J.'s conclusion that, seen against this background, the more open-ended direction given to decision-makers by section 96, namely to balance the efficiency gains against the "effects" of an anti-competitive merger, should not be interpreted in substantially the same manner as the above clauses, which explicitly permitted anti-competitive mergers when the resulting efficiency gains produced *net savings of resources for the Canadian economy*. While the earlier bills seem clearly to have encapsulated the total surplus standard in the efficiency defences, section 96 does not.

132 I note, too, that, even though she may not have been entitled as a lay member of the Tribunal to express a view on an issue that I have held to be a question of law alone, Ms. Lloyd did not agree that "effects" were confined to deadweight loss to the exclusion of effects relating to the other objectives of the Act: paragraph 506.

133 In a word, views expressed by Tribunal members who have considered the issue are about evenly split. I draw some comfort from the existence of this division of opinion both between the judicial members who have considered the issue (Reed J. and Nadon J.), and between the lay members of the Tribunal in this case, if, as I understand it, Dr. Schwartz agreed with Nadon J. Thus, in disagreeing with the Tribunal's interpretation of section 96, I cannot be said to have gone against the unanimous view of those more expert than I in this area of the law.

134 Finally, it was suggested in argument that the Tribunal's interpretation had the support of all economists who had studied the issue. I do not dispute that an impressive array of economists, and law and economics specialists, both in Canada and the United States, have argued that the total surplus standard is the appropriate basis for determining whether an anti-competitive merger that produces efficiency gains should be permitted.

135 Nonetheless, the *Horizontal Merger Guidelines, supra*, in the United States continue to treat the exercise of market power leading to an increase in price above the competitive level as the most important anti-competitive effect of a merger, and the resulting wealth transfer from the consumers to the producers, as a misallocation of resources: see P.T. Denis, "Advances in the 1992 *Horizontal Merger Guidelines* in the Analysis of Competitive Effects" (Symposium on the New 1992 Merger Guidelines), *Antitrust Bulletin*, Fall 1993, pages 479-515.

136 Of course, as I have already noted, since there is no specific efficiency defence in the United States' legislation, the approach of the Federal Trade Commission to efficiency gains when considering the approval of anti-competitive mergers has limited relevance to the problem before us. Nonetheless, it is interesting to note that efficiency gains are generally most likely to make a difference in merger review when the likely adverse effects of the merger are not great, and will almost never justify a merger to monopoly or near monopoly: *Horizontal Merger Guidelines, supra*, at page 150.

137 In addition, some commentators in the United States have expressed surprise at the interpretation of section 96 adopted in the *MEG*. See, for example, J.F. Brodley, "The Economic Goals of Antitrust: Efficiency, Consumer Welfare, and Technological Progress, (1987) 62 *N.Y.U. L. Rev.* 1020, at 1035-36; S.F. Ross, "Afterword B Did the Canadian Parliament Really Permit Mergers That Exploit Canadian Consumers So the World Can Be More Efficient?" (1997) 65 *Antitrust Law Journal* 641. Thus, Ross writes (*supra*, at 652, note 41):

[1]

As Professor Brodley has observed, the logical extension of competition policy based solely on societal wealth maximization would be to prefer a monopolist that was able to perfectly price discriminate (charge each consumer the maximum amount each consumer was willing to pay) to the typical Canadian industry with a relatively few number of firms, which would not produce at a single competitive price.

138 Hence, it is clear that there is more than one view among commentators on whether competition policy should disregard *a priori* transfers of wealth and other "effects" of anti-competitive mergers, and consider only whether the merger has the effect of increasing or decreasing the resources in the economy as a whole. Nonetheless, when the issue arises in the legal context of a section 92 proceeding instituted by the Commissioner, it must be answered by reference to the *Competition Act,* and Parliament's stated purpose and objectives in enacting it. In my view, the narrow reading that the Tribunal gave to the word, "effects", in section 96 cannot be justified by reference to the views of lawyer-economists in the United States, no matter how eminent.

(vi) Conclusions

139 Having concluded for the above reasons that the Tribunal erred in law when it interpreted section 96 as mandating that, in all cases, the only effects of an anti-competitive merger that may be balanced against the efficiencies created by the merger are those identified by the total surplus standard, this Court should not prescribe the "correct" methodology for determining the extent of the anti-competitive effects of a merger. Such a task is beyond the limits of the Court's competence.

140 Whatever standard is selected (and, for all I know, the same standard may not be equally apposite for all mergers) must be more reflective than the total surplus standard of the different objectives of the *Competition Act*. It should also be sufficiently flexible in its application to enable the Tribunal fully to assess the particular fact situation before it.

141 It seems to me that the balancing weights approach proposed by Professor Townley, and adopted by the Commissioner, meets these broad requirements. Of course, this approach will no doubt require considerable elaboration and refinement when it comes to be applied to the facts of particular cases.

142 Further, while the adoption of the balancing weights approach is likely to expand the anti-competitive effects to be considered, and hence to narrow the scope of the defence, I see no reason why it should, as the respondent submitted, practically write section 96 out of the Act.

Issue 3: The Burden of Proof

143 The Tribunal held (at paragraph 403) that, since section 96 constitutes a defence to an infringement of section 92, the merging parties bear the burden of proving each of its elements on the balance of probabilities, except the existence or scale of the effects that must be balanced against the efficiency gains.

144 The Commissioner submitted that the Tribunal had erred in law in holding that he had the legal onus of proving anything at all under section 96. While the evidential burden may shift as a case unfolds, the legal burden throughout, counsel for the Commissioner argued, remains with the respondents.

145 Apart from setting out the parties' contentions, the Tribunal gave little clue about the reasons for its conclusion on the burden of proof issue. One obvious possibility is that the Tribunal endorsed the submissions made by the party in whose favour it decided particular issues. Thus, the Tribunal stated that the respondents had submitted that the Commissioner bears

the burden of proving the scale of the "effects" of an anti-competitive merger (that is, on the Tribunal's interpretation of section 96, the deadweight loss), because the Commissioner's investigative powers put him in a better position than the respondents to obtain the necessary information from third parties.

146 On the hearing of the appeal, counsel for the respondents added that, if merging parties were to attempt to obtain the kind of information required to establish the effects of the merger for the purpose of section 96, including information on competitors' pricing and costs, they would run the risk of being accused of conspiring to restrain competition contrary to section 45 of the Act.

147 Counsel for the Commissioner, on the other hand, relied on statements made by officials of the Ministry of Consumer and Corporate Affairs, when appearing before the Legislative Committee on Bill-91. They advised the Committee that, once the Commissioner had proved a substantial lessening of competition under section 92, the burden of proving any defence was borne by the merging parties.

148 On the facts, the burden of proof did not have to be decided when the present case was before the Tribunal. However, since the effects that must be considered by the Tribunal include facts not taken into account when it first made the decision under appeal, it is necessary for the Court to determine the issue, which is largely one of first impression.

149 It seems clear that deciding which party bears the burden of proving what elements of the efficiency defence is a pure question of law that is not confined to the particularities of this case. For the reasons given earlier, I am of the view that the standard of review of the Tribunal's conclusion on this issue is correctness.

150 Two general principles would seem to support the Commissioner's position. First, the party who asserts, must prove the assertion. Since it is the respondents who assert that the efficiency gains of the merger are likely to exceed, and to offset, its anti-competitive effects, this principle indicates that the respondents should be required to prove each and every aspect of the assertion. The second general principle is that the burden of proving a defence generally rests with the defendant.

151 However, the principle that the party who asserts must prove is not absolute: Sopinka, Lederman and Bryant, *The Law of Evidence in Canada*, 2^{nd} edition, (Butterworths Canada Ltd.; 1999), page 89. In addition, in the absence of authority, considerations of fairness, probability and policy would seem to be important determinants of the legal burden of proof: Sopinka, Lederman and Bryant, *supra,* at pages 86-90.

152 It would be somewhat odd, as counsel for the respondents argued, to place the legal onus of proving the anti-competitive effects of a merger on the party whose interest it is to deny that they exist or to minimise them. In addition, in the process of establishing a substantial lessening of competition, the Commissioner will often have gathered evidence on the effects of the merger that will also be relevant to the section 96 defence, including evidence on likely price increases following the merger and the impact of the merger on inter-related businesses.

153 These are matters on which the Commissioner is in a better position than the respondents to gather evidence by virtue of the investigative powers conferred on him by statute. Indeed, as Sopinka, Lederman and Bryant note (*supra*, at page 89), if "one party is peculiarly situated to prove a fact" a court may reverse the burden and place it on that party.

154 Accordingly, I have concluded that the Tribunal was correct to distribute the legal onus of proof as it did, so that the respondents bear the onus of proving every aspect of the section 96 defence, save for the anti-competitive effects of the merger.

F. CONCLUSIONS

155 In summary, I would allow the appeal, set aside the decision of the Tribunal with respect to the interpretation of section 96 of the *Competition Act* and remit the matter to the Tribunal for redetermination in a manner consistent with these reasons.

156 The Tribunal need only identify and assess "the effects of the prevention or lessening of competition" for the purpose of section 96 and decide whether the efficiencies that the Tribunal has already found to have been proved by the respondents are likely to be greater than, and to offset, those effects.

157 The Commissioner has the legal burden of proving the extent of the relevant effects, while the respondents have the burden, not only of proving the scale of the efficiency gains that would not have occurred but for the merger, but also of persuading the Tribunal on the ultimate issue, namely, that the efficiency gains are likely to be greater than, and to offset, the effects.

158 The appellant should have his costs, but because the respondents were successful on the burden of proof issue, I would reduce the costs awarded by 20% of those otherwise allowable.

***Létourneau J.A.*:**

159 I have had the benefit of reading the reasons for judgment issued by my colleague, Evans J.A.. I agree with him that the interpretation of the word "effects" in section 96 of the *Competition Act* (Act) R.S.C. 1985, c. C-34 involves a pure question of law that falls to be decided on a standard of correctness.

160 I also agree with my colleague that the word "effects" in section 96 of the Act ought not to be limited, as the Tribunal did, to the effects identified by the total surplus standard. As my colleague has pointed out, the interpretation of section 96 of the Act involves balancing market power and efficiency gains. The approach taken in this matter both in the United States and in Canada is by no means free from ambiguity and harsh criticism: see Robert H. Lande, The Rise and (Coming) Fall of Efficiency as the Ruler of Antitrust (1988) 33 *Antitrust* 429; David B. Andretsch, Divergent Views in antitrust Economics (1988) 33 *Antitrust Bull.* 135; Alan A. Fisher, Frederick I. Johnson and Robert H. Lande, Price Effects of Horizontal Mergers (1989) 77 *Calif. L.R.* 777; Lloyd Constantine, An Antitrust Enforcer Confronts the New Economics (1989) 58 *Antritrust L.J.* 661; Roy M. Davidson, When Merger Guidelines Fail to Guide (1992), *Canadian Competition Policy Record* 44, at page 46; Stephen F. Ross, Afterword - Did the Canadian Parliament Really Permit Mergers that Exploit Canadian Consumers so the World can be More Efficient? (1997) 65 *Antitrust Law Journal* 641, at pages 643-646; Tim Hazledine, Rationalism Rebuffed? Lessons from Modern Canadian and New Zealand Competition Policy (1998) *Review of Industrial Organization* 243; Jennifer Halliday, The Recognition, Status and Form of the Efficiency Defence to a Merger: Current Situation and Prospects for the Future (1999) *World Competition* 91. A review of these authorities reveals that the provision is at best confusing and puzzling. At worst, it can defeat the very purpose of the Act. I reproduce sections 96 and 1.1 for convenience:

96. (1) The Tribunal shall not make an order under section 92 if it finds that the merger or proposed merger in respect of which the application is made has brought about or is likely to bring about gains in efficiency that will be greater than, and will offset, the effects of any prevention or lessening of competition that will result or is likely to result from the merger or proposed merger and that the gains in efficiency would not likely be attained if the order were made.

(2) In considering whether a merger or proposed merger is likely to bring about gains in efficiency described in subsection (1), the Tribunal shall consider whether such gains will result in

(*a*) a significant increase in the real value of exports; or

(*b*) a significant substitution of domestic products for imported products.

(3) For the purposes of this section, the Tribunal shall not find that a merger or proposed merger has brought about or is likely to bring about gains in efficiency by reason only of a redistribution of income between two or more persons.

96. (1) Le Tribunal ne rend pas l'ordonnance prévue à l'article 92 dans les cas où il conclut que le fusionnement, réalisé ou proposé, qui fait l'objet de la demande a eu pour effet ou aura vraisemblablement pour effet d'entraîner des gains en efficience, que ces gains surpasseront et neutraliseront les effets de l'empêchement ou de la diminution de la concurrence qui résulteront ou résulteront vraisemblablement du fusionnement réalisé ou proposé et que ces gains ne seraient vraisemblablement pas réalisés si l'ordonnance était rendue.

(2) Dans l'étude de la question de savoir si un fusionnement, réalisé ou proposé, entraînera vraisemblablement les gains en efficience visés au paragraphe (1), le Tribunal évalue si ces gains se traduiront:

a) soit en une augmentation relativement importante de la valeur réelle des exportations;

b) soit en une substitution relativement importante de produits nationaux à des produits étrangers.

(3) Pour l'application du présent article, le Tribunal ne conclut pas, en raison seulement d'une redistribution de revenu entre plusieurs personnes, qu'un fusionnement réalisé ou proposé a entraîné ou entraînera vraisemblablement des gains en efficience.

Purpose

1.1 The purpose of this Act is to maintain and encourage competition in Canada in order to promote the efficiency and adaptability of the Canadian economy, in order to expand opportunities for Canadian participation in world markets while at the same time recognizing the role of foreign competition in Canada, in order to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the Canadian economy and in order to provide consumers with competitive prices and product choices.

Objet

1.1 La présente loi a pour objet de préserver et de favoriser la concurrence au Canada dans le but de stimuler l'adaptabilité et l'efficience de l'économie canadienne, d'améliorer les chances de participation canadienne aux marchés mondiaux tout en tenant simultanément compte du rôle de la concurrence étrangère au Canada, d'assurer à la petite et à la moyenne entreprise une chance honnête de participer à l'économie canadienne, de même que dans le but d'assurer aux consommateurs des prix compétitifs et un choix dans les produits.

161 First, section 96 is broadly worded and provides no guidance as to the meaning of efficiency found in the section, the effects of the lessening of competition which are to be weighed against the efficiency gains, and the test, standard or trade-off to be applied in weighing the elements.

162 For example, what kind of economic efficiency does section 96 of the Act refer to? Allocative efficiency which is achieved when the existing products at the allocated prices satisfy the consumers' want? Or productive efficiency which is obtained when output is produced with the most cost-effective combination of productive resources available under present technology? Or technological or dynamic efficiency which is achieved through better industrial research development and a better rate of technological progress?

163 What are the anti-competitive effects of the merger that are to be weighed? Is it limited to deadweight loss which occurs when, because of higher prices, consumers choose an alternative and less appropriate substitute for the product that they would have other bought? Does the trade-off analysis include anti-competitive effects likely to arise in other related markets which would be affected by the merger? Does it include wealth transfers from consumers to producers that result from an exercise at market power? Are all the effects of the merger to be weighed and what weight should be given to them? Are they all of the same significance and value? On what basis is one effect to be preferred over the other? On what basis should some effects, if any, be ignored or discarded?

164 What standard should be applied to the trade-off analysis required by the application of section 96? The total surplus standard chosen by the Tribunal in this case which considers only the deadweight loss and none of the redistributive effects involved in the wealth transfer from consumers to producers? Or the price standard under which efficiencies allow for mergers only if prices are to be maintained or reduced? Or the consumer surplus standard which disallows a merger where the loss of consumer surplus exceeds the efficiency gains?

165 Second, the relationship of section 96 with section 1.1, which states the purpose of the Act, is not defined and, in fact to many, section 96 contradicts section 1.1 and defeats the purposes contained in that purpose clause. When weighing the efficiency gains of a merger against the lessening of competition, what should be done of the stated objectives of ensuring that small and medium-sized enterprises have an equitable opportunity to participate in the Canadian economy as well as providing consumers with competitive prices and product choices?

166 Third, section 96 poses no limits to the kind of mergers that can be effected and authorized as long as the efficiency gains will be greater than, and will offset, the effects of the lessening of competition and as long as these gains cannot be obtained by other means than the merger. This means that the creation of a monopoly or near monopoly through mergers could be authorized even though it would eliminate competition altogether, discourage competitive prices for consumers and would undermine, to the point of eradication, the development of small and medium-size enterprises, all these effects contrary to the purposes stated in section 1.1 of the Act.

167 Fourth, the problems created by section 96 are compounded by the fact that the provision is mandatory. The Tribunal shall not make an order preventing a merger where the undefined and elusive balancing test of section 96 is met.

168 Fifth, section 96 appears to have no geographical scope or limit so that efficiency gains made for the benefit of foreign corporations to the detriment of Canadian workers and consumers could be counted in the trade-off analysis that the provision requires. Or are mergers to be approved only if the efficiency gains in Canada exceed the losses in Canada? In the increasing context of globalization of trade and commerce, not to mention international trade treaties such as the *North American Free Trade Agreement Implementation Act*, S.C. 1993, c. 44 and the *World Trade Organization Agreement Implementation Act*, S.C. 1994, c. 47, Schedules I-IV, the issue of whether the balancing test applicable under section 96 is global or limited in its application to Canada becomes crucial. Yet, the provision still provides no guidance in this respect.

169 It is no wonder that conflicting views on the scope of section 96 have emerged and that the section, in search of predictability and workability, has been read down by eliminating some of the significant effects of the lessening of competition. It also comes as no surprise that many, influenced as they were by the Chicago school of thought in antitrust matters, concluded, as the Tribunal did in the present case, that efficiency of the economy overrides competition even with respect to an Act designed to maintain and promote competition.

170 It is true as Mr. Justice Iacobucci said in *Canada (Director of Investigation & Research) v. Southam Inc.*, [1997] 1 S.C.R. 748 (S.C.C.), at page 772 that the focus of the Act is on economy rather than law or, if one prefers, that the "aims of the Act are more economic than they are strictly legal". But section 96 really begs the question: what kind of economy? Monopolistic, competitive or a proper balance between these two poles?

171 The Tribunal found that the merger was likely to prevent competition substantially in Atlantic Canada and to lessen competition substantially in coordination services offered to national account customers: see decision, paragraphs 310 and 313. There was also conclusive evidence that, in many large areas of the country, the merger would not merely lessen competition, but would in fact eliminate it and create monopolies. The following Chart illustrates the impact of the merger with respect to monopolies or near monopolies: see Compendium of the appellant, page 001327:

Table 4

Geographical Markets with Merger-to-Monopoly

Pre-Merger Post-Merger

Market SPI ICG SPI

% % %

Val d'Or 74 23 97

Sept Iles/Baie Comeau 55 45 100

Bancroft/Pembroke/Eganville 92 5 97

Dryden/Fort Frances/Kenora/Ignace 47 52 99

Echo Bay/Sault Ste Marie 55 44 99

Hearst/Wawa/Manitouwadge/Marathon 43 53 96

Little Current/Sudbury 51 48 99

North Bay 81 16 97

Thunder Bay 46 54 100

Fort McMurray 32 67 99

Whitecourt 55 45 100

Burns Lake/Terrace/Smithers/Prince Rupert 62 37 99

Fort Nelson 44 56 100

Valemont 43 57 100

Watson Lake 25 75 100

Whitehorse 33 67 100

172 The Tribunal, in view of its conclusion that efficiency is the paramount objective of the Act, ignored as an effect of the merger the fact that monopolies in certain product markets would ensue and failed to give any weight to that effect in its analysis under section 96. The Act maintains and promotes competition. It assumes that economic efficiency will generally and primarily develop through competition. It also accepts in section 96 that, in some cases, a reduction in competition can and will produce more efficiency than competition as it existed before merger.

173 In my respectful view, however, section 96 was not meant to authorize the creation of monopolies since it would defeat the purpose of section 1.1. The section was not intended to authorize mergers resulting in monopolies whereby, contrary to section 1.1, competition is eliminated, small and medium-sized enterprises are not able to enter or survive in the market and consumers are deprived of competitive prices.

174 As the Supreme Court of the United States has asserted repeatedly with respect to the U.S. antitrust laws, "Congress was dealing with competition, which it sought to protect, and monopoly, which it sought to prevent: *Standard Oil Co. v. Federal Trade Commission*, 340 U.S. 231 (U.S.S.C., 1951) , at pages 248-49 quoting *A. E. Staley Manufacturing Co. v. Federal Trade Commission*, 135 F.2d 453 (U.S. C.A. 7th Cir., 1943), at page 455". As my colleague pointed out, a similar expression of intent can be found in the Minister's (Minister of Consumer and Corporate Affairs and Canada Post) statement in the House of Commons where he reasserted in presenting the Bill that the ultimate objective of the Act was to provide consumers with competitive prices and product choices.

175 I agree with my colleague that the application of a balancing test requires a flexibility that the total surplus standard does not provide. It is true that a flexible approach may not yield the predictability that the assumptions and presumptions underlying the total surplus standard afford. However, if predictability is the preferred option, Parliament is at liberty to revisit section 96 and say so.

176 Finally, contrary to my colleague, I believe the Tribunal erred when it put on the Commissioner the legal burden (i.e., the burden of persuasion) of proving the effects of the lessening of competition. In practice, the merging parties will lead evidence of efficiency gains and of some of the effects of the lessening of competition. This is the evidential burden. They need to do that to establish that the gains offset the effects. Of course, the tendency for the merging parties might be to increase the amount of gains and downplay the effects of the lessening of competition. This is why, as we have seen in this case, the Commissioner also

bears in practice an evidential burden, that is the burden of leading evidence as to both components of the efficiency defence to alert the Tribunal to what the real, as opposed to the alleged, gains and effects are. In the end, however, the legal burden is on the merging parties to convince the Tribunal, first, that the efficiency gains are of the amount that they have contended, second, that the effects of the lessening of competition are those that they have identified and not those submitted by the Commissioner, and third, that the efficiency gains are greater than, and will offset, the effects.

177 I agree with the respondents that the Commissioner, with his statutory investigative powers, may be in a better position to gather information relevant to the effects and, indeed, that it would have done so in the context of the application of section 92 to which section 96 is a defence. The availability of statutory investigative powers will, indeed, enable the Commissioner to assume his evidentiary burden of gathering and filing relevant evidence to counter and rebut the allegations and evidence of the merging parties as to the effects of the lessening of competition. However, this is not sufficient to transfer the legal burden of proving these effects on the Commissioner. Indeed, there is no rationale and justification for putting on the Commissioner the burden of persuasion on one of the three components of the efficiency defence.

178 In conclusion, I would dispose of the matter as proposed by my colleague, except as to costs where I would make no apportionment in view of my conclusion that the Tribunal also erred on the issue of the legal burden of proof.

Appeal allowed in part.

2002 Trib. conc. 16, 2002 Comp. Trib. 16
Competition Tribunal

Canada (Commissioner of Competition) v. Superior Propane Inc.

2002 CarswellNat 4016, 2002 CarswellNat 6793, 2002 Trib. conc. 16, 2002 Comp. Trib. 16, 18 C.P.R. (4th) 417

In the Matter of the Competition Act, R.S.C. 1985, c. C-34 and the Competition Tribunal Rules, SOR/94-290, as amended

In the Matter of an inquiry pursuant to subsection 10(1)(b) of the Competition Act relating to the proposed acquisition of ICG Propane Inc. by Superior Propane Inc.

In the Matter of an application by the Commissioner of Competition under section 92 of the Competition Act

The Commissioner of Competition, applicant and Superior Propane Inc. and ICG Propane Inc., respondents

Lloyd Member, Nadon J., Schwartz Member

Heard: October 9-15, 2001
Judgment: April 4, 2002
Docket: CT1998002

Proceedings: affirmed *Canada (Commissioner of Competition) v. Superior Propane Inc.* (2003), [2003] 3 F.C. 529, 2003 FCA 53, 2003 CarswellNat 217, 2003 CAF 53, 300 N.R. 104, 2003 CarswellNat 1241, 223 D.L.R. (4th) 55, 23 C.P.R. (4th) 316 (Fed. C.A.)

Counsel: *John F. Rook, Q.C.*, *William J. Miller*, *Jo'Anne Strekaf*, *Steven T. Robertson*, *Christopher P. Naudie*, *Donna Blois*, for Applicant, Commissioner of Competition
Neil Finkelstein, *Jeff Galway*, *Martha Cook*, *Brian Facey*, *Charlotte Kanya-Forstner*, for Respondents, Superior Propane Inc., ICG Propane Inc.

Subject: Intellectual Property; Property; Corporate and Commercial
Related Abridgment Classifications
Commercial law
VI Trade and commerce
VI.5 Competition and combines legislation
VI.5.d Abuse of dominant position (monopolies) and mergers
Headnote
Commercial law --- Trade and commerce — Competition and combines legislation — Abuse of dominant position (monopolies) and mergers
Competition Tribunal must consider all objectives of Competition Act and particular circumstances of each merger when determining whether efficiencies of merger offset anti-competitive effect of merger — Appropriate standard for assessing efficiencies of mergers is Balancing Weights Approach — Including effects of entire redistribution of income and wealth caused by merger would vitiate Balancing Weights Approach and was not appropriate — Only socially negative effects of such redistribution were to be included.
The Commissioner of Competition applied for an order dissolving the merger of two propane companies. The Competition Tribunal found that the merger would substantially prevent and lessen competition and that divestiture was the sole appropriate remedy. However, the merger was saved from divestiture pursuant to s. 96 of the Competition Act by reason of efficiencies resulting from the merger. The Commissioner successfully appealed.

The appeals court held that the Tribunal had erred in limiting its consideration of the effects of the merger to resource-allocation effects and in not considering all of the objectives of the Act and the particular circumstances of the merger. The Tribunal was ordered to reconsider the matter, in accordance with the principles laid out by the court.

Held: The Application was dismissed on reconsideration.

Per Nadon, J: As an adjudicative body, the Tribunal's assessment does not include public interest consideration. Unlike American anti-trust law in which the overriding objective is consumer protection, in Canada s. 96 of the Competition Act gives paramountcy to the statutory objective of economic efficiency. Adopting an approach which prevented efficiency-enhancing mergers in all but rare circumstances must be wrong in law.

A merger to monopoly is not more objectionable than other instances of substantial lessening or prevention of competition unless additional effects are shown. However, once all the concerns raised by the Commissioner having been considered (deadweight loss, interdependent pricing, service quality, etc.) to consider monopoly, per se, as a qualitative factor, would be to double-count those effects.

The appropriate standard for assessing the efficiencies of mergers was the Balancing Weights Approach, by which a weighting factor is accorded to consumers as a group in order that consumer loss and producer gains be justly balanced. Including the effects of the entire redistribution of income and wealth caused by the merger would vitiate the Balancing Weights Approach. Accordingly, only the socially negative effects of such redistribution should be included. On the Commissioner's evidence, the measured adverse redistributive effect on consumers was approximately $2.6 million. The measured deadweight loss was $3 million and the maximum deadweight loss attributable to changes in the merged company's product line was $3 million dollars. Under any reasonable weighting scheme, the gains in efficiency of $29.2 million were greater than and offset all of the effects of lessening and prevention of competition attributable to the merger under review.

Per Dr. L. Schwartz (concurring): The proclaimed supremacy of the consumer interest in the United States is frequently overstated. The efficiency defence in s. 96(1) applies to mergers generally, even if imported and exported goods and services are not involved. Since the impact of a merger on small business is not a consideration under ss. 92 or 93, it might be inconsistent to give that impact greater weight under s. 96, despite the Court's direction otherwise. It is not reasonable to suppose that a firm with market power would impose the same price increase whether demand was inelastic or elastic.

Per Ms. C. Lloyd (dissenting): The majority erred in not considering some of the effects presented by the Commissioner. The majority should have considered the consumer's surplus transfer in its entirety. When all effects were properly considered the efficiency gains of $29.2 million per year did not adequately compensate society and offset the negative effects of this anti-competitive merger.

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APPLICATION by Commissioner of Competition to dissolve merger of two propane companies.

***Nadon J.*:**

I. Introduction

1 On April 4, 2001, the Federal Court of Appeal (the "Court") set aside our decision of August 30, 2000. More particularly, the Court concluded that we erred in interpreting section 96 of the *Competition Act*, R.S.C. 1985, c. C-34 (the "Act"). As a result, the Court remitted the matter to us for redetermination in a manner consistent with its Reasons for Judgment (the "Appeal Judgment").

2 On December 7, 1998, an application was brought by the Commissioner of Competition (the "Commissioner") pursuant to section 92 of the Act for an order dissolving the merger of Superior Propane Inc. ("Superior") and ICG Propane Inc. ("ICG") or otherwise remedying the substantial prevention or lessening of competition that was likely to occur in the market for propane in Canada upon the implementation of the said merger. In our August 30, 2000, decision (the "Reasons"), we found that the merger of Superior and ICG would substantially prevent and lessen competition based on our analysis of the competitive effects with respect to two product markets (retail propane and national account coordination services) and 74 local geographic markets. Further, we concluded at paragraph 314 of our Reasons that "...the sole remedy appropriate in this case would be the total divestiture by Superior of all of ICG's shares and assets (including those of the previously integrated branches thereof)." The majority (Nadon J. and L. Schwartz) found that the merger was saved from divestiture by reason of the efficiencies resulting

from the merger. Specifically, the majority concluded, pursuant to section 96 of the Act, that the efficiencies arising from the merger were greater than, and offset, the effects of lessening or prevention of competition attributable to the merger.

3 When determining whether the efficiencies were greater than the anti-competitive effects, the majority adopted the "Total Surplus Standard". Under this standard, the gains in efficiency brought about the by merger are compared against the efficiency costs of the merger as represented by the deadweight loss. The Court found that the Tribunal erred in law by limiting the effects to be considered to resource-allocation effects and by failing to ensure that all of the objectives of the Act, and the particular circumstances of each merger, were considered in the balancing exercise mandated by section 96 of the Act.

4 The purpose of these Reasons and Order is to redetermine the extent of the effects of the aforementioned anti-competitive merger in light of the Court's decision. Consistent with the redetermination proceedings contemplated by the Court and upon agreement among counsel, no additional evidence was adduced at the five day hearing.

5 The redetermination proceedings raise several issues: (a) What is the scope of the redetermination proceedings? (b) Which findings of the Tribunal should or should not be revisited? (c) What is the jurisdiction and mandate of the Tribunal? (d) Which economic standard or test should be applied under subsection 96(1) of the Act? (e) What are the effects of the anti-competitive merger that must be considered by the Tribunal in this case? (f) How should they be treated and who bears the burden of proof? and (g) What is the result of the trade-off analysis conducted under subsection 96(1) of the Act based on the effects accepted by the Tribunal?

II. The Redetermination Proceedings

6 In *Air Canada* (*Air Canada v. Canada (Director of Investigation & Research)* (1993), 51 C.P.R. (3d) 131, [1993] C.C.T.D. No. 19 (Competition Trib.)), the Tribunal had to define the nature and extent of redetermination proceedings which arose out of a decision of the Federal Court of Appeal. In 1992, after having issued a consent order governing the operation of what was then known as Gemini, a computer reservation system used by Air Canada and Canadian Airlines, an application was brought to the Tribunal to vary the consent order. The Tribunal made a decision as to the scope of its jurisdiction. On appeal to the Federal Court of Appeal, the Court reversed and remitted the matter back to the Tribunal for reconsideration. Mr. Justice Strayer, who presided the Tribunal in the redetermination proceeding, made the following remarks starting at page 135:

> ...we have decided that the hearing for purposes of reconsideration will focus on establishing that the preconditions for the making of an order in accordance with s. 92 of the Act have been met and determining the appropriate remedy in the circumstances...
>
> We are satisfied that the means that we have chosen are, as a practical matter, adequate, fair and consistent with our understanding of the decision of the Federal Court of Appeal. (at page 135)
>
> *The sole justification for the tribunal once again becoming seized of this matter is the judgment of the Federal Court of Appeal. Without the direction to reconsider, the Tribunal would effectively be functus*. Unfortunately, and perhaps unavoidably given the complexity of the issues, the intentions of the Federal Court of Appeal with respect to the scope or nature of the hearing for reconsideration ... are not entirely transparent. (at page 136)
>
> *...the tribunal has a limited mandate in this matter--to reconsider certain issues in accordance with the direction of the Federal Court of Appeal*. We are of the opinion that much of the ground to be covered in the reconsideration is broadly the same as was previously covered...
>
> It is our understanding of the Federal Court of Appeal decision that the tribunal has been directed to "reconsider" the "matter" on the basis that the condition precedent to the exercise of the power to vary has been met. *The "matter" that is referred to is the November 5, 1992, application of the Director... The hearing to be held commencing November 15, 1993, is not a "new" case. The tribunal is neither required nor authorized by the Court of Appeal to hold a hearing de novo. The only reason that the tribunal can readdress this matter at all is because of the Court of Appeal decision and it must act in accordance with that decision*. (at page 140)

. . . . .

> Further, although Air Canada may have some new evidence, the issue of the possible restructuring of Canadian through a sale of its international routes was raised at the original hearing. At that time, Air Canada had ample opportunity to canvass this issue thoroughly. The tribunal addressed the evidence put before it in its decision of April 22, 1993, and concluded that it was not convinced that a sale of its international routes would leave Canadian as a viable domestic competitor... This finding formed part of the decision which was considered on appeal before the Federal Court of Appeal. Even if we were not precluded by the finding of that court, *it would be an exceptional measure for the tribunal to reopen this issue which it has already decided and to hear new evidence* ... (at page 141) [Emphasis added]

7 The Appeal Judgment provides the Tribunal with some guidance for the redetermination proceedings relating mainly to (a) the scope of the proceedings, (b) the meanings of effects for the purpose of section 96, (c) the scope of the burden on the Commissioner and the respondents with respect to section 96, and (d) the nature of the balancing exercise to be performed by the Tribunal pursuant to section 96. At paragraphs 156-157 of the Appeal Judgment, the Court stated:

> The Tribunal need only identify and assess "the effects of the prevention or lessening of competition" for the purpose of section 96 and decide whether the efficiencies that the Tribunal has already found to have been proved by the respondents are likely to be greater than, and to offset, those effects.
>
> The Commissioner has the legal burden of proving the extent of the relevant effects, while the respondents have the burden, not only of proving the scale of the efficiency gains that would not have occurred but for the merger, but also of persuading the Tribunal on the ultimate issue, namely, that the efficiency gains are likely to be greater than, and to offset, the effects.

8 The parties are not in agreement regarding the scope of the redetermination proceedings. The Commissioner argues that the scope thereof is described in paragraph 156 of the Appeal Judgment and that the "effects" that must be considered by the Tribunal are those described in paragraph 92 of the Appeal Judgment:

> Thus, although section 96 requires the approval of an anti-competitive merger where the efficiencies generated are greater than, and offset, its anti-competitive effects, the ultimate preference for the objective of efficiency in no way restricts the countervailing "effects", to deadweight loss. Instead, the word, "effects" should be interpreted to include all the anti-competitive effects to which a merger found to fall within section 92 in fact give rise, having regard to *all* of the statutory purposes set out in section 1.1.

9 The respondents disagree with the Commissioner for what they submit is an attempt to relitigate matters that were previously decided by the Tribunal but also attempt to convince the Tribunal to revisit its express and implicit findings regarding the likelihood of price increases following the merger, the size of the deadweight loss and the corresponding size of the wealth transfer.

10 The Appeal Judgment requires the Tribunal to conduct a broad assessment of all of the anti-competitive "effects" of the merger using a different standard or test, in lieu of the Total Surplus Standard, that reflects all of the objectives of the purpose clause of the Act. The Tribunal's initial findings were expressly tied to resource allocation and failed, according to the Court, to give adequate weight to the full range of objectives set out in the purpose clause of the Act. The Tribunal is now required to consider the wealth transfer that will result from the merger and to reconsider its prior findings with respect to the negative qualitative effects of the merger.

11 One of the important related issues is whether certain findings made by the Tribunal in its Reasons should be reexamined. Most of the Tribunal's findings in its Reasons were not appealed, and thus were not in issue before the Court. These findings cannot be revisited at this time. However, there were a number of findings that were made by reason of the erroneous interpretation of subsection 96(1) of the Act. In light of the Court's reasons and its interpretation of that section, this Tribunal must now make certain additional findings.

12 The respondents argue that the Commissioner is estopped from relitigating the qualitative effects of the merger on the basis of *res judicata*.

13 The Commissioner submits that a distinction must be drawn by the Tribunal between those "findings" which must necessarily be revisited in order to comply with the Court's direction to "consider all of the anti-competitive effects bearing in mind the purpose clause" and those "findings" that should not be "abandoned". The Commissioner submits that the Tribunal's "finding" regarding the negative qualitative effects of the merger must be revisited because the Tribunal's assessment in this regard was limited to the "impact on resource allocation of the negative qualitative effects". The Commissioner also argues that the estimated deadweight loss of $3 million per year attributable to price increases by the merged entity should not be revisited.

14 Further, the Commissioner submits that the doctrines of *functus officio* and *res judicata* invoked by the respondents do not apply with respect to the assessment by the Tribunal of any "effects" which fall within the scope of the Court's direction and which must be reconsidered in light of a proper reading of the purpose clause and in light of the particular circumstances of this case.

15 The majority of the Tribunal stated in its Reasons at paragraph 447, that:

> The Tribunal further believes that the only effects that can be considered under subsection 96(1) are the effects on resource allocation, as measured in principle by the deadweight loss which takes both quantitative and qualitative effects into account...

16 It is on the basis of this erroneous interpretation of section 96 that the majority refused to consider the wealth transfer and limited its assessment of the negative qualitative effects of the merger to their impact on resource allocation. As a result of this narrow interpretation of the statute, the majority did not consider the wealth transfer or any of the other (i.e. non-resource allocation) impacts of the negative qualitative effects of the merger.

17 At common law, the doctrine of *res judicata* only applies to a judicial decision which constitutes a final Judgment. In this instance, the Tribunal's decision with respect to the anti-competitive effects of the merger is not final, since the Court has remitted this matter to the Tribunal and has directed that the Tribunal reconsider the "effects of any prevention or lessening of competition" in accordance with a proper reading of the statute. Accordingly, the doctrine of *res judicata* has no application to the findings that were made as a result of our error in law. See Spencer Bower, Turner and Handley, The Doctrine of Res Judicata, 3d ed. (London: Butterworths, 1996), paragraph 19 (General Test), paragraphs 153-54 ("Finality"), paragraph 162 ("Decision subject to revision by tribunal itself") [hereinafter, *Spencer Bower, Turner and Handley*].

18 Further, when an appellate court reverses the findings of an inferior tribunal on a particular issue, the tribunal's judgment on that issue is voided *ab initio* and the appellate judgment becomes the sole source of *res judicata* between the parties. To the extent that any operation of *res judicata* arises in this instance, the Commissioner submits it arises to preclude Superior from challenging the express findings of the Court:

> 60. When a tribunal with original jurisdiction has granted, or refused, the relief claimed and an appellate tribunal reverses the judgment or order at first instance, the former decision, until then conclusive, is avoided *ab initio* and replaced by the appellate decision, which becomes the *res judicata* between the parties. Even if the appeal fails the operative decision becomes that of the appellate court which replaces the earlier decision as the source of any estoppels. (Spencer Bower, Turner and Handley)

III. The Role of the Tribunal

19 The Court made a number of remarks concerning the jurisdiction and mandate of the Tribunal, the selection and role of lay members of the Tribunal, and the significance that should be attached to section 1.1 of the Act (the "purpose clause") when interpreting specific provisions of the Act. We believe that it is important to expand on these remarks in order to provide for a better understanding of these issues.

20 More particularly, the Court describes the Tribunal as an adjudicative body and the Court recognizes that the Tribunal lacks the wide powers of multi-functional administrative agencies such as provincial securities commissions (Appeal Judgment,

at paragraph 48). The scope of the Tribunal's expertise is limited by virtue of not having broad policy development powers (Appeal Judgment, at paragraph 48), but like other regulatory administrative tribunals, it is charged with the responsibility of protecting the public interest by striking a balance among conflicting interests and objectives (Appeal Judgment, at paragraph 98). Yet, the composition of the Tribunal indicates a considerable level of expertise (Appeal Judgment, at paragraph 56) by virtue of the appointment process for lay members and their expertise (Appeal Judgment, at paragraph 54).

21 Further, the Court finds the purpose clause of the Act to have the "...typically indeterminate quality and inherent inconsistencies of purpose or objective clauses...", yet "statutory provisions containing general statements of legislative purpose are integral to the statute and can carry as much weight as its other sections..." (Appeal Judgment, at paragraph 87), and that balancing competing objectives in order to determine where the public interest lies in a given case requires the exercise of discretion (Appeal Judgment, at paragraph 99). Finally, the Tribunal is as well-suited to this task as "other independent, specialized, administrative tribunals that are required to perform similar balancing exercises in the discharge of their regulatory functions." (Appeal Judgment, at paragraph 99).

A. Jurisdiction and Mandate of the Tribunal

22 Regarding the Tribunal's conclusion that advancing views on the social merit of various groups in society and achieving the proper distribution of income in society were not its role under the Act, the Court states at paragraph 98 of the Appeal Judgment:

> In my view, this conclusion gives insufficient weight to the range of experience and perspectives that the Act contemplates that the members of the Tribunal may possess, and overstates the degree of "social engineering" involved in considering a broad range of anti-competitive effects under section 96. *Like other regulatory administrative tribunals, the Tribunal is charged with the responsibility of protecting the public interest, which it does by striking a balance among conflicting interests and objectives in a manner that respects the text and purposes of the legislation*, is informed both by technical expertise and by the judgment that comes from its members' varied experiences, and is responsive to the particularities of the case. [Emphasis added]

23 The Court's premise seems to lead to the conclusion at paragraph 116 of the Appeal Judgment that:

> Conversely, it is in my view far from a fatal objection to the balancing weights approach that its proponent at the hearing before the Tribunal, Professor Townley, testified that, as an economist, he was unable to determine what were the effects of the merger of Superior and ICG and whether the efficiencies likely to be produced thereby were greater than, and offset, them. I take his point simply to have been that he was called as a witness expert in economics and that the balancing exercise called for by section 96 required broader public policy judgments that were outside his area of expertise, *but were for the Tribunal to make as it thought would best advance the public interest within the parameters of the Act*. [Emphasis added]

24 The Tribunal is, no doubt, an adjudicative body, subject to review by the Court. The Tribunal is a quasi-judicial body that is mandated to hear cases and make decision based on its interpretation of the legislation (section 9 of the *Competition Tribunal Act* (the "CTA")). It is of interest to compare the Tribunal with multi-functional administrative agencies. Whereas those agencies often have a quasi-legislative function as well as policy development and enforcement powers, the Tribunal does not. The chair of such an agency reports to the Minister or through the Minister to the legislature; the chair of the Tribunal, required to be a member of the Federal Court, does not. The Tribunal regulates nothing except its own proceedings.

25 As a purely adjudicative body, the distinctive features of the Tribunal are its specialized area, competition law, and the presence of lay members who function in all respects as judges except that they do not decide matters of law. The lay members' contribution to the adjudication of matters arises from their specialized education and expertise, which enables them to understand the specialized evidence in fields of economics and commerce that typically appears in cases involving competition law. The presence of lay members recognizes that competition law is highly specialized, that judicial training in areas outside the law is limited, and that the judges of the Federal Court of Canada may be lacking in experience in commercial matters generally.

26 Thus, it is true that the lay membership does not possess, nor will they develop, the detailed knowledge of a particular regulated industry. This can only suggest that the role of the Tribunal differs in critical respects from the role of multi-functional

administrative agencies. Moreover, multi-functional administrative agencies will be entirely without the benefit of judicial members. This would be consistent with the quasi-legislative function that some, perhaps many, of these agencies discharge in their rule-making. However, the Tribunal has only an adjudicative function in which the judicial and lay members play complementary roles.

27 At the time that Bill C-91, An Act to Establish the Competition Tribunal and to amend the *Combines Investigation Act* and the *Bank Act* and other acts in consequence thereof (1 st Session, 33 rd Parliament, 1984-85-86), was introduced, the Minister explained the need for, and the role of, the proposed tribunal:

> The Economic Council of Canada's 1969 Interim Report on Competition Policy stated that any shift of competition policy legislation out of the criminal law should be accompanied by the formation of a specialized tribunal to adjudicate these matters. In their 1976 Report, Lawrence A. Skeoch and Bruce C. McDonald endorsed this view but stressed the need for the adjudicator to be separate from departmental policing and policy making functions. This conflict in roles has also been the subject of comment recently by the Supreme Court of Canada.
>
> In the Southam case, the Supreme Court decided that the investigatory functions of the RTPC [Restrictive Trade Practices Commission], such as the power to gather evidence through hearings and to direct further investigation, impaired its ability to act as an impartial adjudicator in authorizing search and seizure. This finding, which was made under the Charter of Rights and Freedoms, signalled a need to create an adjudicative body which would be free of the dual roles of investigation and adjudication that the RTPC has carried out in the past.
>
> The issue of adjudication of competition matters has been the subject of much discussion over the long history of competition law reform. Many interested parties have proposed reliance on the ordinary courts to adjudicate competition matters. One factor often cited in support of the courts is their ability to produce consistent results with clear and full rights of appeal. Others have expressed a preference for the use of a specialized tribunal because it would provide greater potential for expertise in economics and business, and would permit more scope for response by the decision maker to social and economic change. In particular, lay experts are better able to reflect the reality of the business world.
>
> *On balance, the Government believes it is more appropriate that these matters be adjudicated by a highly judicialized tribunal*. This hybrid will allow the use of expert lay persons as well as judges in the decision-making process. Nevertheless, the Government agrees that it is very important to have in the law an adjudication system that ensures the impartiality, due process and certainty which is associated with the courts.
>
> . . . . .
>
> The Tribunal's functions will be strictly adjudicative. It will have no role in supervising the investigative powers of the Director, initiating investigations or providing research of policy advice to the Government...
>
> (Minister of Consumer and Corporate Affairs [Canada], The Honourable Michel Côté, *Competition Law Amendments: A Guide*, December 1985 at 10-11.) [Emphasis (italics) added] [hereinafter, *Competition Law Amendments: A Guide*]

28 The reasons for replacing the RTPC with the Tribunal emphasize the Tribunal's strictly adjudicative role. Hence, the Tribunal's mandate is not to make decisions driven by "public interest concerns". In our view, the guardian of the public interest, if there is one in competition matters, is the Commissioner who has the statutory obligation to conduct inquiries, the discretion to initiate civil legal proceedings before the Tribunal and other courts and the powers to enforce the Act in the public interest. The Commissioner also has the right to intervene before administrative agencies to defend competition.

29 Since the Tribunal is not an administrative body such as the Canadian Radio-Telecommunications Commission, the National Energy Board, the Ontario Securities Commission, etc., its lay members are called upon only to apply the Act based on their assessment of the evidence. For example, under section 92 of the Act, the lay members must determine whether a merger prevents or lessens competition substantially and they must contribute to the determination of the order that addresses such findings. Such assessments do not involve public interest consideration. Hence, the Tribunal does not fully understand the Court's remarks at paragraph 99 of the Appeal Judgment:

> Of course, balancing competing objectives in order to determine *where the public interest lies in a given case requires the exercise of discretion*... [Emphasis added]

B. Role of Lay Members

30 The Court drew attention to the selection process for lay members and noted that lay members were representative of the broad-based council that considers their appointment (Appeal Judgment, at paragraph 54). Accordingly, the Court holds that the Tribunal exercises discretion to act on its understanding of the public interest.

31 It is true that the CTA provides for an advisory council to vet candidates for appointment of lay members and to make recommendations to the Minister regarding appointments. However, the members of the advisory council, while required to be chosen from different groups in society, are not representatives of those groups. The Parliamentary Committee that reviewed Bill C-91 in 1986 studied this matter at length and amended the Bill to clarify that lay members were "individuals chosen from" certain groups rather than "representatives of" those groups as the Bill had provided:

> **Mr. Ouellet**: Mr. Chairman, I would like that subclause 3.(3) of the bill be amended by striking out line 17 on page 2 and substituting the following:
>
> > erality of the foregoing, individuals chosen from
>
> This is the reason for my amendment. As has been pointed out by some of the witnesses who have appeared before us, if we leave the end of this paragraph as it is, the business community, legal community, consumer group and labour group might believe that those who will advise the Ministers are advising the Ministers on behalf of these communities and groups. It might create a conflicting advisory board rather than an advisory board which is helping the Minister, in a sense, one that gives genuine and unattached recommendations.
>
> By changing a word there, it will be clear that these people are not representative of these so-called groups, but are chosen from among these groups.
>
> **The Acting Chairman (Mr. Cadieux)**: Mr. Domm.
>
> **Mr. Domm**: Mr. Chairman, to show how interested we are in getting along with the legal profession, and noting that the Canadian Bar Association made this point in their presentation to the committee, we would be prepared to accept that amendment as proposed by Mr. Ouellet.
>
> Amendment agreed to ... (Minutes of Proceedings and Evidence of the Legislative Committee on Bill C-91. House of Commons, Issue No. 10, Tuesday, May 20, 1986 at 10:37)

32 Since the members of the advisory council itself were not selected in order to act as representatives of the groups from which they were chosen, it follows that the lay members recommended by the council were also not to be seen as representative of such groups. The amendment by the Parliamentary Committee makes it clear that the role of the advisory council was to consider lay appointments to the Tribunal based solely on the expertise and experience of candidates, rather than on the extent to which those candidates represented the interests of different groups in society. Indeed, the Minister had already made this clear:

> Parliament has long recognized the need for special investigatory powers to deal effectively with competition matters. However, as stated by the Supreme Court decision in the Southam case, certain procedural safeguards have to be met in order to satisfy the protections embodied in the Canadian Charter of Rights and Freedoms. There is also a very real need to reassess the adjudication of the non-criminal matters under the Act to ensure that the adjudicator has the economic and business expertise to deal with competition issues and yet still provide procedural fairness and consistency in decision-making. (*Competition Law Amendments: A Guide*, at 5.)

33 The Tribunal further notes that the Minister is bound to consult the advisory council only when it has been constituted. The Tribunal understands that in 1992, an order-in-council terminated the appointment of each of the members of the advisory council established pursuant to subsection 3(3) of the CTA. Indeed, the February 1992-93 Budget announced the winding up of a list of agencies and committees as part of the deficit reduction initiatives. The list included the advisory council on lay members of the Competition Tribunal (Hon. Gilles Loiselle, President of the Treasury Board, *Managing Government Expenditures*, February 27, 1992, page 39). The document explained that "...with Canada's competition regime now mature and well functioning, there is no longer a need to maintain a separate statutory advisory committee [sic]." The elimination of the advisory council indicates to us that it is unlikely that the council was constituted to ensure the selection of members who may share their views about the public interest generally.

34 Accordingly, in our view, there does not appear to be a basis for inferring that Parliament intended the lay members of the Tribunal to play the same role as members of multi-functional administrative agencies. In particular, lay members of the Tribunal do not exercise their discretion to determine the public interest in the face of conflicting objectives because (a) the Tribunal is adjudicative only and, like a court, has no public-interest mandate; (b) discretion to determine the public interest is not required to adjudicate; (c) the Act, which itself defines the public interest, clearly articulates what the Tribunal is to do when a merger that lessens competition substantially also generates efficiency gains, and (d) the party with the public-interest mandate, if there is one, is the Commissioner.

35 The idea of the Tribunal as a court was readily accepted in 1991 by senior officials of the federal Justice Department:

> The 1986 amendment package, among other things, shifted the merger and monopoly provisions from the criminal law to a civil basis. Adjudication of these provisions, along with the existing civilly reviewable practices, was placed in the hands of the newly created Competition Tribunal. The Tribunal is a hybrid court which sits in panels consisting of judges of the Federal Court Trial Division and lay members possessing knowledge of economics and business matters. (D. Rutherford, Q.C., Associate Deputy Minister, Department of Justice, Canada and J.S. Tyhurst, Counsel, Department of Justice, Canada. "Competition Law and the Constitution: 1889-1989 and into the Twenty-First Century", chapter 8 of R.S. Khemani and W.T. Stanbury (eds.), *Historical Perspectives on Canadian Competition Policy*, The Institute for Research on Public Policy, Halifax, 1991 at 277) [hereinafter, *Rutherford and Tyhurst*]

36 It is noteworthy that neither the Minister nor these senior officials made any mention whatsoever to any public-interest role for the Tribunal or any such role therein for the lay members of the Tribunal.

IV. Roots of the Merger Provisions of the Act

37 In the Appeal Judgment, the Court adopts the legislative history of section 96 as recited by Madame Justice Reed in the *Hillsdown* decision (*Canada (Director of Investigation & Research) v. Hillsdown Holdings (Canada) Ltd.* (1992), 41 C.P.R. (3d) 289 (Competition Trib.)) and refers to Reed J.'s analysis of the preceding, unenacted versions of the efficiency defence in Bills C-42 and C-29. In the Court's view, these Bills "...did not require that the efficiencies gained from an anti-competitive merger be balanced against its effects." (Appeal Judgment, paragraph 129 at 50-51)

38 To illustrate, the Court points out that

> [130] Thus, Bill C-42 would have permitted an anti-competitive merger to proceed, provided only that substantial efficiency gains could be proved "by way of savings of resources for the Canadian economy" that would not otherwise have been attained: clause 31.71(5). Bill C-29 called for a determination of whether "the gains in efficiency would result in a substantial real net saving for the Canadian economy": clause 31.73(c). Neither of these provisions calls for a balancing of efficiencies against effects. Instead they focus on resource maximization in the economy as a whole in the same way as the total surplus standard.
>
> [131] I agree with Reed J.'s conclusion that, seen against this background, the more open-ended direction given to decision-makers by section 96, namely to balance the efficiency gains against the "effects" of an anti-competitive merger, should not

be interpreted in substantially the same manner as the above clauses, which explicitly permitted anti-competitive mergers when the resulting efficiency gains produced *net savings of resources for the Canadian economy*. While earlier bills seem clearly to have encapsulated the total surplus standard in the efficiency defences, section 96 does not. (Appeal Judgment, at page 51) [Emphasis in original]

39 It appears to the Tribunal that both the Court and Reed J. have decided the meaning of subsection 96(1) of the Act solely by reference to its terms and to the terms of the corresponding subsection of preceding bills designed to amend the *Combines Investigation Act*, R.S.C. 1970, c.C-23, ("*Combines Investigation Act*"). We believe that a careful and detailed review of the legislative history of section 96 is essential to properly understand the true meaning of that provision.

A. 1969 Interim Report of the Economic Council of Canada

40 The source of the various bills proposed by the federal government was the *Interim Report on Competition Policy* issued by the Economic Council of Canada in July 1969 (the "Report"). That Report was the second of three reports in response to a special Reference from the federal government dated July 22, 1966, requesting the Council:

In the light of the Government's long-term economic objectives, to study and advise regarding:

(a) the interests of the consumer particularly as they relate to the functions of the Department of the Registrar General [now the Department of Consumer and Corporate Affairs];

(b) combines, mergers, monopolies and restraint of trade;

(c) patents, trade marks, copyrights and registered industrial designs.

(Report, at 1)

41 The Economic Council pointed out in the Report that the first part of the Reference was treated in the Council's *Interim Report on Consumer Affairs*, published in 1967, and that its next report would discuss the matters in (c) of the Reference (Report, at 1). The Economic Council wrote that:

The present Report deals with the second part - that is, with "combines, mergers, monopolies and restraint of trade" or, as we prefer to call it, competition policy. (Report, at 1)

Accordingly, the Economic Council distinguished competition policy from the federal role in consumer protection.

42 Describing the objectives of previous competition policy, the Economic Council observed:

In the past, the major objective of Canadian competition policy has usually been expressed in such terms as "the protection of the public interest in free competition". But it is necessary to go behind this and ask what the preservation of competition was intended to accomplish. One would be unwise to assume that what the legislators aimed at was a single, simple end such as economic efficiency. At least some role was likely played by considerations such as the desire to diffuse economic power (and thus, by implication, political power), sympathy for the plight of the small enterprise and entrepreneur, suspicion of big business, and concern for the fairness of competitive behaviour.

On the whole, however, competition policy in Canada appears to have been directed towards more strictly economic ends. Two such ends may be distinguished, one being concerned with the distribution of income, the other with the allocation of real resources in the economy.

Popular thinking about competition policy has tended to stress the first, or income, objective...

Professional economists, while not ignoring income distribution effects, have tended to be more concerned with the second objective of competition policy-the resource-allocation objective. This is a less obvious objective, but a highly relevant one for broad economic goals such as productivity growth. To many economists, the greatest objection to monopoly (again using the extreme example) is that it distorts the way scarce human and physical resources are brought together and used to meet the many demands of consumers. It leads, in other words, to inefficiency. The monopolist's prices are too high, relative to other prices, and because the usual adjustment machinery is not operative, they remain so. As a result, "relative prices become unreliable as indexes of relative scarcities and relative demands ... too little will be produced and too few resources utilized in [monopolistic] industries with high margins; and too much will be produced and too many resources utilized in industries with low margins." ... (Report, at 6-7)

43 The Economic Council concluded that competition policy (i.e. policies toward combines, mergers, monopolies and restraint of trade) should focus on economic efficiency:

It will be a recurrent theme in this Report that Canadian competition policy should aim primarily at bringing about more efficient performance by the economy as a whole. *Competition should not itself be the objective* but rather the most important single *means* by which efficiency is achieved... (Report at 9) [Emphasis in original, underlined emphasis added]

Essentially, we are advocating the adoption of a single objective for competition policy: the improvement of economic efficiency and the avoidance of economic waste, with a view to enhancing the well-being of Canadians...

This concentration on one objective is not meant to imply any necessary disparagement of other objectives, such as more equitable distribution of income and the diffusion of economic power, which have been entertained for competition policy in the past. It is simply that we believe:

(1) that a competition policy concentrated on the efficiency objective is likely to be applied more consistently and effectively; and

(2) that there exist more comprehensive and faster-working instruments, particularly the tax system and the structure of transfer payments, for accomplishing the deliberate redistribution of income and the diffusion of economic power, to whatever extent these are thought to be desirable.

(Report, at 19-20)

44 Thus, the Report firmly established that redistributive effects of competition policy were separate matters. The Council also cautioned against the uncritical acceptance of competition policies in other countries, in particular, the United States:

In drawing lessons from abroad, appropriate allowance must of course be made for differences between the Canadian and foreign economic environments. This has often been pointed out with reference to the United States. Although competition policies in Canada and the United States, as instituted in the late nineteenth century, were in many ways a response to common concerns, their subsequent divergence has been partly a reflection of certain rather deep-seated differences between the two countries ... and the smaller size and greater openness and world-trade orientation of the Canadian economy. *Perhaps the most important implication of the latter difference is that the Canadian economy is less able than its U.S. counterpart to afford a competition policy that, on occasion, may be prepared to sacrifice economic efficiency for other ends, such as the preservation of small business*. (Report, at 48) [Emphasis added]

45 The Economic Council recommended the creation of a tribunal that would adjudicate mergers to determine anti-competitive effects and "offsetting public benefits":

In its examination of a merger, the tribunal might be expected to have regard to all aspects of the merger that were related in any important way to the tribunal's general terms of reference. It would be primarily concerned with whether the merger was likely to lessen competition to the detriment of final consumers, and whether there were likely to be any offsetting public benefits. In addition, and without restricting the generality of the foregoing, the tribunal would be requested to pay attention to the following matters *in so far as they appeared to be of substantial economic importance in any particular case*:

. . . . .

> (8) the likelihood that the merger would be productive of substantial "social savings", i.e. savings in the use of resources (including resources used for such purposes as research and development), viewed from the standpoint of the Canadian economy as a whole.

(Report, at 115-116) [Underlined emphasis added]

46 Given the Economic Council's overriding concern with efficiency and its belief that distributional concerns were not part of competition policy, it is clear that the tribunal was not to be concerned with the redistributional effects of an anti-competitive merger when it considered item (8) because those effects were not losses of resources and, as redistributions of income, were not losses to society when viewed from the standpoint of the Canadian economy as a whole. Accordingly, the use of the phrase "offsetting public benefits" could not be used to introduce redistributional effects. Yet, the Economic Council did refer to a "balancing assessment":

> ...[The Director] would leave the consideration of item (8), dealing with social savings, to the tribunal, which in many cases would find itself required to perform *a balancing assessment between possible detrimental effects on competition and possible beneficial effects in the form of social savings*. It should be pointed out in this connection that what appear to be cost savings to individual firms are not always "social savings", i.e. savings for the total economy. Thus, for example, a firm that has grown larger by acquiring another firm may be able to obtain certain supplies more cheaply purely by virtue of its greater bargaining power. There are various possible outcomes in terms of profits and prices, but there is no saving in terms of the real resources (the physical amounts of labour, capital, etc.) required to produce and transport the supplies in question. No real resources are freed for other uses in the economy... (Report, at 117) [Emphasis added]

Accordingly, the Economic Council's "balancing assessment" referred, not to adverse redistributive effects on consumers, but to the detrimental effects of a merger on competition. In this assessment, the Economic Council emphasized the need to distinguish between real savings and pecuniary savings.

B. Legislative History of the Efficiency Defence

47 Bill C-256 was the government's first attempt to amend the *Combines Investigation Act* following publication of the Report. The government did not accept the Economic Council's insistence on economic efficiency as the sole objective of competition policy, as can be seen in the preamble to Bill C-256:

> Whereas competition in the private sector is ordinarily the best means of allocating resources, of enhancing efficiency in the production and distribution of goods and services and of transmitting the benefits of efficiency to the public, and competition also furthers individual enterprise by decentralizing economic power and reducing the need for government intervention in the achievement of economic objectives;
>
> And Whereas it is therefore desirable to promote competition actively and also to remove, throughout Canada, obstacles to competition whether created by combinations, mergers, monopolies or other situations or practices, and such objectives can only be achieved through the recognition, encouragement and enforcement of the role of competition as a matter of national policy;
>
> And Whereas it is also recognized that in cases where a market is too small to support a sufficient number of independent firms of efficient size to promote effective competition, alternative means of promoting maximum efficiency may be required, *but that where such an alternative means is adopted, it is necessary to ensure that the resultant benefits will be transmitted in substantial part and within a reasonable time to the public and that the public will be protected against any abuses that the alternative means of promoting efficiency may facilitate*;
>
> And Whereas it is necessary and desirable, in the interest of efficiency of production and distribution and the transmission of the benefits thereof to the public, to promote honest and fair dealing in the market;

Now therefore... (House of Commons, Bill C-256, 3 rd Session, 28 th Parliament, 19-20 Elizabeth II, 1970-71. (First Reading, June 29, 1971) [Emphasis added]

48 The preamble specifically calls attention to economic power, and to consumer welfare when it would be necessary, due to small market size, to depart from competition in order to achieve efficiency. The merger provisions of Bill C-256 addressed this concern with an efficiency defence that included a "passing on" requirement:

s.34(3) A merger shall not be prohibited or dissolved by order of the Tribunal if it is satisfied

(a) that none of the parties thereto could reasonably have commenced or continued to carry on business in the relevant market independently; or

(b) that

(i) the merger has led, is leading or is likely to lead to a significant improvement of efficiency over that which any of the parties to the merger could have achieved by commencing or continuing to carry on business independently or in any other manner that would have led to less restriction of competition than resulted or would be likely to result from the merger, and

(ii) a substantial part of the benefits derived or to be derived from such improvement of efficiency are being or are likely to be passed on, through conditions imposed by the market or by order of the Tribunal, to the public within a reasonable time in the form of lower prices or better products.

49 It was a clear concern of Bill C-256 that redistributional effects of anti-competitive mergers saved by efficiency gains not harm consumers beyond a reasonable time period. This concern was successively de-emphasized in subsequent bills.

50 Section 1 of Bill C-42 contained as preamble:

An Act to provide for the general regulation of trade and commerce by promoting competition and the integrity of the market place and to establish a Competition Board and the office of Competition Policy Advocate

WHEREAS a central purpose of Canadian public policy is to promote the national interest and the interest of individual Canadians by providing an economic environment that is conducive to the efficient allocation and utilization of society's resources, stimulates innovation in technology and organization, expands opportunities relating to both domestic and export markets *and encourages the transmission of those benefits to society in an equitable manner*;

AND WHEREAS one of the basic conditions requisite to the achievement of that purpose is the creation and maintenance of a flexible, adaptable and dynamic Canadian economy that will facilitate the movement of talents and resources in response to market incentives, that will reduce or remove barriers to such mobility, *except where such barriers may be inherent in economies of scale or in the achievement of other savings of resources*, and that will protect freedom of economic opportunity and choice by discouraging unnecessary concentration and the predatory exercise of economic power and by reducing the need for detailed public regulation of economic activity;

AND WHEREAS the effective functioning of such a market economy may only be ensured through the recognition and encouragement of the role of competition in the Canadian economy as a matter of national policy by means of the enactment of general laws of general application throughout Canada and by the administration of such laws in a consistent and uniform manner;

NOW, THEREFORE,... (Bill C-42, 2 nd Session, 30 th Parliament, 25-26 Elizabeth II, 1976-77. (First Reading March 16, 1977) [Emphasis added]

51 Bill C-42's preamble expresses concern for efficiency and equity generally, and states that saving resources could entail a departure from competition. However, in contrast with the previous bill, Bill C-42 limited the availability of the efficiency defence and dropped the "passing on" requirement:

> s.31.71(5) The Board shall not make an order under subsection (3) where it is satisfied by the parties to a merger or proposed merger to which this section applies that the merger or proposed merger has brought about or that there is a high probability that it will bring about substantial gains in efficiency, by way of savings of resources for the Canadian economy that are not reasonably attainable by means other than the merger.
>
> . . . . .
>
> (7) Where the Board finds that
>
> > (a) subsection (5) applies in respect of a merger or proposed merger to which this section applies, and
> >
> > (b) the merger or proposed merger will or is likely to result in virtually complete control by the parties to the merger or proposed merger in respect of a product in a market,
>
> the Board shall, notwithstanding subsection (5), make an order under subsection (3)...

52 The new approach to equity in merger review was therefore not to require a "passing on" of the benefits of efficiency gains to consumers, but rather to deny the availability of the efficiency defence when the merger would lead to virtually complete control of a product in a market. However, when the efficiency defence was available, no measures for consumer protection in respect of an anti-competitive merger were provided in the merger provisions.

53 The preamble and corresponding provisions in Bill C-13 (3rd Session, 30th Parliament, 26 Elizabeth II, 1977) were virtually identical to the above provisions of Bill C-42, although the efficiency defence in subsection 31.71(5) now required a "clear probability of substantial gains in efficiency that save resources for the Canadian economy". The limitation on the availability of the efficiency defence was retained.

54 Bill C-29 (2nd Session, 32nd Parliament, 32-33 Elizabeth II, 1983-84) differed in several respects. It contained no preamble or purpose clause and hence no reference to any goal including equity. It assigned merger review to the courts with an efficiency defence:

> s.31.73 The Court shall not make an order under section 31.72...
>
> > (c) where it finds that the merger or proposed merger has brought about or is likely to bring about gains in efficiency that will result in a substantial real net saving of resources for the Canadian economy and that the gains in efficiency could not reasonably be expected to be attained if the order were made.

Like Bills C-42 and C-13, there was no "passing on" requirement; however, unlike those Bills, there was no limitation on the availability of the efficiency defence.

55 In December, 1985, the Minister introduced Bill C-91 (1st Session, 33rd Parliament, 33-34 Elizabeth II, 1984-85) with a purpose clause and an efficiency defence which survived subsequent Parliamentary review and were included in the Act.

56 In *Hillsdown, supra*, Reed J. concluded that subsection 96(1) of the Act differed from the efficiency defences in Bills C-42 and C-29 only because it required the balancing of efficiency gains against the effects of the merger which those Bills did not apparently require. However, it does not appear that Reed J. took note

> (a) of the explicit concern with distributional equity in the preambles of Bills C-256, C-42 and C-13, and the explicit omission thereof in Bills C-29, C-91 and the Act;

(b) that Bill C-42 and all subsequent bills and the Act had dropped the "passing on" requirement in the efficiency defence contained in Bill C-256, and

(c) that the limitation on the availability of the efficiency defence in Bills C-42 and C-13 was omitted from Bills C-29, C91 and the Act.

57 In the Tribunal's view, Bill C-29, by requiring the "substantial real *net* saving", did call for a comparison of gains in efficiency attributable to the merger with the effects that reduced the savings therefrom. This formulation was an indication that the gains in efficiency and the effects had to be expressed in like units, otherwise the netting could not be done. For example, it is not clear how adverse redistributive effects, which are not losses of real savings, could be netted against real savings. Moreover, Bill C-29 contained no preamble or purpose clause and no reference to equity.

58 While, unlike Bills C-256, C-42 and C-13, Bill C-91 made no reference to equity, the issue of fairness to consumers came before the Parliamentary Committee reviewing Bill C-91.

C. The Parliamentary Committee

59 In its Appeal Judgment, the Court held the following:

[100] Finally, I also find it difficult to accept the Tribunal's interpretation of the Act for the following two reasons. First, when Bill C-91 was introduced in Parliament it was widely regarded as a consumer protection measure. Thus, the Minister responsible stated in the House of Commons (*Debates, supra*, at 11927) that the Consumers' Association of Canada saw the Bill as promising "real progress for consumers". Indeed, the guidebook introduced when the legislation was first tabled states (Consumer and Corporate Affairs Canada, *Competition Law Amendments: A Guide* (December 1985), page 4):

> Consumers and small business are among the prime beneficiaries of an effective competition policy.

[101] In addition, the background document released when the amendments were previously tabled (Consumer and Corporate Affairs Canada, *Combines Investigation Act Amendments 1984: Background Information and Explanatory Notes* (April 1984), page 2), states that:

> the Bill is concerned with fairness in the functioning of markets-fairness between producers and consumers, fairness between businesses and their suppliers, and suppliers and their customers.

[102] It thus seems to me unlikely that Parliament either intended or understood that the efficiency defence would allow an anti-competitive merger to proceed, regardless of how much the merged entity might raise prices, provided only that the efficiencies achieved by the merger exceeded the resulting loss of resources in the economy at large. As Reed J. noted in the *Hillsdown* case, *supra*, at pages 337-38, differences in the drafting of the efficiency defence in the precursors to Bill C-91, which were not enacted, point in the same direction, and are considered in paragraphs 129-131, *post*.

60 The Court's extract from page 4 of the *Competition Law Amendments: A Guide*, is an extract from the Minister's statement noted above and, in the Tribunal's view, requires some examination. The quoted passage comes in the context of the following:

The relatively small size of the Canadian market and the overall importance of international trade to the economy dictates that certain industries have to be concentrated in order to achieve scale or other efficiencies necessary to compete in world markets. However, the trend toward increasing concentration historically has been a cause for concern, and many industries are protected from competition by high economic and institutional barriers to entry, such as high tariffs. The Bill brings the law into focus with current economic realities so that it is better able to deal with the implications for Canadian industry of foreign competition in Canada and competition in world markets.

Consumers and small business are among the prime beneficiaries of an effective competition policy. These two groups are afforded little protection from anti-competitive conduct on the part of large, dominant firms under the existing legislation.

> The Bill strengthens the law and makes it more effective, thus ensuring *fairness in the marketplace*. This will benefit consumers and will maintain and encourage the drive and initiative of the small business sector, which has the greatest potential for job creation. (*Competition Law Amendments: A Guide*, at 4) [Emphasis added]

The full extract makes it clear that the creation of dominant firms able to compete successfully is the policy goal, and that consumers and small businesses will be better protected from anti-competitive conduct by these firms. When viewed in context, the cited extract does not confirm that the civil matters under Act are primarily measures for consumer protection, although consumers and small businesses would be "among the prime beneficiaries" not only from improved protection but also from the greater ability to compete.

61 In quoting the document *Combines Investigation Act Amendments 1984: Background Information and Explanatory Notes* (April 1984), the Court is referring not to Bill C-91 but rather to Bill C-29. As noted above, Bill C-29 differed from its predecessors by making no reference whatsoever to equity. Moreover, its efficiency defence explicitly ignored the redistributive effects that concerned its predecessor bills: the "passing on" requirement of Bill C-256 and the limitation on the efficiency defence in Bills C-42 and C-13 were dropped from this Bill. The "fairness" in the sentence quoted by the Court refers not to social equity but, rather, the fairness of opportunity provided in a competitive marketplace; there is no presumption that the resulting distribution of income and wealth in a competitive economy will be fair or equitable. Indeed, competitive markets may distribute income and wealth inequitably.

62 In the Tribunal's view, Parliament clearly understood that consumer protection was not the main goal of the amendments to the Act or of the merger provisions in particular. The Committee that considered Bill C-91 considered two amendments to the purpose clause that would have confirmed that view, but those amendments were not adopted by the Committee and not reported to the House of Commons:

> **Mr. Ouellet**: My amendment, Mr. Chairman, relates to the purpose of the bill, which is stated on page 7. I would like to strike out lines 14 to 26 and substitute the following:
>
> > The purpose of this act is first and foremost to provide consumers with competitive prices and product choices, and also in order to [e]nsure that small and medium-size enterprises have an equitable opportunity to participate in the Canadian economy and in order to maintain and encourage competition in Canada in order to promote the efficiency and adaptability of the Canadian economy, in order to expand opportunities for Canadian participation in world markets while at the same time recognizing the role of foreign competition in Canada.
>
> The purpose of my amendment is to give priority to consumers interests. You will note, Mr. Chairman, that not one word of my amendment is different from clause 1.1.
>
> . . . . .
>
> **Mr. Ouellet**: The reason for my amendment is to give priority to competitive prices and a choice of products for consumers. A Competition Act is first and foremost one that should protect consumers. The prime objective of a Minister of Consumer and Corporate Affairs should be to protect consumers. The way in which the purpose of the bill is presented suggest that consumer protection is the Minister's least concern. I do not think that this is the case. I therefore want to restore the normal order and refer to consumers first, then to competition in world markets and finally to the Canadian economy.
>
> . . . . .
>
> **Mr. Domm**: Yes. I appreciate the opportunity to point out that the purpose of this clause we are discussing today is to encourage competition, and particularly participation in world markets. It is not to overlook consumers. But I think it is to act as a guide to the purpose and object of the legislation. Competition itself is not an end, but it is rather the most effective means of stimulating efficiency and productivity and Canadian industrial growth. I think that we have to be cognizant of efficiency, international competitiveness and fairness.
>
> Consumers would benefit directly from increased competition because that of course results in lower prices and increased choice and better quality. I think there are some other factors that we should consider too, such as the Constitution. I would like to ask our gentleman from Justice to elaborate on that at this time.

. . . . .

Mr. Rosenberg: This morning, Mr. Ouellet, you raised the question about the constitutionality of the tribunal's jurisdiction. In looking at your amendment, I am a little bit concerned that in characterizing the purpose of the act as being first and foremost to provide consumers with competitive prices and product choices, essentially it seems to be characterized as a concern with individual contracts between consumers and the prices consumers pay for goods rather than with a concern for competition generally.

I am concerned when you start characterizing the business of the federal government as being individual consumer contracts, you are straying into an area which is within provincial jurisdiction; that is, contracts or property and civil rights in the province. I think it is important to characterize the goal of the law as being generally the encouragement of competition.

That being the purpose, one of the effects of it is going to be to lead to lower consumer prices and better product choice, but I think it is important not to lose sight of the fact the general purpose has got to be with respect to the competitive system generally throughout the country and not with respect to specific consumer concerns. The provinces have consumer protection statutes within their jurisdiction.

Mr. Domm: Thank you very much. We should also point out some positions taken by organizations like the Canadian Federation of Independent Business. On page 312 of their brief, they are very pleased with the inclusion of small business in the purpose clause. Also, the Canadian Manufacturers' Association, page 301: they are pleased with the wording of proposed subsection 1.1, which fully recognizes competition is international as well as domestic in today's marketplace, on page 1. The Chamber of Commerce, on page 316, point 2, is pleased that any framework legislation such as Bill C-91 must in itself be capable of being interpreted in a dynamic fashion. These are other reinforcing justifications for dealing specifically with the encouragement of competition in Canada.

Mr. Cadieux: I would just like to add, Mr. Chairman, that when you look at the title, whether you look at it in French or in English, *loi sur la concurrence* or Competition Act, and then go into the object-and if I read the English version of your text, which is perhaps more explicit, the purpose of this act is first and foremost to provide consumers with competitive prices, etc.-I think I agree more and more with the legal experts here that perhaps we are creating a horse of a different colour right now. We do have to deal with competition and of course, as a consequence, will ensure better prices for the consumer. Because of this, I will have to vote against the proposed amendment.

Motion negatived: nays, 3; yeas, 2

The Chairman: Mr. Orlikow's amendment now, on the same clause.

Mr. Orlikow: Mr. Chairman, I would move the following amendment to clause 19. I would move to strike out lines 14 to 26 and substitute the following words:

> 1.1 The purpose of this Act is to maintain and encourage competition in Canada in order to provide consumers with competitive prices and choice of goods and services wherever they may live, while at the same time ensuring that small and medium-sized enterprises have a full opportunity to participate in an economy with open markets.

The Chairman: Do I have some comment from Mr. Cappe or Mr. Domm? Mr. Cappe.

Mr. Cappe: Mr. Chairman, I do not have any comments on the reordering of the objectives. I think the dropping of the reference to promoting efficiency and adaptability of the Canadian economy is important, partly because of the way it affects consumers. I will just make that one comment.

Amendment negatived: nays, 3; yeas, 2 (Minutes of Proceedings and Evidence of the Legislative Committee on Bill C-91. House of Commons, Issue No. 10, Tuesday, May 20, 1986 at 10:59-10:62)

63 The Tribunal notes, for greater certainty, that Mr. Cappe and Mr. Rosenberg appeared before the Committee in their positions as Assistant Deputy Minister, Policy Coordination and General Counsel, respectively, for the Department of Consumer and Corporate Affairs and were co-drafters of Bill C-91.

64 It is apparent that the Minister's comments regarding Bill C-91 to which the Court refers relate to the benefits of competition generally for consumers. As the Parliamentary Committee emphasized, the principal focus of the amendments to the Act was not to protect consumers directly because, *inter alia*, doing so intruded in the provinces' domain and restricted the attainment of other goals, including efficiency, that also benefit consumers.

65 It is certainly true that Bill C-91 received support from the Consumers' Association of Canada, but only insofar as the Bill promoted its approach to consumer welfare. In fact, the Association was critical of the efficiency defence. A representative of the Association appeared before the Parliamentary Committee and made the following statement:

> **Mr. Thompson**: ...I would just like to sum up our remarks at this stage by saying that we think Bill C-91 is substantially better that what we have now. It is progress; there is no question about that. This is probably a familiar refrain to this committee at this stage. However, we think that from the consumer perspective it falls a long way short of what we deserve...
>
> We have a very short list of suggestions for improvements, I think it is fair to say-improvements in the tribunal powers, opportunities for consumers to appear before the tribunal, the removal of "unduly" from the conspiracy section, the removal of the object or intent test from "abuse of dominant position", tightening up of the efficiency defence and mergers, and a lowering of pre-notification thresholds.
>
> We feel that those are proposals which would significantly improve price and choice for consumers in the economy... (Minutes of Proceedings and Evidence of the Legislative Committee on Bill C-91, House of Commons, Issue No. 6, Tuesday, May 8, 1986 at 6:11)

66 The Consumers' Association of Canada was not alone in its criticism before the Parliamentary Committee of the efficiency defence in Bill C-91. We wish to point out and emphasize the remarks of Professor William Stanbury who stated that the provision was vague because it required, in his view, comparing "...a redistribution of income and the other involves with real gains in terms of the savings of resources." (Minutes of Proceedings and Evidence of the Legislative Committee on Bill C-91, Issue No.3, Tuesday, April 29, 1986 at 3:7).

67 Mr. D. O'Hagan, representing the Canadian Labour Congress, cited the position on the efficiency defence of the Consumers' Association of Canada with approval and insisted that

> ...the tribunal is empowered to attach structural conditions to assure that efficiency gains would be passed on to consumers in the form of better prices, better quality; to workers in the form of more stable jobs, better incomes and better working conditions; and to other community groups in ways that are relevant to them... (Minutes of Proceedings and Evidence of the Legislative Committee on Bill C-91, Issue No. 9, Thursday, May 15, 1986 at 9:12-9:13)

68 However, Mr. L. Hunter, former Director of Investigation and Research and co-drafter of Bill C-91, testified before the Committee as follows:

> Economic efficiency in the merger section, which is a defence as well, is really based on two fundamental premises. First of all, we want a law that will allow the government to be able to stop merger activity which has a serious effect on competition, however defined. "Substantially" happens to be the word that is used. At the same time, we want to recognize that mergers can truly bring about efficiency savings. They can lower costs. Those cost savings are important to the economy and to consumers.
>
> For many years, going back to the Economic Council of Canada's report in 1969, there has been the notion of trading off these two things. On the one hand we want to look at the effect on competition and how serious that is; on the other hand,

we want to look at what cost savings or efficiency gains there will be from the merger activity. This proposal basically says that if those efficiency savings are greater than the likely cost of competition, you should allow the merger.

Regarding what that efficiency test will come to mean, I think economists would tell you that it has a relatively precise meaning. It certainly means long-run economies of scale. By merging, you increase the production line you can undertake and that will lower your unit cost. That is an efficiency saving. There may also be economy efficiencies that arise from the dynamic nature of your business and the degree of innovation and research you undertake... (Minutes of Proceedings and Evidence of the Legislative Committee on Bill C-91, Issue No. 7, Monday, May 12, 1986 at 7:27-7:28)

69 Finally, the Committee debated at length an amendment to remove the efficiency defence from the proposed merger provisions of Bill C-91:

Mr. Ouellet: ...The purpose of this amendment is to remove from the bill the exception that is given there to the industry to plead before the tribunal that the merger should be approved where gain in efficiency would result.

My feeling is that this gain of efficiency is of such a magnitude that it could in fact impair the tribunal in preventing some mergers from taking place. In almost every merger, it would be possible to plead with good economics experts, accountants and so on that there will be gains in efficiency...

Mr. Domm: We would oppose the motion for amendment. I can talk to it at some length here, but I suppose in summary our reason for opposition would be that the purpose of this policy is basically to promote efficiencies. This is not an absolute override but rather a balancing defence of the benefits against the costs. For this reason, we would prefer to leave the proposed section 68 intact as printed.

. . . . .

Mr. Orlikow: Yes, Mr. Chairman, I certainly want to support Mr. Ouellet's amendment. I am not going to make a long speech at this stage. It has already been argued and we have had witnesses who have pointed out that to a large extent mergers really bring no real efficiencies and no real reductions in prices and certainly do not lead to more competition. We have had a whole series of mergers. We had Imasco taking over Canada Trust, Brascan Housing taking over paper companies, and mining companies going into Trilon. I think it is in today's *The Financial Post* or *The New York Times*. We are talking about assets of $60 billion or $90 billion, which means they have more economic power than the major bank. You have power corporations taking over all sorts of businesses and now moving into power finance.

There is no evidence these take-overs, these mergers, have done anything for Canadian, or have produced more jobs. If we could do the kind of in-depth study of those corporations we should be doing, we would find there are less jobs now than there were before the mergers, prices have not come down, and they have not spent more money on research and development.

It seems to me, and I have said this before, with this kind of clause in the bill, it is an open invitation for these mergers to be encouraged. These kinds of clauses give the people and the companies involved in mergers a defence to argue they are going to be more efficient and so on, if they should be charged under the provisions of this bill. I think it will be very difficult for the tribunal, as it has been for the courts with the old legislation, to take any effective action. For that reason, I would support Mr. Ouellet's amendment.

Mr. Domm: To refer to answer by Mr. Orlikow, page 7 of the bill, where we have outlined the purpose of the bill in proposed subsection 19.(1.1), is clearly to promote the efficiency and adaptability of the Canadian economy in order to expand opportunities for Canadian participation in world markets.

Regarding his concern, which has just been expressed-that there is no obligation to pass gains on to the consumer-I say such an obligation can be very difficult to objectively measure or to monitor, and unless the lessening of competition is overwhelming, competition in the market will result in gains passed on to consumers. For that reason, I would not be willing to support that amendment.

Mr. Orlikow: Just for the record, Mr. Chairman, I remind Mr. Domm and members of the committee that witnesses, including Professor Stanbury, were very emphatic that this bill would be and is quite deficient in its ability to attain the objectives which it sets out, if it does not give the tribunal the opportunity to deal with mergers.

Mr. Ouellet: I have a question to ask to the Parliamentary Secretary. As Professor Stanbury has pointed out to us, proposed section 68 contemplates a trade-off between gain and efficiency, and the lessening of competition. According to the government, which of the two is most important?

Mr. Domm: I think it goes back to a former statement I made in response to your original motion. It is a balancing defence we are looking for. It is not a question of which one, but rather a balancing defence of the benefits against the costs.

Mr. Ouellet: Do you agree that, as Professor Stanbury indicated to us, the matters which the tribunal will have to consider under this clause are not comparable, since one involves a redistribution of income and the other involves real gain and resource savings? Because Parliament does not seem to give any guidance to the tribunal and its priorities and the way to be applied to lessening competition and gaining efficiency, it seems it would be very difficult for the tribunal to choose. It seems clear it would be very difficult for the tribunal to choose. It seems clear there might be some gain of efficiency in any take-over, in any merger. Is this what government feels is more important, to the detriment of lessening competition?

Mr. Domm: The provision we are asking for provides "a simple redistribution of income shall not be considered to be a gain in efficiency."

. . . . .

Mr. Ouellet: This satisfies my questions. I thank Mr. Cappe, but I still believe such exceptions represent a major loophole in the merger sections and such a wide loophole should not be in the legislation. If we really want to have a legislation that effectively deals with mergers which could lessen competition, such exceptions where gain and efficiency should not be accepted.

Amendment negatived: nays, 4; yeas, 2 (Minutes of Proceedings and Evidence of the Legislative Committee on Bill C-91, Issue No. 11, Wednesday, May 21, 1986 at 11:38-11:42).

70 The Tribunal notes that the Committee took issue with the absolute defence of "superior competitive performance" under the abuse of dominance provisions in Bill C-91. That defence had provided as follows:

s.51(4) No order shall be made under this section where the Tribunal finds that competition has been, is being or is likely to be prevented or lessened substantially in a market as a result of the superior competitive performance of the person or persons against whom the order is sought.

The Committee rejected this absolute defence and instead provided that "superior competitive performance" was to be a factor that the Tribunal would be required to consider when deciding whether a practice lessened or prevented competition substantially in a market (Minutes of Proceedings and Evidence of the Legislative Committee on Bill C-91, Issue No. 11, Wednesday, May 21, 1986 at 11:33, 11:35). This factor now appears as subsection 78(4) of the Act.

D. Free Competition

71 In oral argument and in written reply, the Commissioner refers to the Court's treatment of the wealth transfer and to its acknowledgment of the "consumer protection" objective of the Act which, the Commissioner submits, is reflected in a long line of Canadian jurisprudence. The Commissioner emphasizes "...the protection of the public interest in free competition..." (Reply Memorandum of the Commissioner of Competition on the Redetermination Proceedings ("Commissioner's Reply Memorandum on Redetermination Proceedings"), paragraph 91 at 34) and argues that the extraction of wealth transfers from consumers through the exercise of market power represents injury to the public that the Supreme Court of Canada condemned in 1912 in *Weidman v. Shragge* (1912), 46 S.C.R. 1 (S.C.C.), (Commissioner's Reply Memorandum on Redetermination Proceedings, paragraph 92 at 34).

72 The Commissioner also draws attention to the 1992 Supreme Court of Canada decision in *Nova Scotia Pharmaceuticals* (*Canada v. Pharmaceutical Society (Nova Scotia)*, [1992] 2 S.C.R. 606 (S.C.C.)) in which the appellants were charged with two counts of conspiracy to prevent or lessen competition unduly, contrary to the *Combines Investigation Act*, paragraph 32(1)(c). The Commissioner quotes Gonthier J.'s decision:

> ...As this Court has always held in its previous judgments, the aim of the Act is to secure for the Canadian public the benefit of free competition. Excessive market power runs against the objectives of the Act... (Commissioner's Reply Memorandum on the Redetermination Proceedings, footnote 84 at 34)

73 The Tribunal notes that this quote omits the next and final sentence in that paragraph of Gonthier J.'s decision which states:

> When it occurs in the context of a conspiracy to restrict competition, s. 32(1)(*c*) will apply.

It goes without saying that Gonthier J. was referring to criminal conspiracy, and not to the merger provisions, including the efficiency defence, under the civil law regime introduced in 1986.

74 As a subsidiary matter, the Tribunal notes that the Supreme Court of Canada declined to rely on the doctrine of "free competition" in its decisions in *R. v. K.C. Irving Ltd.* ((1976), 32 C.C.C. (2d) 1 (S.C.C.)), which dealt with charges of both monopoly and merger and in *Atlantic Sugar Refineries Co. v. Canada (Attorney General)* ((1980), 54 C.C.C. (2d) 373 (S.C.C.)). In *R. v. Aetna Insurance Co.* ((1977), 34 C.C.C. (2d) 157 (S.C.C.)), the doctrine was discussed by the majority only in the context of the meaning of the word "unduly", and in *Canada (Attorney General) v. Law Society (British Columbia)* ([1982] 2 S.C.R. 307 (S.C.C.)), it appears that the Supreme Court of Canada ignored the concept in order to approve the exemption of regulated conduct.

75 The inadequacy of the criminal law approach in light of the central goal of economic efficiency was pointed out by senior Department of Justice officials in 1991 who wrote, quoting Bruce McDonald with approval:

> Although the criminal law had provided a safe constitutional haven for nearly three quarters of a century, concerns began to be expressed in the 1960's that competition legislation founded on such a basis might not be effective. Bruce McDonald wrote in 1965:
>
> > The demands of 1889 are not the demands of the 1960's, and the combines cases illustrate the contortions through which the courts have been going in their attempts to accommodate the change absent any fundamental overhaul of the statute. The object of the statute has changed, and increasingly the control of combines is recognized as a sophisticated problem requiring analysis of economic data. The Canadian courts, aware of their deficiencies in the training needed for such evaluations, resist as much as possible any debate over or inquiry into economic data or theory. The considerations of 1889 which impelled the legislators to make the combines law criminal no longer obtain. The undesirability of combines no longer stems appreciably from rejection on moral grounds; nor can the Act be specific in such a way as to bring combines offences within the other general category of moral element... This is not to suggest that combines ought to be in one of the two categories; but only that, if it is not, the use of the criminal law as the appropriate control device must be seriously questioned.
>
> This theme was echoed by the Economic Council in its 1969 *Interim Report on Competition Policy*. The Council had been asked in 1966 "In light of the government's longterm economic objectives, to study and advise regarding ... combines, mergers, monopolies and restraint of trade...". It concluded that the primary goal of competition policy should be the promotion of economic efficiency. That, to the Council, also meant moving from the strictures of the criminal law to a more flexible civil law basis:
>
> > The basic reasons for seeking to place some of the federal government's competition policy on a civil law basis would be to improve its relevance to economic goals, its effectiveness, and its acceptability to the general public. The greater flexibility afforded by civil law is especially to be desired in those areas of the policy that do not lend themselves well

to relatively unqualified prohibitions and that may in addition call for some case-by-case consideration of the likely economic effects of particular business structures or practices. (Rutherford and Tyhurst, at 258-259)

76 In the Tribunal's view, the statutory history and, in particular, the introduction of the civil law regime for mergers in the 1986 amendments to the *Combines Investigation Act* indicate that it would be wrong to adjudicate mergers on the basis of the "free competition" doctrine that has been applied by courts at various times in criminal conspiracy matters.

77 The shift in the review of merger from criminal to civil law further indicates the correctness of the "full-blown rule of reason" approach that Gonthier J. distinguished from the "partial rule of reason" that he found to be required by the conspiracy provisions in the *Nova Scotia Pharmaceuticals* case. Except for refusals to deal under section 75 of the Act which does not require a finding of substantial lessening of competition, the Tribunal has decided all cases before it, including mergers, under the full-blown rule of reason. Accordingly, the Tribunal may review all of the effects of an anti-competitive merger when the efficiency defence in section 96 is invoked.

E. Tribunal's Conclusions

78 The Court writes:

Given the purposes historically pursued by competition legislation and, in particular, the expressly stated purpose and objectives of the *Competition Act*, it is reasonable to infer from Parliament's failure to state expressly that only deadweight loss is to be considered as an "effect" of a merger for the purpose of section 96, that other effects related to the statutory purpose and objectives, including the interests of the consumers of the merged entity's products, must also be taken into account when the trade-off is made between efficiencies and anti-competitive effects. (Appeal Judgment, paragraph 109 at 43)

79 On the basis of the statutory history, the detailed and systematic review of Bill C-91 by the Parliamentary Committee, and the Committee's refusal to delete the efficiency defence or to amend the purpose clause to make consumer protection the primary focus of the legislation, the Tribunal can conclude only that the Committee was well aware that the 1986 amendments to the *Combines Investigation Act* sought goals that differed from the goals historically pursued by Canadian competition legislation. Historically, of course, Canada's merger law did not provide an efficiency defence to an anti-competitive merger. The introduction of section 96 itself indicates that the goals pursued by the 1986 amendments differed from those purposes historically pursued.

80 That the Parliamentary Committee removed the absolute defence of "superior competitive performance" under the proposed abuse of dominance provisions, but accepted the efficiency defence for mergers without amendment is a clear indication that the Committee fully understood the concept of efficiency and the consequences of providing the efficiency defence in merger review. It is clear to the Tribunal that the Parliamentary Committee endorsed the view that efficiency was the paramount objective of the merger provisions of the Act. It is difficult to reconcile these considerations with the Court's conclusion that Parliament did not intend or understand the outcome, or that it intended something else, particularly in light of the various preambles and purpose clauses after Bill C-13 that dropped all reference to equity as a goal of the legislation.

81 When Bill C-91 was introduced on second reading, the Minister stated in the House of Commons that the bill was a major economically-oriented statute:

...The report of the Commission on the Economic Union and Development Prospects for Canada underlined the importance of international trade for the Canadian economy by saying that, as much as possible, Canada should use international trade to ensure a continued and aggressive competition on the domestic market.

Mr. Speaker, economically oriented major statutes, such as the laws on competition, bankruptcy, corporations, copyright and trademarks provide the essential tools for orderly trade as they establish the basic rules for a competitive and fair market-based economy. However, most of these instruments are old, inoperative and out of date. Our rules are obsolete, inadequate, and in some cases, more an obstacle than an incentive to productivity. Canadian businesses will have difficulty

> in taking up the challenge to claim their fair share of international markets and facing the impact of international competition on the domestic market if they are paralyzed by inadequate legislation. Moreover, if our businesses are disadvantaged, all Canadians will suffer.
>
> I therefore believe, Mr. Speaker, that the Members of this House have a clear and pressing responsibility. They must update these statutes, eliminate such obstacles to growth and economic prosperity and see to it that businesses and consumers are treated fairly on the market. (*House of Commons Debates*, (April 7, 1986) at 11926)

While, quite obviously, the government was concerned with fairness "on the market", the primary reason for amending the *Combines Investigation Act* in 1986 was the need to strengthen Canadian business and provide an incentive for productivity in the face of aggressive international competition to which the government was committed and which would ultimately benefit consumers. Laws on bankruptcy, corporations, copyright and trademarks are concerned with fairness but fairness is not their purpose; those laws are principally concerned with promoting national economic development. Similarly, the Act is a key part of the fundamental framework for economic development. In the Tribunal's view, the portions of the Minister's speech cited by the Court (Appeal Judgment, paragraphs 89 and 91 at 36-37) are indeed consistent with the above-quoted remarks of the Minister.

82 In its Reasons at paragraph 413, the Tribunal concluded that efficiency was the paramount objective of the merger provisions of the Act, and the Court has stated that the Tribunal was correct:

> [90] In spite of the existence of multiple and ultimately inconsistent objectives set out in section 1.1, in certain instances the Act clearly prefers one objective to another. Thus, section 96 gives primacy to the statutory objective of economic efficiency, because it provides that, if efficiency gains exceed, and offset, the effects of an anti-competitive merger, the merger must be permitted to proceed, even though it would otherwise be prohibited by section 92. In this sense, the Tribunal was correct to state that section 96 gives paramountcy to the statutory objective of economic efficiency. (Appeal Judgment, at 36-37)

The Court also stated that this conclusion did not limit the definition of effects to be considered:

> [92] Thus, although section 96 requires the approval of an anti-competitive merger where the efficiencies generated are greater than, and offset, its anti-competitive effects, the ultimate preference for the objective of efficiency in no way restricts the countervailing "effects" to deadweight loss. Instead, the word, "effects" should be interpreted to include all the anti-competitive effects to which a merger found to fall within section 92 in fact gives rise, having regard to *all* of the statutory purposes set out in section 1.1. (Appeal Judgment, at 37)

83 The Court instructed the Tribunal to consider redistributive effects but it did not prescribe the method by which the Tribunal would perform its task. The Tribunal must follow this instruction in light of the clear legislative history that indicates that the merger provisions were not driven by the consumer interest. The Tribunal concludes that adopting an approach that prevents efficiency-enhancing mergers in all but rare circumstances must be wrong in law.

V. The Standard or Test to Assess the Efficiency Defence

84 The Commissioner asserts that the full amount of income redistributed by the merger is to be included in the assessment of "effects". The Respondents argue, *inter alia*, that when the appropriate treatment of the redistributive effects (i.e. the income/wealth transfer) is made, the gains in efficiency are sufficient to allow the instant merger to proceed.

85 In the Tribunal's view, the appropriate standard for judging the sufficiency of efficiency gains in relation to the effects of an anti-competitive merger is without doubt the central issue in this matter. The different standards were addressed by the Commissioner's expert witness, Professor Townley, in his report (exhibit A-2081) and his testimony. The Tribunal dealt with alternate standards rather briefly given its acceptance of the Total Surplus Standard. However, in light of the Court's decision, we will now examine the various standards.

A. Price Standard

86 Under a pure Price Standard, a merger can be approved only if it does not lead to an increase in market power. No consideration of efficiencies is allowed, even if efficiencies can be shown to lead to a price decrease.

B. Modified Price Standard

87 Although Professor Townley refers to a "price standard", he uses that label in connection with a merger where efficiency gains can be considered. In his description of the standard, efficiencies are considered as a positive factor in merger review but only when the post-merger price does not rise:

> If firms wish to merge, and if the merger would cause the price of the commodity in question to decrease, both consumers and firms would be better off than before the merger. That is, upward pressure on price is caused by increased market power while downward pressure is exerted by decreased marginal costs. If the latter is stronger than the former, then the potential for an overall price dec[r]ease exists, thus benefitting consumers. (Townley report, exhibit A-2081 at 28)

88 For greater clarification, and due to its similarity to the Price Standard as discussed above, the Tribunal refers to this standard as the Modified Price Standard. By requiring that efficiency gains be so large that the post-merger price decreases as a result of the merger, the Modified Price Standard requires that at least some of the cost-savings be passed on to consumers in the form of lower prices. However, under a Modified Price Standard, there is no basis for attacking a merger simply because of the efficiency gains that can be attributed to it.

89 Professor Townley notes that this standard is consistent with the Pareto Improvement Criterion, and can therefore be endorsed as a matter of welfare economics. He notes, however, that this standard assigns a distributional weight of zero to merging firms (i.e. to the gains to the shareholders thereof) while assigning an infinitely large weight to consumers. He further notes that

> ...The problem here is that application of this standard would disallow some mergers that are potentially welfare-enhancing.
>
> It was noted above that strict application of the Pareto Improvement Criterion would rule out some projects or policies that a reasonable person would support. For example, a policy that would make most people better off but a single person worse off would fail this criterion. Similarly, to rule against a merger that would involve only a slight price increase yet massive cost savings would seem unreasonable. (Townley report, exhibit A-2081 at 28-29)

Accordingly, Professor Townley does not advocate the Modified Price Standard.

C. Consumer Surplus Standard

90 Professor Townley describes the Consumer Surplus Standard as applicable to the case of a merger characterized by a price increase and efficiency gains. If the gains in efficiency exceed the total loss of consumer surplus (i.e. the deadweight (or efficiency) loss plus the consumer surplus that is redistributed from consumers to shareholders as excess profits), then the merger would be approved (Townley report, exhibit A-2081 at 29).

91 As presented by Professor Townley, the Consumer Surplus Standard does not require that the post-merger price decline or remain at the pre-merger level. It could allow a merger to proceed even if the post-merger price increased.

92 Professor Townley adopts the following notation to describe the effects of the merger:

(a) the portion of lost consumer surplus (B) transferred to shareholders;

(b) the corresponding increase in the shareholder profit due to the higher price (B);

(c) the cost-savings (gains in efficiency) from the merger (A); and

(d) the loss of efficiency or deadweight loss (the remaining portion of lost consumer surplus) from the merger (C).

In principle, at least, Professor Townley's variables are quantifiable and completely describe all of the effects on economic efficiency and on consumer welfare. The merger is approved if the gains in efficiency exceed total loss of consumer surplus, i.e. if A>B+C. Where these variables are not completely quantified, the required assessment nevertheless remains the same: are the efficiency gains greater than all of the effects on efficiency and on consumers. (The Tribunal notes that subsection 96(1) requires that efficiency gains exceed and offset all of the effects of lessening or prevention of competition. It is not always clear whether advocates of the Consumer Surplus Standard regard this standard as sufficient to meet the requirement to offset.)

93 Professor Townley is critical of the Consumer Surplus Standard. It "...is not consistent with any traditional welfare criterion (at least to my knowlege)..." (Townley report, exhibit A-2081 at 29-30). Moreover, by including the entire amount of the loss of consumer surplus experienced by all consumers, it treats all consumers alike (i.e. assigns the same weight to each) and protects all consumers even when some consumers are better off than the shareholders of the merged firm:

> From a welfare perspective, assigning distributional weights according to the Consumer Surplus Standard may be appropriate if consumers of the product in question are relatively poor. However, what if those who consume the product of the merged firms are relatively wealthy? That is, what if the commodity in question is a luxury produced by firms owned by relatively poor individuals? (This is akin to legislating rent controls on luxury apartments when the tenants are wealthier than the landlords.) I have no notion as to how likely this situation may be, but a Consumer Surplus Standard does not allow the discretion to deal with this type of case. (Townley report, exhibit A-2081 at 31-32)

Accordingly, Professor Townley is critical of the Consumer Surplus Standard because it does not discriminate among consumers, i.e. between relatively poor and relatively well-off consumers.

94 Under the Consumer Surplus Standard, the lost consumer surplus that is transferred to shareholders equals the excess profits received. However, the loss of surplus matters but the corresponding profit gain does not offset that loss in any way whatsoever. Like the Modified Price Standard, the Consumer Surplus Standard assigns a zero weight to shareholder profits even when society benefits therefrom. As he is concerned with social welfare maximization, Professor Townley does not ignore the possibility that gains to shareholders could be socially positive and hence he does not advocate the Consumer Surplus Standard either.

D. Total Surplus Standard

95 According to Professor Townley, the Total Surplus Standard, like the Consumer Surplus Standard, is applicable to a merger that results in both higher price and lower costs. The merger is approved if the loss of consumer surplus is exceeded by the increase in producer surplus. Using his notation, the merger is approved if: (A+B)>(B+C).

96 In this formulation, the income loss by consumers (B) equals the corresponding excess profit to shareholders due to the higher price (B). Unlike the Consumer Surplus Standard, the Total Surplus Standard includes the effect on shareholders but regards these gains and losses as exactly offsetting, so the test reduces to whether A>C. Accordingly, total surplus increases if the cost-savings exceed the deadweight (or efficiency) loss.

97 Professor Townley notes that the Total Surplus Standard is consistent with the Potential Pareto Improvement Criterion, i.e. that the shareholders could fully compensate the consumers and still be better off. He notes that the Criterion is met even though the compensation does not take place and he criticizes the Total Surplus Standard for regarding the gains in shareholder profit and consumer losses of income as completely offsetting:

> Therefore, like aggregate compensating variation and aggregate equivalent variation, a positive (negative) change in total surplus measure need not indicate a welfare increase (decrease) when income distribution issues exist but are ignored in the analysis. The total surplus method employs equal welfare weights across individuals and firms, and this may not be appropriate. That is, if price rises but the Total Surplus Standard is satisfied in a situation where consumers are relatively less wealthy than producers, aggregate economic well-being may decrease despite an increase in total surplus. (Townley report, exhibit A-2081 at 18)

98 Professor Townley's principal objection to the Total Surplus Standard is that it does not distinguish between shareholders of the merged firm and consumers of the product of the merged firm. If shareholders are uniformly better off than consumers, then the redistribution of income arising from the merger may be unfair to the less well-off group, and hence be socially adverse.

99 Presumably, however, if, as in his earlier illustration of the luxury commodity, the consumers were better off than the shareholders, Professor Townley would not be critical of a merger that was approved under a Total Surplus Standard. In that case, the redistribution of income would not be unfair to consumers because, by hypothesis, they are the better-off group to begin with. The merger would both increase efficiency and promote distributional fairness by transferring income to shareholders. Such redistributional effect would be socially positive.

100 The Tribunal notes that if the consumer and shareholder groups were each characterized by variability of income and wealth of their members, it might be difficult to characterize the redistribution of income arising from a merger as being unfair to one group or the other.

101 Professor Townley's concern is similar to his criticism of the Consumer Surplus Standard. In his view, that standard fails because it treats all consumers alike, hence protecting the better-off consumers from loss of income to supposedly equally well-off shareholders. However, his objection to the Total Surplus Standard is that it treats consumers and shareholders alike even when they are different. Indeed, his common objection to both is that they each prescribe a fixed weight and could hence fail to identify welfare-reducing mergers in particular cases.

E. Balancing Weights Approach

102 Accordingly, the key issue for Professor Townley is whether the distributional considerations are properly addressed by according the producers/shareholder group and the consumer group equal weights. Professor Townley stated that he, in his professional academic capacity, could not indicate what the appropriate weights were, but he advocated that the Tribunal had the capacity to do so.

103 In his Balancing Weights Approach, Professor Townley invites the Tribunal to attach a weight of unity to all producer gains from a merger. He proposes that a weight(w) be determined for all consumers "...because information on individual affected consumers is lacking..." (Townley report, exhibit A-2081 at 33), such that the weighted surplus is zero, hence:

$$1(A+B) - w(B+C) = 0$$

where A, B and C are known quantitative estimates of the magnitudes of all of the effects of the merger. Solving this equation for w, the balancing weight, establishes the weight accorded to consumers as a group in order that the consumer loss and the producer gains are just balanced.

104 In the instant merger, the Commissioner submits that A equals \$29.2 million, B equals \$40.5 million, and C equals \$3 million. On these figures, the balancing weight is found to be 1.6 (Memorandum of the Commissioner of Competition on the Redetermination Proceedings ("Commissioner's Memorandum on Redetermination Proceedings"), paragraph 113 at 46). Then, the Tribunal would decide whether the balancing weight was reasonable "...Based on whatever quantitative and qualitative information is available regarding the distributional impacts of a merger..." (Townley report, exhibit A-2081 at 33).

105 The Commissioner urges that, in employing Professor Townley's approach to the instant merger, the Tribunal should consider all relevant qualitative effects of the merger, not just the qualitative information that is available regarding the distributional impacts of the merger:

> Professor Townley recognized that the computed balancing weight only accounts for things that can be quantified and should be "assessed in light of qualitative factors". The other relevant qualitative effects of the merger should also be taken into account at this stage of the analysis. These include the extremely significant qualitative effects which are described in greater detail in Section III of this memorandum and in paragraphs 90 and 91 above. (Commissioner's Memorandum on Redetermination Proceedings), paragraph 117 at 47)

106 In oral argument, counsel for the Commissioner argued that the reasonableness of the balancing weight should be judged in relation to all the evidence and statutory considerations:

> MS STREKAF: Then, in order to look at those numbers, whether it's too high or too low, according to Professor Townley's approach what you would need to do is look at all of the evidence. You would need to look at 1.1 and the other guidance provided in the Act to see whether in fact the merger should be allowed or should be rejected. (Transcript, vol. 2, October 10, 2001, lines 1-8 at 270)

107 It is not entirely clear to the Tribunal what the Commissioner is seeking here. In particular, Professor Townley did not indicate that the computed balancing weight should be assessed in light of information that is not relevant to the consideration of equity between consumers and shareholders (Townley report, exhibit A-2081 at 33).

108 Moreover, Professor Townley advocates assigning the same weight to all consumers only because information on individual consumers is lacking. Since Professor Townley is concerned with welfare-maximizing mergers, where such information is available and describes significant differences among consumers, he would presumably want to take it into consideration.

109 Using the Balancing Weights Approach to assess the distributional concerns in the instant case, the Tribunal must find that the weight that properly reflects the consumer loss is at least 60 percent higher than the weight on shareholder gains, assuming again that the consumer and shareholder groups are distinct and reasonably internally homogeneous. If it can so find, then that is a factor that counts against the merger, and must be considered with all other factors required to be considered. Indeed, if estimates of A, B, and C accurately described all of the effects of a merger, the appropriateness of the balancing weight would be determinative. Accordingly, if the Tribunal knew, or could derive, the correct weight, it would be able to determine whether or not that weight exceeded the balancing weight.

F. Sources of the Correct Weight

110 In the Tribunal's view, the correct weight should be established by society or should reflect social attitudes toward equity among different income classes. There may be several sources from which the proper weighting can be inferred, one such being the tax system, which is explicitly, although not solely, concerned with equity. It is clear that the prevailing system of taxation in Canada does reflect a social consensus about the desirability of imposing burdens on different income classes. If tax rates are progressive with respect to income, then society has decided that the marginal dollar of income is worth less to the high-income taxpayer than it is to the low-income taxpayer. If, for example, the lowest tax rate is 20 percent and the highest is 50 percent, there is clear indication that low-income individuals are favoured over high-income individuals; assigning a weight of 1.0 to the latter group, the corresponding weight on the former would be 2.5.

111 Based on their recent review of the literature for the Canadian Tax Foundation, Professors Boadway and Kitchen conclude that:

> ...Taken overall, the tax system seems to be roughly proportional to income. This does not imply that government policy considered more generally is not redistributive. Much of what governments do on the expenditure side of the budget appears to be motivated by redistributive objectives, and it seems that a substantial amount of redistribution does, in fact, take place through expenditure programs - a consideration that further weakens the case for a highly progressive income tax structure. (See R. Boadway and H. Kitchen, *Canadian Tax Policy*, Paper No. 103, 3rd edition, Canadian Tax Foundation, 1999 at 45.)

112 It appears to the Tribunal that if the proper weight is to be inferred from the tax system alone, then it is unlikely to be as high as 1.6 given the general proportionality of effective tax rates. However, the Tribunal would expect to have the benefit of expert opinion in matters as specialized as this.

113 Having regard to the combined system of taxes and public expenditures in Canada, there appears to be a basis for attaching a greater weight to the income groups that could be described as poor or needy than to shareholders assuming they are neither. Professor Townley's report presents certain information in this regard which the Tribunal examines below.

G. Standard for Evaluating Efficiency Gains in the United States

114 Commenting on the Total Surplus Standard, the Court writes as follows:

> [134] Finally, it was suggested in argument that the Tribunal's interpretation had the support of all economists who had studied the issue. I do not dispute that an impressive array of economists, and law and economic specialists, both in Canada and the United States, have argued that the total surplus standard is the appropriate basis for determining whether an anti-competitive merger that produces efficiency gains should be permitted.
>
> [135] Nonetheless, the *Horizontal Merger Guidelines, supra*, in the United States continue to treat the exercise of market power leading to an increase in price above the competitive level as the most important anti-competitive effect of a merger, and the resulting wealth transfer from the consumers to the producers, as a misallocation of resources...
>
> [136] Of course, as I have already noted, since there is no specific efficiency defence in the United States' legislation, the approach of the Federal Trade Commission to efficiency gains when considering the approval of anti-competitive mergers has limited relevance to the problem before us. Nonetheless, it is interesting to note that efficiency gains are generally most likely to make a difference in merger review when the likely adverse effects of the merger are not great, and will almost never justify a merger to monopoly or near monopoly: *Horizontal Merger Guidelines, supra*, at page 150.
>
> [137] In addition, some commentators in the United States have expressed surprise at the interpretation of section 96 adopted in the *MEG*. See, for example, J.F. Brodley, "The Economic Goals of Antitrust: Efficiency, Consumer Welfare, and Technological Progress, (1987) 62 *N.Y.U.L. Rev.* 1020, at 1035-36; S.F. Ross, "Afterword-Did the Canadian Parliament Really Permit Mergers That Exploit Canadian Consumers So the World Can Be More Efficient?" (1997) 65 *Antitrust Law Journal* 641... (Appeal Judgment, at 52-53)

115 It is clear that the Court has placed weight on the treatment of efficiencies under U.S. antitrust law and has used it as the benchmark to evaluate the Tribunal's assessment under the Act. In the Tribunal's view, the differences between the American and Canadian approaches to merger review and efficiencies are very significant and cannot be appreciated without some knowledge of the history of American antitrust. (The Tribunal relies on two publications of the American Bar Association, Section of Antitrust Law: Monograph 12, *Horizontal Mergers: Law and Policy* (1986) and *Mergers and Acquisitions: Understanding the Antitrust Issues*, Robert S. Schlossberg and Clifford H. Aronson, eds. (2000) for its review of the American approach to efficiencies.)

116 The Price Standard guided courts in the United States for much of the past century and created judicial hostility toward efficiency evidence and arguments. In *Brown Shoe* (*United States v. Brown Shoe Co.*, 179 F. Supp. 721 (U.S. D.C. Mo., 1959) , *aff'd* 370 U.S. 294 (U.S. Mo., 1962)), the district court agreed with the government that certain advantages to Brown Shoe as a result of the acquisition would actually lower the price or raise product quality; however, the independent retailer would be less able to compete with the more efficient merged firm.

117 On appeal to the United States Supreme Court, Brown Shoe strongly denied that the merger would produce any cost savings, while the government, believing that such savings existed, attacked the alleged efficiency gains, charging that they would allow Brown Shoe to lower its prices. The United States Supreme Court recognized that consumers might benefit from the merger, and further noted that the law protected competition, not competitors. Nonetheless, it was primarily concerned that American antitrust law protected viable, small, locally-owned businesses and resolved the competing considerations in favour of "decentralization" (*United States v. Brown Shoe Co.*, 370 U.S. 294, at 344 (1962)).

118 In *Philadelphia National Bank* (*United States v. Philadelphia National Bank*, 374 U.S. 321 (U.S. Pa., 1963)), the defendants attempted to justify the merger by arguing, *inter alia*, that the new firm would be better able to compete with large out-of-state banks and would benefit the economy of the local community. While not contesting the accuracy of these assertions, the United States Supreme Court held at page 371:

> ...We are clear, however, that a merger the effect of which 'may be substantially to lessen competition' is not saved because, on some ultimate reckoning of social or economic debits and credits, it may be deemed beneficial...

In *Proctor and Gamble* (*F.T.C. v. Procter & Gamble Co.*, 386 U.S. 568 (U.S. Ohio, 1967), at 580), the United States Supreme Court wrote:

> Possible economies cannot be used as a defense to illegality. Congress was aware that some mergers which lessen competition may also result in economies but it struck the balance in favor of protecting competition.

In *Foremost Dairies* (*Foremost Dairies, Inc.*, 60 F.T.C. 944 (U.S. F.T.C., 1962)), the U.S. Federal Trade Commission held that significant gains in efficiency from the merger placed smaller rivals at a serious competitive disadvantage.

119 These decisions illustrate the American hostility toward efficiencies. Under the Price Standard, efficiency gains from a merger could not constitute a defence, but could assist the government in defeating the merger.

120 The judicial hostility toward efficiencies was reflected in the 1968 Merger Guidelines of the U.S. Department of Justice that allowed efficiencies as a justification for a merger otherwise subject to challenge only "under exceptional circumstances". Similarly, the 1982 Guidelines allowed for consideration of efficiency gains only in "extraordinary circumstances".

121 In our view, the hostility toward efficiencies in the United States arose not because the antitrust laws were opposed to efficiency *per se*, but rather because those laws were primarily concerned with "decentralization", i.e. preventing industrial concentration. In *Brown Shoe*, the United States Supreme Court was concerned that since the merged firm would have a market share exceeding 5 percent, a decision to approve the merger would result in the inability to prevent similar mergers by Brown's competitors. In *Philadelphia National Bank* , the Court was concerned with the relationship between market power and market structure as measured by market share and as endorsed by economists of that period. The Court held that a transaction that gave the merging firms a post-merger market share of 30 percent was presumptively illegal and could not be justified by other beneficial aspects such as efficiency gains. The "incipiency doctrine" arising from *Brown Shoe* and the "structuralist presumption" from *Philadelphia National Bank* are perhaps the principal results of the policy toward efficiencies embedded in the Price Standard.

122 It appears to the Tribunal that the enforcement agencies in the United States have moved away from the Price Standard to either the Modified Price Standard or the Consumer Surplus Standard. Following revisions in 1984 and 1992 to the treatment of efficiencies in the Merger Guidelines, the current guidelines were adopted in 1992 and clarified in 1997:

> The Agency will not challenge a merger if cognizable efficiencies are of a character and magnitude that the merger is not likely to be anticompetitive in any relevant market. To make the requisite determination, the Agency considers whether cognizable efficiencies likely would be sufficient to reverse the merger's potential harm to consumers in the relevant market, e.g., by preventing price increases in that market... (*Horizontal Merger Guidelines*, Issued by the U.S. Department of Justice and the Federal Trade Commission, Revised section 4, April 8, 1997) [hereinafter, *Horizontal Merger Guidelines*]

123 If the Agencies require that proven efficiencies *must* prevent price increases in order to reverse the potential harm to consumers, then the applicable standard is the Modified Price Standard. As written, however, the guidelines appear to regard preventing a price increase as sufficient but not necessary to reverse the harm to consumers. Accordingly, the Agencies' applicable standard may be the Consumer Surplus Standard. Whatever the standard, it is clear that the impact on the consumer is the paramount concern when efficiency gains are considered in merger review in the United States.

124 While there is no statutory defence of efficiency in American antitrust law, the enforcement agencies use their discretion in deciding whether to challenge a merger and will consider efficiencies as part of their assessment of the competitive effects of the merger. Accordingly, if cognizable efficiency gains are so large that the merger can no longer be said to harm consumers, then the agencies are prepared to approve the merger. In this sense, efficiency gains must "cleanse" the transaction in order to avoid challenge.

125 It appears that the only litigated cases in the United States in which challenged mergers were allowed to proceed based on efficiency gains have involved the merger of non-profit hospitals (*F.T.C. v. Butterworth Health Corp.*, 946 F. Supp. 1285 (U.S. W.D. Mich., 1996) , *aff'd*, 121 F.3d 708 (U.S. Mich. Ct. App., 1997) (*per curiam*) (table decision)) and *United States v. Long Island Jewish Medical Center*, 983 F. Supp. 121 (U.S. E.D. N.Y., 1997)). In these cases, the non-profit status of the merging parties was important in the courts' findings that the efficiency gains would ultimately benefit consumers.

126 But for the case of non-profit hospital mergers, there are no litigated cases in the United States in which cognizable efficiency gains were found large enough to permit an otherwise anticompetitive merger to proceed. The practical effect of the shift from a Price Standard to the Modified Price Standard or the Consumer Surplus Standard by the government enforcement agencies in the United States has been to continue the traditional hostility to efficiency gains (see D. Garza. *The New Efficiencies Guidelines: The Same Old Wine in a More Transparent Bottle*, Antitrust, Summer 1997 at 6-10.).

127 Exemplifying this hostility, the U.S. Federal Trade Commission recently referred to two recent cases involving efficiencies and submitted:

> ...Both *Cardinal Health* and *Staples* hold that, even if an efficiencies defense can be entertained, defendants must show that the "proven" efficiencies will be passed on and that they overwhelm any possible anticompetitive effects of the merger. (*Federal Trade Commission v. H.J. Heinz Company, et al.*, Reply Brief for the Plaintiff-Appellant Federal Trade Commission, No.00-5362, November 29, 2000 at 43 footnote 20)

128 The current head of the U.S. Federal Trade Commission provided a review of the recent litigation as of 1999 in which plausible efficiency claims were successfully attacked by the enforcement agencies and he concluded that the historical attitudes toward efficiencies remain:

> ...First, the government's attitude toward merger efficiencies has evolved toward greater acceptance. The days are long past when a merger will be attacked because it would lower costs. Moreover, at least in their Guidelines, the Agencies no longer argue that lower costs are not merger specific because of a hypothetical, but unlikely to be achieved in practice, alternative means to obtain the efficiencies. Nor is the "pass-on" requirement a basis for near automatic rejection of claimed lower costs.
>
> Second, problems nevertheless remain... Because the merging parties must show that the merger will likely lower costs, there is no justification for the government's prejudice against certain efficiencies. Hostility reflects the long standing reluctance to accept fully the cost-reducing potential of mergers.
>
> Third, the Agencies' attitude in court remains one of unrelenting hostility toward claims of lower costs...
>
> Perhaps these litigated cases do not accurately reflect the government's attitude. Mergers are now rarely litigated, and it may be too much to expect that the Agencies eschew advocacy. Nevertheless, these cases provide evidence of the lack of change in governmental attitudes. Past studies have found that overly hostile Agency attitudes toward merger efficiencies were widespread, and these recent cases are completely consistent with those studies. (Timothy J. Muris, *The Government and Merger Efficiencies: Still Hostile After All These Years*, George Mason Law Review, vol. 7:3, 1999 at 729-752, at 751)

129 The Tribunal concludes that in the United States, there is effectively no efficiency defence to an anti-competitive merger except in unusual cases such as non-profit hospital mergers. The courts and the enforcement agencies have adopted

the position that no harm to consumers can be tolerated under the antitrust laws, and hence efficiency gains cannot justify an anti-competitive merger.

130 Yet, as is clear from Muris' critique, the Tribunal cannot but note that there is strong debate within the American antitrust regime over the appropriate treatment of efficiencies in merger review.

H. Differences between Canadian and American Approaches to Mergers and Efficiencies

131 It is clear that the Court has placed weight on the American approach to antitrust and on the views of American commentators who, in line with that approach, are antagonistic to the Total Surplus Standard. In so doing, the Court does not appear to take account of the historic and continuing hostility toward efficiencies in merger review under American antitrust law and the reasons for that hostility, and it may not have completely realized the several critical, and perhaps subtle, ways in which the merger provisions of Canada's Act differ from the antitrust statutes and the judicial histories thereof in the United States.

(1) Market Structure Considerations

132 First, under subsection 92(2) of the Act, evidence consisting solely of market share or concentration is insufficient for the Tribunal to conclude that a merger will lessen or prevent competition substantially. This provision is a reaction to the incipiency doctrine adopted by the U.S. Supreme Court in *Brown Shoe* and to the structuralist presumption arising from *Philadelphia National Bank* . It should not be forgotten that American merger review had, by the 1960s, focussed virtually entirely on whether the post-merger market share was large enough to support a finding of illegality. It was not until its decision in *General Dynamics* (*United States v. General Dynamics Corp.*, 415 U.S. 486 (U.S. Ill., 1974)) in 1974 that the United States Supreme Court departed from rigid reliance on calculated market shares and gave consideration to other pertinent factors.

133 Whereas the decisions in *Brown Shoe* and *Philadelphia National Bank* reflected the economic learning of the day, the drafters of the amendments to Canada's Act in 1986 sought to take advantage of the more recent scholarship and research literature that placed the market power-market share relationship in considerable doubt. Accordingly, if "monopoly" is taken to mean one producer, then even in that extreme case a merger to monopoly cannot automatically be found to lessen competition substantially under section 92 just because the firm has a market share of 100 percent.

(2) Efficiencies and Competitive Effects

134 Second, as noted above, the Horizontal Merger Guidelines of the American enforcement agencies ("Horizontal Merger Guidelines") require that efficiency gains "cleanse" the merger of its harmful effects. In this way, the analysis of efficiencies is directly tied to the analysis of the merger's competitive effects on consumers. Only when the agencies are convinced that the negative effects have been eliminated will they decline to challenge the merger.

135 The requirement that proven efficiency gains "cleanse" the anti-competitive merger arises in the United States from the absence of a specific affirmative statutory defence that would permit an anti-competitive merger to proceed. The late Professor Areeda, perhaps the foremost expert on American antitrust law, addressed this matter succinctly:

> Although we have, to be sure, spoken of an economies "defense," it is not as a defense to a final conclusion that a merger "lessens competition" or is "illegal". Rather, the "defense" terminology refers to the rebuttal of a first order inference from a portion of the evidence (such as market shares) that a merger presumptively lessens competition and violates the statute. That is, it is a defense to a prima facie case... (P. Areeda et. al; *Antitrust Law*, Vol. IVA (Revised Edition), Aspen Publishers, 1998 at 28)

136 The approach to efficiencies under subsection 96(1) of the Act is very different. There is no requirement for efficiency gains to prevent the effects of lessening or prevention of competition from occurring, and the Tribunal found accordingly (Reasons, at paragraph 449). Were this the requirement, efficiencies would be considered as a factor in the section 92 inquiry. Indeed, the respondents argued this in the liability phase when they sought to show that the cost-savings from the instant merger were so large that the price would actually fall, hence the merger would not be anti-competitive. The Tribunal rejected this

argument in its entirety when it concluded that section 92 was about market power, the ability to influence price, rather than about whether price would, or would likely, rise or fall as a result of the merger (Reasons, at paragraph 258).

137 It is plainly Parliament's intent that, in merger review, efficiencies are to be considered only under section 96 and not under section 92. As a result, the consideration of efficiency gains is not to be tied into the analysis of competitive effects of the merger. Section 96 is worded accordingly by requiring that gains in efficiency be "greater than and offset" the effects of lessening or prevention of competition, rather than prevent those effects from occurring. Accordingly, "cleansing" of those effects is not required under the Act and, indeed, effects of lessening or prevention of competition may remain even when the test under section 96 is met.

(3) Trade-off Analysis

138 Third, as the Horizontal Merger Guidelines note, efficiencies are considered at the level of the individual relevant market. Consequently, in a merger where several relevant product and/or geographic markets have been delineated, the efficiency gains must reverse the harm in each such market. Accordingly, the insufficiency of those gains in even one relevant market can lead the enforcement agencies to disregard efficiency gains produced by the merger entirely.

139 With one exception, the Horizontal Merger Guidelines allow no trade-off whereby, for example, efficiency gains in one part of the country offset the anti-competitive effects in another part. According to those Guidelines, the reason for this treatment is found in the *Clayton Act*:

> Section 7 of the Clayton Act prohibits mergers that may substantially lessen competition "in any line of commerce ... in any section of the country." Accordingly, the Agency normally assesses competition in each relevant market affected by a merger independently and normally will challenge the merger if it is likely to be anticompetitive in any relevant market. In some cases, however, the Agency in its prosecutorial discretion will consider efficiencies not strictly in the relevant market, but so inextricably linked with it that a partial divestiture or other remedy could not feasibly eliminate the anticompetitive effect in the relevant market without sacrificing the efficiencies in the other market(s). Inextricably linked efficiencies rarely are a significant factor in the Agency's determination not to challenge a merger. They are most likely to make a difference when they are great and the likely anticompetitive effect in the relevant market(s) is small. (*Horizontal Merger Guidelines*, section 4, footnote 36)

Accordingly, it is only when efficiencies are inextricably linked that inter-market trade-offs can be considered, but even that exception is rare and related to the inadequacy of the remedy.

140 By contrast, section 96 of the Act applies to the transaction in its entirety. There is no requirement that gains in efficiency in one market or area exceed and offset the effects in that market or area. Rather, the tests of "greater than" and "offset" in section 96 require a comparison of the aggregate gains in efficiency with the aggregate of the effects of lessening or prevention of competition across all markets and areas. Accordingly, the Act clearly contemplates that some markets or areas may experience gains in efficiency that exceed the effects therein, while others may not.

(4) Industrial Concentration

141 The Court recognizes that the American antitrust laws do not contain an explicit efficiency defence, but does not explain the rationale. Given the historical American concern with preventing increases in industrial concentration and the possible political ramifications of conjoining economic and political power, efficiency concerns have been given much less importance. The same cannot be said for Canada. Since industrial concentration was already high in certain sectors and because of the increased openness of the Canadian economy to foreign competition, further increases in domestic concentration were deemed less important than the gains in economic efficiency that could be obtained, if proven. Moreover, the express concern in 1971 with economic and political power in Bill C-256 was dropped from subsequent attempts to amend the *Combines Investigation Act*.

142 Commentators on the penultimate version of the amendments to the Act, while calling attention to mergers that increase concentration in the small Canadian economy, write:

> On the other hand, smallness of market also means a greater probability of the existence of non-captured scale and other economies. For this reason, it seems to us essential that when a Canadian merger is challenged, the parties to it be given ample opportunity to offer an economies-capture defence. We must add, however, for this defence to be valid, the economies must occur in real resource use, as contrasted with the mere use of the new-found market power of bigness to squeeze extra "pecuniary" gains out of the profit margins of upstream suppliers, or of downstream processors and distributors. (B. Dunlop, D. McQueen and M. Trebilcock, *Canadian Competition Policy: A Legal and Economic Analysis*, Canada Law Book Inc., Toronto 1987 at 186)

Given the size of the American economy and the historic purpose of American antitrust laws, it is not surprising that the potential for losing scale economies was not a significant concern; indeed, under the Price Standard, such economies worked against the merger.

(5) Small Business

143 As noted above, small business historically received special consideration in the United States. The survival of small, locally-owned enterprises was a key goal of antitrust laws and, as noted above, efficiency considerations in mergers that created large competitors to small business were treated with hostility. While the emphasis of the U.S. antitrust laws on protecting small businesses from competition from larger firms has diminished very markedly, the hostile attitudes toward efficiencies have not.

144 The treatment of small business under Canada's Act is again very different. As the Tribunal noted, the purpose clause of the Act does not protect small businesses from large competitors; rather the Act provides that, under competition, small businesses have an "equitable opportunity" to participate in economic activity. Accordingly, if by virtue of greater efficiency, a merged firm obtains a competitive advantage over smaller, less efficient competitors, the Act finds no violation. If however that merger is anti-competitive, then if the test under section 96 is satisfied, the merger would proceed nonetheless.

(6) Foreign Ownership

145 Another important difference between the two countries is the implicit concern with Canadian ownership and economic control. In light of the degree of industrial concentration in Canada, mergers among large Canadian companies in the same industry would frequently be denied absent a recognized defence. One consequence of this is that large Canadian companies could more easily merge with foreign enterprises since the resulting merged company would less frequently cross the anti-competitive threshold in Canada.

146 It must be remembered that the Act was amended and the efficiency defence inserted therein at the same time as the debate on free trade with the United States and the growing trend toward privatization. In a globally more liberal environment for international trade and investment, the efficiency defence in section 96 allows the possibility that mergers among major Canadian businesses may produce entities that may possibly compete more effectively with large foreign enterprises at home and abroad.

(7) Efficiencies: "merger-specific" v. "order-driven"

147 As stated in the Horizontal Merger Guidelines, claimed efficiency gains must be "merger-specific". Although those Guidelines do not elaborate, this requirement appears to mean that a claimed efficiency gain is not cognizable if it could be achieved in another, presumably less anti-competitive, way.

148 The Tribunal found that the gains in efficiency in the instant merger would not be achieved absent the merger (i.e. if the order were made) and hence could be included in the test under subsection 96(1) (Reasons, at paragraph 462). This requirement is not the same as the one used by the American enforcement agencies. After satisfying itself that the two approaches were not identical, the Tribunal noted the same distinction was addressed in *Hillsdown, supra*, which supported the view that the Act

did not require that claimed gains in efficiency not be achievable in another, less anti-competitive way, although this was the requirement of the Commissioner's Merger Enforcement Guidelines ("MEGs").

149 The Commissioner may require that efficiency gains be merger-specific when deciding whether to challenge a merger. However, once an application is brought under the Act, included efficiency gains are "order-driven" rather than "merger-specific". Since an order of the Tribunal is formulated based on its findings under section 92 of the Act, efficiency gains are evaluated in light of the order. Hence, efficiencies can have no influence on the order that the Tribunal formulates.

I. American Commentary

150 The Court refers approvingly (Appeal Judgment, at paragraph 137) to American commentators who clearly articulate consumer protection as the overriding objective of U.S. antitrust laws. However, the merger provisions of Canada's Act are not so focussed on consumer protection. It appears to the Tribunal that American commentators have generally not realized this. Instead, they have been quick to attack section 96 of Canada's Act, and always on the basis that it diverges from the approach under American antitrust law. In this, the commentators are entirely correct, but they ignore Canadian economic conditions and concerns, in particular, the comparatively small size of the Canadian economy.

151 For example, in his analysis of the Act, Professor Ross advocates that the phrase "prevention or lessening of competition" in subsection 96(1) be interpreted in the same way as the phrase "restrain or injure competition unduly" in section 45 (presumably paragraph 45(1)(d)) and hence prevent redistributions of wealth from anti-competitive mergers as Parliament intended for criminal conspiracy (S. Ross, *Afterword-Did the Canadian Parliament Really Permit Mergers That Exploit Canadian Consumers So That The World Can Be More Efficient*?, Antitrust Law Journal, vol. 65, Issue 1, Fall 1996 at 641) [hereinafter, *Ross*]. The Tribunal disagrees with this view. If Parliament had intended the same meanings to these phrases, it would have used the same language when it added section 96 to the Act in 1986.

152 Secondly, Professor Ross notes the concern that the Consumer Surplus Standard would "...effectively read an efficiency defence out of the Competition Act" (Ross, at 647). Referring to the *obiter dicta* comments of Reed J. in the *Hillsdown* decision, he concludes that that standard would permit mergers where the efficiency gains are "...almost certain" and the "threat of substantially lessened competition is only likely..." (Ross, at 648). However, nothing in the Act suggests this, and in the Tribunal's view, the requirement that efficiency gains be shown on a balance of probabilities applies equally to any effects that are asserted.

153 Professor Ross may be correct to conclude that subsection 96(2) is inconsistent with the Total Surplus Standard (Ross, at 648), but it is also inconsistent with the Consumer Surplus Standard and the Modified Surplus Standard.

154 Professor Ross defines and criticizes a "total Canadian welfare model" because, when it results in blocking a merger by excluding efficiency gains and effects outside of Canada, it violates the non-discrimination requirements under international treaties and agreements (Ross, at 643-644). In the Tribunal's understanding, the "total Canadian welfare model" as defined by Professor Ross includes consideration of the deadweight loss to the Canadian economy and losses due to income transfer from Canadian consumers to foreign shareholders. Accordingly, it is a version of the Consumer Surplus Standard in which effects are limited to those experienced in Canada. As discussed below, the Tribunal disagrees with his conclusion regarding Canada's international obligations and his interpretation of the purpose clause of the Act.

155 In the Tribunal's view, Professor Ross appears to be antagonistic to any approach that differs from the approach adopted in the United States. Indeed, although his position is not entirely clear, his view appears to the Tribunal to be that no harm from an anti-competitive merger should be tolerated, regardless of proven efficiency gains. Although he refers to a consumer welfare standard, he appears to articulate the Modified Price Standard, which was criticized by Professor Townley at the first hearing.

156 The Court's reliance on Professor Brodley's article is puzzling since that article does not discuss Canadian law at all (Joseph F. Brodley, *The Economic Goals of Antitrust: Efficiency, Consumer Welfare, and Technological Progress* (1987) 62 N.Y.U. Law Review, 1020) [hereinafter, *Brodley*]. It cites neither the Act nor the Canadian MEGs, and it does not express surprise at the interpretation of section 96 adopted in the MEGs. Instead, addressing the on-going debate within American

antitrust law Professor Brodley writes that one approach to reconciling efficiency and consumer welfare would be to abandon the consumer interest. In light of Congressional and judicial decisions, he finds this unacceptable (Brodley, at 1035-36).

157 Professor Brodley emphasizes that consumer protection is the goal of American antitrust law. Regarding economic goals, he concludes:

> ...These economic objectives can be implemented by placing greater emphasis on stability and predictability of antitrust rules, preventing exclusionary conduct that threatens production efficiency, and recognizing a limited efficiencies defense when otherwise restrictive conduct would enhance production or innovation efficiency. (Brodley, at 1053)

Professor Brodley's article serves as a reminder of the debate within American antitrust law as it adapts to economic conditions a century after the antitrust laws were first introduced. It discusses Canada's approach not at all.

158 The Tribunal does not criticize the American antitrust regime, but it notes that it is the result of circumstances, policies, and judicial interpretation of the pertinent statutes that are unique to the United States. The opinions of American commentators on Canada's Act, whether cited by the Court or by the Commissioner, should be seen in the context of historical and continuing hostility toward efficiencies in merger review in the United States.

159 In the Tribunal's view, the prevailing hostile approach to efficiencies in American antitrust law derives from the primary focus of that regime on consumer protection. The adoption of the American approach to efficiencies under the Act would, without question, introduce the hostility that characterizes that approach. As noted above, the amendments in 1986 to the merger provisions of the *Combines Investigation Act* were primarily focussed on economic efficiency.

J. Does the Total Surplus Standard Vitiate Section 92?

160 In its Reasons, the Tribunal emphasized that the Consumer Surplus Standard could not be correct in law because it frustrates the attainment of efficiency that was Parliament's paramount objective in passing the merger provisions of the Act (Reasons, at paragraph 437).

161 The Commissioner now takes issue with that conclusion, and submits that adopting the Total Surplus Standard leads to the opposite situation, wherein anti-competitive mergers would routinely be saved because relatively small gains in efficiency will need to be proven in order to exceed the deadweight loss (Transcript, vol. 5, October 15, 2001, at 809-815).

162 In the Tribunal's view, these matters are extremely important for the proper understanding of the merger provisions of the Act.

(1) Background

163 In its Reasons regarding the Consumer Surplus Standard, the Tribunal took note of the observation of Professors Trebilcock and Winter that the deadweight loss of a price increase is typically quite small and the Tribunal confirmed this observation using data from the instant merger and Table 8 of Professor Ward's expert report (exhibit A-2059 at 34) to determine the deadweight loss of a hypothetical 15 percent price increase (Reasons, at paragraphs 434-436).

164 In describing the effects of an anti-competitive merger, the Tribunal distinguished between the efficiency effects and the redistributive effects thereof, and it did so under the assumption that competitive conditions prevailed before such a merger (Reasons, at paragraph 422). In the Tribunal's understanding, this is the typical approach in applying economic theory and, accordingly, when that theory is properly applied, the deadweight loss typically will be small.

165 The Tribunal notes that where competitive conditions do not prevail before the merger, then the deadweight loss from an anti-competitive merger may be much larger. In final argument in the first hearing, the Commissioner discussed this possibility at length and presented alternate estimates of the deadweight loss (Commissioner's Memorandum of Fact and Law, at paragraphs 744-756). The Commissioner concluded:

> It is our submission therefore that in order to perform an accurate total surplus standard test, the measure of deadweight loss to be contrasted to the efficiency gains must be done without the limitation imposed by the pre-merger perfectly competitive price assumption. The evidence shown in this case strongly supports the view that there exists at least a degree of market power in the market such that firms do not pre-merger set price exactly equal to average variable cost or marginal cost and that, given this markup, the true deadweight loss measure is that provided by Table T3. (Commissioner's Memorandum of Fact and Law, at paragraph 756)

166 In final argument, the Commissioner presented Table R3 to address an error in Table T3. The Tribunal excluded R3 and certain other estimates of the deadweight loss because they were based on information in respect of which expert opinion was required. As the Commissioner had not led any expert evidence in this regard, the respondents did not have the opportunity to address the matter raised in R3 (Reasons, at paragraph 451).

167 The Tribunal notes the estimates of deadweight loss shown in Table R3 were $54.89 million, calculated on an assumed price increase of nine percent, and $23.44 million calculated on an assumed price increase of four percent. Because Table R3 and other estimates of the deadweight loss premised on the existence of pre-merger distortions in price were excluded, the Tribunal did not discuss in its Reasons the Commissioner's argument that the measurement of the deadweight loss should take such distortions into account.

168 However, both of the estimates of deadweight loss shown in Table R3 were substantially larger than the $3 million estimate of deadweight loss, predicated on an average price increase of 8 percent, on which the Commissioner now relies. If these estimates had been properly introduced and had withstood cross-examination, the Tribunal might have concluded, using the Total Surplus Standard that it adopted, that the estimated efficiency gains of $29.2 million did not exceed and offset the effects of lessening of competition so measured.

169 The Tribunal cannot and will not revisit its decision. Nevertheless, it appears to the Tribunal that the typical analysis of effects, based on the assumption that pre-merger conditions were competitive, may not have been appropriate in this case and that the deadweight loss may be much larger than the estimate thereof on which the Commissioner now relies. It therefore cannot be said that the Total Surplus Standard necessarily would have led the Tribunal to approve the instant merger had the deadweight loss been measured properly.

(2) "Greater than and offset..."

170 The Commissioner suggests that under the Total Surplus Standard, an anti-competitive merger could be saved by minor cost-savings:

> It is our submission that is in fact what the Act was intended to address, to address situations where you had very substantial efficiency gains that resulted from the merger. It was in those circumstances that the efficiency defence is intended to apply, not intended to apply to authorize mergers where you simply can demonstrate that by getting rid of a president and a vice-president it is enough to allow otherwise a merger that reduces competition and increases prices to pass the test. (Transcript, vol. 5, October 15, 2001, lines 15-25 at 815)

171 In the Tribunal's view, this submission is premised on the conventional assumption that competitive conditions prevail prior to an anti-competitive merger, hence the resulting deadweight loss must be relatively small. The Tribunal used the same approach in its Reasons, at paragraph 422, when explaining and analyzing the effects in the typical case; it was not, however, illustrating the entire statutory requirement. While the Tribunal agrees that in such cases, relatively small gains in efficiency will be needed to exceed the typically small deadweight loss, the Act requires more under section 96.

172 Indeed, as the Tribunal pointed out in its Reasons (at paragraphs 449-450 and 468), subsection 96(1) makes it quite clear that the efficiency defence is not available if efficiency gains merely exceed the effects of lessening or prevention of competition. To be available, those gains must also offset the effects, and it cannot be concluded that the Tribunal would find that efficiency gains (whether large or small) that marginally exceeded the effects (whether large or small) would also offset

those effects. In particular, it cannot be concluded that an anti-competitive merger would be approved under section 96 if the only savings were the salaries of two senior executives.

173 In the instant case, the Tribunal found that the proven gains in efficiency were substantial in comparison to the losses in efficiency as measured by the deadweight loss, and this finding allowed the Tribunal to conclude that the statutory requirement to offset had also been met (Reasons, at paragraph 468). In the Tribunal's view, the application of the Total Surplus Standard in merger review under the Act does not result in the automatic acceptance of an anti-competitive merger, even where the pre-merger environment can properly be characterized as competitive. As noted above, when the evidence shows that pre-merger conditions are not competitive, it cannot be concluded that the deadweight loss would necessarily be so small that only minor gains in efficiency would exceed and offset that loss under the Total Surplus Standard.

K. Can the Consumer Surplus Standard be Met in this Case?

174 The Commissioner submits that:

> ...As a result, once the estimated size of the transfer is quantified by the Commissioner, it represents a relevant "measured effect" that should be added to the other measured effects for the purpose of determining the combined measured and qualitative effects, unless the Respondents demonstrate with appropriate evidence that some other treatment for the transfer is appropriate in the performance of the tradeoff in the circumstances of a particular case... (Commissioner's Memorandum on Redetermination Proceedings, paragraph 93 at 38-39)

In stating that the measured transfer of income (i.e. the measured redistributive effect) should be added in its entirety to the measured deadweight loss, and combined with those qualitative effects which are themselves efficiency effects or re-distributive effects on consumers, the Commissioner is advocating the Consumer Surplus Standard in respect thereof. Moreover, the Commissioner cites with approval the "...pragmatic approach of adding the wealth transfer to the allocative efficiency losses for the purposes of performing the section 96 defence..." suggested by American authors Fisher, Lande and Ross (Commissioner's Reply Memorandum on Redetermination Proceedings, paragraph 102 at 39).

175 Referring only to measured effects, the Commissioner submits that the instant merger could succeed if the proven annual efficiency gains were at least 7.5 percent of annual sales (Transcript, volume 5, October 15, 2001, at 814, line 12 to 815, line 2). On annual sales of $585 million, proven efficiencies of at least 7.5 percent thereof would exceed the Commissioner's measured total ($43.5 million) of the deadweight loss and income transfer.

176 The Tribunal notes that proven efficiencies, in this case equal to $29.2 million per year for ten years, are five percent of annual sales and hence are insufficient to exceed the total loss of consumer surplus as measured by the Commissioner.

177 The Tribunal disagrees with the Commissioner's submission: if the instant merger had produced proven efficiency gains equal to 7.5 percent of sales, then they would still be less than the measured loss of consumer surplus; hence, the Consumer Surplus Standard as applied only to measured deadweight loss and the income transfer would not be satisfied. The Commissioner's total measured loss of surplus is based on price increases averaging 8 percent across all business segments, and on a demand elasticity of -1.5; referring to Table 8 in Professor Ward's report (exhibit A-2059), the Commissioner finds that the components of lost surplus, the deadweight loss and the transfer, are 0.5 percent and 7.0 percent of sales respectively under those conditions.

178 However, the evidence in this case is that propane demand is inelastic; hence the demand elasticity could not be less than -1.0. Indeed, as the Tribunal noted in its Reasons, the respondents had argued that the measured deadweight loss was overstated because it was calculated at the demand elasticity of -1.5 and they noted that it was inconsistent with the estimation of price increases at a demand elasticity of -1.0 which the Commissioner had done by adopting and rounding down the estimated price increases in Table 2 of Professor Ward's Reply Affidavit to the Rebuttal Affidavit of Dennis W. Carlton & Gustavo E. Bamberger (exhibit A-2060) (Reasons, at paragraph 456)

179 The Commissioner acknowledged that the combined deadweight loss and redistributional effect are larger when calculated at a demand elasticity of -1.0 than when calculated at a demand elasticity of -1.5:

> Second, the majority noted that the respondents pointed out the deadweight loss estimates would be lower if they had been calculated at an industry demand of -1.0. As previously noted in oral argument, Professor Ward's Table 8 demonstrates that as demand becomes more inelastic, the deadweight loss for a particular price increase becomes smaller but the transfer becomes larger by an amount that makes the combined deadweight loss and transfer larger. As a result, if an elasticity of -1.0 had been used to prepare the table in Appendix A instead of an elasticity of -1.5, the deadweight loss would have been smaller, the transfer would have been larger, and the combined deadweight loss and transfer in the aggregate would also have been larger. (Commissioner's Memorandum on Redetermination Proceedings, paragraph 22 at 14)

180 While there is no evidence on the deadweight loss and transfer calculated at a demand elasticity of -1.0, it is clear that the lost surplus would exceed 7.5 percent of sales when calculated at a demand elasticity of -1.0. Accordingly, the Commissioner is incorrect to state that proven efficiency gains of 7.5 percent of sales would be required in order to meet the Consumer Surplus Standard.

181 In the Tribunal's view, the inability of efficiency gains of five percent of sales to meet the Consumer Surplus Standard in this case, and the insufficiency of gains of 7.5 percent to do so, amply illustrates that the required level of proven efficiency gains thereunder is unlikely to be attained except in the rarest of circumstances. We are of the view that the defence in subsection 96(1) would, for all intents and purposes, never succeed under this standard.

L. Is the Entire Transfer Necessarily Included?

182 The Commissioner's position is that the statistical and other evidence that informs the assessment of adverse redistributional effects is unnecessary in light of the Appeal Judgment of the Court. In the Commissioner's view, the redistribution of income and wealth as measured by the transfer of $40.5 million is the effect to be included in its entirety with no inquiry into the adverse elements thereof. In addition, the Balancing Weights Approach is nothing more than a tool to assist the Tribunal.

183 However, if the Commissioner is correct that the entire $40.5 million is to be included, then the Balancing Weights Approach is no longer necessary because it adds nothing to the decision that the Tribunal must make.

184 The Commissioner's position is that the measured redistributive effect must be taken into account in its entirety even when the consumers and shareholders are the same people:

> The Commissioner submits the merger clearly reduces the competitiveness of propane prices and this "effect" of the merger reduces the benefits of competitive propane prices to Canadian propane consumers by at least the amount of the consumers' surplus transfer. While it may be true that individual shareholders of Superior are, in some sense, consumers of propane themselves, it is the competitiveness of propane prices to consumers as consumers of the relevant product, and who are affected by the price increase, that is at issue here. Indeed, since all producers are in some sense consumers, competitive prices that benefit consumers will benefit all producers as well. The important consideration is that the consumers' surplus transfer is the immediate result of the anti-competitive merger. There is no preference for one or another class of consumer, but simply a public interest decision embedded in the Act that requires the likelihood of consumers being deprived of the benefits of more competitive prices (consumers' surplus transfer) as a result of an anti-competitive merger to be negatively weighted. Because in any given case competitive prices benefit the consumers of a product, but not the producers of that product, the identification of "competitive prices to consumers" as a goal of the *Act* effectively makes a policy choice to favour consumers. (Commissioner's Memorandum on Redetermination Proceedings, paragraph 29 at 16-17)

185 In recognizing that shareholders are also consumers, the Commissioner draws attention to the simultaneous positive and negative redistributional effects on those individuals. Yet the Commissioner asserts that no consideration of positive

redistributional effects is warranted even in those circumstances. In our view, this situation would more reasonably be judged socially neutral in the analysis of effects under section 96 of the Act.

186 In the Tribunal's view, there is no policy choice to favour consumers in the merger provisions of the Act. The Tribunal concluded that efficiency was the paramount objective of the merger provisions of the Act, and the Court agreed while requiring that the transfer be considered under subsection 96(1). A similar policy choice to favour efficiency is found in section 86 of the Act which permits higher prices to consumers if efficiencies are large enough to justify the specialization agreement.

187 A second reason for rejecting the necessity of including the entire amount of the transfer is that doing so vitiates the statutory efficiency defence. In their earlier influential article on American antitrust, Fisher and Lande observed:

> In approaching wealth transfers for a tradeoff analysis, the first problem is that the legislative history provides us with no guidance as to the precise relative weights of wealth transfers and efficiency effects. Giving any weight at all to redistribution would greatly affect the welfare tradeoff, because in general the redistribution effect (area S in Diagram IV-1) is many times greater than the deadweight loss (area D in Diagram IV-1)... As the percentage increase in price or the elasticity of demand decreases, the redistribution effect becomes dramatically larger than the deadweight loss. *Since the elasticity of demand and the probable percentage price increase are interrelated, in most mergers fitting the Williamsonian conditions the redistribution effect is likely to be between approximately four and forty times the deadweight loss*. (A. Fisher and R. Lande, *Efficiency Considerations in Merger Enforcement*, California Law Review, vol. 71, December 1983, no.6, 1582, at 1644-1645) [Emphasis added] [hereinafter, *Fisher and Lande*]

188 As an example of Fisher and Lande's analysis, where the price elasticity of demand is -1.0 and the consequential price increase is 10 percent, the wealth transfer will be 20 times the deadweight loss (for constant elasticity of demand). Accordingly, proven efficiency gains would be insufficient unless they were at least 21 times greater than the deadweight loss. For linear demand under the same conditions, the wealth transfer will be 22 times the deadweight loss. Hence, proven efficiency gains would be insufficient unless they were at least 23 times greater than the deadweight loss (Fisher and Lande, Table IV-4 at 1645).

189 By comparison, the proven efficiency gains in the instant merger ($29.2 million) are approximately 10 times the measured deadweight loss. Thus, even where the deadweight loss is relatively small and the proven efficiency gains are substantial in comparison, the latter will almost always be insufficient if the entire transfer were required to be included. In the Tribunal's view, the Fisher-Lande calculations demonstrate that including the entire transfer would result in the availability of the efficiency defence in section 96 only in rare circumstances.

190 A similar conclusion was reached in 1993 by a former official of the Bureau of Competition Policy who noted:

> ...If the words "the effects of any prevention or lessening of competition" are not limited to the deadweight loss resulting from a merger ... but are also considered to contemplate the wealth transfer associated with any price increase expected to result from the merger ... merging parties will very rarely, if ever, be able to meet the requirements of s. 96. The combined effect of the deadweight loss and the neutral wealth transfer resulting from a price increase typically far exceeds in order of magnitude any efficiencies which may be brought about by a merger. The Director recently stated that he is not aware of any merger that would have generated efficiencies sufficient to outweigh the sum of the likely wealth transfer and deadweight loss of the merger, and that he does not believe that such a merger will likely present itself in the future. (P.S. Crampton, *The Efficiency Exception for Mergers: An Assessment of Early Signals from the Competition Tribunal*, the Canadian Business Law Journal, vol. 21, 1993, 371, at 386)

Accordingly, a second reason for not requiring the full inclusion of the transfer, as a matter of law, is that it would make the defence of efficiency in section 96 unavailable except in rare circumstances, hence vitiating a statutory provision the paramount objective of which is economic efficiency.

191 Although arguing that the full amount of the transfer should be included in the measured effects, counsel for the Commissioner suggests two situations in which the transfer could be treated as neutral, or reduced and not given full effect. In

the first such situation, excess profits from sales to non-residents should be excluded. The second is the case of pre-existing monopsony.

(1) Redistribution to Foreigners

192 While advocating that the entire amount of the redistributed income be included as an effect for the analysis under subsection 96(1), counsel for the Commissioner suggests, in response to a question from the Tribunal (Transcript, vol. 1, October 9, 2001, at 68, lines 18-23) that there may be circumstances where the Tribunal should use its discretion to do otherwise. One instance is a merger of Canadian exporters following which the price increase is paid very largely by foreign consumers. In this case, counsel submits that the domestic component of the wealth transfer may be quite modest and the large component falling on foreign consumers could be ignored. The Tribunal should use its discretion to disregard the latter and therefore give the total wealth transfer less weight; accordingly, significant efficiency gains in comparison with the loss of efficiency (i.e. a small deadweight loss) and other effects could well allow the anti-competitive merger to proceed (Transcript, vol. 1, October 9, 2001, at 72, line 15, at 73, line 6).

193 The respondents argue, similarly, that many of Superior's largest customers are foreign owned companies and that the effect of the transfer on these foreign shareholders is not an adverse effect that should be considered (Memorandum of the Respondents Superior Propane Inc. and ICG Propane Inc. in Relation to the Redetermination Proceedings ("Respondents' Memorandum on Redetermination Proceedings"), paragraph 136 at 62).

194 The Tribunal notes that international aspects of the application of section 96 have been raised previously, most notably by Madame Justice Reed in *obiter dicta* in the *Hillsdown* decision. Reed J. queried whether the Act required neutral treatment of the redistribution of income consequent to an anti-competitive merger of foreign-owned firms located in Canada, as the excess profits earned on sales to Canadian consumers would flow to the foreign shareholders. It appears that the hypothetical situation posited by counsel to the Commissioner is the opposite of that characterized by Reed J.

195 The international ramifications of section 96 have been discussed by the American Professor Ross whose article was cited with approval by the Court. He posits an anti-competitive acquisition under the Act in Canada of a Canadian-owned firm by an American-owned firm where efficiency gains are large but accrue only in the United States; yet consumers pay higher prices, there are significant layoffs in Canada, and the deadweight loss is small. He concludes that under a "...*total world welfare*" standard, such merger would be approved, but under the "...*consumer surplus* model (roughly followed in the United States)", it would be blocked. He further concludes that under a "...*total Canadian welfare* model", the merger could be blocked by excluding the efficiency gains in the United States, but this raises serious questions of discrimination under Canada's international obligations under NAFTA and GATT. Accordingly, for this reason, and because he endorses the American approach to efficiencies generally, he doubts that the Canadian Parliament intended a standard other than the Consumer Surplus Standard (Ross, at 643-644).

196 Under the purpose clause of the Act, the purpose thereof is to maintain and encourage competition in Canada in order, *inter alia*, to promote the efficiency and adaptability of the Canadian economy. Accordingly, in the Tribunal's view, efficiency gains and deadweight loss (i.e. losses in efficiency) in foreign markets resulting from an anti-competitive merger in Canada are to be excluded in the application of section 96. This is clearly stated in the statute and is not a discretionary matter for the Tribunal. Accordingly, if the deadweight loss in foreign markets is an excluded effect, so are all other effects in foreign markets. In the Tribunal's view, the Act does not endorse a "*total world welfare*" standard.

197 A "*total Canadian welfare* standard" as defined by Professor Ross may or may not be discriminatory under Canada's international obligations, but the Act is not. In the Tribunal's understanding, those obligations require "national treatment" in the application of Canadian laws. Accordingly, if efficiency gains and effects in foreign markets are excluded when reviewing an anti-competitive merger of two Canadian-owned firms in Canada, the same exclusion must be accorded if those merging firms are owned by non-residents. In Professor Ross' hypothetical, the anti-competitive merger of an American-owned and a Canadian-owned firm would be blocked under the Total Surplus Standard (even if consideration of the layoffs was excluded) because there are no gains in efficiency in Canada.

198 Accordingly, the Tribunal agrees with counsel for the Commissioner that the portion of the transfer experienced by foreign consumers should be excluded in the section 96 analysis. However, the Tribunal does not agree that so doing is a matter of discretion.

(2) Pre-existing Monopsony

199 Counsel for the Commissioner submits that a second such instance for the Tribunal's exercise of discretion under subsection 96(1) arises in the case of an anti-competitive merger that offers countervailing power to an existing monopsony. Where consumers have organized to extract a subcompetitive price from producers in an industry, the gain in consumer surplus is not a gain to society because it comes at the expense of a corresponding loss in producers' profits. A subsequent merger that conferred market power on producers might be allowed to proceed in light of efficiency gains by ignoring the loss of the consumer surplus due to the pre-existing monopsony; only that portion of the wealth transfer that resulted from the increase in price above the competitive level would be considered (Transcript, vol. 5, October 15, 2001, at 825, line 23 to 826, line 17).

200 The Tribunal agrees that, if it is to consider redistributional effects under a standard other than the Total Surplus Standard, it should not automatically count the loss of consumer surplus attributable to pre-existing monopsony power against the merger if section 96 is invoked. The appropriate treatment of the various redistributional effects depends on the evidence presented, and that portion of the wealth transfer from consumers to producers may not be an adverse effect of the merger.

201 Although the Tribunal agrees with the submission of counsel, it notes that a merger policy that favours consumers over producers/shareholders would object to the loss of pre-existing monopsony benefits and, hence, in the scenario offered by counsel, the loss to consumers of their monopsony benefits would be counted against a merger that offered countervailing market power. Yet this is not the approach offered by counsel for the Commissioner, presumably because it is not what the Act requires. As noted previously, the Tribunal held and the Court agreed that the paramount objective of the merger provisions of the Act is efficiency.

(3) General

202 Accordingly, it is not clear to the Tribunal why it should take less than the full amount of the transfer into consideration in the subsection 96(1) analysis only in these two situations advanced by counsel for the Commissioner. In light of the concerns of Madame Justice Reed and Professor Townley, both of whose concerns are given weight by the Court, and having regard for the approach taken by the Commissioner's advisers in light of the Commissioner's dissatisfaction with the approach published in the 1992 MEGs, it is clear to the Tribunal that it should consider all effects routinely for their socially adverse, positive and neutral impacts.

203 In the Tribunal's view, the monopsony example raises a critical issue. Why should the merger provisions of the Act deny the consumer benefit in that instance? There must be some reason why merger policy concerns itself with the competitive price, even when achieving that price harms consumers by denying their monopsonistic gains.

204 The answer to that question, which has never been discussed in any part of the review of the instant merger is, clearly, economic efficiency itself. Competitive prices are desirable, not because they are low or fair to consumers-indeed, they may be quite the opposite-but rather because, in a wide range of circumstances, they promote economic efficiency quite generally. If this were not true, then there would be no particular reason to favour competitive markets. Clearly, there are more effective ways to ensure low and fair consumer prices over the economy as a whole than through a policy of maintaining and encouraging competition in Canada, but these other ways risk substantial, widespread bureaucracy and inefficiency, and reduction in economic growth and living standards, and they would not long be tolerated by Canadians.

205 Doubtless, there will be mergers that redistribute income adversely. If these redistributive welfare losses cannot be addressed more effectively in other ways, then there is a strong argument for taking them into account in merger policy. As noted by the Report of the Economic Council of Canada, and also in our Reasons, it was the Tribunal's view (Reasons, at paragraph

438) that redistributional issues were better handled outside of competition law. An example was offered by Madame Justice Reed in the *Hillsdown, supra*, decision: the merger of two drug companies where the relevant product is a life-saving drug.

206 The Tribunal notes that Parliament established the Patented Medicine Prices Review Board ("PMPRB"), an independent, quasi-judicial body, on December 7, 1987. Its regulatory function is to protect consumer interests by regulating the maximum prices charged by manufacturers for patented medicines to ensure that they are not excessive. The PMPRB's mandate extends to all patented drugs, prescription and non-prescription medicines sold in Canada for human and veterinary use (see generally www.pmprb-cepmb.gc.ca).

207 It thus appears that Parliament had already fully addressed Madame Justice Reed's concern when it established the PMPRB, equipped it with expert board members and professional staff, and mandated it specifically to ensure that prices of medicines were not excessive. There is no proper role for the Tribunal in this aspect of drug company mergers, as it would duplicate the role of the PMPRB which, unlike the Tribunal, has the relevant expertise and authority to regulate medicine prices in the consumer interest. Moreover, patentholders have rights which extend beyond the Tribunal's jurisdiction.

208 The regulation of retail propane prices is an option that is open to government. There is no doubt that Parliament does not hesitate to use all of the means at its disposal to raise the welfare of all Canadians. The Tribunal's proper role, especially since it deals only with the civil matters under the Act, is to ensure that the benefits of a competitive economy are achieved within the law.

M. Consumer Surplus Standard cannot be Correct in Law

209 In describing the Consumer Surplus Standard, the Court did not expressly endorse, neither did it reject, it. Rather, the Court stated:

> [22] The "consumer surplus standard" posits that a merger should be permitted only if the resulting efficiency gains exceed the sum of the wealth transferred to the producers and the deadweight loss occasioned by increases in price charged by the merged entity. In practice, this standard will also be difficult to establish and consequently will tend to narrow the availability of the efficiency defence. (Appeal Judgment at 12)

210 While the Court concluded that the Tribunal erred in law by adopting the Total Surplus Standard, it declined to prescribe the correct methodology:

> [139] ...Such a task is beyond the limits of the Court's competence.
>
> [140] Whatever standard is selected (and, for all I know, the same standard may not be equally apposite for all mergers) must be more reflective than the total surplus standard of the different objectives of the *Competition Act*. It should also be sufficiently flexible in its application to enable the Tribunal to fully assess the particular fact situation before it.
>
> [141] It seems to me that the balancing weights approach proposed by Professor Townley, and adopted by the Commissioner, meets these broad requirements. Of course, this approach will no doubt require considerable elaboration and refinement when it comes to be applied to the facts of particular cases.
>
> [142] Further, while the adoption of the balancing weights approach is likely to expand the anti-competitive effects to be considered, and hence narrow the scope of the defence, I see no reason why it should, as the respondent submitted, practically write section 96 out of the Act. (Appeal Judgment at 54-55)

211 It is clear however that the Commissioner's expert witness on welfare economics, Professor Townley, rejected the Consumer Surplus Standard because it failed to distinguish between those consumers for whom the merger's impact would be socially adverse and those for whom it would not (i.e. it applied a "fixed weight *a priori*").

212 It appears that, on appeal, the respondents argued that the Balancing Weights Approach would vitiate the efficiency defence in subsection 96(1). The Court disagreed with the respondents' submission, but the Court's response at paragraph 142

of the Appeal Judgment indicates that it was concerned that section 96 not be vitiated by reason of the standard adopted by the Tribunal.

213 The Tribunal accepts, as it must, the Court's directive that the Balancing Weights Approach does not vitiate the efficiency defence. Recognizing the Court's concern, the Tribunal also takes the instruction that, as a matter of law, it cannot adopt a standard that vitiates section 96.

214 The Tribunal concludes that the Consumer Surplus Standard, which requires that the full amount of the transfer be added to the deadweight loss in establishing the effects of an anti-competitive merger, is so limiting that its adoption in all cases would be contrary to the conclusion of the Court, would rule out the inquiry that Professor Townley regards as necessary to assess the welfare effects of the merger, and generally makes the efficiency defence unavailable under the Act, and so cannot be correct in law because it vitiates the statutory provision in subsection 96(1).

215 The fact that in this case proven efficiency gains of 7.5 percent of sales would not satisfy the Consumer Surplus Standard adequately demonstrates that the requirement therein is so high that it would be met, if ever, only in rare circumstances. Based on its review of the legislative history of the Act and the Parliamentary review of the 1986 amendments, the Tribunal concludes that the efficiency defence (and the exclusion of the limitations thereon in preceding bills) was not inserted into the Act for such limited use; rather, it was meant to be an essential part of the Canadian merger policy that emphasizes economic efficiency.

VI. The Effects

216 The Commissioner accepts, as he must, the Tribunal's finding of estimated efficiency gains of $29.2 million per year for ten years, although he insists that the measured deadweight loss of $3 million per year for ten years is correct despite the Tribunal's attempt to quantify certain qualitative effects. The Commissioner maintains that the full amount of the estimated income transfer of $40.5 million per year should be included and asserts several effects that the Tribunal should consider qualitatively in light of the purpose clause of the Act and the ruling of the Court. The Commissioner submits that regardless of the way in which the Tribunal performs the analysis under section 96 of the Act, it will find that the respondents have not met their burden to show that efficiencies both exceed and offset the effects.

217 The respondents assert that the Tribunal must make specific findings regarding the deadweight loss because it did not do so in its Reasons following the first hearing. Moreover, the Tribunal should consider that Professor Ward's evidence failed to find price increases in certain segments, hence the Commissioner's estimates of deadweight loss and transfer in these segments should be reduced or disregarded. Regarding qualitative effects and certain other matters, the Tribunal is *functus officio* and cannot revisit its findings. In addition, the Commissioner is prevented from introducing new evidence in the current hearing and therefore cannot establish certain effects.

218 The respondents further assert that whereas the Commissioner is now advocating the Consumer Surplus Standard, only the adverse portion of the income transfer can be considered. Since propane expenditures account for a relatively small portion of total expenditure for all consumers, the effect of the predicted price increase is small as is the impact of the transfer. Propane consumers are not generally poor or needy, and accordingly, the entire transfer of income should be regarded as neutral. On this basis, the Tribunal should allow the merger to proceed.

A. Deadweight Loss

219 The Commissioner submits that the resource misallocation effect (loss of efficiency) of the merger was correctly measured by the deadweight loss of $3 million per annum and should not be revisited by the Tribunal. In response to the Tribunal's conclusion in its Reasons that the measured deadweight loss was probably overstated, the Commissioner states that any overstatement due to the estimation based on total combined sales rather than combined sales of the parties in overlapping markets is *de minimus* (Commissioner's Memorandum on Redetermination Proceedings, paragraphs 19-20 at 13).

220 In response to the Tribunal's conclusion that the measured deadweight loss was overstated since it had been calculated incorrectly with a demand elasticity of - 1.5 rather than - 1.0, the Commissioner refers to Table 8 of Professor Ward's expert

report (exhibit A-2059) that demonstrates that the deadweight loss for a particular price increase becomes smaller as demand becomes more inelastic, and that while the deadweight loss would have been smaller if calculated at a demand elasticity of -1.0, the redistributive effect would have been larger and the combined deadweight loss and transfer would also have been larger (Commissioner's Memorandum on Redetermination Proceedings, paragraph 22 at 14). See paragraph 178 *supra*. However, the Commissioner does not argue that the Tribunal should revisit its conclusion regarding the overstatement of the deadweight loss on this basis.

221 The Commissioner states that the measured deadweight loss of $3 million was based solely on the price increase by the merged entity and did not include the mis-allocation effect (i.e. deadweight loss) due to interdependent pricing in certain markets by competing firms (Commissioner's Memorandum on Redetermination Proceedings, paragraphs 23-24 at 14-15).

222 The Commissioner states that the deadweight loss estimate does not include the mis-allocation of resources due to the prospective elimination of certain programs and services by the merged firm. The Commissioner notes that the Tribunal concluded that the impact thereof would be minimal and most unlikely to exceed, in amount, the estimated deadweight loss, implying a maximum effect equivalent to that of a price increase in the range of 7-11 percent. It appears that the Commissioner does not seek to disturb the Tribunal's conclusion (Commissioner's Memorandum on Redetermination Proceedings, paragraph 40 at 20-21).

223 Pointing out that the Tribunal concluded that the upper limit on the deadweight loss was $6 million, the respondents submit that the Tribunal did not make a specific finding on the size of the deadweight loss and they submit that the Tribunal should do so now. The respondents further assert that the Tribunal did not find that any specific price increase was likely when it made findings about the anti-competitive effects (Respondents' Memorandum on Redetermination Proceedings, paragraph 21 at 8) and that, on Professor Ward's evidence, the Tribunal could not conclude that a price increase would occur on a balance of probabilities (Respondents' Memorandum on Redetermination Proceedings, paragraph 25 at 10). They also maintain that only sales volumes in overlapping markets can be used when estimating the deadweight loss and the redistributive effect, and then only for residential and industrial business segments because Professor Ward did not make any estimates of price increases for his "Other" segment and his estimate for auto-propane was statistically insignificant (Respondents' Memorandum on Redetermination Proceedings, paragraph 26 at 10). They introduce calculations that the deadweight loss is $1.8 million and the transfer of income is $23.7 million which estimates are themselves overstatements (Respondents' Memorandum on Redetermination Proceedings, paragraphs 61-64 at 26-28).

224 The respondents submit that the proper estimation of the deadweight loss would exclude Superior's sales in Atlantic Canada because it is not an overlapping market, would exclude sales in "Category 1" markets since there is no substantial lessening of competition therein and would reduce sales in the automotive segment for lack of statistically significant evidence of a price increase, *inter alia*. The respondents' further estimates of the deadweight loss and transfer are substantially lower; the Commissioner offers rebuttal thereto in reply.

225 The respondents submit that the Tribunal's Reasons included consideration of the deadweight loss in Atlantic Canada, hence the Tribunal is *functus officio* in that regard (Respondents' Memorandum on Redetermination Proceedings, paragraph 74 at 35). They further submit that any deadweight loss arising from interdependent and coordinated pricing behaviour has already been considered by the Tribunal when it accepted the measured deadweight loss of $3 million (Respondents' Memorandum on Redetermination Proceedings, paragraph 76 at 36). The respondents also state that the Tribunal fully considered the deadweight loss implications of the negative qualitative effects of the merger, found them minimal, and is *functus officio* in that regard (Respondents' Memorandum on Redetermination Proceedings, paragraphs 66-67 at 29-31).

226 The purpose of this Redetermination Hearing is the consideration of effects that were not considered in the Reasons which followed the first hearing. The Tribunal made certain findings in respect of the deadweight loss and those findings were not disturbed by the Court. Those findings will not be revisited.

227 In its Reasons, the Tribunal did not consider separately the deadweight loss arising from interdependent and coordinated pricing by competitors of the merged firm because the Commissioner did not argue for consideration of this effect. Rather,

the Commissioner argued that interdependent and coordinated pricing was itself the effect to be considered, and the Tribunal disagreed (Reasons, at paragraph 465). Since the Commissioner did not propound deadweight loss from interdependent and coordinated pricing by competitors of the merged firm at the first hearing, the Tribunal did not make a specific finding in that regard. Rather, the Tribunal found, after all of the evidence, that the full extent of the measured (or estimated) deadweight loss was $3 million.

228 In any case, the Tribunal notes that there is no evidence of deadweight loss from interdependent and coordinated pricing on the record. Professor Ward did not address this issue at all in his expert report, and in his oral testimony cited by the Commissioner, Professor Ward said in regard thereto only "...There could possibly be two different effects..." (Commissioner's Memorandum on Redetermination Proceedings, paragraph 24 at 14-15). It appears to the Tribunal that Professor Ward did not examine these effects or present any opinion thereon. Accordingly, the Tribunal can reach no conclusion about deadweight loss from interdependent and coordinated pricing by competitors.

229 The Tribunal agrees with the respondents that it did not adopt a specific price increase for the purpose of assessing the deadweight loss. Rather, it accepted the Commissioner's estimate of $3 million as the deadweight loss and the Tribunal augmented it by its assessment of the maximum deadweight loss that could be attributed to changes in the product line by the merged firm. Accordingly, the Tribunal concluded that the deadweight loss would not exceed $6 million.

230 The Tribunal agrees with the respondents that it did not make a specific finding on the deadweight loss, for the reason that it was not necessary to do so in light of the small magnitude thereof in relation to proven efficiency gains. The Tribunal did, however, accept the $3 million estimated deadweight loss that the Commissioner proposed was the effect of the price increase by the merged firm. The Tribunal finds merit in some, but not all, of the respondents' claims that this estimate is overstated. Subsection 96(1) requires consideration of all effects of lessening or prevention of competition in Canada. Hence, there is no basis for excluding sales in Atlantic Canada just because it is not an overlapping market. Similarly, there is no basis for excluding sales in Category 1 markets just because no substantial lessening of competition was shown therein in the section 92 inquiry. On the other hand, the respondents may be correct that no deadweight loss in auto-propane should be considered because Professor Ward's estimated price increase in auto-propane was statistically insignificant and because his was the only statistical evidence before the Tribunal regarding the magnitudes of likely price increases.

231 Given the express purpose of this Redetermination Hearing, the Tribunal will not revisit its conclusion that Professor Ward did give an opinion about price increases generally and in certain segments such as auto-propane. Accordingly, the Tribunal will not revisit its conclusions that the $3 million estimate of deadweight loss submitted by the Commissioner is probably overstated and that the total deadweight loss is most unlikely to exceed $6 million.

232 The Commissioner further quotes the American authors noted above who make the point that the redistributive effects can have additional negative implications for efficiency. Citing articles by R. Posner and by R. Lande, these authors argue that the redistributed income will eventually be transformed into efficiency losses because the merged firm may become complacent and allow costs to rise (Commissioner's Reply Memorandum on Redetermination Proceedings, paragraph 103 at 39). To the Tribunal, this interesting observation suggests that the estimated deadweight loss from the instant merger is too low. However, these inferences are unsupported by anything on the record and the Tribunal will not consider them further.

233 In the Tribunal's view, the requirement in subsection 96(1) that efficiency gains must be "greater than" the effects of lessening or prevention of competition favours a quantification of efficiency gains and the effects to be considered, where possible. That a particular effect cannot, even in principle, be quantified does not relieve the Tribunal of assessing that effect in the "greater than" test. Accordingly, where it is possible to quantitatively estimate such effects even in a rough way, perhaps by establishing limits as the Tribunal has done regarding certain qualitative effects, it is desirable to do so where the evidence permits. On the other hand, effects that are, in principle, measurable should be estimated; failure to do so will not lead the Tribunal to view them qualitatively.

B. Interdependent and Coordinated Behaviour

234 The Commissioner argues now that the redistribution of income arising from the coordinated pricing behaviour of competitors should be considered as a qualitative effect by the Tribunal.

235 The Commissioner did not propound this effect at the first hearing.

> MEMBER SCHWARTZ: Apart from Dr. Ward's testimony here, which I don't want to minimize, I don't recall that the Commissioner advocated it in the first hearing that these were sources of deadweight loss and transfer that needed to be considered. Rather that the Commissioner said, as I understood it, that interdependence and coordination were themselves, I suppose, so important that they needed to be given a qualitative consideration outside of any deadweight loss or transfer issues.
>
> So am I wrong when I say the Commission did not seek to have deadweight loss and transfer from the coordinated effects considered?
>
> MS. STREKAF: Well, I think that - I guess two responses.
>
> First of all, there was no calculation put forward with respect to what the deadweight loss and transfer would be with respect to category two and three markets in the original case. I think the second response, and that relates to - part of the scope of this hearing is to now focus in and drill down very specifically in accordance with what the Federal Court of Appeals direction has been and to examine the effects in their totality. And in looking-
>
> . . . . .
>
> MS. STREKAF: In this context here, we are not - we had not put forward a specific number as to what those deadweight loss and transfers would be. But relying on the evidence that was at the hearing of Professor Ward, he recognized that there would be an additional deadweight loss and a transfer, and in discussing the coordination effects more specifically later on in the brief, we attempt to try and put some boxes around what those numbers might be to give you kind of an order of magnitude of how you might view that from a qualitative perspective rather than trying to quantify those numbers.
>
> MEMBER SCHWARTZ: Thank you very much. (Transcript, vol. 1, October 9, 2001, at 116, line 25 to 118, line 22)

236 In the Tribunal's view, the same evidentiary issues that attend the claim of deadweight loss from interdependent and coordinated behaviour attend the claim of redistributional effect. There is no evidence thereof on the record. Again, Professor Ward did not address this redistributional effect in his expert report. His oral evidence is, as noted above, speculative. Indeed, his oral evidence cited by the Commissioner addresses the possibility of loss of producer surplus by the competing independent firms, not the possible loss of consumer surplus by migrating customers (Commissioner's Memorandum on Redetermination Proceedings, paragraph 24 at 15).

237 Since the Tribunal had adopted the Total Surplus Standard, it would not have considered the redistributional effect of interdependent and coordinated behaviour by competitors had it been propounded at the first hearing. In light of the Appeal Judgment, the Tribunal is of the view that it should consider the submissions of the parties in this matter. However, as there is no evidence on which the Tribunal could assess the claimed redistributive effect of interdependent and coordinated behaviour, the Tribunal rejects the Commissioner's submission.

C. Service Quality and Programmes

238 The Commissioner maintains that the Tribunal, while it considered the deadweight loss effect of the removal or reduction of services and pricing arrangements offered by ICG, should now consider the redistribution of income associated with that exercise of market power. It should further consider the qualitative impacts associated with the elimination of or reduction in consumer choice in, for example, the national account coordination services product market (Commissioner's Memorandum on Redetermination Proceedings, paragraphs 34-41 at 19-21).

239 The respondents point out that the Tribunal stated in its Reasons that there was no evidence regarding the scope of any program removal or service reduction. In addition, they argue that the Commissioner has not explained why consumers value

choice *per se*, i.e. beyond the effect it has on price or quality of service, which matters have already been considered by the Tribunal (Respondents' Memorandum on Redetermination Proceedings, paragraphs 68-73 at 31-34).

240 The Tribunal recognized that ICG had established certain services and pricing arrangements that Superior and other propane marketers did not offer. (However the Commissioner notes that, in western Canada, Superior offers a program similar to ICG's "Cap-It" arrangement.) In the Tribunal's view, GolfMax and similar arrangements are specialized marketing arrangements and represent ways in which ICG has sought to differentiate itself from its competition in selling propane. The removal of certain specialized marketing arrangements by the merged company would cause a buyer for whom that arrangement was its preferred way of acquiring propane, to select a less-preferred arrangement. As with switching induced by a direct increase in price, this change of arrangements would entail a loss of efficiency as measured, in principle at least, by the deadweight loss and a redistribution of income from buyer to seller. If estimates of these effects could be made, the effects of reduced choice would be captured in the conventional way. If such estimates could not be made, then the effects would have to be established in some other way per the evidence.

241 On the evidence that propane demand was inelastic, the Tribunal concluded that propane consumption would not decline significantly if those marketing arrangements were eliminated. On the evidence, the Tribunal concluded that to the extent that certain marketing arrangements were removed, the deadweight loss therefrom would be "minimal" and "...most unlikely to exceed in amount the estimated deadweight loss..." of $3 million. (Reasons, paragraphs 466-467). In this way, the Tribunal used the available evidence to place an upper bound on the effect on efficiency brought about by the reduction or removal of certain marketing arrangements argued by the Commissioner as a qualitative factor.

242 The Tribunal was directed by the Court to consider the redistributive effects that it ignored initially. However, the Tribunal notes that at the first hearing, the Commissioner did not adduce any evidence on this matter. Rather, the Commissioner was content to argue that the removal/reduction of programs and services should be considered as (negative) qualitative effects. The Commissioner never argued, and hence adduced no evidence, regarding the redistributive effect resulting from this removal/reduction of programs and services.

D. Atlantic Canada

243 The Commissioner submits that the prevention of competition in Atlantic Canada that the Tribunal found in its section 92 inquiry is an effect to be considered qualitatively under section 96 of the Act. The respondents state that there is insufficient information on the record to assess the effect of this prevention of competition and that the Tribunal is *functus officio* in regard to the effects of prevention in Atlantic Canada, except for redistributional effects.

244 The Tribunal accepted that the merger prevents ICG's plans to expand in Atlantic Canada from being implemented. As a result, the price of propane will likely be higher than it would be if the merger did not take place. Accordingly, the possible effects of this prevention of competition in Atlantic Canada would be the efficiency gains and reduction in excess profits that would have resulted from the additional competition that the merger precludes.

245 Having identified and accepted the prevention of competition in Atlantic Canada, the Tribunal must assess the effects of such prevention. The prevention itself is distinguishable from its effects in the same way as above where the Commissioner distinguished between interdependent pricing and the effects thereof. There is no evidence on the record about the extent to which the price of propane would have fallen if ICG's expansion had occurred, and accordingly the possible efficiency gains and redistributional effects that the merger prevents in Atlantic Canada are not directly measured.

246 With respect to the prevented efficiency gains, the Tribunal notes that the Commissioner's calculation of the $3 million deadweight loss included sales by Superior in Atlantic Canada. Such calculation is an indirect way of including the prevented efficiency gains in Atlantic Canada. Though it might be a poor estimate, it was not criticized as such and accordingly, there is no basis or need for the Tribunal to reconsider the deadweight loss effect in a qualitative way. The Tribunal is *functus officio* in regard to the deadweight loss in Atlantic Canada.

247 Regarding the redistribution of income in the form of reduced excess profits to incumbents, the Tribunal agrees with the respondents that there is no evidence that would assist it in evaluating this effect from either a qualitative or quantitative perspective.

248 The Court states that the Tribunal found that, while the merged entity will eliminate "...all consumer choice, and remove all competition, in the propane supply market, as it is likely to do in Atlantic Canada, for example...", these effects were not to be considered under section 96 (Appeal Judgment, paragraph 107 at 43).

249 It appears to the Tribunal that, with respect, the Court may have confused prevention of competition and choice with reduction of competition and choice. There is no evidence that this merger will remove all competition in Atlantic Canada. Moreover, the Tribunal did not find that the merger would, or likely would, remove all competition in the propane supply market in Atlantic Canada. Finally, if the Court's statement concerning the elimination of consumer choice is a reference to Atlantic Canada, the Tribunal notes that it did not find that the merger would, or would likely, eliminate all consumer choice there.

E. Interrelated Markets

250 Referring to the Appeal Judgment, the Commissioner submits that the merger will result in additional losses of efficiency (i.e. deadweight loss) and additional redistribution of income in interrelated markets. The Commissioner points out that only 10.7 percent of the combined volumes of propane sold by Superior and ICG in 1998 were for residential end-use applications, and that propane is used as an intermediate input in a variety of industries and businesses (Commissioner's Memorandum on Redetermination Proceedings, paragraphs 30-33 at 17-18).

251 The Commissioner submits further that:

> An increase in the price of propane for these customers has the potential to increase the cost of goods produced or the services provided by these customers. Where an increase in propane prices results in a price increase for those other products, there will be additional resource misallocation (deadweight loss) and transfer effects beyond those identified above. These additional effects also result from the merger. While it is not feasible to quantify these effects, where, as here, the product involved represents a significant input in other products, this effect should be taken into account... (Commissioner's Memorandum on Redetermination Proceedings, paragraph 33 at 18)

252 The respondents assert that the Commissioner has provided no evidence on the effects from the merger in interrelated markets.

253 In the Tribunal's view, the issue here is whether an intermediate purchaser of propane will absorb the propane price increase or pass it on in some way. Whether the increase is large or small or whether propane is a significant input is not the issue.

254 The statutory wording of section 96 requires the showing of "...effects of any prevention or lessening of competition that will result or is likely to result...". In the Tribunal's view, the Commissioner's reference to the "...potential to increase the cost of goods..." is an insufficient basis for inferring that the effects or likely effects thereof will occur or for estimating the magnitudes thereof even in a rough way. In the Tribunal's view, the Commissioner has alluded to, but has not established, the effects and consequently the Tribunal agrees with the respondents. The Tribunal comments further on this matter below.

255 However, the Tribunal agrees that effects in related markets, where they are shown to arise from the lessening or prevention of competition, are important considerations under the Act and notes that the wording of subsection 96(1) provides for their inclusion. In particular, it is important to identify in which of the interrelated markets the effects occur in order to assess whether the redistribution of income occurs from consumer to shareholder or between shareholders of different businesses.

F. Loss of Potential Dynamic Efficiency Gains

256 The Commissioner submits that the merger will result in the loss of dynamic efficiency gains that would have been achieved by ICG's "transformation project". While these foregone gains are difficult to predict, the Commissioner submits that

qualitative consideration thereof is warranted because this concern relates to the objective of efficiency and adaptability in the purpose clause of the Act. The respondents state that the Tribunal is *functus officio* as regards dynamic efficiencies.

257 The Tribunal notes that ICG had adopted a new business model and was in the process of implementing various technologies when the merger occurred. The Commissioner notes:

> ...Whether the ICG model or the Superior model would have ultimately proved to be the more efficient remains an open question, however, what has been lost as a result of the merger are any potential dynamic efficiencies or enhanced competition that might have resulted over time from ICG's adoption of a technology-based approach to propane distribution... (Commissioner's Memorandum on Redetermination Proceedings, paragraph 78 at 32)

258 To accept the Commissioner's claim, the Tribunal would have to accept that ICG's transformation plan would succeed in achieving dynamic efficiency gains and cost savings. While there is evidence that ICG planned to introduce certain new technologies, there is no evidence on the gains or savings therefrom; for example, no expert witness testified to the likelihood of these gains being achieved, their "dynamic" character, or their quantum, and accordingly, the loss of such gains appears speculative even, apparently, to the Commissioner. Accordingly, the Tribunal rejects the Commissioner's submission.

G. Monopoly

259 In written argument, the Commissioner asserts that the creation of monopolies in 16 geographic markets for retail propane and the creation of monopoly in the "national accounts coordination services" market are qualitative effects that must be considered in the section 96 inquiry pursuant to the purpose clause of the Act (Commissioner's Memorandum on Redetermination Proceedings, paragraphs 67-73 at 29-31).

260 In oral argument, the Commissioner characterizes the instant merger as a monopoly having regard not only to those 16 geographic markets, but also to the much larger number of geographic markets where market power will be created or enhanced and will be expressed in coordinated pricing behaviour by other propane suppliers therein (Transcript, vol. 1, October 9, 2001, at 92, lines 9-24 and at 94, lines 1-11).

261 The respondents maintain that since section 96 concerns the "...effects of any lessening or prevention of competition...", the Commissioner must show additional effects of monopoly beyond those which have already been included in the deadweight loss and redistribution of income, and that no such additional evidence has been presented. They also maintain that the decision of the Court requires consideration of monopoly as a factor under section 96 only when the merged firm will have a market share of 100 percent, such not being the case in the instant merger. Finally, the respondents introduce calculations showing that the effects (deadweight loss and redistribution of income) in the Commissioner's monopoly markets are small.

262 The Court referred to the creation of monopoly as follows:

> [107] Another consequence of limiting the anti-competitive "effects" of a merger to deadweight loss is that it is irrelevant that the merger results in the creation of a monopoly in one or more of the merged entity's markets. According to the Tribunal, the fact that the merged entity of Superior and ICG will eliminate all consumer choice, and remove all competition, in the propane supply market, as it is likely to do in Atlantic Canada, for example, is not an "effect" that legally can be weighed under section 96 against the efficiency gains from the merger.
>
> [108] Again, such a conclusion seems to me to be so at odds with the stated purpose of the Act, namely "to maintain and encourage competition", and the statutory objectives to be achieved thereby, as to cast serious doubt on the correctness of the Tribunal's interpretation of section 96. (Appeal Judgment at 43)

(1) Definitional

263 The Tribunal did not find that the merged entity of Superior and ICG would eliminate all consumer choice and remove all competition, in the propane supply market, and in particular it did not find that this was likely in Atlantic Canada.

264 Even in those 16 markets described by the Commissioner's experts as "monopoly or near-monopoly markets", many consumers will have other product choices. The Tribunal accepted that, for the purposes of the section 92 inquiry, the product market was limited to "retail propane" and hence excluded other fuels pursuant to the criterion it adopted for market delineation (i.e. the five percent price increase of the "hypothetical monopolist" test). The result of that approach is the exclusion of alternatives that exist but are unlikely to be chosen. While other choices are available, it appeared to the Tribunal that they would not be chosen in sufficient quantities to meet the criterion it adopted, and hence those choices were excluded from the product market.

265 To further illustrate the issues of market definition, the Tribunal refers to its finding that "national account coordination services" constitutes a separate product market and that the instant merger is a merger of the only two firms in Canada that currently provide the service (Reasons, at paragraphs 73-82). In the sense that only one supplier will remain after the merger, the merger can be said to create a monopoly in "national account coordination services".

266 Nevertheless, it is not clear that a purchaser with propane requirements at many different locations will have "no choice". As the respondents argued, such firms will be able to obtain propane through regional and local suppliers and would even get a lower price for propane that would cover the apparently small incremental staffing cost to the national buyer. Moreover, as the Tribunal indicated in its Reasons, some national buyers of propane do in fact purchase propane this way. The Commissioner did not challenge that evidence at the first hearing.

267 However, the Tribunal based its decision to delineate a separate product market on the witness testimony that indicated that certain national buyers would bear a significant increase in the price of propane by the merged firm rather than switch to these regional and local suppliers despite the apparent monetary savings. Accordingly, the merger cannot be said to eliminate all choice for those buyers; all that can be said is that after the merger, the remaining choices will be so unattractive to some national buyers that, despite the apparent economic advantage, they will not choose them. Hence, it was appropriate to delineate a separate product market for the purposes of the Tribunal's inquiry under section 92. The Tribunal did not characterize the merger as a monopoly in "national account coordination services".

268 In the Tribunal's view, the term "monopoly" should be used with some appreciation of the definitional issues. The difficulty of defining monopoly outside of pure economic theory has been emphasized by Professors Trebilcock and Winter in an article cited by the Tribunal at paragraph 427 of its Reasons:

> ...To the layperson or undergraduate economics student, "monopoly" refers to a firm that sells free of any competitive discipline a product with no substitutes. A monopoly so-defined is fictional. Every product has some alternatives, if only because a consumer can keep the "cash" to purchase other commodities and services. Market power is a matter of degree, so a "monopoly" is not categorically defined... (M. Trebilcock and R. Winter, *The State of Efficiencies in Canadian Merger Policy*, Canadian Competition Record, Winter 1999-2000, vol. 19, no. 4, at 108)

269 Professor Ware made similar observations:

> Monopolies are much in the news in turn of the century Canada. Perhaps prompted by the Propane case as well as the merger of Air Canada and Canadian Airlines, there has been a virtual cacophony of "monopoly" allegations in the press. The implication seems to be that one only has to make this label stick to a proposed grouping or reorganization in order to bring down the wrath of competition law justly upon it.
>
> Although the term "monopoly" has a ring of precision to it, and forms a foundation stone for every student's introduction to economics, many would be surprised to learn that as an economic concept, the term monopoly is quite misleading and almost vacuous...
>
> The fact that monopoly is not a robust economic concept does not mean that competition policy and antitrust economics are ill-conceived. Rather, they are properly concerned with the search for market power and its abuse, not for monopoly, or even "monopolization". If predicated on the search for market power, the term monopoly can be understood more accurately

> as the product of an exercise in the definition of an antitrust market. What a merger to monopoly in this sense would mean is that for some products, firms involved in a proposed merger would have sufficient market power post-merger to profitably raise price by 5% (holding all other prices constant and abstracting from several factors...). The process of market delineation, as set out in the merger guidelines of Canada (and the United States) is not a process of identifying "monopoly" or even pure economic market power. It is a legal and procedural device designed as a step, albeit an important step, in a sequence of investigations established to identify the possibility that market power will increase as a consequence of a merger. Note that this exercise does *not* conclude that there are no other substitutes for the candidate products (so that the merger actually creates, in an economic sense, a monopoly); but, rather that a merger has the potential to create a minimum degree of market power. I use the term potential because subsequent steps in the analysis must consider the likelihood of entry within an adequate time period, the effect of capacity constraints, whether countervailing buyer power might exist, the implications of the merger for innovation, *etc.*
>
> Monopoly, then, is at best an elusive concept. The Tribunal and the Competition Bureau have, hitherto, largely recognized that such structural identifiers are only tools in the evaluation of market power and its consequences for economic efficiency... (R. Ware, *Efficiencies and the Propane Case*, International Antitrust Bulletin, Vol. 3, Issue 3, Fall/Winter 2000 at 17-18)

(2) Statutory History and Related Provisions

270 Although the Act does not provide a definition of the term "monopoly", its predecessor statute did. Section 33 of the *Combines Investigation Act* stated:

> Every person who is party or privy to or knowingly assists in, or in the formation of, a merger or monopoly is guilty of an indictable offence and is liable to imprisonment for two years.

Section 2 thereof provided a definition of "monopoly":

> "monopoly" means a situation where one or more persons either substantially or completely controls throughout Canada or any area thereof the class or species of business in which they are engaged and have operated such business or are likely to operate it to the detriment or against the interest of the public, whether consumers, producers or others, but a situation shall not be deemed a monopoly within the meaning of this definition by reason only of the exercise of any right or enjoyment of any interest derived under the *Patent Act*, or any other Act of the Parliament of Canada.

271 Under the amendments of 1986 to the *Combines Investigation Act*, merger is now a civil rather than a criminal offense. Since the definition of monopoly under section 2 of the *Combines Investigation Act* was not carried into the new Act, the Tribunal can assume only that that definition was not intended to be used. Indeed, the absence of any definition of monopoly indicates only that Parliament felt that none was needed under the Act as amended.

272 Under section 92, the Tribunal must decide whether a merger lessens or prevents competition substantially and, per subsection 92(2), it cannot so find solely on the basis of evidence of market share or concentration. Accordingly, even a merger to market share of 100 percent does not automatically violate section 92. Only after its consideration of entry and other factors can the Tribunal conclude that such merger will lessen or prevent competition substantially. Labelling such a merger as a "monopoly" neither adds to, nor detracts from, the Tribunal's required inquiry, which concerns the ability to exercise market power. The Tribunal is of the view that the creation of monopoly is irrelevant to its task under the merger provisions of the Act.

273 It is noteworthy that the offence of "monopolization" under the *Combines Investigation Act*, was decriminalized in 1986. The provisions thereof were amended and were included under "abuse of a dominant position" in section 79 of the amended Act. Accordingly, assuming a monopoly could be adequately defined, its formation does not constitute an offence under that section; indeed, nor is the occurrence of an anti-competitive act by such entity proscribed. Rather, the Commissioner is required to demonstrate dominance, a practice of anti-competitive acts, and the substantial lessening or prevention of competition that results from that practice.

274 As further indication that the civil provisions of the Act are not hostile to monopoly *per se*, the Tribunal refers to section 86 which allows the Tribunal to order the registration of a specialization agreement, and thereby to permit monopoly or elements thereof, when gains in efficiency are sufficiently large, i.e. when:

> ...the implementation of the agreement is likely to bring about gains in efficiency that will be greater than, and will offset, the effects of any prevention or lessening of competition that will result or is likely to result from the agreement and the gains in efficiency would not likely be attained if the agreement were not implemented... (Act, paragraph 86(1)(a))

Thus, an agreement that might otherwise be struck down as a criminal conspiracy may be registered when the gains in efficiency from the agreement are shown to meet essentially the same test as applies to mergers under subsection 96(1).

275 If the Court intended the creation of a monopoly to be a factor to be considered in conducting the subsection 96(1) inquiry then, *mutatis mutandis*, that view must also apply to specialization agreements because the efficiency test is the same. However, section 86 specifically authorizes the creation of monopoly or elements thereof through specialization agreements. It would make no sense to require the Tribunal to consider the creation of a monopoly as a negative effect of a specialization agreement when, by law, monopoly is permitted, indeed, desired, in that form.

(3) Section 96 Applies to this Merger

276 Writing in partial dissent of the Court, Létourneau, J.A. states that

> ...section 96 was not meant to authorize the creation of monopolies since it would defeat the purpose of section 1.1. This section was not intended to authorize mergers resulting in monopolies whereby, contrary to section 1.1, competition is eliminated, small and medium-sized enterprises are not able to enter or survive in the market and consumers are deprived of competitive prices. (Létourneau, J.A., Appeal Judgment, paragraph 15 at 8-9)

277 If, as it appears, Létourneau, J.A. is suggesting that the efficiency defence should not be available when mergers lead to structural monopolies then, with respect, he must be wrong. Defining monopoly as 100 percent market share, the Commissioner argued at the first hearing that section 96 was not available to such mergers as a matter of law, although mergers to a market share of 96 percent would be reviewed in a different way. As discussed in its Reasons, at paragraphs 418-419, the Tribunal held otherwise and the Court did not disturb this conclusion saying, rather, that the Tribunal should consider the purpose clause of the Act when analysing the effects under section 96. For this reason, the Commissioner no longer maintains the position taken at the first hearing.

278 As noted above, Bills C-42 and C-13 made the efficiency defence unavailable when the merger would result in virtually complete control of a product in a market. This provision was not included in Bills C-29, C-91 or the Act.

279 If Létourneau, J.A. is commenting on the instant transaction then, with respect, he must be largely mistaken about its effects. The merger, while it lessens and prevents competition substantially, does not eliminate all competition and does not prevent entry by small and medium-sized businesses and does not prevent their survival in the market. Yet it is an anti-competitive merger and it does deprive consumers of competitive prices.

280 It follows therefore, that in terms of the section 96 inquiry, the finding of monopoly according to any particular definition thereof is irrelevant. If the creation of a so-called monopoly is not *per se* sufficient to justify a conclusion of substantial lessening or prevention of competition under section 92 of the Act, then its creation cannot be a bar to the application of section 96. The Court did not interfere with the Tribunal's decision that the defence in section 96 applies to the instant merger. Since section 96 compares efficiency gains with the "...effects of any prevention or lessening of competition that will result or is likely to result from the merger...", the Court must have meant that there were effects of the substantial lessening on the record that the Tribunal had not considered.

281 Absent a statutory definition of monopoly, the Tribunal concludes that for the purposes of the Act, monopoly can be defined only as an entity with a high degree of market power. Indeed, by referring to markets not considered to be "monopoly

or near-monopoly", the Commissioner advocated such in oral argument. Accordingly, its effects for the purposes of section 96 of the Act are those efficiency and redistributive effects associated with any other exercise of market power; if there are other effects associated with the concept of monopoly, then they must be proven. However monopoly may be defined, a merger thereto is not more objectionable under the Act than other instances of substantial lessening or prevention of competition unless additional effects are shown.

282 In the Tribunal's opinion, the definitional problem reflects differences of opinion regarding the relationship between section 96 and the purpose clause. As it stated in its Reasons, the Tribunal views section 96 as a clear instruction that competition is not be to maintained or encouraged as otherwise required by the purpose clause. On this view, the Tribunal's task is clear; there is no conflict in the operation of these two important provisions.

(4) Additional Effects

283 It is clear from the history of American antitrust law that the conjoining of economic power and political power was a clear concern. Other values were also protected under American antitrust law, including job loss, effects on local communities, and decentralization by the absolute protection of small businesses. These effects are clearly matters that would have to be considered qualitatively if they were held to be effects for the purpose of section 96. Apart from the effect on small and medium-sized enterprises, such effects were not held to result from the instant merger.

284 The larger issue in regard to most of these concerns is that they are not connected to any of the objectives of Canadian competition policy, so it will be difficult to introduce them into the inquiry under section 96. For example, the Tribunal observed that job loss resulting from an anti-competitive merger was not an effect of lessening of competition for the purpose of section 96 because such losses also result from mergers that are not anti-competitive and in that case the Commissioner can take no notice thereof under the Act (Reasons, at paragraphs 443-444).

285 The Tribunal agrees with the respondents that, having considered all of the concerns raised by the Commissioner (i.e. deadweight loss, interdependent pricing, service quality, etc.) to consider, in addition, the creation, *per se*, of monopoly as a qualitative factor under section 96 is to double-count those effects (Respondents' Memorandum on Redetermination Proceedings, paragraph 87 at 40). Accordingly, the Commissioner must demonstrate those effects of monopoly which have not yet been considered; however, no such effects have been shown.

H. Small and Medium-Sized Enterprises

286 Referring to the Appeal Judgment, the Commissioner submits that, in its inquiry under section 96, the Tribunal should consider the impact of the merger on small and medium-sized enterprises in view of the reference thereto in the purpose clause of the Act.

287 The Commissioner cites the following:

- expert evidence that the market power this merger confers on Superior will allow it to discipline competitors by selectively lowering prices and thereby squeezing competitors in certain markets (Commissioner's Memorandum on Redetermination Proceedings, paragraph 56, at page 26)

- an internal document in which a Superior branch manager states that ICG and Irving each gained a commercial account at Superior's expense and that Superior would retaliate if the "trend" continued (Commissioner's Memorandum on Redetermination Proceedings, paragraph 58, at pages 26-27)

- an internal ICG document in which an ICG employee in Alberta states that ICG retaliated against Canwest and Cal-Gas and that the latter is now "pricing responsibly" (Commissioner's Memorandum on Redetermination Proceedings, paragraph 59, at page 27)

- the testimony of Mr. Edwards that he did not want to establish operations in a market with only one major competitor (Commissioner's Memorandum on Redetermination Proceedings, paragraph 60, at page 27)

• evidence that Superior retaliated against Imperial Oil's attempted entry (Commissioner's Memorandum on Redetermination Proceedings, paragraphs 61-62, at pages 27-28)

• one witness' testimony that he was concerned with predatory pricing and the confidential testimony of another that prices are sometimes so low that he finds it difficult to survive (Commissioner's Memorandum on Redetermination Proceedings, paragraphs 63-64, at page 28)

• expert evidence that the acquisition of ICG makes it more likely that Superior will discipline competitors engaged in aggressive discounting by meeting their prices (Commissioner's Memorandum on Redetermination Proceedings, paragraphs 63-64, at page 28)

The Commissioner also asserts, but does not show, that the merger increases Superior's ability to effectively deter expansion or entry of small and medium-sized propane suppliers with restrictive practices known to increase rivals' costs or decrease rivals' revenues (Commissioner's Memoramdum on Redetermination Proceedings, paragraphs 56-66 at 26-29).

288 The respondents state that small competitors will benefit from the merger to the extent that they follow the price increases of the merged firm and hence will not be harmed. They also state that the Tribunal is *functus officio* regarding deterrence of entry and expansion, disciplining of competitors, and the qualitative effects flowing from entry restriction (Respondents' Memorandum on Redetermination Proceedings, paragraphs 79-85 at 37-40).

289 The Tribunal takes the witness claims of predatory pricing seriously, but regards the testimony of the two competitors cited by the Commissioner as insufficient to establish predation. The Act is concerned with predation but there is no indication that any of these firms complained to the Commissioner about the pricing behaviour of Superior or of ICG prior to the merger. Moreover, the suggestion of predatory pricing is made by two competitors that remain in the industry. Distinguishing between predatory conduct and aggressive competition requires more evidence than is available here. In this regard, some of the cited testimony is confidential. Having reviewed the confidential transcript, however, the Tribunal regards this evidence as speculative and it cannot find predation or the likelihood thereof on the strength of such testimony.

290 The Tribunal accepted the evidence that new entrants or smaller firms seeking to expand find it difficult to compete for customers of Superior and ICG, in part, because of those firms' practice of writing customer contracts with certain anti-competitive provisions; 90-95 percent of both firms' customers are under standard form contracts (Reasons, at paragraph 132). As the Tribunal noted, there was some suggestion that Superior was considering relaxing some of these provisions if the merger proceeded, and there was discussion whether Superior's plans in this regard would be effective. Nonetheless, there is no evidence that the conditions of entry will be more difficult in this regard after the merger.

291 The Commissioner's examples of competitor discipline do not establish that Superior disciplined its small competitors; ICG, Irving, and Imperial Oil are certainly not small or medium-size businesses. That ICG apparently disciplined the regional firms is not evidence that Superior did so.

292 The Commissioner cites the experience of Mr. Edwards, who chose to locate his new propane business near London, Ontario. A former president of Superior, Mr. Edwards testified that he established his propane marketing business near London for a combination of personal and business reasons. His complete testimony is:

MR. EDWARDS: One was a personal one. I had moved from Toronto to London to do something else, and that didn't work out, so when I decided to re-enter the business, I was in London. Also, it's very close to the Sarnia infrastructure, which is the principal supply point in North America. The economies between Windsor and Toronto are very stable and often buoyant and steady, stable kinds of economies. There was - I didn't want to find myself competing in a market where I had one competitor.

MR. MILLER: Why is that?

MR. EDWARDS: Well, I had experienced that previously when I was out in Atlantic Canada. I competed nose to nose with the Irvings. If you move to Atlantic Canada to compete against the Irvings, I think you have an appreciation for what nose-to-nose competition with the Irvings would be like. It would be aggressive, at best.

I chose London because there is a variety of competitors serving a variety of markets, so I thought if I was going to enter the business, I would be better to enter it in that form.

MR. MILLER: In that there is more room to move against smaller independents?

MR. EDWARDS: If you duke it out with one major competitor, I suppose - my experience with the Irvings was that the duking out, it can be fairly punishing for a new entrant.

I thought if I positioned myself amidst a variety of competitors, I could incrementally compete with them a little bit here, a little bit there. (Transcript, vol. 8, October 6, 1999, at 1070, line 11 to 1071, line 20)

293 Mr. Edwards was president and chief executive officer of Superior until May 1996, and he incorporated his propane business in London, Ontario in June 1997 (Transcript, vol. 8, October 6, 1999, at 1063). Accordingly, his experience with the Irvings must have been during his tenure at Superior. Hence, his testimony must be taken to mean that Superior found it difficult to compete with Irving in Atlantic Canada, not that Irving "punished" small and medium-sized competitors, although it may be true.

294 The Commissioner cites the expert evidence of Professors Schwindt and Globerman, who testified that by eliminating ICG as a competitor, the merger would provide a greater incentive for Superior to meet price reductions by independent firms that competed actively on price; it would not have to share the eventual benefits of this disciplining strategy with ICG. In this way, independent firms (presumably, small and medium-sized enterprises) would be less inclined to compete on price. This expert opinion evidence was not challenged by the respondents at the first hearing, and the Tribunal accepted that evidence of the likely market structure in many geographic markets in coming to its decision that the merger lessened competition substantially.

295 The respondents submit that the Tribunal is *functus officio* with respect to the evidence of deterrence of entry and expansion, disciplining of competitors, and the qualitative effects flowing from entry restriction. The Tribunal considered the evidence on these matters in connection with its inquiry under section 92 of the Act. It cannot reconsider its findings or entertain new evidence. However, in light of the Appeal Judgment of the Court, the Tribunal must now consider, based on evidence available on the record, the effects of the merger on small and medium-sized enterprises in its inquiry under section 96 that it did not consider in its first Reasons.

296 In the Tribunal's view, while the Commissioner has not shown that Superior behaved aggressively toward its small and medium-sized competitors, the Commissioner has provided a reasonable basis for believing that this merger will likely result in coordinated pricing by its small and medium-sized competitors. The Commissioner does not dispute the respondents' claim that these competitors will likely experience higher margins and profits in consequence as the respondents suggest; rather, the Commissioner maintains that the resulting market structure is contrary to the goal of competition in the purpose clause of the Act, and that the impact on small and medium-sized competitors is inconsistent with an equitable opportunity to participate in economic activity as stated therein.

297 According to the Court, the impact of an anti-competitive merger on small and medium-sized enterprises is an effect of lessening or prevention of competition to be considered under subsection 96(1). The Court expresses its concern at several points in its Appeal Judgment. At paragraph 4, the Court suggests that "...the elimination of smaller competitors from the market..." is an effect that should be considered.

298 The Tribunal observes that there is no evidence in this case that the merger eliminates smaller competitors from the market, and the Commissioner does not submit such. In the Tribunal's view, the Commissioner is concerned that smaller competitors will choose to price interdependently rather than offer competitive challenge to the merged firm. The concern expressed by

Professors Schwindt and Globerman was not predatory behaviour by the merged firm; rather, they used the words "retaliation" and "squeeze" to indicate interdependence. In their expert report, predation is not mentioned even once (Report of R. Schwindt and S. Globerman, exhibit A-2056, (August 16, 1999) at 25-41).

299 At paragraph 69 of the Appeal Judgment, the Court concludes that the determination of the effects to be considered under section 96, including "...the impact on competing small and medium sized businesses...", is a question of law. At paragraph 88, the Court concludes that these effects should

> ...include the other statutory objectives to be served by the encouragement of competition that an anti-competitive merger may frustrate, such as the ability of medium and small businesses to participate in the economy...

300 The purpose clause of the Act states that when competition is maintained and encouraged, an equitable opportunity to participate in economic activity will be afforded to small and medium-sized enterprises. If the Tribunal is to consider the effect of an anti-competitive merger on small and medium-sized enterprises in the inquiry under subsection 96(1), then it must determine whether the merger denies those enterprises an equitable opportunity to participate in economic activity.

301 When those enterprises are competitors of the merged firm, it will not suffice to determine that the merger has a negative impact on them. Many mergers that are not anti-competitive will negatively affect smaller competitors and may indeed cause them to reposition or exit, but such mergers do not deny an equitable opportunity of smaller competitors to participate in economic activity. What must be shown is that the effect on small and medium-sized enterprises is an effect of the lessening or prevention of competition. That smaller competitors will begin to price in an interdependent/coordinated fashion in many relevant markets is a lessening of competition. While there may be deadweight loss and redistributive effects, there is, as noted above, no evidence thereof.

302 Alternatively, the small and medium-sized enterprises may be customers of the merged firm. In reply, the Commissioner states that the opportunity to charge anti-competitive prices is incompatible with the objective of the purpose clause of the Act that relates to an equitable opportunity for small and medium-sized businesses to participate in the economy:

> The paragraph quoted in fact says the opposite of the Respondents' characterization. It says that the Tribunal should not focus on one effect of the merger to the exclusion of the others; it does not say that any effect that benefits small business must be considered as a positive effect. *It refers to the wording of the Act, which relates to an equitable opportunity for small and medium-sized businesses to participate in the economy. That does not include an opportunity to charge anti-competitive prices*. Indeed, the Court also refers to the goal of the availability to consumers of a choice of goods at competitive prices, which is antithetical to the "positive" effect, cited by the Respondents, of a price increase resulting from an anti-competitive merger and subsequent price coordination amongst propane suppliers to exploit that increase. (Commissioner's Reply Memorandum on Redetermination Proceedings, paragraph 76 at 29) [Emphasis (italics) added]

303 In the Tribunal's view, the emphasized statement cannot be correct. If the purpose clause gave small and medium-sized business customers the absolute right to competitive prices, there would be an irreconcilable conflict between section 96 and the purpose clause because the former permits an anti-competitive merger when its requirements are met. In the Tribunal's view, the purpose clause does not grant absolute entitlements; even the objective of efficiency and adaptability is not absolute but is, rather, based on the result of a tradeoff analysis. Section 96 accords the efficiency objective in merger review priority over the other objectives only when its requirements are met. Accordingly, small and medium-sized business customers do not lose an equitable opportunity to participate in economic activity when the anti-competitive merger and the higher price are permitted by section 96. Similarly, small business customers of a firm that is part of a registered specialization agreement may also pay supra-competitive prices, yet the Act allows such agreements when the requirements of section 86 are met. An equitable opportunity to participate is not an absolute right to competitive prices granted by the purpose clause of the Act.

304 More generally, since, as in section 96, the statute explicitly permits an anti-competitive merger to proceed subject to certain conditions being met, it is illogical and contradictory to require that those conditions include the attainment of results that would be achieved under competition. Such an approach surely vitiates the statutory provision in section 96. Since this

cannot be what the Court meant, it must be correct for the Tribunal to focus on the denial of an equitable opportunity of small and medium-sized businesses to participate in economic activity.

305 To find the denial of an equitable opportunity of small and medium-sized enterprises to participate requires a demonstration that anti-competitive conduct offensive under the Act (i.e. section 79 or section 50) is taking place or will likely take place. On the evidence in this case, the Tribunal cannot conclude that small and medium-sized competitors and customers will lose an equitable opportunity to participate in economic activity.

VII. Redistributive Effects (the Wealth Transfer)

306 The Tribunal recognized the redistributive effects of the instant merger, but treated them as offsetting because it concluded that the Total Surplus Standard was the applicable standard; hence, the redistributive effects were, on balance, socially neutral. The Court concluded that the Tribunal

> ...erred in law when it interpreted section 96 as mandating that, in all cases, the only effects of an anti-competitive merger that may be balanced against the efficiencies created by the merger are those identified by the total surplus standard... (Appeal Judgment, paragraph 139 at 54)

Accordingly, among the effects which the Tribunal must consider are the redistributive effects based on the evidence available in the record.

A. Commissioner's Position

307 The Commissioner asserts that the higher price that will result from the merger will have the effect of transferring $40.5 million from propane consumers to shareholders of the merged firm annually. In the Commissioner's view, this is a "measured effect" of the merger that should be added to the other measured effects for the purpose of assessing all of the merger's effects. The Commissioner also submits that once the estimated size of the transfer has been quantified, the Commissioner's burden has been satisfied and that the respondents must demonstrate with appropriate evidence that some other treatment for the transfer is appropriate (Commissioner's Memorandum on Redetermination Proceedings, paragraphs 92-93 at 38-39).

308 The Commissioner submits that it is important to distinguish between producers (i.e. shareholders of the merged firm) and consumers of propane even if the former are also consumers thereof. Under the purpose clause of the Act, the concern for competitive prices to consumers requires that the entire redistributional effect be taken into account (Commissioner's Memorandum on Redetermination Proceedings, paragraphs 26-29 at 15-17).

309 In taking this view, the Commissioner refers to decisions in criminal cases under the Act and its predecessor statutes pursuant to which the objective of competition law is free competition for the public at large and that injury to the public from supra-competitive prices cannot be justified. Accordingly, "...[a] wealth transfer which arises from the direct exercise of market power and the imposition of increased prices *prima facie* offends the purpose and objectives of the *Act*." (Commissioner's Reply Memorandum on Redetermination Proceedings, paragraph 92 at 34-35).

310 The Commissioner notes that an alternate treatment of the transfer is provided in the opinion in dissent of Tribunal Member, Ms. Lloyd, who concluded that the wealth transfer should be considered from a qualitative perspective (Commissioner's Memorandum on Redetermination Proceedings, paragraph 102 at 42-43). However, the Commissioner does not advocate this view.

311 A third approach to the wealth transfer was that offered by Professor Townley, who would consider whether the Balancing Weights Approach is reasonable based on the evidence regarding the distributional aspects of the merger (Commissioner's Memorandum on Redetermination Proceedings, paragraph 110 at 45). However, the Commissioner states that Professor Townley's approach has been superseded by the Court's Appeal Judgment which recognizes the significance of the transfer itself. While adopting the Townley approach would, in the Commissioner's submission, lead the Tribunal to disapprove the

merger (Commissioner's Reply Memorandum on Redetermination Proceedings, paragraph 100 at 38), the Commissioner does not rely on that approach.

312 In the Commissioner's further submission, Professor Townley's Balancing Weights Approach is "...simply a tool that is available to *assist* the Tribunal in performing the tradeoff..." and that it is the respondents' burden to satisfy the Tribunal on the ultimate issue with respect to section 96 (Commissioner's Memorandum on Redetermination Proceedings, paragraph 119 at 480) [Emphasis in original]. According to the Commissioner, it is not necessary to consider the disproportionate effect on relatively low-income families and small, rural businesses that Professor Townley described in his report (Commissioner's Memorandum on Redetermination Proceedings, paragraph 116 at 47).

313 The Commissioner submits that as a result of the Appeal Judgment of the Court, the new approach adopted by his senior advisors in regard to assessing the transfer following the Commissioner's rejection of the Total Surplus Standard in the MEGs also reflected an incorrect and overly narrow interpretation of the Act (Commissioner's Reply Memorandum on Redetermination Proceedings, paragraph 99 at 37-38). Accordingly, the Commissioner no longer relies on that approach, which was emphasized at the first hearing.

B. Respondents' Position

314 The respondents submit that in its Appeal Judgment, the Court did not prescribe the correct methodology for assessing the effects under subsection 96(1). Accordingly, and in light of that Judgment, the Tribunal must fully assess the particular fact situation before it and consider only that portion of the wealth transfer that the Commissioner has shown to have adverse distributional impact and is important in its magnitude (Respondents' Memorandum on Redetermination Proceedings, paragraphs 100-101 at 45-46).

315 They further submit that the Commissioner's own position in law at the first hearing was that articulated by Mr. G. Allen, a senior advisor in the Bureau of Competition Policy, and that that approach seeks to determine the significant adverse redistributive effects of the transfer. That approach is consistent with Professor Townley's approach and, consistent with these experts, the entire income transfer cannot automatically count against the merger (Respondents' Memorandum on Redetermination Proceedings, paragraphs 106-108 at 48-49).

316 They submit that the Commissioner has now adopted the Consumer Surplus Standard, and they point out that Professor Townley testified that that standard involves an *a priori* fixed weight and was inconsistent with traditional welfare economics (Respondents' Memorandum on Redetermination Proceedings, paragraph 122 at 54-55 and paragraph 125 at 56-57).

317 The respondents cite witness testimony that propane expenditure is a small fraction of the buyer's total expenditures (Respondents' Memorandum on Redetermination Proceedings, paragraph 130 at 59) and that the effect of an eight percent price increase is a transfer of less than one percent of annual income of the buyer. While denying that there is evidence of an average eight percent price increase, they suggest that the income transfer therefrom would be inconsequential (Respondents' Memorandum on Redetermination Proceedings, paragraph 131 at 59).

318 The respondents assert that the redistributional effect of the merger is not adverse. They argue that the transfer of income will, in part, be between shareholders of the merged company and the shareholders of large, publicly-owned enterprises that buy propane, and the shareholders may even be the same persons. Further, many of Superior's largest customers are controlled by substantial foreign investors whose interests are not protected by the Act, particularly under the purpose clause thereof (Respondents' Memorandum on Redetermination Proceedings, paragraphs 133-136 at 60-62).

319 They also state that propane consumers are not generally poor or needy and that there is no evidence to the contrary. Many consumers are large industrial and agricultural concerns and wealthy individuals. They refer to Professor Townley's expert report (exhibit A-2081) that cited results of a survey of propane consumers by the Canadian Market Research Ltd. survey in 1997 ("CMR Study"), finding that 10 percent of residential customers studied used propane to heat their swimming pools. They also assert that the CMR Study is of limited scope, and they question why income transferred from people who use propane to heat

second homes, cottages or ski chalets should be treated as a negative effect. They submit that the Commissioner has the burden of justifying that treatment (Respondents' Memorandum on Redetermination Proceedings, paragraphs 138-147 at 62-67).

320 The respondents further submit that there is no evidence on the importance of the income effect on agricultural and auto-propane buyers. They conclude that there is no evidence that the redistributional impact of the merger is adverse, and that adopting the approaches of G. Allen and Professor Townley results in a neutral treatment of the wealth transfer (Respondents' Memorandum on Redetermination Proceedings, paragraphs 148-150 at 67-68).

C. Decision of the Court

321 At paragraph 74 of its Appeal Judgment, the Court disagreed with the Tribunal's interpretation of the purpose clause of the Act and stated that it should not be read subject to the specific and contrary provisions of section 96. In paragraph 75, the Court describes the test to be applied under subsection 96(1) as a "balancing test". At paragraph 77, the Court states that

> In referring to "the effects of any prevention or lessening of competition", subsection 96(1) does not stipulate what effects must or may be considered. When used in non-statutory contexts, the word, "effects", is broad enough to encompass anything caused by an event. Indeed, even though it does not consider the redistribution of wealth itself to be an "effect" for the purpose of section 96, the Tribunal recognizes, as all commentators do, that one of the *de facto* effects of the merger is a redistribution of wealth... (Appeal Judgment, at 32)

322 With reference to Reed J.'s comments *obiter dicta* in the *Hillsdown* decision at paragraph 131 of the Appeal Judgment, to the dissenting view of Ms. Lloyd at paragraph 132, to the treatment of the wealth transfer under the Horizontal Merger Guidelines, paragraphs 135-136, approvingly to certain American commentators on the interpretation of section 96 in the Commissioner's MEGs, paragraph 137, and in opposition to the views of "lawyer-economists" in the United States, paragraph 138, the Court concludes that

> ...the Tribunal erred in law when it interpreted section 96 as mandating that, in all cases, the only effects of an anti-competitive merger that may be balanced against the efficiencies created by the merger are those identified by the total surplus standard... (Appeal Judgment, paragraph 139 at 54)

323 The Court further concluded that it should not prescribe the correct methodology, such task being beyond the limits of the Court's competence (Appeal Judgment, at paragraph 139). It also stated that:

> Whatever standard is selected (and, for all I know, the same standard may not be equally apposite for all mergers) must be more reflective than the total surplus standard of the different objectives of the *Competition Act*. It should also be sufficiently flexible in its application to enable the Tribunal to fully assess the particular fact situation before it. (Appeal Judgment, paragraph 140 at 54)

324 The Court then suggested that the Balancing Weights Approach of Professor Townley was consistent with its broad requirements:

> It seems to me that the balancing weights approach proposed by Professor Townley, and adopted by the Commissioner, meets these broad requirements. Of course, this approach will no doubt require considerable elaboration and refinement when it comes to be applied to the facts of particular cases. (Appeal Judgment, paragraph 141 at 55)

D. Tribunal's Analysis of the Transfer

325 On the basis of the above, the Tribunal must now determine how to treat the redistributive effect (i.e. the transfer of wealth) based on the submissions of the parties, while taking instruction from the Court.

(1) General

326 There is some confusion over terminology. The Tribunal does not consider the redistribution of income that results from an anti-competitive merger to be an "anti-competitive effect". Rather, having regard to the decision of the Court, and referring to the wording of subsection 96(1), the redistributional impacts are among the effects of lessening or prevention of competition that the merger brings about or is likely to bring about. Redistribution of income and/or wealth occurs in many different ways in society, and often has nothing to do with competition policy. For example, government may redistribute income through the tax system or through public expenditures without transferring income anti-competitively.

327 The Tribunal notes the distinction for greater certainty because it is a distinction that is not made by the Court:

> Nonetheless, the *Horizontal Merger Guidelines, supra*, in the United States continue to treat the exercise of market power leading to an increase in price above the competitive level as the most important anti-competitive effect of a merger, and the resulting wealth transfer from the consumers to the producers, as a misallocation of resources: see P.T. Denis... (Appeal Judgment, paragraph 135 at 53)

At places in its Appeal Judgment the Court appears to refer to the redistributional effect as an anti-competitive effect, but such reference may reflect a convenient vocabulary rather than a statement of judicial understanding. In line with conventional economic analysis, the Tribunal does not regard the wealth transfer as anti-competitive or as a misallocation of resources. An anti-competitive effect is a misallocation of resources that reduces society's aggregate real income and wealth. A transfer redistributes income and wealth within society but does not reduce it.

328 Whatever the practice or terminology may be in the United States, the Tribunal seeks to distinguish these two sets of effects. In its Reasons, the Tribunal distinguished between the resource-allocation effects of an anti-competitive merger and the redistributive effects (Reasons, at paragraphs 422-425). It stated that it did not regard the redistributive effects of a merger as anti-competitive (Reasons, at paragraph 446), which does not preclude giving consideration to those effects.

329 In the simplest analysis, the redistribution of income that results from an anti-competitive merger of producers has a negative effect on consumers (through loss of consumer surplus) and a corresponding positive effect on shareholders (excess profit). Whether these two effects are completely or only partially offsetting is a social decision that, in Professor Townley's words, requires a value judgment and will depend on the characteristics of those consumers and shareholders. In some cases, society may be more concerned about one group than the other. In that case, the redistribution of income will not be neutral to society but rather will be seen as a social cost of, or social gain from, the merger.

Yet it is rarely so clear where or how the redistributive effects are experienced. As Williamson notes:

> For some products, however, the interests of users might warrant greater weight than those of sellers; for other products, such as products produced by disadvantaged minorities and sold to the very rich, a reversal might be indicated. But a general case that user interests greatly outweigh seller interests is not easy to make and possibly reflects a failure to appreciate that profits ramify through the system in ways-such as taxes, dividends, and retained earnings-that greatly attenuate the notion that monolithic producer interests exist and are favored ... (O. Williamson, *Economies as an Antitrust Defense Revisited*, volume 125, No. 4, University of Pennsylvania Law Review, 1977, 699, at 711)

When viewed in this light, the redistributive effects are generally difficult to identify correctly, and will involve multiple social decisions. Given the informational requirements of such assessments, the assumption of neutrality could be appropriate in many circumstances.

330 The Court notes favourably the views of Madame Justice Reed expressed in *obiter dicta* in the *Hillsdown* decision. In commenting on the Total Surplus Standard in *Hillsdown*, Madame Justice Reed questioned whether the redistributional effects were always offsetting and hence socially neutral. In her example of a life-saving drug, she questioned whether society was unaffected by the redistribution from ailing consumers to shareholders of the producer when it exercised its market power and raised the price of the drug. Accordingly, Madame Justice Reed appeared to articulate the view that the redistributional effects

might not always be socially neutral; yet she did not state that this was always the case so that the assumption of neutrality could be appropriate, presumably in less dire circumstances.

331 In criticizing the Consumer Surplus Standard, Professor Townley offered an example in which shareholders of a producer of a luxury good were less wealthy than the buyers (Townley Report, exhibit A-2081 at 32). In such cases, the exercise of market power would result in excess profits to the less wealthy group and would be seen as socially positive, rather than neutral. Such examples need not be far-fetched; mergers among airlines may benefit travellers who, on average, may be better off than the shareholders thereof; similarly, mergers among taxi owners, or among owners of ski resorts.

332 In its Appeal Judgment, the Court noted the following:

> ...Proponents of the total surplus standard argue that there is no economic reason for favouring a dollar in the hands of consumers of the products of the merged entity over a dollar in the hands of the producers or its shareholders, who are, after all, also consumers. Moreover, in the absence of complete data on the socio-economic profiles of the consumers and of the shareholders of the producers, it would be impossible to assess whether the redistributive effects of the wealth transferred as a result of the higher prices charged by the merged entity would be fair and equitable: paragraphs 423-425. (Appeal Judgment, paragraph 27 at 13-14)

The Tribunal can only agree that such information is required to determine the fairness and equity of the resulting distribution of income under a standard other than the Total Surplus Standard.

(2) Tribunal's Approach to the Redistributive Effects

333 Having regard to the comments, in *obiter dicta*, of Madame Justice Reed in *Hillsdown* cited above, and to the favourable view thereof of the Court, the Tribunal must accept that the redistributional effects can legitimately be considered neutral in some instances, but not in others. Fairness and equity require complete data on socio-economic profiles on consumers and shareholders of producers to know whether the redistributive effects are socially neutral, positive or adverse. While complete data may never be attainable, the Tribunal must be able to establish on the evidence the socially adverse effects of the transfer.

334 It is true, as the Commissioner submits, that the purpose clause of the Act does not discriminate against certain groups of consumers. However, the Tribunal cannot conclude that the redistribution of income is an effect that is necessarily always or entirely negative from society's viewpoint. To do so would be to adopt the "*a priori* fixed weight" to which Professor Townley objects based on his expertise in welfare economics. Moreover, that approach characterizes the Consumer Surplus Standard which, in the Tribunal's opinion, vitiates the statutory efficiency defence in section 96; accordingly, the Tribunal is not prepared to adopt that standard.

335 Noting that the Court has reservations about certain standards for the treatment of efficiency gains but has indicated its general approval of the Balancing Weights Approach of Professor Townley, the Tribunal is of the view that it should, as Professor Townley stated in his report, consider whatever qualitative or quantitative information is available that allows it to assess the redistributional effects. It therefore rejects the Commissioner's submission that the transfer of income must necessarily be included in its entirety once the Commissioner has estimated the size thereof and quantified it as a measured effect to be added to the other measured effects when assessing all of the effects of the merger under subsection 96(1). In the Tribunal's view, this largely quantitative approach is opposite to the instruction of the Court.

336 The Commissioner's alternatives to this approach are: (i) the qualitative approach advocated by Ms. Lloyd in dissent; (ii) the Balancing Weights Approach of Professor Townley, and (iii) at the first hearing, the evaluation of the adverse redistributional effects on a case-by-case basis described by the Commissioner's senior adviser G. Allen. It appears to the Tribunal that approach (i) is not now advocated by the Commissioner, and the Commissioner claims that the decision of the Court renders approach (iii) incorrect in law and that approach (ii) is incomplete and useful only as a tool to assist it in its broader inquiry.

337 The Commissioner's revised view of the Balancing Weights Approach is surprising because the Court indicated its approval thereof, albeit with the comment that it requires further refinement and elaboration when applied to the facts

of a particular case. The Commissioner's abandonment of the case-by-case assessment of adverse redistributive effects as propounded at the first hearing is also surprising, as it provides the elaboration and refinement in particular cases that supports the Balancing Weights Approach.

338 Following the instruction of the Court, the Tribunal would adopt the Balancing Weights Approach if there were sufficient information in evidence to come to an assessment of whether the estimated balancing weight of 1.6 is reasonable given the socio-economic differences between and among consumers and shareholders. Moreover, no alternate weight has been submitted nor any other approach that the Tribunal could use to evaluate the reasonableness of the estimated balancing weight of 1.6 as a measure of redistributive effects. While not adopting the Balancing Weights Approach, the Commissioner submits that in view of the record in its entirety, there is no basis for concluding that a weight of 1.6 or less is reasonable. There is, however, some limited information in the record that the Tribunal can use to reach a conclusion on the redistributive effects.

(3) Pecuniary Gains

339 Before reviewing that information, the Tribunal takes note of the Court's remarks concerning subsection 96(3) of the Act which, if correct, have very significant implications for the understanding of the merger provisions of the Act. Following the interpretation of the Commissioner's MEGs, the Tribunal regarded subsection 96(3) as denying that pecuniary savings could be included in "gains in efficiency". For example, if a merger of buyers enabled them to extract lower prices from sellers through the exercise of bargaining power, those savings would be a redistribution of pecuniary income from sellers to buyers, not an increase in societal real income as the result of the improved use of resources achieved through the merger. Accordingly, those savings should not be treated as gains in efficiency, even though buyers do achieve lower prices thereby. Another example of a pecuniary gain is tax-savings achieved by the merger, which represent a transfer from taxpayers generally to shareholders of the merged firm.

340 Thus, the Tribunal has viewed subsection 96(3) as a statutory reminder that there must be a gain to society, as opposed to a gain to one party at the expense of another, in order for a gain in efficiency to exist, i.e. that only those savings that resulted from improved resource allocation could be considered. In the Tribunal's view, the provision has no implications for the treatment of effects, a view that appears to be shared by all commentators on this part of the Act.

341 The Court's remarks concerning subsection 96(3) are as follows:

> [82] I attach some weight to subsection 96(3) of the *Competition Act*, which provides that the Tribunal shall not find that a merger or proposed merger "is likely to bring about gains in efficiency by reason only of a redistribution of income between two or more persons." Hence, subsection 96(3) expressly *limits* the weight accorded to redistribution in assessing the *efficiencies* generated by the merger.
>
> [83] No similar limitation is imposed by the Act on the *effects* side of the balance. If Parliament had intended redistribution of income to be *excluded altogether* from the "effects" of an anti-competitive merger, as the Tribunal held, the drafter might well have been expected to have made an express provision, similar to that contained in subsection 96(3) with respect the efficiencies side of the balance. The absence of such a provision suggests that, contrary to the Tribunal's conclusion, Parliament did not intend to impose such a limitation on the "effects" side. (Appeal Judgment, at 33-34)

342 If the Court is correct, then the pecuniary gain that benefits consumers as exemplified above, although not a gain in efficiency, would be an effect of the merger because, apparently, no limitation has been imposed on "effects".

343 In the Tribunal's view, it is very doubtful that Parliament intended that pecuniary gains be considered in merger review under section 96, whether the pecuniary gains benefitted either buyers or sellers. Certainly, there is nothing in the statutory history or legislative review that suggests this. Indeed, as the Court stated, efficiency is explicitly the paramount objective of section 96.

344 While the Court affirmed the Tribunal's conclusion, it required a broader conception of "effects":

> [92] Thus, although section 96 requires the approval of an anti-competitive merger where the efficiencies generated are greater than, and offset, its anti-competitive effects, the ultimate preference for the objective of efficiency in no way restricts the countervailing "effects" to deadweight loss. Instead, the word, "effects", should be interpreted to include all the anti-competitive effects to which a merger found to fall within section 92 in fact gives rise, having regard to *all* of the statutory purposes set out in section 1.1. (Appeal Judgment, at 37)

345 The Tribunal is of the view that the Court's instruction to it to consider all relevant effects including redistributive effects does not require it to consider pecuniary gain as an effect under subsection 96(1).

(4) Professor Townley's Statistical Evidence

346 Table 2 of Professor Townley's expert report contains information from the Statistics Canada report entitled *Family Expenditure in Canada, 1996*, and presents data on consumption of "bottled propane" by household income quintile. Table 2 states that household expenditure on bottled propane is 0.23 percent of total household expenditure. Accordingly, bottled propane expenditures are shown to constitute a very small share of total household spending (Townley report, exhibit A-2081, at 37).

347 Professor Townley calls attention to the pattern in Table 2 that the expenditure share declines as household income and total expenditure rise. For example, propane expenditure constitutes 1.68 percent of the total expenditure of the 20 percent of households with the lowest income (i.e. the lowest-income quintile). For the 20 percent of households that have the highest income (the highest-income quintile), propane spending is only 0.07 percent thereof. Professor Townley notes that while absolute spending does not display this pattern, the fact that bottled propane expenditure decreases as a share of total expenditure as income rises indicates to him that a price increase would have a relatively larger impact the lower one's income (Townley report, exhibit A-2081, at 36).

348 Professor Townley also points out that the average household expenditure on bottled propane nation-wide is only 0.23 percent of total household expenditure. However, he expresses concern that the Statistics Canada survey, because it does not distinguish among uses of propane (i.e. home heating versus running a barbeque), does not convey the impact of a price increase on households that use it for home heating (Townley report, exhibit A-2081 at 36). He regards the household expenditure data in the Statistics Canada survey as heavily skewed toward minor consumers (Townley report, exhibit A-2081, at 38).

349 Professor Townley quotes from a 1998 report of the Propane Gas Association, that cites a Statistics Canada estimate that 102,000 Canadian households are "fuelled by propane" (Townley report, exhibit A-2081, at 38). It is not entirely clear what the phrase "fuelled by propane" refers to, and the Tribunal cannot conclude that it refers exclusively to home heating.

350 Setting aside the household expenditure data that Professor Townley suggests may be skewed, the Tribunal observes that according to the Statistics Canada data shown in Table 2, 4.7 percent of the households in the lowest-income quintile and 29.1 percent of households in the highest-income quintile consume bottled propane. Accordingly, consumption of bottled propane is not limited to low-income groups.

351 While the 4.7 percent of households in the lowest-income quintile number only 102,465 households out of all 10,900,500 households in Canada as stated in Table 2, they should not, in the Tribunal's view, be ignored. However, as Professor Townley points out, the Statistics Canada survey includes the non-essential uses of propane by households in that income quintile. There is no information on the record in this regard that would assist in determining the extent to which the redistribution of income from this group is adverse.

352 The Court alluded to a possible distinction between essential and non-essential uses:

> Second, the demand for propane is fairly inelastic, that is, consumers are relatively insensitive to price increases. Although some consumers purchase propane for less than essential purposes, such as heating their swimming pools, most purchase

> it for home heating, automotive fuel and industrial purposes. Consequently, propane is not a discretionary item that most consumers can choose to forego. (Appeal Judgment, paragraph 11, at 8)

353 It appears to the Tribunal that while many consumers (including business consumers) do, in fact, have choices available other than propane, these alternatives may, for various reasons, not be attractive and so would not likely be adopted. However, there is no doubt, given the available evidence, but that many consumers have no good alternatives. Yet, if the essentiality of the application is a relevant variable, it will be difficult to draw firm conclusions about the adverse effect of the re-distribution of income based on the available evidence.

354 The CMR study, as described by Professor Townley, is a 1997 survey of commercial and residential customers of Superior in Atlantic Canada, Ontario and Quebec. The survey finds that Superior's commercial customers tend to be small businesses in rural areas, and its residential customers tend to be low-income, older-than-average and located in rural areas. Among Superior's residential customers in eastern Canada,

> ...15% of Superior customers earned less than $25,000 per year, 11% earned between $25,000 and $35,000 annually, 12% earned between $35,000 and $45,000, 11% between $55,000 and $75,000, and 9% earned more than $75,000 annually. (32% of those surveyed did not state their annual income.) (Townley report, exhibit A-2081, at 39)

355 The CMR study of eastern Canada consumers tends to support the impressions gained from the Statistics Canada material concerning residential consumers of propane. There is discussion of consumption by residential end-use or essentiality; for example, 53 percent of Superior's residential customers use propane for heating and 10 percent to heat a swimming pool (Townley report, exhibit A-2081, at 39).

356 The Tribunal cannot avoid the conclusion that the redistributive effect of the merger on low-income households that purchase propane will be socially adverse. As suggested above, however, the number of such households is quite small and some undetermined number of them may not be using propane for essential purposes.

357 The Tribunal places less weight on the redistributive effect on households which, as the respondents observe, use propane for swimming pools, barbeques, heating second homes, cottages and ski chalets. Many, although not necessarily all, of those households will presumably be in the higher income groups. The record is silent in this regard.

(5) Interrelated Markets: Redistributive Effects

358 The Tribunal noted above the Commissioner's observation that slightly more than 10 percent of propane sales by the merged company will be made directly to consuming households. The remaining 90 percent of sales will be made to businesses that use propane as an intermediate input in their production processes. Having regard to the Court's concern for interrelated markets and to the witness testimony at the first hearing, the Tribunal can only conclude that such propane will be acquired by large and successful, and in some cases widely-owned, companies that are well-known, as well as by small and medium-sized businesses about which little information is available.

359 The Tribunal heard the testimony of some small and medium-sized business owners, and it infers therefrom and from the CMR study regarding Superior's commercial customers in eastern Canada, that propane is used by some businesses whose owners will be negatively affected by the reduction in their profits that will result from their higher costs of propane to the extent that they cannot pass the price increase on in the form of higher prices for their products. For example, local restaurant owners that appeared as witnesses for the Commissioner may be able to raise their prices to offset their increased costs. On the other hand, it appears that some unstated number of family-owned agricultural operations use propane in crop-drying and those businesses may have no alternative or perhaps only unattractive alternatives to that use, and no ability to increase their prices.

360 The Commissioner refers to witness evidence that propane is "...a significant input for farmers for grain drying..." (Commissioner's Memorandum on Redetermination Proceedings, paragraph 32, at 18). Relying on the witness evidence, the respondents point out that the gross retail cost of propane accounts for two to three percent of the cost of drying crops and that the projected increase therein due to the merger would represent an effect that would be regarded by the

Commissioner's recently-adopted methodology for assessing redistributive effects as unimportant (Respondents' Memorandum on Redetermination Proceedings, paragraphs 129-130, at 58-59).

361 More importantly, in the Tribunal's view, there is nothing on the record that allows us to conclude that owners of agricultural enterprises are needy; indeed, according to the testimony of some owners of agricultural operations concerning the size of their businesses, they may be relatively well-off. Absent better evidence in this regard, it is impossible to determine whether and to what extent the redistribution of profits from agricultural businesses to the merged company's shareholders is socially adverse. Similar lack of information applies to the other small and medium-sized businesses to which the Commissioner refers.

362 The Tribunal notes further that since 90 percent of the merged firm's sales will be to other businesses, the impact of the price increase will fall on the products of those firms and will, through interrelated markets, ultimately be borne by business owners and household purchasers throughout the economy, to the extent that they are not borne by the lower profits of owners of those businesses that purchase the propane directly from the merged company. How the burden of the price increase is ultimately shared across business owners in interrelated markets and by households is an important question that is difficult to answer. Certainly, however, shareholders of the merged firm will not escape the price increases.

363 Yet, having regard to the evidence of regressivity of the price increase on consumers of "bottled propane" discussed above, there is no basis for assuming that outcome generally. The price increase may hit higher income groups disproportionately depending on their consumption patterns and on the extent to which propane is involved in the production of those goods and services. There is no evidence according to which such incidence of the price increase on 90 percent of initial propane sales might be inferred.

364 There may well be some small and medium-sized businesses that are only marginally profitable and also unable to pass on the price increase. However, there is no information on the record that would allow the Tribunal to assess the number of such enterprises or to distinguish between them and those that are perhaps quite successful. In the former, the redistribution of profit to the shareholders of the merged firm might not be socially neutral; in the latter, perhaps, it would be.

(6) Tribunal's Decision on Redistributive Effects

365 Based on its review of the evidence, the Tribunal cannot agree with the respondents' position that the redistributive effects are completely neutral. It is our view that the gains and losses are not completely offsetting and that there is a social loss that requires consideration.

366 However, on the basis of the evidence, the Tribunal cannot find that such loss is measured by the Commissioner's measured transfer of $40.5 million per annum, because the Commissioner has not demonstrated that that amount is the socially adverse effect. There is considerable reason to think that portions, perhaps significant portions, of the measured transfer are redistributions of profit among shareholders that society would regard neutrally.

367 The evidence tends to support the socially adverse redistributive effects regarding low-income households that use propane for essential purposes and have no good alternatives, but the number of such households appears to be small. In the Balancing Weights Approach of Professor Townley, the interests of those households should be weighted more heavily than the interests of the shareholders of the merged firm, but the higher weight is not determinable given the information on the record. In the Tribunal's view, the interests of other households and business owners should be weighted equally with shareholders of the merged firm in this case, particularly since, as the Commissioner has noted, all producers are, in a sense, consumers as well.

368 The Tribunal notes that it is possible to quantify the adverse redistributive effects of the transfer on household consumers of bottled propane in the lowest-income quintile based on the evidence of Professor Townley and Professor Ward. As there are approximately 102,465 consuming households in that group, and as the average expenditure per consuming household in that group is $277 per year (Townley report, exhibit A-2081, Table 2), total sales to that group are approximately $28.4 million per annum. Since the Commissioner's measured deadweight loss assumes a demand elasticity of-1.5 and a price increase to residential consumers in general of 11 percent (Commissioner's Memorandum on Redetermination Proceedings, Appendix A),

the transfer is 9.2 percent of sales (Ward report, exhibit A-2059, Table 8). Accordingly, on the Commissioner's evidence, the measured adverse redistributive effect on that group is approximately $2.6 million. This estimate assumes that all propane consumed by households in this group is for essential purposes.

VIII. Conclusions

369 It is clear, in our view, that the Court did not direct us to consider the entire amount of the wealth transfer as an "effect" of the lessening or prevention of competition. Rather, the Court has directed us to consider all of the "effects" in light of the statutory purposes of the purpose clause of the Act. Had the Court been of the view that the full amount of the wealth transfer constituted an "effect" under subsection 96(1), it would, no doubt, have said so in clear terms. The Court did not make a determination nor did it purport to make one with respect to the "effects" that will result from the prevention or lessening of competition in the merger under review. The Court did not attempt to make such a determination because the findings to be made are clearly within the Tribunal's expertise. The Court recognized this when it stated at paragraph 139 of the Appeal Judgment:

> Having concluded for the above reasons that the Tribunal erred in law when it interpreted section 96 as mandating that, in all cases, the only effects of an anti-competitive merger that may be balanced against the efficiencies created by the merger are those identified by the total surplus standard, this Court should not prescribe the "correct" methodology for determining the extent of the anti-competitive effects of a merger. Such a task is beyond the limits of the Court's competence.

370 Having assessed the measured adverse redistributive effect based on the evidence, it remains for the Tribunal to decide how to combine it with the measured deadweight loss of $3 million and the maximum deadweight loss attributable to changes in the merged company's product line of $3 million. Weighting redistributive effects equally with efficiency losses, the three effects would be added together to produce a maximum total effect of approximately $8.6 million.

371 However, there is no statutory basis under the Act (or in U.S. antitrust law) for assuming such equal weighting: perhaps the adverse redistributive effects should weigh twice as heavily as efficiency losses, in which case the three weighted effects would not exceed $11.2 million. Alternatively, since efficiency concerns are paramount in merger review, perhaps adverse redistributive effects should be weighted half as much as deadweight losses. In the instant case, it is clear that the adverse redistributive effects are, on the evidence, quite small. Accordingly, the Tribunal is of the view that any under any reasonable weighting scheme, the gains in efficiency of $29.2 million are greater than and offset all of the effects of lessening and prevention of competition attributable to the merger under review.

A. Observation

372 In the Tribunal's view, demonstrating significant adverse redistributional effects in merger review will, in most instances, not be an easy task. This may be why the Commissioner has argued so strongly for the inclusion of the transfer in its entirety, no questions asked. As cited by the respondents in part, Mr. Howard Wetston, the former Director of Investigation and Research addressed the evidentiary issue in commenting on the *Hillsdown* decision. Speaking of section 96, he said:

> The section itself is broadly framed, and so, it may be argued, supports various interpretations. Economists have advocated treating the wealth transfer neutrally owing to the difficulty of assigning weights *a priori* on who is more deserving of a dollar. Even considering that some system of weighting could be articulated, the practical implications of this are likely insurmountable - for, who is losing and who is receiving the transfer? Shares are often widely held in companies. Are the shareholders of pension-fund investors in a firm more or less deserving than the customers of that firm? Moreover, who are the customers? In cases of intermediate products, is one looking to the shareholders of the consuming companies or to their customers?
>
> One solution to this dilemma is to adopt the U.S.-style approach to consideration of efficiencies; namely, that savings must be passed on to consumers. Yet, if Parliament's desire had been to deny the possibility of any price impact on customers by giving consideration to the wealth transfer effects of a merger, then this could have been specified in the language of the section.

> Under these circumstances, I am respectfully of the view that, from an enforcement perspective, it is preferable not to depart at this time from the approach adopted in the *Merger Enforcement Guidelines*. Moreover, it should be understood that, regardless of the interpretation, the number of cases falling into this category will not be large. (Remarks delivered by Howard I. Wetston, Q.C., Director of Investigation and Research, Bureau of Competition Policy, to the Canadian Institute, Toronto, June 8, 1992)

373 In the Tribunal's view, the remarks of Mr. Wetston are very significant. First, he recognized that adequate measurement of the redistributive effects of a lessening or prevention of competition might well be impossible in light of the difficult questions that must be addressed. Second, Mr. Wetston recognized that no such effort was required under the American approach. However, there is no indication in the statute or elsewhere that Parliament intended this approach. The explicit efficiency defence in subsection 96(1) of the Act is clear evidence that Parliament intended not to follow the American approach to efficiencies.

374 This decision has been a very difficult exercise. The difficulty results in great part from the wording of subsection 96(1) of the Act which requires the Tribunal to weigh efficiencies against the "effects" of a lessening or prevention of competition. In that regard, we believe that the view expressed by Professor W.T. Stanbury before the legislative committee on Bill C-91, is entirely apposite:

> Now I come to the matter of the efficiency defence. Proposed section 68 [now s.96] of Bill C-91 clearly contemplates a trade-off between gains in efficiency and the lessening of competition. This raises a number of difficult questions. The first and most important is the matter of incommensurability - namely, that the tribunal will be asked to deal and make a judgment between a lessening of competition, which will probably result in higher prices, and gains in efficiency, which are real savings to society. These are not comparable kinds of things because one involves a redistribution of income and the other involved real gains in terms of the savings of resources.
>
> *Second, there is an inherent and unavoidable value judgment that the tribunal must make in dealing with proposed section 68. The sad part is that Parliament has given no guidance to the tribunal as to its priorities, as to the weights to be applied to the lessening of competition* [*effects*] *and gains in efficiency*.
>
> . . . . .
>
> With respect to the efficiency defence, there the clarification is not much of definition but of saying to the tribunal what priorities Parliament puts upon efficiency as opposed to the lessening of competition. *It is a judgment call; there is no technical way that can be handled by numbers or anything of that sort*. But Parliament could say...
>
> Let me just give you an historical example. In Bill C-256 the efficiency defence could be used only if the firms under review could show that at least part of the gains in efficiency were going to be passed on to consumers, you may recall. There is no such provision here. It seems to me that Parliament is indicating its priorities, that there is a difference in priorities there. I am not saying that we should adopt that; *I am saying that Parliament should decide and give instructions to the tribunal as to what values it wants the tribunals to adopt. The tribunal has to adopt a value - it cannot avoid it - in dealing with proposed section 68 of the Bill*. (Minutes of Proceedings and Evidence of the Legislative Committee on Bill C-91, Monday, May 7, 1986, Issue 7, page 3:4) [Emphasis added]

It was the Tribunal's initial view, on its acceptance of the Total Surplus Standard, that the Act did not give rise to the difficulties to which Professor Stanbury referred. However, in light of the Court's Appeal Judgment, we feel that, as Professor Stanbury pointed out to the Legislative Committee, subsection 96(1) requires the Tribunal to compare matters that cannot be easily, if at all, compared. On the one hand, there are efficiencies, which are real savings to society, and on the other hand, there are the redistribution effects which arise by reason of a price increase. We have attempted to render the incomparable "comparable" by, whenever possible, quantifying the effects. We have not been totally successful in this endeavour but we have come to the conclusion that the $29.2 million of efficiencies brought about by the merger is greater than and outweighs the "effects" of the lessening of competition.

375 Ms. Lloyd, in her dissenting opinion, which we have had the benefit of reading in draft form, has taken a different view of the matter. It is clear that, in her view, even if the merged company had been able to show efficiencies of, say, $100 million per year, that would not have sufficed to offset the effects of any prevention or lessening of competition.

376 Ms. Lloyd has taken what we would characterize as the "qualitative approach". We are convinced that under that approach rarely will a merger succeed in passing the section 96 test. Our review of the legislative history of the merger provisions, and in particular, of section 96 of the Act, leads us to conclude that that could not have been Parliament's intention.

377 The Tribunal therefore concludes that the Commissioner's application must be dismissed.

IX. Concurring Opinion (Dr. L. Schwartz)

378 Agreeing as I do with the Tribunal's decision, I would like to comment on certain ancillary matters that have arisen. In my view, the Court and Létourneau, J.A., have raised economic issues that I feel require further discussion.

A. Chicago School

379 In the Appeal Judgment, Létourneau, J.A. suggests that advocates of the "Chicago School of thought in antitrust matters" agree with the earlier decision of the Tribunal in this merger case (Appeal Judgment, at paragraph 11, Létourneau, J.A.). I have difficulty in characterizing the attitude of the Chicago School regarding the proper treatment of efficiency in merger review. For example, Nadon, J. cited the views of Robert Bork with approval (Reasons, at paragraph 426). However, Judge Posner writes:

> ...The problem, as we shall see, is that it is very difficult to measure the efficiency consequences of a challenged practice; and thus throughout this book we shall be continually endeavoring to find ways of avoiding the prohibition of efficient, albeit anti-competitive, practices without having to compare directly the gains and losses from a challenged practice... (R.A. Posner, *Antitrust Law: An Economic Perspective*, Chicago: University of Chicago Press, 1976 at 22)

In Judge Posner's view, the measurement of efficiency gains and losses is so difficult that it ought to be avoided. In my view, there is no agreement among Chicago School advocates on the proper treatment of efficiencies in reviewing horizontal mergers under American antitrust law.

380 In my understanding, the Chicago School of thought views all antitrust matters through the lens of applied price theory. On this view, I doubt that a separate product market for "national account coordination services" could be justified in light of the uncontradicted evidence proffered by the respondents. However, relying on the oral evidence of the Commissioner's witnesses, the Tribunal did not adopt applied price theory's conception of firms; it could be said, rather, that the Tribunal adopted a "transactions cost" perspective.

381 If economic theory and analysis are relevant under the Act, then virtually every decision of the Tribunal will reflect the "applied price theory" perspective of the Chicago School to some extent. In my view, however, the present and earlier decisions of the Tribunal in the instant case cannot be described as wholly consistent with that school of antitrust thought.

382 Létourneau, J.A. regards section 96 of the Act as vague.

> ...Are all the effects of the merger be weighed and what weight should be given to them? Are they all of the same significance and value? On what basis is one effect to be preferred over the other? On what basis should some effects, if any, be ignored or discarded? (Appeal Judgment, at paragraph 5)

383 Up until the Court released its Appeal Judgment in the instant matter, I had not viewed section 96 of the Act as vague, having in mind the recommendation of the Economic Council of Canada in its 1969 Report, the exclusion of redistributive objectives from the 1986 amendments in contrast to earlier bills, the Parliamentary review, various Ministerial statements, and particularly, the paramountcy of the objective of economic efficiency in section 96 of the Act that the Court has confirmed. That

said, if the Act is vague, it is my view that the apparent preference in some quarters for following the American approach will be of limited assistance in achieving the objectives of the purpose clause of the Act.

384 As noted by the Tribunal at paragraph 187 *supra*, Lande and Fisher acknowledged the lack of guidance in the American legislative history regarding the relative weighting of wealth transfers and efficiency effects. Fisher and Lande, who are generally critical of the Chicago School of antitrust, appeared to adopt the same position as Judge Posner. They concluded that case-by-case adjudication of efficiency gains versus effects was itself so "unworkable", even under the Consumer Surplus Standard, that merger review should avoid any such analysis (Fisher and Lande, at 1650). Their recommended approach was to evaluate all mergers based on rigid market-share criteria with few exceptions (Fisher and Lande, at 1691) and, of course, none for efficiency. However, the Act specifically calls for a case-by-case assessment of gains in efficiency and effects of lessening or prevention of competition, and it rules out sole reliance on market shares.

385 In my view, the proclaimed supremacy of the consumer interest in the United States is frequently overstated. The recurring softwood lumber dispute between Canada and the United States amply illustrates how the interests of domestic lumber producers in the United States have prevailed at the expense of the American consumer (particularly homebuyers), and evidence of gains in efficiency is not even required of those producers in return for the market restrictions that they seek. When viewing the American antitrust regime, we ought to remember that it is often circumscribed by other policies in which the consumer interest is not paramount.

B. Implications of Subsection 96(2)

386 There is a view that the efficiency defence in subsection 96(1) is available only when subsection 96(2) considerations are directly involved. This is not my understanding and, in response to a direct question from the Tribunal, the Commissioner did not take that position (Transcript, vol. 1, October 9, 2001, line 7, at 85). Subsection 96(2) requires special attention be given to exports and imports where they are involved, but subsection 96(1) applies to mergers generally, even if imported and exported goods and services are not involved.

387 As I understand the legislative history, the 1986 amendments, including section 96, were motivated in large part by the pressures of growing international trade and investment on Canadian businesses and by the need to encourage them to restructure in order to be able to succeed in the more competitive environment that ultimately benefits Canadian consumers. However, this does not indicate to me that the efficiency defence in subsection 96(1) was limited to mergers where subsection 96(2) considerations were directly involved. Rather, Canadian firms that become more efficient through mergers that stimulate exports and reduce imports can be given special consideration.

C. Small Business

388 The Court, relying on the purpose clause, has stated that the effects of an anti-competitive merger on small businesses must be considered when section 96 is invoked. Given the Court's emphasis on the purpose clause, it is puzzling that such consideration is only to be accorded under section 96. If the Court is correct in its view of the significance to be paid to small and medium-sized enterprises under the Act, surely it would be expected that such concern would be as relevant, if not more so, under section 92.

389 Section 93 of the Act lists certain factors that the Tribunal may consider when determining whether a merger prevents or lessens competition substantially under section 92. Neither efficiency nor small business are listed factors, and I infer therefrom that it was not Parliament's intent to allow the Tribunal to consider these factors in coming to a conclusion under section 92.

390 It is true that paragraph (h) in section 93 of the Act enables the Tribunal to consider any non-listed factor. However, in light of the purpose of the Act as provided in the purpose clause, objectives relating to efficiency and small businesses were well-understood; bluntly, they were too big to miss. Hence, if Parliament wanted to allow the Tribunal to consider these factors in the section 92 inquiry, it would not have left them to the residual paragraph (h) in section 93. The Tribunal refused to consider the impact of efficiency gains on price in its analysis under section 92 (Reasons, at paragraph 258), and the Court did not disturb

the Tribunal's conclusion that efficiency gains could not be considered under section 92 even if there were clear evidence that the price would decline as a result of those gains.

391 Similarly, a merger may have profound implications for small businesses, yet that is not a factor in the Tribunal's assessment of whether the merger prevents or lessens competition substantially. Thus, if parties to a merger did not invoke section 96, there would be no basis for the Tribunal to consider the small-business implications at all.

392 The purpose clause applies to the Act in its entirety. Accordingly, I think the better view is that since the impact of a merger on small business is, per statute, not a consideration under section 92 or section 93, then it may be inconsistent to give that impact greater weight under section 96.

D. Deadweight Loss and Elasticity of Demand

393 At paragraph 103 of the Appeal Judgment, the Court holds that applying the Total Surplus Standard leads to "paradoxical" consequences when viewed in light of the consumer protection objectives of the Act. In particular, that standard

> ...makes it easier to justify a merger between suppliers of goods for which demand is relatively inelastic than of goods for which demand is relatively elastic.

The Court continues:

> [104] This is because, where the demand for particular goods is inelastic, as it is for propane, the goods cannot be substituted as cost-effectively as where the demand is elastic. Hence, price increases that result from the exercise of market power are tolerated more by purchasers of goods for which the demand is inelastic than by purchasers of those where the demand is elastic. Thus, since purchasers of goods for which demand is inelastic are relatively insensitive to price, fewer will purchase substitute goods despite increases in price. Therefore, a significant price increase will result in a smaller deadweight loss where demand is inelastic than where it is elastic.
>
> [105] Thus, on the Tribunal's interpretation of section 96, the more inelastic the demand for the goods produced by the merged entity, the smaller will be the efficiencies required from the merger in order to offset its anti-competitive effects. It follows on this reasoning that, for the purpose of balancing efficiencies and effects, a potentially large wealth transfer from consumers of goods for which demand is inelastic to producers is to be ignored.
>
> [106] It is certainly not obvious how an interpretation of "effects" that creates a differential treatment of mergers by reference to the elasticity of demand for the goods produced by the merged entity is rationally related to any of the statutory aims of the *Competition Act*. (Appeal Judgment, at 42) [Underlined emphasis added]

394 It appears to me that the Court has placed some weight on its findings in these matters. With respect, I believe that the Court's views rest on a misapprehension of the relationship between deadweight loss and elasticity of demand.

395 What can be said is that, for a given demand elasticity and pre-merger sales, the calculated deadweight loss will be larger the larger is the price increase. This conclusion is reached by inspecting the formula for approximating the deadweight loss when competitive conditions prevail prior to the merger:

$$\text{deadweight loss} = (\text{percentage price increase})^2 \times \text{demand elasticity} \times \text{sales}/2$$

Similarly, a larger demand elasticity results in a larger deadweight loss, holding the other variables, including the price increase, constant. Certain issues can be illuminated by using this formula and the *ceteris paribus* assumption (Reasons, at paragraphs 435-436).

In pricing decisions, however, the *ceteris paribus* assumption is not met because the price increase will depend on the demand elasticity. A firm with market power will impose a larger price increase when demand is inelastic than when demand is elastic, for in the latter case, customers will more readily shift to alternatives. Thus, where demand is elastic, the price increase will be relatively small; hence the deadweight loss will be relatively small. In contrast, where demand is inelastic, the price increase will be relatively large, hence the deadweight loss will be relatively large.

Thus, it is not reasonable to suppose that a firm with market power would impose the same "significant price increase" whether demand was inelastic or elastic. Therefore, it does not follow that the deadweight loss would necessarily be smaller in the former case than in the latter, yet this is the Court's view.

396 The evidence of Professor Ward in this case illustrates the relationship between deadweight loss and demand elasticity. Using the average price increases of Superior and ICG when regional and discount firms are in the market, drawn from Table 7 of his expert report (exhibit A-2059) and, in parentheses, the associated deadweight losses as a percentage of sales in his Table 8 shows the following pattern:

Propane Demand Elasticity

	-1.5	-2.0	-2.5
Residential price increase	8.0%	4.1%	2.1%
deadweight loss	(0.5%)	(0.2%)	(0.1%)
Industrial price increase	8.9%	5.4%	3.3%
deadweight loss	(0.6%)	(0.3%)	(0.1%)
Automotive price increase	7.7%	4.5%	2.7%
deadweight loss	(0.5%)	(0.3%)	(0.1%)

397 For example, when demand is relatively elastic (-2.5), the deadweight loss in residential will be 0.1 percent of sales in that segment. However, if demand were relatively inelastic (-1.5), the deadweight loss would be larger, i.e. 0.5 percent of sales, because the price increase is much larger. The same pattern is observed in the industrial and automotive segments. Thus, contrary to the Court's view, it is apparent that the deadweight loss is larger when demand is inelastic than when it is elastic.

398 These distinctions and the possibility for error were, I believe, first pointed out by W.M. Landes and R.A. Posner in their well-known 1981 paper (*Market Power in Antitrust Cases*, 94 Harvard Law Review, No. 5, March 1981, 937, at 991-996) wherein they criticize Professor Scherer, apparently for a similar mistake in his text. As quoted by the Tribunal at paragraph 188 *supra*, Fisher and Lande also noted in 1983 that the probable percentage price increase and the elasticity of demand are interrelated. The relationship between deadweight loss and elasticity of demand is, in my view, a sophisticated one and I criticize no one. However, the Tribunal did not err in its appreciation of this relationship or its implications, and I respectfully disagree with the findings of the Court and the conclusions that it reached thereon.

X. Dissenting Opinion (Ms. Christine Lloyd)

399 The majority of the Tribunal redetermined the effects of the aforementioned anticompetitive merger for the purpose of the efficiency defence under section 96 of the Act, in light of the Appeal Judgment dated April 4, 2001. I recognize that efficiencies are given special consideration under section 96 of the Act and may constitute a defence in an otherwise anticompetitive merger. Section 96 involves a balancing process and as stated by the Court, must be assessed in accordance with the objective and goals of the Act. This objective is to maintain and encourage competition in Canada in order to achieve the goals of the Act. These goals are: the promotion of the efficiency and adaptability of the Canadian economy; the expansion of opportunities for Canadian participation in world markets; the equitable opportunity for small and medium-sized enterprises to participate in the Canadian economy and the provision of competitive prices and product choices to consumers.

400 My dissent has regard to the majority's assessment and treatment of selected effects and their resultant conclusions. I am also concerned with the issue of the burden of proof as it relates to the complexity and extensiveness of the evidence that the majority claims should have been introduced by the Commissioner in order to prove certain effects of the merger. For instance, is it required that each of the effects of the merger be *quantified* by the Commissioner in order to be considered in the analysis? Which of the effects should be considered on a qualitative basis when conducting the analysis prescribed by section 96 of the Act? Finally, and importantly, I disagree with the view of the majority that the Tribunal should only consider "the

socially adverse" portion of the consumers' surplus transfer in the section 96 analysis. Indeed, I cannot find any justification under the Act or elsewhere for treating the transfer of consumer wealth in this manner.

401 The majority concludes that no consideration should be given to some of the effects presented by the Commissioner. These effects are: the reduction or elimination of customer programs; the prevention of competition in Atlantic Canada; the effects in interrelated markets; the loss of potential dynamic efficiency gains, and the effects on small and medium-sized enterprises. I believe that these effects should be given consideration. In relation to the consumers' surplus transfer, the majority decided to consider only the part deemed "socially adverse". I disagree with that conclusion. I am of the view that the transfer should be considered in its entirety when assessing the trade-off analysis.

402 Consequently, when conducting the trade-off analysis in section 96, I considered certain effects that were dismissed by the majority and conclude that the efficiency gains are not greater than and do not "offset" the negative effects of this anti-competitive merger within the parameters of the Act.

A. Reduction or Elimination of Customer Programs

403 The majority, consistent with the earlier reasoning, only considered the impact on "resource allocation" when addressing the negative qualitative effects of the merger. The majority concluded that this effect was minimal and that the amount was unlikely to exceed the estimated deadweight loss. The Commissioner, in argument, points out that the majority did not, however, consider the transfer effects that would be associated with a reduction in real output and the creation of a deadweight loss. In these Reasons, the majority decided not to consider the redistributive effect associated with the removal/reduction of programs and services as the Commissioner did not adduce any evidence on this matter. Consequently, the majority decided not to revisit the original conclusion on this issue. While I agree with the majority that no evidence was adduced as to the amount of the transfer effects associated with a reduction in real output and the creation of a deadweight loss, I am nevertheless of the opinion that the effects associated with the elimination or the reduction of consumer choice should be considered on a qualitative basis.

404 In my opinion, in the absence of ICG as a vigorous competitor, Superior, post-merger, will feel no competitive pressure or incentive to maintain the innovative programs established by ICG. One of the goals under the purpose clause of the Act is to provide consumers with competitive prices and product choices. Bundling propane with special service features is a means of differentiating an otherwise indistinguishable product. Providing a value-added feature sets the product apart from its competitors and this competitive advantage for the company then in turn, benefits consumers.

405 It is clear that the merger will have a significant negative impact on customer programs, services and product choice because of the disappearance of ICG as a competitor. As a result, Superior no longer has to compete on the basis of those services. Nonetheless, as the value of these services is very difficult to assess and hence are not quantified, I am of the view that they should be considered from a qualitative perspective.

406 In the case before us, consumers with a preference for a large national supplier of propane or with a need for "national account coordination services" will be deprived of all choice of suppliers. Indeed, Superior will lack incentive to provide national account customers with value added features beyond a central billing function. This potential loss of value-added features through the loss of ICG deprives the customer of product choices and while it cannot be quantified, this loss cannot be ignored and must be given weight qualitatively in the balancing process.

B. Prevention of Competition in Atlantic Canada

407 The majority recognized at paragraph 244, *supra*, that the merger prevents ICG's plans to expand in Atlantic Canada from being implemented and as a result, the price of propane will likely be higher than it would be if the merger does not take place. Accordingly, they conclude that the effects of this prevention in Atlantic Canada should have been quantified in the form of efficiency gains and reduction in excess profits to the incumbents that would have resulted from additional competition that the merger precludes. The majority concludes that there is no evidence on the record about the extent of these effects resulting therefrom.

408 It is a fact that Superior and Irving are the predominant operators in Atlantic Canada. ICG was looking to establish a branch office in Sydney, Nova Scotia, in partnership with the Petro-Canada agent. One of the expected results emerging from the additional competition in the region might have included more competitive prices and more product choices. Any potential benefits through the increased competition that ICG would have created are now thwarted by the merger.

409 Therefore, I agree with the Commissioner's position that the loss of the benefits of competition that might otherwise have developed in Atlantic Canada due to ICG's activities in the absence of the merger is a relevant qualitative effect that should be taken into consideration. The fact that it is difficult to predict what would have occurred in the absence of the merger does not mean that the real effect of the merger preventing competition from developing in Atlantic Canada should be left out of the analysis.

C. The Effects in Interrelated Markets

410 The majority is of the view that an increase in the price of propane which has the potential to increase the costs of goods produced or the services provided by businesses (i.e. an increase in the price of a significant input), is not relevant. The majority states at paragraph 253, *supra*, that the issue here is whether an intermediate purchaser of propane will absorb the propane price increase or pass it on to customers in some way. Further, the majority states that whether the increase is large or small or whether propane is a significant input is not the issue.

411 I strongly disagree with this view, especially in light of the Court, who acknowledged that one of the effects of a merger that may be relevant to the efficiency defence, is the "...impact of the merger on inter-related businesses." (Appeal Judgment, at paragraph 152).

412 Regarding the effects on interrelated businesses, the evidence demonstrates that by far the majority of propane volume (89.3 percent) in 1998 was sold by Superior and ICG Propane Inc. to bulk agents and for commercial, agricultural, industrial and automotive end use applications. Only 10.7 percent was sold for residential use. Further, there is significant evidence on the record that shows that the cost of propane was a significant input for products or services. This evidence was reported at paragraphs 30 and 32 of the Commissioner's Memorandum on Redetermination Proceedings.

413 This evidence indicates to me that the negative effects of a price increase would affect businesses as the cost of goods or services they produce would increase. Due to the fact that the relevant product in this case constitutes an input into a wide range of products and services in the Canadian economy, it is not feasible to quantify the additional resource allocation (deadweight loss) and transfer effects for each product or service affected by this "cost increase". This effect is important and must, in my view, be taken into account and be given appropriate weight in the balancing process.

D. The Loss of Potential Dynamic Efficiency Gains

414 The majority rejects the Commissioner's submissions that the merger will result in the loss of dynamic efficiency gains that would have been achieved by ICG's transformation process. The majority states at paragraph 258, *supra*, that there is no evidence on the gains therefrom, and note that no expert witness testified to the likelihood of these gains being achieved, their "..."dynamic" character, or their quantum, and accordingly the loss of such gains appears speculative..."

415 Although more in the nature of an *obiter*, I feel compelled here to express my surprise with the comment made by the majority regarding the necessity to have evidence on the "likelihood of those efficiency gains being achieved". In my humble opinion, this evidence regarding "likelihood" was not adduced with respect to the $29.2 million of efficiency gains alleged to result from the merger. In that regard, I expressed my concerns with respect to the likelihood of the respondents' alleged efficiency gains being achieved. I discussed these concerns in detail in my previous dissenting opinion (Reasons, at paragraphs 486-493).

416 The evidence demonstrates that ICG, in a competitive environment, had, prior to the merger, undergone a business re-engineering to enhance efficiency and improve productivity. ICG had embraced technology as one method by which to achieve

that goal. They had established computer-based systems to better manage the business and had given themselves a competitive advantage in the propane market. The process was not fully implemented when Superior acquired ICG and these innovations will now be reversed. I am of the view that the merger results in the loss of a propane company prepared to re-engineer its approach to conduct its business and attempt through innovation to improve its efficiency and competitiveness.

E. Effects on Small and Medium-Sized Enterprises

417 The majority expresses the views at paragraphs 286 to 305, *supra*, that the Commissioner has not shown that Superior behaved aggressively toward its small and medium-sized competitors. Further, the majority states that, although it takes the witnesses claims of predatory pricing seriously, the evidence is not sufficient to establish predation.

418 The majority comes to the conclusion that in order to consider the effects of Superior's increased market power and its ability therefrom to resort to "unfair tactics" to deter entry, or expansion or to discipline small and medium-sized enterprises, a case of predatory pricing should have been presented by the Commissioner. I recognize that pricing aggressively is an element of healthy competition and may not constitute violations under the provisions of the Act. However, I am of the view that evidence of a company's past conduct might constitute a relevant factor to be considered. The potential effect that this merged company might have on small and medium-sized enterprises in the future, and their equitable opportunity to compete becomes an issue.

419 Indeed, the evidence demonstrates that Superior's practices are designed to either increase rivals' costs or decrease rivals' revenues. Superior's own records indicate that "retaliation" is a response to any competitive company who has taken or attempts to take business away from Superior. This evidence was referred to in the Commissioner's Memorandum on Redetermination Proceedings at paragraphs 56 to 66. It is apparent that Superior's increased market power gives it *the ability* to "discipline" its competitors. Superior's retaliatory behaviour goes beyond normal competitive practices. Some examples of Superior's retaliatory behaviour are drastic margin cuts, tying up customers with multi-year contracts, removal charges, free tanks (normally rented) and the "last look" on tenders. Imperial Oil's failure to enter propane retailing is an example of Superior's aggressive reaction and inclination to resort to measures that deter expansion, entry or discipline competitors. While I recognize that Imperial Oil does not fall into the category of "small and medium-sized enterprises", I believe that Imperial Oil's exit from the market is indicative of how Superior's behaviour could negatively impact small and medium-sized enterprises. Furthermore, I see no reason why Superior would act any differently towards a company considered small or medium-sized.

420 Small and medium-sized enterprises are entitled under the Act to an equitable opportunity to compete. This increased ability to deter expansion, entry and discipline competitors is a real possibility that is supported by Superior's past behaviour. It is an effect that runs contrary to the goal of the Act to "provide an equitable opportunity for small and medium-sized enterprises to participate in the Canadian economy" and hence should be given weight in the balancing exercise.

F. The Consumers' Surplus Transfer

421 A significant effect of this merger is the wealth transfer from consumers to Superior Propane Inc. (consumers' surplus transfer) which has been estimated by the Commissioner to be as high as $40.5 million per annum. This wealth transfer results from the supra-competitive market prices that Superior would likely charge as a consequence of its market power. In the view of the Court, the Act is not in itself concerned with "economics" so narrowly conceived as to exclude from consideration under section 96 these redistributive effects and hence these effects must be given weight in the balancing process.

422 In its earlier Reasons, the majority recognized the redistributive effects of the instant merger, but treated them as offsetting because it concluded that the Total Surplus Standard was required in law; hence, that the redistributive effects were, on balance, socially neutral. In these Reasons, the majority asks what treatment should be given to the consumers' surplus transfer based on the submissions of the parties, while taking instruction from the Court. The majority concludes that the redistribution of income that results from an anti-competitive merger of producers has a negative effect on consumers (loss of consumers' surplus) and a correspondingly positive effect on shareholders (excess profit) and states that whether these two effects are completely or only partially offsetting is a *social decision*. Further, the majority recognizes at paragraph 333 of these Reasons that redistributional effects can legitimately be considered neutral in some instances, but not in others. The majority then went on to say that "...

[w]hile complete data may never be attainable, the Tribunal must be able to establish on the evidence the socially adverse effects of the transfer." The majority concludes that the redistributive effects are not completely neutral in the instant merger but refuse to consider the entirety of the Commissioner's measured transfer of $40.5 million per annum on the grounds that he has not demonstrated that *this amount is the socially adverse effect*. The majority is of the view that the interests of households and business owners should be given equal weights with shareholders of the merged entity in this case, particularly since, as the Commissioner has noted, all producers are, in a sense, consumers as well.

423 The merger reduces the competitiveness of propane prices and this effect reduces the benefits of competitive propane prices to *all* Canadian propane consumers by at least the amount of the consumers' surplus transfer. While individual shareholders of Superior may well be consumers of propane, the principle issue at hand is the competitiveness of propane prices for *all Canadian consumers* regardless of consumer segment; that is their demographics or the product end-use. The important consideration is that competitive propane prices should be available to all propane consumers as they are all affected by a price increase. Hence, the consumers' surplus transfer is an immediate effect resulting from the anti-competitive merger. I am of the view that there should be no preference for one segment of consumers over another segment. Indeed, the purpose clause of the Act explicitly recognizes the goal of providing consumers with "competitive prices". Further, the majority's approach for treating the transfer would require complete data on the socio-economic profiles of the consumers and of the shareholders of the producers. With such an approach, it would be impossible to assess whether redistributive effects on the wealth transferred as a result of the higher prices charged by the merged entity would be fair and equitable.

424 The fact that the merger will likely result in a transfer estimated at $40.5 million per annum due to Superior's ability to exercise its market power in the form of higher prices is a serious consideration given the Appeal Judgment and the language of the purpose clause of the Act. Therefore, I came to the conclusion that the entirety of the estimated income transfer of $40.5 million per year should be included in the section 96 trade-off analysis in light of the purpose clause.

G. Requirement to Quantify the Effects

425 As stated above at paragraph 400, I am concerned with the position adopted by the majority which requires the Commissioner to present evidence of a quantitative nature with regards to the effects of the anti-competitive merger for the purpose of the section 96 analysis. In my view, such requirement makes the Commissioner's evidentiary burden formidable. Indeed, as the Commissioner points out, certain effects under consideration are more qualitative in nature and in many instances some are impossible to quantify. For instance, the majority discards the effects on interrelated markets as, in their view, the magnitude of that effect was not established by the Commissioner. The majority implies at paragraph 254 that this effect should have been measured by calculating the deadweight loss and transfer effects resulting from a price increase in each market affected by the merger. Propane being a commodity, the end-uses of which extends to a very large number of businesses in Canada, makes such measurement highly complex. With such a required approach, not only would the Commissioner have to prove the number of businesses affected but he would also have to present evidence of a deadweight loss arising in each industry (interrelated market). That would be a daunting task to prove *even one* specific effect of the merger.

426 Finally, although the majority recognized at paragraph 372, with respect to the transfer effect in particular, that demonstrating significant adverse redistributional effects in merger review will, in most instances, "not be an easy task", the majority nevertheless maintains the view that this would constitute the appropriate treatment for the transfer. As I stated above, I see no justification under the Act for reducing the transfer to the part that is "socially adverse". The purpose clause of the Act explicitly recognizes the goal of providing all Canadian consumers with "competitive prices". I am concerned that the approach adopted by the majority regarding the transfer might well be impossible to implement in light of the complex issues such an approach would entail.

427 If the standard imposed on the Commissioner, as a result of this decision, were that he had to quantify each of the effects of an anti-competitive merger and demonstrate the *socially adverse* redistributional effect (part of the consumers' surplus transfer), it is my opinion that the merger provisions of the Act would be, at a minimum difficult, if not impossible to enforce.

H. Conclusion

428 In light of my dissenting reasons, when conducting the trade-off analysis in section 96, I conclude that the efficiency gains of $29.2 million per year are not greater than the combined measured effects ($43.5 million per year) and serious qualitative effects that I discussed above. As a result, the merger fails the "greater than" aspect of the test.

429 Further, I am of the view that the efficiency gains of $29.2 million per year do not "adequately compensate society", do not "offset" the negative effects of this anti-competitive merger within the parameters of the Act, for the combined measured $40.5 million of consumers' surplus transfer, the estimated deadweight loss of $3 million per year and the negative qualitative effects that I have identified. Finally, as I stated in my previous dissenting opinion, I still cannot find any meaningful consideration or real benefits in the nature of dynamic efficiencies that could have had an impact on the outcome of my analysis. Indeed, the respondents provided no evidence that the efficiencies claimed will *compensate for* the detrimental effects that will result from the merger. For example, the respondents could have claimed that the merger is likely to bring about dynamic efficiencies arising from innovation that will benefit the Canadian economy. Such qualitative efficiency gains could have been assessed in the trade-off analysis as ways to compensate for the detrimental effects caused to the economy as a whole. However, the respondents did not even attempt to present any such *beneficial* effect to the economy that will result from the merger.

430 Finally, as I discussed above at paragraph 425, I am of the view that this case raises serious concerns with respect to the evidentiary burden that must be met by the Commissioner in order to enforce the merger provisions of the Act. As I stated earlier, I disagree with the majority that each effect of the anti-competitive merger should be quantified in order to be considered under section 96 of the Act. Such a task would amount to an extremely difficult exercise to carry out with any degree of reliability.

(1) Observation

431 In this case, I was particularly concerned with the tremendous number of estimates that were provided as input into the calculations that formed part of the extensive economic evidence presented in relation to the efficiencies defence. For example, the input required to establish deadweight loss and transfer estimates included compounded estimates of volumes, prices per litre by end-use and projected price increases by end-use. This is not to say that using some arithmetic standard is not necessary; however, in my view such a standard should be used as a tool/guide in reaching a decision and should not be interpreted as having such precision so as to be concluded as being an end in itself. Qualitative input is, in my view, imperative in analysing the effects of an anti-competitive merger.

432 Relying on estimates and calculations to arrive at what appears to be a precise number provides a false sense of security in that numbers interpretation. In addition it eliminates or at a minimum, reduces the discretion/judgment that the Court allowed the Tribunal in conducting the balancing exercise. The Court recognized "...given the difficulties of for example assessing both the relative elasticity of demand for the goods produced or supplied by a merged entity, and the qualitative aspect of deadweight loss, the application of the total surplus standard is far from mechanical..." In my view it is inherent in this statement that the Court accepts that the results derived from any merger analysis may be imprecise and subject to margins of error. A qualitative analysis and learned judgment is therefore essential.

XI. Order

433 The Tribunal hereby orders that the Commissioner's application for an order under section 92 of the Act is denied.

Application dismissed.

End of Document

2017 CAF 236, 2017 FCA 236
Federal Court of Appeal

Toronto Real Estate Board v. Commissioner of Competition

2017 CarswellNat 6861, 2017 CarswellNat 8751, 2017 CAF 236,
2017 FCA 236, 153 C.P.R. (4th) 426, 286 A.C.W.S. (3d) 369

THE TORONTO REAL ESTATE BOARD (Appellant) and COMMISSIONER OF COMPETITION (Respondent) and THE CANADIAN REAL ESTATE ASSOCIATION (Intervener)

M. Nadon, D.G. Near, Donald J. Rennie JJ.A.

Heard: December 5, 2016
Judgment: December 1, 2017
Docket: A-174-16

Proceedings: affirming *Commissioner of Competition v. Toronto Real Estate Board* (2016), 2016 Comp. Trib. 7, 2016 CarswellNat 1506, Denis Gascon Chair, Paul Crampton C.J., Wiktor Askanas Member (Competition Trib.); and affirming *Commissioner of Competition v. Toronto Real Estate Board* (2016), 2016 CarswellNat 2132, 2016 Comp. Trib. 8, Denis Gascon J. Chair, Paul Crampton C.J. Chair, Wiktor Askanas Member (Competition Trib.)

Counsel: William V. Sasso, Jacqueline Horvat, Carol Hitchman, for Appellant
John F. Rook, Q.C., Andrew Little, Emrys Davis, for Respondent
Sandra A. Forbes, Michael Finley, for Intervener

***M. Nadon, Donald J. Rennie JJ.A.*:**

I. Introduction

1 This is a statutory appeal from two decisions of the Competition Tribunal (the Tribunal) which held that certain information sharing practices of the Toronto Real Estate Board (TREB) prevented competition substantially in the supply of residential real estate brokerage services in the Greater Toronto Area (GTA): *Commissioner of Competition v. Toronto Real Estate Board*, 2016 Comp. Trib. 7 (Competition Trib.) (Tribunal Reasons, TR) and *Commissioner of Competition v. Toronto Real Estate Board*, 2016 Comp. Trib. 8 (Competition Trib.) (the Order).

2 TREB maintains a database of information on current and previously available property listings in the GTA. TREB makes some of this information available to its members via an electronic data feed, which its members can then use to populate their websites. However, some data available in the database is not distributed via the data feed, and can only be viewed and distributed through more traditional channels. The Commissioner of Competition says this disadvantages innovative brokers who would prefer to establish virtual offices, resulting in a substantial prevention or lessening of competition in violation of subsection 79(1) of the Competition Act, R.S.C. 1985, c. C-34 (Competition Act). TREB says that the restrictions do not have the effect of substantially preventing or lessening competition. Furthermore, TREB claims the restrictions are due to privacy concerns and that its brokers' clients have not consented to such disclosure of their information. TREB also claims a copyright interest in the database it has compiled, and that under subsection 79(5) of the Competition Act, the assertion of an intellectual property right cannot be an anti-competitive act.

3 For the reasons that follow, we would dismiss the appeal.

II. Background and Procedural History

4 TREB, the appellant, is a not-for-profit corporation incorporated under the laws of Ontario. With approximately 46,000 members, it is Canada's largest real estate board. TREB itself is not licensed to trade in real estate and does not do so.

5 TREB operates an online system for collecting and distributing real estate information among its members. This "Multiple Listing Service" or MLS system is not accessible to the general public. Part of the MLS system is a database (the MLS database) of information on properties, including, *inter alia*: addresses, list prices, interior and exterior photographs, length of time for sale, whether the listing was withdrawn or expired, etc. The information is entered by TREB's member brokers into the system and appears almost instantly on the MLS database. When inputting information, some fields are mandatory and others are optional. The MLS database contains both current listings and an archive of inactive listings going back to 1986. TREB's members have full access to the database at any time.

6 Many brokers operate sections of their websites where their clients can log in and view information, called "virtual office websites" or VOWs. TREB's data feed delivers information to brokers to populate these sections of their websites. Importantly, not all information in the MLS database is included in the data feed. Certain data is excluded (the "disputed data"). However, TREB's VOW Policy contains no restriction upon how its members can communicate the same disputed data to their clients through other delivery mechanisms. Consequentially, some information cannot be shared with clients in a VOW, but can be shared with them by other methods, such as in person, by email, or by fax.

7 In May 2011, the Commissioner first applied to the Tribunal, under subsection 79(1) of the Competition Act, for an order prohibiting certain behaviours related to TREB's restrictive distribution of digitized data. The Commissioner alleged that TREB's policies excluded, prevented, or impeded the emergence of innovative business models and service offerings in respect of the supply of residential real estate brokerage services in the GTA.

8 In April 2013, the Tribunal dismissed the Commissioner's application, finding that the abuse of dominance provisions of the *Competition Act* could not apply to TREB because, as a trade organization, TREB did not compete with its members (*Canada (Commissioner of Competition) v. Toronto Real Estate Board*, 2013 Comp. Trib. 9 (Competition Trib.)). However, on appeal in February 2014, this Court set aside the Tribunal's order and referred the matter back for reconsideration, finding that subsection 79(1) of the Competition Act could apply to TREB (*Canada (Commissioner of Competition) v. Toronto Real Estate Board*, 2014 FCA 29, 456 N.R. 373 (F.C.A.), leave to appeal to S.C.C. refused, 35799 (24 July 2014) [2014 CarswellNat 2755(S.C.C.)] (*TREB FCA 1*)).

9 The matter was reconsidered by a different panel of the Tribunal in the fall of 2015. On April 27, 2016, the Tribunal issued its reasons on the merits and made an order granting, in part, the Commissioner's application (*Commissioner of Competition v. Toronto Real Estate Board*, 2016 Comp. Trib. 7 (Competition Trib.)). The issue of remedy was the subject of a further hearing and order of the Tribunal on June 3, 2016 (*Commissioner of Competition v. Toronto Real Estate Board*, 2016 Comp. Trib. 8 (Competition Trib.)). Those two decisions are now on appeal before this Court.

10 The intervener in this case is the Canadian Real Estate Association (CREA), a national organization representing the real estate industry in Canada. TREB is a member of CREA. CREA owns the MLS trademarks. The MLS system is operated by local boards (in this case, by TREB) under license from CREA.

III. The Tribunal Decision

11 The Tribunal first addressed the abuse of dominance issue by defining the relevant market to be "the supply of MLS-based residential real estate brokerage services in the GTA" (Tribunal Reasons (TR) at para. 161). The Tribunal then addressed the three part test in subsection 79(1) of the Competition Act. For ease of reference, we reproduce the provision here:

> **Prohibition where abuse of dominant position**
>
> **79** (1) Where, on application by the Commissioner, the Tribunal finds that

(a) one or more persons substantially or completely control, throughout Canada or any area thereof, a class or species of business,

(b) that person or those persons have engaged in or are engaging in a practice of anti-competitive acts, and

(c) the practice has had, is having or is likely to have the effect of preventing or lessening competition substantially in a market, the Tribunal may make an order prohibiting all or any of those persons from engaging in that practice.

Ordonnance d'interdiction dans les cas d'abus de position dominante

79 (1) Lorsque, à la suite d'une demande du commissaire, il conclut à l'existence de la situation suivante:

a) une ou plusieurs personnes contrôlent sensiblement ou complètement une catégorie ou espèce d'entreprises à la grandeur du Canada ou d'une de ses régions;

b) cette personne ou ces personnes se livrent ou se sont livrées à une pratique d'agissements anticoncurrentiels;

c) la pratique a, a eu ou aura vraisemblablement pour effet d'empêcher ou de diminuer sensiblement la concurrence dans un marché, le Tribunal peut rendre une ordonnance interdisant à ces personnes ou à l'une ou l'autre d'entre elles de se livrer à une telle pratique.

12 The Tribunal found that TREB "substantially or completely controls the supply of MLS-based residential real estate brokerage services in the GTA" and therefore the terms of paragraph 79(1)(a) were met (TR at para. 162).

13 With respect to paragraph 79(1)(b), the Tribunal found that TREB had engaged in, and continued to engage in a practice of anti-competitive acts (TR at para. 454). TREB took the position that its actions were motivated by concern for the privacy of real estate buyers' and sellers' information, and that this concern constituted a legitimate business justification for the VOW restrictions which had to be balanced against the evidence of anti-competitive intent (TR at paras. 21, 285 - 287, 321).

14 In this context, the Tribunal found TREB's concern with privacy to be unpersuasive. We will turn to this issue in greater detail later in these reasons; suffice to say at this point that, looking at the record before it, the Tribunal found little evidence that TREB's VOW committee had considered or acted upon privacy concerns before establishing TREB's VOW Policy (TR at paras. 321, 360, 390).

15 Turning to paragraph 79(1)(c), the Tribunal found that the VOW restrictions prevented competition substantially in the market. After describing this branch of the test (TR at paras. 456 - 483), the Tribunal adopted a "but for" approach to this analysis, comparing the real world with the hypothetical world in which the VOW restrictions did not exist. Thus, in the Tribunal's view, it was the burden of the Commissioner to adduce evidence to prove "a substantial difference between the level of actual or likely competition in the relevant market in the presence of the impugned practice and the level of competition that likely would have prevailed in the absence of that practice" (TR at para. 482).

16 In describing the applicable test, the Tribunal made the point that the Commissioner could bring either quantitative or qualitative evidence, or both, to meet his burden. Because of its view that "dynamic competition is generally more difficult to measure and to quantify", there may be a greater need for the Commissioner to rely on qualitative evidence. This is particularly so in innovation cases. However, the Tribunal also recognized "that it may be more difficult to meet this burden when the Commissioner relies largely on qualitative evidence" (TR at paras. 471, 470).

17 After reviewing the parties' submissions on the evidence with respect to a lessening of competition (TR at paras. 484 - 499), the Tribunal noted that "there is a high degree of competition in the Relevant Market, as reflected in considerable ongoing entry and exit, a significant degree of discounting activity with respect to net commissions, and a significant level of ongoing technological and other innovation, including with respect to quality and variety and through Internet-based data-sharing vehicles" (TR at para. 501).

18 Nonetheless, in addressing the "but for" question, the Tribunal found that the VOW restrictions prevented competition in five ways: by increasing barriers to entry and expansion; by increasing costs imposed on VOWs; by reducing the range of brokerage services available in the market; by reducing the quality of brokerage service offerings; and by reducing innovation (TR at paras. 505 - 619).

19 However, the Tribunal found that the Commissioner had failed to prove that the VOW restrictions were preventing competition in three other manners: by reducing downward pressure on broker commission rates; by reducing output; and by maintaining incentives for brokers to steer clients away from inefficient transactions (TR at paras. 620 - 638).

20 After satisfying itself that the VOW restrictions were preventing competition in five ways, the Tribunal then addressed the substantiality of those anti-competitive effects. Turning first to magnitude and degree, the Tribunal framed the question as whether "full-information VOW brokerages likely would be hired by significantly more clients as a real estate brokerage but for the aggregate impact of the three components of TREB's anti-competitive acts" as a result of being able to display the disputed data (TR at para. 646).

21 TREB had argued that without conversion of website viewers into clients, the popularity of a website was irrelevant (TR at paras. 645, 648). However, the Tribunal found that website innovation could also be relevant if it spurred other competitors to compete (TR at para. 649).

22 After noting that the Commissioner had failed to conduct an empirical assessment with regard to local markets where sold information (the final price at which a house sold) was available through VOWs and other local markets where such information was not available through VOWs, the Tribunal declined to draw the adverse inference against the Commissioner which TREB argued it should draw. The Tribunal noted that "as a statutory authority, the Commissioner has to be prudent with, and make difficult decisions regarding the allocation of, the limited public funds available for administering and enforcing the Act at any given time" (TR at para. 656).

23 The Tribunal also considered, in refusing the draw the inference, the fact that the Commissioner's expert, Dr. Vistnes, had advised the Commissioner that an empirical assessment would be costly, difficult, and of little value. Notwithstanding its refusal to draw the adverse inference sought by TREB, the Tribunal made it clear that the Commissioner continued to bear the burden of proving that the required elements of his application were met which "may well be a more challenging task in the absence of quantitative evidence" (TR at para. 656).

24 The Tribunal then stated that it was prepared to draw an adverse inference against the Commissioner in regard to the testimony of two of its witnesses, Messrs. Nagel and McMullin, whose brokerages (respectively Redfin Corporation and Viewpoint Realty Services Inc.) conducted business in areas where the disputed data was available and in other areas where such data was not available (Nova Scotia and parts of the United States). Because neither witness presented evidence with regard to these other markets, the Tribunal inferred that the conversion rates of those websites would not be helpful to the Commissioner's case. However, the Tribunal then noted that it would not give much weight to its inference because of Dr. Vistnes' opinion that the low conversion rates could be the result of local differences in the relevant markets.

25 The Tribunal also commented that "even a limited comparison between one local U.S. market where sold information is available and one local U.S. market where such information is not available may have been at least somewhat helpful", adding that the same comment applied to Nova Scotia with respect to pending sold prices. The Tribunal also commented that the absence of such a comparison made its task with regard to the "substantiality" element of paragraph 79(1)(c) much more difficult. The Tribunal concluded by saying that the absence of such comparison "resulted in this case being much more of a 'close call,' than it otherwise may have been" (TR at para. 658).

26 However, the Tribunal highlighted the little weight it gave to the low conversion rates:

> [662] The Tribunal does not accord much significance to the fact that the low conversion rates of firms such as ViewPoint, Redfin and TheRedPin suggest that many consumers are evidently treating the information available on their websites as

> complements to the information available from the (different) broker they ultimately use to list or purchase their home. The fact remains that the innovative tools, features and other services available on those websites is assisting them to compete, and is forcing traditional brokerages to respond.

In other words, if we understand the Tribunal correctly, it was not prepared to, in effect, give any weight to the fact that the conversion rates of ViewPoint, Redfin, and TheRedPin were not significant. However, later in its reasons, the Tribunal makes the finding that if the disputed data were available to these firms in the GTA, they likely would have been successful in converting "an increasing and significant number of website users into clients". Paragraph 676 reads:

> [676] The Tribunal concludes that being able to obtain sold information from the VOW Data Feed, and to work with that data as they see fit, would likely enable full-information VOWs, including ViewPoint and those such as TheRedPin who would like to become full-information VOWs, to convert an increasing and significant number of website users into clients.

27 Then, in dealing with the issue of qualitative evidence, the Tribunal made six observations based on the evidence adduced on behalf of the Commissioner:

> [666] First ... the Disputed Data is very important, if not critical, in assisting Internet-based brokerages to distinguish themselves from incumbent traditional brokerages. ...
>
> [667] Second, home purchasers and sellers value being able to obtain information with respect to sold prices, the conditional sale status of homes in the market, firm "pending sold" information, [withdrawn, expired, suspended or terminated] listings and cooperating broker commissions *prior to* meeting with their broker/agent, or in any event *prior to* finalizing the listing price of their homes or making an offer on a home.
>
> [668] Third, an inability to display and use the Disputed Data to develop innovative products has been preventing, and is likely to continue to prevent, ViewPoint from entering the Relevant Market. This has also prevented Realosophy and TheRedPin from growing as much as they likely would have grown ... this also prevented Sam & Andy from expanding within the Relevant Market, and prevented their brokerage customers from doing the same.
>
> [669] Fourth, ViewPoint, Realosophy and TheRedPin are Internet-based innovative brokerages that, in aggregate, likely would have introduced a considerably broader range of brokerage services, increased the quality of some important services (such as CMAs), benefited from lower operating costs and considerably increased the overall level of innovation in the Relevant Market, "but for" the VOW Restrictions. ...
>
> [670] Fifth, the VOW Restrictions have erected barriers to the entry and expansion of innovative brokers in the Relevant Market ...
>
> . . .
>
> [672] Sixth, the VOW Restrictions have stifled innovation in the supply of Internet-based real estate brokerage services in the GTA.
>
> (emphasis in original)

28 The Tribunal then discussed the importance of the disputed data fields to brokers and consumers, finding that sold data, pending and conditional solds, and withdrawn, expired, suspended or terminated listings were valued by home buyers and sellers (TR at paras. 675 - 685). In the Tribunal's opinion, making cooperating broker commissions available would also increase transparency in the market and would allow brokers to distinguish themselves by providing more information (TR at paras. 686 - 690).

29 The Tribunal then reviewed counterarguments to its above findings. The Tribunal did not find significant that some VOW operators in Nova Scotia, which does not have any VOW restrictions, had abandoned their VOWs (TR at para. 693). Likewise, the Tribunal did not find significant the fact that statistics from the National Association of Realtors in the United

States indicated that customers did not value the disputed data fields that highly (TR at para. 694 - 696). The Tribunal noted that in the United States, where sold information was "widely displayed by competitor websites", the National Association of Realtors had started displaying sold information on what appeared to be its official website (TR at para. 700). In addition, the Tribunal was satisfied that the fact that brokers displayed the disputed data when permitted indicated that that information was of value to home buyers; otherwise brokers would not display it (TR at para. 701).

30 The Tribunal stated its conclusion on the magnitude of the effect of the VOW restrictions on competition in the following way:

> [702] For the reasons set forth above, the Tribunal concludes that the VOW Restrictions have adversely affected non-price competition in the Relevant Market to a degree that is material. Indeed, <u>the Tribunal concludes that the aggregate adverse impact of the VOW Restrictions on non-price competition has been substantial, having regard to the considerable negative effect on the range of brokerage services, the negative effect on the quality of service offerings, and the considerable adverse impact on innovation in the Relevant Market</u>. In the absence of an order, this substantial adverse impact is likely to continue. The Tribunal has reached this conclusion despite the fact that, the quantitative evidence on commission rates does not indicate that net commissions for real estate brokerage services were, are or likely would be, materially higher than in the absence of the VOW Restrictions.
>
> (emphasis added)

31 Then, turning to duration and scope, the Tribunal found that, as the VOW restrictions had been in place since 2011, the duration was substantial. Likewise, as the effects were present throughout the GTA, a substantial part of the market was impacted (TR at paras. 703 - 704).

32 Thus, the Tribunal found that all three of the subsection 79(1) requirements had been met and that the VOW restrictions were substantially preventing competition for residential real estate brokerage services in the GTA. At paragraphs 705 to 715 of its reasons, the Tribunal summarized its views on the three elements of subsection 79(1).

33 Turning to copyright, the Tribunal found that TREB did not lead sufficient evidence to demonstrate copyright in the MLS database. Copyright in a database exists where the "selection or arrangement of data" is original (TR at para. 732). The Tribunal found that TREB's evidence did not speak to skill and judgment in compiling the database, but rather illustrated that it was a more mechanical exercise. The Tribunal pointed to many facts including: TREB did not present witnesses on the arrangement of the data; a third party corrects errors in the database; contracts referencing copyright are not evidence that copyright exists; members provide the information which is uploaded "almost instantaneously" to the database; TREB's database is in line with industry norms across Canada; and creating rules on accuracy and quality of the information does not reflect the originality of the work (TR at para. 737).

34 In the alternative, the Tribunal found that, even if TREB had copyright in the database, it would not enjoy the protection offered by subsection 79(5) because TREB's conduct amounted to more than the "mere exercise" of its intellectual property rights (TR at paras. 720 - 721, 746 - 758).

IV. Issues

35 In order to dispose of this appeal, we must determine the three following issues:

> 1. Did the Tribunal err in finding that TREB had substantially reduced competition within the meaning of subsection 79(1) of the Competition Act?
>
> 2. Did the Tribunal err in failing to conclude that TREB's privacy concerns or statutory obligations constituted a business justification within the scope of paragraph 79(1)(b)?
>
> 3. Does subsection 79(5) of the Competition Act preclude TREB and CREA from advancing a claim in copyright in the MLS database? If not, did the Tribunal err in its consideration of TREB's claim of copyright?

V. Analysis

A. Standard of Review

36 Before addressing the three issues, a few words on the standard of review are necessary.

37 There is a statutory right of appeal to this Court from decisions of the Tribunal. Subsection 13(1) of the Competition Tribunal Act, R.S.C. 1985 (2nd Supp.), c. 19 (*Competition Tribunal Act*) provides that any decision or order can be appealed "as if it were a judgment of the Federal Court". In *Canada (Commissioner of Competition) v. CCS Corp.*, 2013 FCA 28, [2014] 2 F.C.R. 352 (F.C.A.) (*Tervita FCA*), our Court held that questions of law arising from decisions of the Tribunal were to be reviewed on the standard of correctness (TR at paras. 53 - 59; see also *Canada (Commissioner of Competition) v. Superior Propane Inc.*, 2001 FCA 104 (Fed.)C.A. at para. 88, [2001] 3 F.C. 185 (Fed. C.A.)). That determination was upheld by the Supreme Court of Canada in *Tervita Corp. v. Canada (Commissioner of Competition)*, 2015 SCC 3, [2015] 1 S.C.R. 161 (S.C.C.) (*Tervita SCC*).

38 As to questions of mixed fact and law, the Supreme Court in *Tervita SCC* also upheld this Court's determination in *Tervita FCA* that such questions were to be determined on the standard of reasonableness. With regard to questions of fact, leave of this Court is required (Competition Tribunal Act, s. 13(2)). In the present matter, no such leave was sought and consequently we cannot interfere with the Tribunal's findings of fact (see *CarGurus, Inc. v. Trader Corporation*, 2017 FCA 181 (F.C.A.) at para. 17; *Nadeau Ferme Avicole Ltée / Nadeau Poultry Farm Ltd. v. Groupe Westco Inc.*, 2011 FCA 188 (F.C.A.) at para. 47, (2011), 419 N.R. 333 (F.C.A.) (*Nadeau Poultry Farm*)).

B. Substantial Reduction in Competition

(1) TREB's and CREA's Submissions

39 TREB submits that the Tribunal erred in finding that the test under subsection 79(1) of the Competition Act was made out. In its view, the Commissioner bore the burden of proving each element of the test and did not discharge that burden on any of the three elements.

40 TREB asserts that since it does not control the relevant market, paragraph 79(1)(a) has not been established.

41 TREB submits that it did not act with the necessary anti-competitive purpose, therefore the Tribunal erred in finding that paragraph 79(1)(b) was made out. In its view, the VOW Policy was meant to allow its members to offer VOWs and thus reach a greater range of potential buyers. The exclusion of some data from the data feed was made for legitimate privacy related reasons.

42 With respect to paragraph 79(1)(*c*), TREB submits that the Tribunal erred in accepting speculative qualitative evidence. Actual quantitative evidence was available and should have been brought forward by the Commissioner. His failure to do so should have led the Tribunal to make an adverse inference against him. CREA, the intervener, agrees with TREB's submissions on these three points.

43 CREA further argues that the Tribunal read out, for all intents and purposes, the requirement of 'substantiality' from the subsection 79(1) test. In its view, statements by brokers are insufficient to establish that access to the disputed data would increase competition substantially. While access to the disputed data may help brokers improve their services, this is not equivalent to a competitive benefit. CREA points to other evidence it claims demonstrates that brokers operating with the current VOW data feed are equally or more competitive than those with access to more data. Furthermore, CREA asserts that there is no proven link between broker success and receiving more data.

(2) The Commissioner's Submissions

44 The Commissioner asserts that TREB's policies regarding the disputed data comprise at least three acts that constitute an anti-competitive practice, as quoted by the Tribunal at paragraph 320 of its reasons:

i. The exclusion of the Disputed Data from TREB's VOW Data Feed;

ii. Provisions in TREB's VOW Policy and Rules that prohibit Members who want to provide services through a VOW from using the information included in the VOW Data Feed for any purpose other than display on a website; and

iii. Prohibiting TREB's Members from displaying certain information, including the Disputed Data, on their VOWs... This prohibition is reinforced by terms in TREB's Data Feed Agreement that limit the use of the MLS data in the VOW Data Feed to a purpose that is narrower than the corresponding provision in the [authorized user agreement] that applies to Members using the Stratus system...

45 In other words, the Commissioner argues that it is anti-competitive to prohibit the disputed data from being distributed via the data feed.

46 The Commissioner further submits that the Tribunal's paragraph 79(1)(b) analysis is reasonable, entitled to deference, and supported by the evidence. The Tribunal applied the correct legal test, and its finding regarding TREB's purpose in implementing the VOW restrictions is one of fact, and therefore not reviewable on this appeal. In the alternative, the Commissioner submits that the facts indicate that the Tribunal's finding on this point was reasonable. The Tribunal looked at the evidence as a whole and determined that, while privacy concerns were mentioned at TREB's VOW taskforce meetings, they were not a principal motivating factor. Furthermore, this finding turned on a credibility assessment of the testimony of Mr. Richardson, TREB's CEO, which is entitled to deference.

47 Regarding paragraph 79(1)(c), the Commissioner submits that the Tribunal once again applied the correct legal test. TREB and CREA misstate the law when they say that the Commissioner must provide quantitative evidence to prove a substantial lessening or prevention of competition. In the Commissioner's view, this position is not supported by the case law. The Commissioner differentiates *Tervita SCC*, which found quantification necessary for a merger test under a different section of the *Competition Act*, namely subsection 96(1). Indeed, according to the Commissioner, non-price effects such as service quality, range of products, and innovation are not amenable to quantification. The Commissioner submits that TREB and CREA are *de facto* arguing that he has a legal burden to quantify the substantial lessening or preventing of competition. In addition, the Commissioner says that the Tribunal's refusal to draw an adverse inference against him on this point is entitled to deference.

(3) The Abuse of Dominance Framework

48 Subsection 79(1), which is reproduced at paragraph 11 above, sets out the three requirements necessary to establish an abuse of dominant position. The Commissioner bears the burden of establishing each of these elements (*Canada (Commissioner of Competition) v. Canada Pipe Co.*, 2006 FCA 233 (F.C.A.) at para. 46, (2006), 268 D.L.R. (4th) 193 (F.C.A.), leave to appeal to S.C.C. refused, 31637 (10 May 2007) [2007 CarswellNat 1107(S.C.C.)] (*Canada Pipe*)).The burden of proof with respect to each element is the balance of probabilities (*Canada Pipe* at para. 46; TR at para. 34).

49 Once the Commissioner establishes each element of subsection 79(1), the person or persons against whom the Commissioner's proceedings are directed, in this case TREB, can avoid sanction if they demonstrate that the impugned practice falls under one of the statutory exemptions. The only provision relevant to this case is subsection 79(5) of the Competition Act, which states that "an act engaged in pursuant only to the exercise of any right or enjoyment of any interest" derived under certain legislation pertaining to intellectual or industrial property, including the Copyright Act, R.S.C., 1985, c. C-42 (Copyright Act), is not an anti-competitive act.

50 TREB says, in its written submissions, that it "does not control the relevant market(s)" (TREB's Memorandum of Fact and Law at para. 66). However, this is the extent of its submissions on the issue. As TREB's substantive arguments clearly focus on paragraphs 79(1)(b) and (c), we continue on to examine in more depth the requirements of those provisions.

(4) Paragraph 79(1)(b)

51 Paragraph 79(1)(b) requires that the person or persons "have engaged in or are engaging in a practice of anti-competitive acts". There is no dispute that TREB's VOW policies constitute a practice. An indicative list of anti-competitive acts is provided in the *Competition Act* at section 78. None of those acts are directly relevant to this appeal. However, that list is non-exhaustive.

52 This Court in *Canada Pipe* found that an anti-competitive act is defined by reference to its purpose. Drawing on the Tribunal's decision in *Canada (Director of Investigation & Research) v. NutraSweet Co.* (1990), 32 C.P.R. (3d) 1 (Competition Trib.) (*NutraSweet*), this Court said that the requisite purpose is "an intended predatory, exclusionary or disciplinary negative effect on a competitor" (*Canada Pipe* at paras. 66, 74. See also NutraSweet at page 34).

53 To be more precise, *NutraSweet* pointed out that the "purpose common to all acts [listed in section 78], save that found in paragraph 78(f), is an intended negative effect on a competitor that is predatory, exclusionary or disciplinary" (at page 34). Indeed, paragraph 78(1)(f) cannot apply to a competitor, as it reads:

> 78 (1) For the purposes of section 79, *anti-competitive act*, without restricting the generality of the term, includes any of the following acts:
>
> . . .
>
> (*f*) buying up of products to prevent the erosion of existing price levels;

54 In *TREB FCA 1*, Sharlow J.A. determined that the 'on the competitor' language from *NutraSweet* and *Canada Pipe* could not mean 'on a competitor of the person accused of anticompetitive practices' (at paras. 19 - 20). On that premise, requiring a predatory, exclusionary, or disciplinary negative effect on a competitor in all cases would render paragraph 78(1)(f) meaningless. Paragraph (*f*) reflects a self-serving intent, not a relative one intended to harm a competitor. Yet it has been defined by Parliament to constitute an anti-competitive act.

55 With this in mind, we believe that the Tribunal applied the correct framework with respect to paragraph 79(1)(b). The Tribunal stated that it was looking for a predatory, exclusionary, or disciplinary effect on a competitor (TR at para. 272). Acting on the direction given by *TREB FCA 1*, the Tribunal defined competitor to mean "a person who competes in the relevant market, or who is a potential entrant into that market" and not a "competitor" of TREB (TR at para. 277).

56 The Tribunal correctly noted that subjective or objective intent could be used to demonstrate the requisite intent (TR at paras. 274, 283; *Canada Pipe* at para. 72). It closely scrutinized the evidence of TREB's subjective intent (TR at paras. 319 - 431). The Tribunal also looked to the "reasonably foreseeable or expected objective effects of the act (from which intention may be deemed...)" (TR at paras. 432 - 451) as instructed by *Canada Pipe* at para. 67 (see also *Tele-Direct (Publications) Inc. v. American Business Information Inc.* (1997), [1998] 2 F.C. 22, 154 D.L.R. (4th) 328 (Fed. C.A.), leave to appeal refused, 26403 (21 May, 1998) [1998 CarswellNat 3212(S.C.C.)] (*Tele-Direct*)). The Tribunal conducted a balancing exercise between the exclusionary effects (evidenced by subjective intent) and TREB's alleged legitimate business justifications (TR at paras. 319 - 431; *Canada Pipe* at para. 73).

57 The application of this test to the facts is a question of mixed law and fact. Ultimately, the Tribunal found that "the evidence of subjective anti-competitive intent and reasonably foreseeable exclusionary effects outweighs the very limited evidence that was adduced in support of the alleged legitimate business justifications that TREB claims underpinned the development and implementation of the VOW Restrictions" (TR at para. 452). This is a very fact-driven analysis. The Tribunal weighed the evidence, heard competing witnesses, and made findings of credibility. We see no error that would make this analysis unreasonable.

(5) Paragraph 79(1)(c)

58 Paragraph 79(1)(c) requires that "the practice has had, is having or is likely to have the effect of preventing or lessening competition substantially in a market" (underlining added). The market in question is not contested. The Tribunal defined the

market to be "the supply of MLS- based residential real estate brokerage services in the GTA" (TR at para. 161). We now turn to address the five other elements, as underlined above, in turn.

(a) The Practice

59 The Commissioner's Notice of Application was filed in May 2011, before TREB's current VOW Policy and Rules were in place. In November 2011, TREB enacted its new rules. The Commissioner accordingly amended her Statement of Claim. Nonetheless, the Statement of Claim remains broadly worded and does not specify which particular parts of TREB's rules and policies the Commissioner is impugning.

60 The alleged anti-competitive practices relate to what TREB does with some of the data from the MLS system and what TREB allows its members to do with this data. This "disputed data" is defined by the Tribunal, at paragraph 14 of its reasons, to include four types of information:

- sold data
- pending sold data
- withdrawn, expired, suspended, or terminated listings ("WESTs")
- offers of commission to the successful home buyer's real estate broker, also called the cooperating broker.

The utility of this data is described in the Tribunal's reasons at paragraphs 675 to 691, which fall within the "Substantiality" section of the reasons.

61 The parties' submissions and the evidence centred almost entirely on three particular practices, which the Tribunal collectively refers to as the "VOW Restrictions" (TR at para. 14). Those practices were the focus of the Tribunal's reasons and, after separate written and oral submissions on remedy, these restrictions remained the focus of the Tribunal's order. The following chart provides an overview of the restrictions, as listed in the Tribunal's reasons at paragraph 14, and their sources.

Restriction	**Source**
The exclusion of the disputed data from the VOW Datafeed	Policy articles 17, 15, 24
The prohibition on the display of the disputed data on a VOW	Rule 823; Datafeed Agreement clause 6.3(a)
The prohibition on the use of the VOW Datafeed information for any purpose other than display on a website	Datafeed Agreement clause 6.2(f), (g)

62 It is worth noting that the following TREB rules and policies are *not* affected by the Tribunal's order.

Restriction	**Source**
An individual needs the permission of their broker of record to establish a VOW	Datafeed Agreement clause 6.3(g)
Before viewing listing information on a VOW, a consumer must enter a lawful broker-consumer relationship with the brokerage; this includes agreeing to terms and conditions acknowledging entering into such a relationship and declaring that the consumer has a bona fide interest in the purchase, sale or lease of residential real estate	Rules 805, 809(i), (iii)
	Policy articles 1, 6, 7(iii)
Any listings other than TREB's MLS listings must be labelled as such and searched separately by consumers	Rules 828, 829

(b) Temporal Requirement

63 The temporal aspect of paragraph 79(1)(c) is not in issue. The effect on competition can be past, present, or future (*Canada Pipe* at para. 44) The Tribunal found that the VOW restrictions had anti-competitive effects in the past, present and future (TR at para. 706).

64 A duration of two years will usually be sufficient to establish an effect (*Tervita FCA* at para. 85). Here, TREB's VOW restrictions came into force in November 2011 and the Tribunal found the anti-competitive effects had been occurring for a substantial period of time (TR at paras. 703, 708).

(c) Preventing or Lessening

65 Paragraph 79(1)(c) refers to either a prevention and/or lessening of competition. The Tribunal found a prevention of competition (TR at para. 705). This means that there is no past time that the Tribunal can look at to compare with the present: the Tribunal must look at the present state of competition compared to a hypothetical world in which the VOW restrictions did not exist. This approach is not contested.

(d) Competition

66 Paragraph 79(1)(c) looks to the level of competition, as opposed to any effects of the behaviour on competitors (*Canada Pipe* at paras. 68 - 69). A "but for" inquiry is an acceptable method of analysis (*Canada Pipe* at paras. 39 - 40). This is a relative assessment: the current intensity of competition is not relevant in isolation.

67 Two questions must be asked regarding the nature of the competition element. The first is: competition for what? Here, the relevant competition is over real estate brokerage clients (TR at paras. 645 - 646). It is important to distinguish this competition from other, related, competition: for example, all websites want to attract web traffic in order to compete for advertising dollars.

68 Second, we must ask: competition between whom? This case is about competition in the "the supply of MLS-based residential real estate brokerage services in the GTA" (TR at para. 161). In order to supply MLS-based services, a broker must be a member of TREB. Therefore, we are really discussing competition between segments of TREB members.

69 The use of imprecise terminology sometimes makes it difficult to distinguish between competing TREB members. The Tribunal uses the terms "full information VOW-based brokerages" or "full information VOW brokerages" in contrast to "traditional 'bricks-and-mortar' brokerages." The Commissioner uses the terms "genuine VOWs" and "innovative brokers" in contrast to "VOWs." Dr. Vistnes, the Commissioner's expert witness, uses the terms "innovative VOW-based brokers" or "VOW-based brokers" in contrast with "traditional brick-and-mortar brokers."

70 However, for the purpose of the legal analysis required by paragraph 79(1)(c), the current competition between any two groups is not important *per se*. Rather, it is the general competition in the defined market between all participants now (with the VOW restrictions) and in the hypothetical "but for" world (without the VOW restrictions).

(e) Substantiality

71 The final element requiring elaboration is substantiality: the difference between the present and "but for" worlds must be substantial (*Canada Pipe* at para. 36). In its reasons, the Tribunal addressed substantiality in a separate section of its reasons (TR at paras. 640 - 704).

(i) Overview of the Evidence on Paragraph 79(1)(c)

72 There were eight expert reports in evidence before the Tribunal, four from the initial hearing in 2012 and four from the redetermination hearing in 2015.

73 Generally, the Tribunal found the evidence of the Commissioner's expert Dr. Vistnes to be credible and persuasive. However, on the particular issue of 79(1)(*c*) the Tribunal found that his evidence had missed the mark, saying that "Dr. Vistnes did not have a good understanding of the legal test for what constitutes a 'substantial' prevention or lessening of competition, as contemplated by paragraph 79(1)(c) of the Act. For this reason, the Tribunal refrained from accepting Dr. Vistnes' evidence on that particular issue" (TR at para. 108).

74 The Tribunal found Dr. Church, called by TREB, "to be less forthright, objective and helpful than Dr. Vistnes or Dr. Flyer." The Tribunal also found Dr. Church "to be evasive at several points during his cross-examination and to have made unsupported, speculative assertions at various points in his testimony and in his written expert reports" (TR at para. 109). Dr. Church's evidence on the issue of whether the prevention of competition was "substantial" is neither referred to nor mentioned in the Tribunal's reasons.

75 The Tribunal found Dr. Flyer, called by CREA, to be generally objective and forthcoming. However, it also found that "his testimony often remained general and high-level, and that he did not immerse himself in the details of the Canadian real estate industry and in the specific evidence and matters at issue in this proceeding to the same degree as Dr. Vistnes and Dr. Church" (para. 110) (We note, parenthetically, that given the Tribunal's view of Dr. Church's evidence, the criticism of Dr. Flyer on the basis that his evidence was not as detailed as Dr. Church is somewhat incongruous.) Dr. Flyer focused on the economic impact of the requested remedy on CREA, with considerable attention to the impact on CREA's trademarks. In our view, his reports are of little help in analyzing paragraph 79(1)(c).

76 In addition, there are a total of 23 witness statements from 15 witnesses. The names and the firms of the witnesses whose testimonies (and statements) are most relevant to the Tribunal's determination of substantial prevention of competition are the following:

- William McMullin, Chief Executive Officer of ViewPoint Realty Services Inc. (Viewpoint)
- Shayan Hamidi and Tarik Gidamy, co-founders of TheRedPin.com Realty Inc. (TheRedPin)
- Joel Silver, Managing Director of Trilogy Growth, LP (Trilogy)
- Mark Enchin, Sales Representative of Realty Executives Plus Ltd. (Realty Executives)
- Scott Nagel, Chief Executive Officer of Redfin Corporation (Redfin)
- Sam Prochazka, Chief Executive Officer of Sam & Andy Inc. (Sam & Andy)
- Urmi Desai and John Pasalis, co-founders of Realosophy Realty Inc. (Realosophy)

77 TREB and CREA do not challenge the admissibility of the statements and testimonies of the lay witnesses on which the Tribunal relies for the findings which form the basis of its conclusion that the anti-competitive effects resulting from the VOW restrictions lead, or are likely to lead, to a substantial prevention of competition in the GTA. Nevertheless, we believe that some guidance with respect to the evidence of lay witnesses in the context of a case like the one now before us might be useful.

78 Generally, the evidence of lay witnesses is limited to facts of which they are aware (David Paciocco and Lee Stuesser, *The Law of Evidence*, 7th ed. (Toronto: Irwin Law, 2015) at 195; Ron Delisle et al, *Evidence: Principles and Problems*, 11th ed. (Toronto: Thompson Reuters, 2015) at 874). This principle is reflected in Rules 68(2) and 69(2) of the Competition Tribunal Rules, SOR/2008-141, which are identical, and read "[u]nless the parties otherwise agree, the witness statements shall include only fact evidence that could be given orally by the witness together with admissible documents as attachments or references to those documents".

79 However, opinion evidence from lay witnesses is acceptable in limited circumstances: where the witness is in a better position than the trier of fact to form the conclusions; the conclusions are ones that a person of ordinary experience can make;

the witnesses have the experiential capacity to make the conclusions; or where giving opinions is a convenient mode of stating facts too subtle or complicated to be narrated as facts (*R. v. Graat*, [1982] 2 S.C.R. 819 (S.C.C.) at 836 - 839, (1982), 144 D.L.R. (3d) 267 (S.C.C.); *Hunt (Litigation Guardian of) v. Sutton Group Incentive Realty Inc.* (2002), 60 O.R. (3d) 665 (Ont. C.A.) at para. 17, (2002), 215 D.L.R. (4th) 193 (Ont. C.A.), quoting with approval Alan W. Bryant, Sidney N. Lederman & Michelle K. Fuerst, *The Law of Evidence in Canada*, 4th ed. (Markham, ON: LexisNexis Canada, 2014) at 12.14. See also Paciocco and Stuesser, ibidat 197 - 198 and Delisle et al, ibid at 874 - 876).

80 The question of opinion evidence given by lay witnesses was recently addressed by this Court in *Pfizer Canada Inc. v. Teva Canada Ltd.*, 2016 FCA 161, 400 D.L.R. (4th) 723(F.C.A.), where Stratas J.A., writing for this Court, upheld the Federal Court's acceptance of a corporate executive's testimony about what his pharmaceutical company would have done in the "but for" world in circumstances where the witness had actual knowledge of the company's relevant, real world, operations (at paras. 105 - 108, 112, 121).

81 Nevertheless, we think it is clear that lay witnesses cannot testify on matters beyond *their own conduct* and that of *their businesses* in the "but for" world. Lay witnesses are not in a better position than the trier of fact to form conclusions about the greater economic consequences of the "but for" world, nor do they have the experiential competence. While questions pertaining to how their particular business might have responded to the hypothetical world are permissible provided the requisite evidentiary foundation is established, any witness testimony regarding the impact of the VOW restrictions on competition generally strays into the realm of inappropriate opinion evidence.

(ii) Substantiality Analysis

82 Before addressing this important issue, it will be helpful to consider what the Supreme Court and this Court have said in regard to the expression "the effect of preventing or lessening competition substantially" found in paragraph 79(1)(c) of the Competition Act and the test relevant to a determination of substantial lessening or prevention of competition.

83 First, in *Tervita SCC*, albeit in the context of the merger provisions of the *Competition Act*, the Supreme Court made the following comments at paragraphs 44 to 46 of its reasons:

> [44] Generally, a merger will only be found to meet the "lessen or prevent substantially" standard where it [here, the "it" means the practice at issue] is "likely to create, maintain or enhance the ability of the merged entity to exercise market power, unilaterally or in coordination with other firms". Market power is the ability to "profitably influence price, quality, variety, service, advertising, innovation or other dimensions of competition. Or, in other words, market power is "the ability to maintain prices above the competitive level for a considerable period of time without such action being unprofitable"; where "price" is "generally used as shorthand for all aspects of a firm's actions that have an impact on buyers. If a merger does not have or likely have market power effects, s. 92 will not generally be engaged
>
> (references omitted)
>
> [45] The merger's likely effect on market power is what determines whether its effect on competition is likely to be "substantial". Two key components in assessing substantiality under the "lessening" branch are the degree and duration of the exercise of market power (*Hillsdown* at pp. 328-29). There is no reason why degree and duration should not also be considered under the "prevention" branch.
>
> [46] What constitutes "substantial" will vary from case to case. The Tribunal has not found it useful to apply rigid numerical criteria:
>
>> What will constitute a likely "substantial" lessening will depend on the circumstances of each case. ...Various tests have been proposed: a likely 5% price rise sustainable for one year; a 5% price rise sustainable over two years; a small but significant and non-transitory price rise. The Tribunal does not find it useful to apply rigid numerical criteria although these may be useful for enforcement purposes.

(*Hillsdown*, at pp. 328-329)

(emphasis added)

84 Then, at paragraphs 50 to 51 of *Tervita SCC*, the Supreme Court indicated that the words of paragraph 79(1)(c) of the Competition Act and those of subsection 92(1) were similar and thus conveyed the same idea:

> [50] *Canada Pipe* was a case involving abuse of dominance under s. 79(1)(*c*) of the Act. The words of s. 79(1)(*c*) - "is having or is likely to have the effect of preventing or lessening competition substantially in a market" - are very close to the words of s. 92(1) - "likely to prevent or lessen" - and convey the same ideas. In *Canada Pipe*, the Federal Court of Appeal employed a "but for" test to conduct the inquiry:
>
>> ... the Tribunal must compare the level of competitiveness in the presence of the impugned practice with that which would exist in the absence of the practice, and then determine whether the preventing or lessening of competition, if any, is "substantial"....
>>
>> The comparative interpretation described above is in my view equivalent to the "but for" test proposed by the appellant. [paras. 37-38]
>
> [51] A similar comparative analysis is conducted under s. 92(1). A merger review, by its nature, requires examining a counterfactual scenario: "... whether the merger will give the merged entity the ability to prevent or lessen competition substantially compared to the pre-merger benchmark or 'but for' world" (Facey and Brown, at p. 205). The "but for" test is the appropriate analytical framework under s. 92.

85 Lastly, at paragraph 60 of its reasons in *Tervita SCC*, the Supreme Court made the following remarks regarding the "but for" test:

> [60] The concern under the "prevention" branch of s. 92 is that a firm with market power will use a merger to prevent competition that could otherwise arise in a contestable market. The analysis under this branch requires looking to the "but for" market condition to assess the competitive landscape that would likely exist if there was no merger. <u>It is necessary to identify the potential competitor, assess whether but for the merger [here "but for" the anti-competitive practice] that potential competitor is likely to enter the market and determine whether its effect on the market would likely be substantial.</u>
>
> (emphasis added)

86 In *Canada Pipe*, at paragraphs 36 to 38 and 45 to 46, this Court, in addressing the test required to make a determination under paragraph 79(1)(c), observed that the test is relative in nature. Rather than assessing the absolute level of competition in the market the Tribunal must assess the level of competition in the presence of the impugned practice and compare this with the level of competition that would exist in the absence of the practice. This difference can occur in the past, present or future and the test will be made out where the difference is substantial. This Court noted that it is the role of the Tribunal to adapt this assessment to the case before it.

87 At paragraph 46 of *Canada Pipe*, this Court explicitly indicated that it was not dictating the type of evidence required, rather it wrote: "Ultimately, the Commissioner bears the burden of proof for each requisite element, and the Tribunal must be convinced on the balance of probabilities. The evidence required to meet this burden can only be determined by the Tribunal on a case-by-case basis."

88 It is clear from *Canada Pipe* that what will constitute a "substantial" lessening or prevention of competition depends on the facts of the case and that the Tribunal is not bound to apply a particular test in determining the issue. However, it is clear that in order for the Tribunal to find that a substantial lessening of competition has been established, it must be able, on the evidence before it, to conclude that were it not for the anti-competitive effects of the practice at issue, the market at issue would

be substantially more competitive. In other words, in the present matter, would there be a substantial incremental benefit to competition arising from the availability of the disputed data in TREB's VOW data feed?

89 In the present matter the Tribunal turned its mind to both the meaning of "substantiality" and the appropriate test to be applied. The Tribunal noted, at paragraph 461 of its reasons, that substantiality is an assessment of the exercise of market power. Market power, as the Tribunal defines it in paragraph 165 of its reasons, is the ability to control either prices or non-price dimensions of competition for a significant time. Non-price dimensions of competition include innovation and quality of service, among others.

90 At paragraph 480 of its reasons, the Tribunal acknowledges that the test for substantiality is relative in nature. That is, the Tribunal is to compare the level of competition that exists in the actual world with the level of competition that would exist, but for, the impugned practices. The test then, is to assess whether the difference between these two worlds is substantial. The Tribunal indicates that this test will be met where either price is materially higher, or one or more non-price dimension are materially lower than in the absence of the practices.

91 In making this assessment the Tribunal will have regard to the overall economic conditions of the relevant market. As explained in paragraph 468 of its reasons, this means that the duration of the impact will be considered along with the relative size of impact to determine whether the impact is substantial.

92 In our view, the Tribunal correctly understood the significance of the word "substantially" and the test which it had to apply in determining whether or not, on the facts of this case, TREB's practice regarding the disputed data was a practice which had the effect of preventing competition substantially in the GTA.

93 With these comments in mind, we now turn to TREB's and CREA's submissions as to why we should intervene. Their principal submission on substantiality is that it was improper for the Tribunal to determine whether the anti-competitive effects led to a substantial prevention of competition on the basis of qualitative evidence only. In their view, this led the Tribunal to determine the issue on "speculative opinion evidence unsupported by available empirical evidence" (TREB's Memorandum of Fact and Law at para. 14).

94 In making this submission, TREB and CREA put forward two arguments. The first is that in *Tervita SCC*, the Supreme Court held that the Commissioner had an obligation to quantify any quantifiable anti-competitive effect and that failure to do so would prevent him from relying on qualitative evidence in respect of effects which could have been quantified. Thus, in the view of TREB and CREA, anti-competitive effects can be considered qualitatively by the Tribunal only if they cannot be quantitatively estimated.

95 TREB and CREA further say that the Tribunal erred in concluding (TR, 469 - 470) that the aforementioned principle, enunciated by the Supreme Court in *Tervita SCC* at paragraph 124 of its reasons, did not apply to a determination made under section 92 of the Competition Act or under subsection 79(1) thereof. In other words, they submit that the Tribunal erred in finding that the Supreme Court's holding in *Tervita SCC*, on which TREB and CREA rely, was limited to determinations under subsection 96(1).

96 More particularly, TREB and CREA say that the rationale underlying the Supreme Court's statement of principle in *Tervita SCC* not only applies to determinations under subsection 96(1), but also to determinations arising under both section 92 and subsection 79(1). In support of this view, they rely on that part of paragraph 124 of *Tervita SCC* which we have underlined herein below.

> [124] The Commissioner argues that quantification is not a legal prerequisite to considering anti-competitive effects (R.F., paras. 84 and 88). On the contrary, the Commissioner's legal burden is to quantify the quantifiable anti-competitive effects upon which reliance is placed. Where effects are measurable, they must be estimated. Effects will only be considered qualitatively if they cannot be quantitatively estimated. A failure to quantify quantifiable effects will not result in such effects being considered qualitatively (*Superior Propane IV*, at para. 35). <u>This approach minimizes the degree of subjective judgment necessary in the analysis and enables the Tribunal to make the most objective assessment possible in the</u>

circumstances (*Superior Propane IV*, at para. 38). An approach that would permit the Commissioner to meet her burden without at least establishing estimates of the quantifiable anti-competitive effects fails to provide the merging parties with the information they need to know the case they have to meet.

(emphasis added)

97 TREB's and CREA's second argument is that the Tribunal should have drawn an adverse inference against the Commissioner by reason of his failure to adduce empirical evidence concerning competition on price and dynamic competition in markets (United States and Nova Scotia) where full information VOWs exist and in respect of which it was possible to measure the actual effects on competition. They say that the Commissioner deliberately decided not to perform a quantitative analysis of competition effects in these markets. More particularly, TREB and CREA argue that the Tribunal should have drawn the only inference possible resulting from the Commissioner's failure to adduce quantitative evidence, "namely that there was no substantial prevention or lessening of competition, dynamic or otherwise, that could be demonstrated on a balance of probabilities" (TREB's Memorandum of Fact and Law at para. 77).

98 TREB and CREA then address the reasons given by the Tribunal for not drawing an adverse inference against the Commissioner, namely that the Commissioner had to be prudent with regard to the spending of the funds under his authority and because of Dr. Vistnes' advice to the Commissioner that a study of the United States' experience would constitute a difficult and expensive endeavour that would likely not yield useful answers. (TREB and CREA say that Dr. Vistnes' testimony on this point constitutes an off the cuff response to a question posed by the Tribunal during the hearing). TREB and CREA say that the reasons given by the Tribunal for refusing to draw the adverse inference are improper and cannot be right.

99 In our respectful view, TREB's and CREA's submissions cannot succeed. First in *Tervita SCC*, the Supreme Court did not, contrary to TREB's and CREA's assertion, make any pronouncement pertaining to section 92 of the Competition Act regarding the necessity of quantifying effects which could be quantified. To the contrary, at paragraph 166 of its reasons in *Tervita SCC*, the Supreme Court indicated that there was no obligation on the part of the Commissioner to quantify anti-competitive effects under section 92:

> [166] It may seem paradoxical to hold that the Tribunal was correct in finding a likely substantial prevention of competition, only to then conduct the s. 96 balancing test and find zero anti-competitive effects. However, this result merely appears paradoxical in view of the particular facts of this case. Here, as discussed above, the Tribunal was able to consider evidence as to the effect on the market of the emergence of likely competitors, whether acceptable substitutes existed, and so on. Section 93 expressly permits the consideration of these factors in and of themselves. Ordinarily, the Commissioner would also use the evidence bearing on those factors to quantify the net effect of those factors on the economy in the form of deadweight loss. However, the statutory scheme does not bar a finding of likely substantial prevention where there has been a failure to quantify deadweight loss, and thus the Commissioner's failure to do so in this case was not fatal to the s. 92 determination. By contrast, the balancing test under s. 96 does require that quantifiable anti-competitive effects be quantified in order to be considered. As such, the failure to quantify deadweight loss in this case barred consideration, under s. 96, of the quantifiable effects that supported a finding of likely substantial prevention under s. 92. In circumstances where quantifiable effects were in fact quantified, a finding of likely substantial prevention under s. 92 would be accompanied by the consideration of quantified anti-competitive effects under the s. 96 analysis.
>
> (emphasis added)

100 Although we agree, as a matter of logic, that the Supreme Court's rationale in *Tervita SCC* for requiring that quantifiable effects be quantified could equally be applied to determinations made under both subsection 79(1) and section 92, there can be no doubt that the Supreme Court made it clear, at paragraph 166 cited above, that the principle did not apply to section 92. That being the case, we have no choice but to hold that the principle requiring quantification of quantifiable effects cannot be applied to subsection 79(1). Had it been open to us to decide the issue afresh, we would have held that the principle applied to determinations under subsection 79(1).

101 Consequently, TREB and CREA cannot succeed on their assertion that the Commissioner, in seeking a determination under subsection 79(1), had a legal obligation to quantify all effects which could be quantified. On the basis of *Tervita SCC*, the Commissioner did not have such an obligation.

102 We now turn to the Tribunal's refusal to make the adverse inference against the Commissioner which TREB and CREA sought because the Commissioner had failed to provide an empirical assessment "of the incremental effect of sold and other Disputed Data in increasing a full-information VOW operator's ability to generate clients" (TR at para. 653). This submission, in our respectful view, is also without merit.

103 To begin, we agree with the Commissioner that TREB's and CREA's argument is tantamount to arguing that the Commissioner had a legal burden to adduce quantifiable evidence. As we have just indicated, no such obligation arises under subsection 79(1).

104 Considering that the Commissioner had no such legal obligation, he, like any other plaintiff, had to decide what evidence he had to put forward to prove his case. As we know, he chose to do so by way of qualitative evidence and in so doing, he took the risk of failing to persuade the Tribunal that the anti-competitive effects of TREB's practice resulted in a substantial prevention of competition. As it turned out, the Tribunal was persuaded by the qualitative evidence adduced by the Commissioner.

105 We have carefully considered the case law and cannot see any basis to accept TREB's and CREA's proposition that the Tribunal ought to have drawn an adverse inference against the Commissioner for failing to conduct an empirical assessment of markets in the United States and in Nova Scotia, or for that matter in the GTA. That, in our respectful view, would be akin to giving the Tribunal the power to dictate to the Commissioner how he should present his case. There is no authority for such a proposition.

106 We agree with TREB and CREA in one respect. Had there been a valid basis to draw an adverse inference against the Commissioner, the reasons for refusing to draw the inference given by the Tribunal would clearly not have withstood scrutiny. The fact that the Commissioner has limited funds to spend may be a reality, but it is of no relevance to a determination of whether or not an adverse inference should be made. As to Dr. Vistnes' view with regard to the utility and cost of producing an empirical assessment, that, in our view, is also an irrelevant consideration. Whether the study would have been useful is a matter which the Tribunal would have had to appreciate and determine. It was clearly not up to Dr. Vistnes to make that determination. In any event, it is doubtful that Dr. Vistnes could provide that opinion to the Tribunal as it does not appear in his expert reports. However, as we are satisfied that there was no basis to draw the inference sought by TREB and CREA, the reasons given by the Tribunal, even though misguided, are of no consequence.

107 Additionally, it should be remembered that in *I.B.E.W., Local 894 v. Ellis-Don Ltd.*, 2001 SCC 4 (S.C.C.) at paragraph 73, [2001] 1 S.C.R. 221 (S.C.C.), the Supreme Court made the following point: "Whether or not an adverse inference is warranted on particular facts is bound up inextricably with the adjudication of the facts" (see also *Benhaim v. St-Germain*, 2016 SCC 48 (S.C.C.) at para. 52, [2016] 2 S.C.R. 352 (S.C.C.)). Thus, the Tribunal's refusal to draw an inference against the Commissioner is subject to the standard of reasonableness. We see no basis to conclude that the Tribunal's refusal to draw the inference is unreasonable.

108 TREB and CREA make a further submission regarding the Tribunal's determination that the prevention of competition was substantial. They say that, in any event, it was an error for the Tribunal to rely on evidence which they characterize as speculative qualitative evidence. At paragraph 75 of its Memorandum of Fact and Law, TREB defines quantitative evidence as "empirical evidence of the actual effect of certain impugned acts on competition in an existing real estate market" and defines qualitative evidence as "a reference essentially to opinion and anecdotal evidence of what might happen in the market if certain acts are permitted or not permitted".

109 More particularly (the argument which we now explain is one put forward mainly by CREA), they make four points. First, they say that the Tribunal erred in concluding, on the basis of statements made by brokers to the effect that they needed the disputed data in their VOWs so as to improve their offerings to the public and that their clients, i.e. buyers and sellers,

valued the opportunity of accessing the disputed data on their VOWs, that the availability of the disputed data would result in a substantial incremental competition benefit.

110 In TREB's and CREA's view, the Tribunal's conclusion on substantiality which results from its finding with respect to the anti-competitive effects of TREB's practice was tantamount to reading out the word "substantial" from the statutory provision. They say that, at best, the aforementioned witness statements constitute evidence of "an effect" on competition but clearly not of a substantial incremental competition benefit arising from the availability of the disputed data on the VOWs.

111 Second, TREB and CREA say that it was an error on the part of the Tribunal to find, on the basis of the evidence of William McMullin, that Viewpoint was prevented from entering the GTA market because of the unavailability of the disputed data. They say that Mr. McMullin's evidence on this point, in light of the overall evidence, was not credible adding that, in any event, the Tribunal erred in finding that Viewpoint's entry into the GTA would have had a substantial competitive effect considering that Viewpoint was less competitive (if one considers Viewpoint's commission rates and lack of rebates) in terms of price than other brokerages such as Realosophy and TheRedPin.

112 Third, TREB and CREA say that the Tribunal made a further error in finding that the Commissioner had met his burden of proof on the basis of qualitative benefits asserted by brokers when the evidence showed that brokers operating in the GTA with VOWs fed by TREB's VOW data feed (i.e. without the disputed data) were equally or more competitive than brokers operating on a data feed that included some of the disputed data.

113 Fourth, TREB and CREA say that the Tribunal also erred in finding that a substantial prevention of competition had been demonstrated by the Commissioner because there was a lack of evidence showing a link between the success of brokerages such as Redfin and Viewpoint and the availability of the disputed data in a VOW. In making this point, TREB and CREA argue that it was clear from the evidence that there was no causal relationship between being able to convert website users into clients and the availability of the disputed data on one's VOWs.

114 TREB and CREA conclude on this point by saying that the evidence regarding conversion rates was extremely important because the purpose of designing attractive websites was to convert viewers into clients.

115 TREB and CREA also point out that after finding that the evidence regarding conversion rates did not support the Commissioner's case, the Tribunal downplayed the importance of conversion rates on the basis of Dr. Vistnes' opinion that local differences in the markets under consideration probably explained why the conversion rates were low. TREB and CREA say that there was no evidence of these local differences before the Tribunal on which Dr. Vistnes could give the opinion that he gave. Dr. Vistnes' opinion, in their view, was entirely speculative.

116 Finally, TREB and CREA conclude their arguments regarding conversion rates by saying that even though the Tribunal refused to give any weight to the evidence showing low conversion rates, it nonetheless found, at paragraph 676 of its reasons, that if the disputed data was made available on TREB's data feed, web based brokerages would likely be successful in converting "an increasing and significant number of website users into clients".

117 To place TREB's and CREA's arguments in perspective, it is important to point out that the Tribunal understood the difference in nature between quantitative and qualitative evidence and that it recognized that it was more difficult for the Commissioner to prove his case on the basis of mostly qualitative evidence. The Tribunal indicated that in a case like the one before it, which pertained mostly to dynamic competition, it was inevitable that the Commissioner would have to rely on qualitative evidence in the form of business documents, witness statements, and testimonies, adding, however, that it remained the Commissioner's burden to prove his case on a balance of probabilities (TR at paras. 469 - 471).

118 On the basis of the qualitative evidence put forward by the Commissioner and in particular on the basis of the witness statements and testimonies of the persons referred to at paragraph 76 of these reasons, namely Messrs. McMullin, Hamidi, Gidamy, Silver, Enchin, Prochazka, Desai, and Pasalis, the Tribunal made findings of a number of anti-competitive effects caused by the VOW restrictions. In each case, the Tribunal found both that an anti-competitive effect existed and emphasized the relative significance of that effect as follows:

- The prevention of a considerably broader range of broker services in the GTA (TR at para. 583)

- The prevention of an increase in the quality of these services in a significant way (TR at para. 598)

- The prevention of the advent of considerably more innovation (TR at para. 616)

- The significant adverse impact on entry into, and expansion within the relevant market (TR at para. 550)

119 It was the Tribunal's opinion that "but for" the VOW restrictions these anti-competitive effects would be considerably lower. At paragraph 702 of its reasons, the Tribunal concluded that when considered in the aggregate, these anti-competitive effects on non-price dimensions amounted to a substantial prevention of competition.

120 In other words, the Tribunal held that the ultimate consequence of the anti-competitive effects found to exist was the maintenance of TREB and its members' collective market power in respect of residential brokerage services in the GTA (TR at para. 709) and that failing an order on its part, that market power would likely continue (TR at para. 712).

121 In our view, TREB's and CREA's arguments regarding the Tribunal's reliance on qualitative evidence are without merit.

122 First, it is clear that most of the points which TREB and CREA make on this issue are to the effect that many of the Tribunal's crucial findings are not supported by the evidence. This is particularly so in regard to their criticism of Mr. McMullin's evidence and in regard to Viewpoint's entry into the GTA. Although we have some misgivings in regard to a number of the findings made by the Tribunal, it must be remembered that these findings result from the Tribunal's assessment of the evidence before it. The same goes with respect to the weight which the Tribunal gave to that evidence. As we have already indicated, TREB and CREA, not having sought leave to challenge questions of fact on this appeal, cannot pursue this line of attack. TREB and CREA, without so saying, are inviting us to reassess the evidence before the Tribunal and to make different findings. We clearly cannot do so. Further, as this Court indicated in *Nadeau Poultry Farm* at paragraph 47, parties cannot "under cover of challenging a question of mixed fact and law, revisit the Tribunal's factual conclusions".

123 Second, it is also important to repeat that TREB and CREA do not challenge the admissibility of the statements nor of the testimonies given by the lay witnesses upon which the Tribunal relies for its findings.

124 Third, in our respectful opinion, the underlying premise behind TREB's and CREA's challenge on this point is that qualitative evidence without quantified evidence, which they say was available to the Commissioner, should not be considered nor given any weight. We have already determined that this premise is not well founded.

125 We agree, however, with TREB and CREA that the evidence pertaining to conversion rates does not support the Commissioner's case. Had the conversion rates been the determinative factor in this appeal, we would have intervened. We cannot see how the Tribunal can say, as it does at paragraph 676 of its reasons, that if Viewpoint and others could use the disputed data they would be in a position "to convert an increasing and significant number of website users into clients". The Tribunal's findings on conversion rates, which appear at paragraphs 653, 657, 658, and 664 of their reasons, show that the evidence before it did not support the Commissioner's case.

126 However, as the Commissioner argues, the Tribunal, although recognizing that conversion rates were low, made the point that his application was primarily concerned with dynamic competition and innovation and that, in the absence of quantifiable evidence on point, it had no choice but to determine the matter on the evidence before it, mostly qualitative evidence. More particularly, at paragraph 662 of its reasons, the Tribunal indicated in no uncertain terms that the additional innovation developed by full information VOW brokerages was not only helpful in their attempts to compete but was "forcing traditional brokers to respond" to this new type of competition.

127 We are therefore satisfied that in relying on qualitative evidence for its findings of anticompetitive effects and its ultimate conclusion on substantiality, the Tribunal made no reviewable error. Consequently, we have not been persuaded, in light of the

Tribunal's findings and of the applicable test, that there is any basis for us to interfere with the Tribunal's determination under paragraph 79(1)(c) of the Competition Act.

128 We now turn to the second issue raised by this appeal.

C. Privacy

129 TREB sought to justify its restriction on disclosure of the disputed data on the basis that the privacy concerns of vendors and purchasers constituted a business justification sufficient to escape liability under paragraph 79(1)(b) of the Competition Act. TREB asserted that privacy was integral to its business operations; more specifically, privacy was an aspect of maintaining the reputation and professionalism of its members, central to the interests of purchasers and sellers and to the cooperative nature and efficiency of the MLS system.

130 TREB also asserted that it was required, as a matter of law, to comply with Personal Information Protection and Electronic Documents Act, S.C. 2000, c. 5 (PIPEDA). It contended that this statutory requirement constituted a business justification, separate and apart from any question of the underlying motive TREB may have had for the VOW Policy and its anticompetitive effects. Characterized differently, having concluded that the policy was not motivated by subjective privacy concerns, the Tribunal was nevertheless obligated to continue and also determine, one way or another, whether the policy was mandated by *PIPEDA*. Had the Tribunal considered the consents in light of the requirements of *PIPEDA*, it would have found them lacking, and insufficient to authorize disclosure. This would lead, in TREB's submissions, to the conclusion that the restrictions on disclosure were necessary to comply with the legislation and constitute a business justification.

(1) The Tribunal's Decision

131 In considering privacy as a business justification under paragraph 79(1)(b), the Tribunal found that the "principal motivation in implementing the VOW Restrictions was to insulate its members from the disruptive competition that [motivated] Internet-based brokerages". It concluded that there was little evidentiary support for the contention that the restrictions were motivated by privacy concerns of TREB's clients. The Tribunal also found scant evidence that, in the development of the VOW Policy, the VOW committee had considered, been motivated by, or acted upon privacy considerations (TR at para. 321). The privacy concerns were "an afterthought and continue to be a pretext for TREB's adoption and maintenance of the VOW Restrictions" (TR at para. 390).

132 The Tribunal found the business justification argument simply did not mesh with the evidence. At paragraphs 395 to 398 of its reasons, the Tribunal observed that it was "difficult to reconcile" TREB's privacy arguments with the fact that the disputed data was made available to:

- All 42,500 TREB members via its Stratus system;
- The members of most other Ontario real estate boards through the data sharing program CONNECT;
- Clients of all TREB members and clients of members of most other Ontario real estate boards;
- Some appraisers;
- Third party industry stakeholders including CREA, Altus Group Limited, the CD Howe Institute, and Interactive Mapping Inc. (albeit for confidential use); and
- Customers via email subscription services or regular emails sent by members.

133 Further, the Tribunal noted that for many months TREB did nothing regarding two brokers who displayed the disputed data in apparent violation of TREB's policy (TR at paras. 372 - 374). It observed that few clients had reported concerns to TREB about their data being displayed and distributed online (TR at paras. 386-387) and that TREB did not produce evidence

to support its allegation that including the disputed data in the data feed would push consumers away from using MLS-based services (TR at para. 423).

134 Additionally, agents were entitled to, and routinely did, distribute detailed seller information, including sold prices, to their own clients without any restriction on further dissemination. Moreover, TREB's own intranet system enables TREB's members to forward by email up to 100 sold listings at a time to anyone (TR at para. 398).

135 The Tribunal found no evidentiary foundation to support the assertion that the policy was genuinely motivated by a concern about compliance with *PIPEDA*. Although the need to abide by *PIPEDA* was mentioned in the testimony of TREB's Chief Executive Officer, the Tribunal noted the absence of evidence from TREB's Board of Directors, its Chief Privacy Officer or its Chief Information Officer, which would support the conclusion that compliance with *PIPEDA* necessitated the policy (TR at paras. 378 - 379).

136 The Tribunal noted that while TREB implemented its privacy policy in 2004 and had appointed a Chief Privacy Officer, there was no evidence that the VOW Policy was directed towards compliance. TREB's only contact with the Privacy Commissioner was to ask for an opinion on a different document (a "Questions and Answers" document addressing a number of privacy related topics) in August 2012. These did not include questions related to the disputed data, and, in any event, these communications took place only after the VOW Policy and Rules were set (TR at paras. 375 - 376).

137 The Tribunal also noted at paragraph 407 of its reasons that Mr. Richardson, the CEO of TREB during the relevant time, operated on the assumption that the wording in the consents in the Listing Agreement was sufficient to permit disclosure.

138 In argument, TREB pointed to a 2009 decision of the Privacy Commissioner which held that an advertisement which said that a property sold at 99.3% of the list price contravened *PIPEDA* because it allowed the public to calculate the selling price. The Office of the Privacy Commissioner held that the exception for publicly available information did not apply because the information was obtained under the purchase agreement to which the salesperson was not privy and was not actually drawn from the Ontario registry or any source accessible to the public (TR at para. 388).

139 The Tribunal rejected TREB's assertion that this decision influenced the VOW Policy. It noted that, with two exceptions (the meetings of May 12 and May 20, 2011), privacy concerns were not reflected in the minutes or discussion pertaining to the development of the VOW Policy (see e.g. TR at para. 351). It concluded that privacy considerations were an *ex post facto* attempt to justify the policy.

140 The Tribunal then considered CREA's argument that consumers were concerned about their property information being disclosed on a public website. The Tribunal concluded that the evidence was very limited and not persuasive (TR at para. 776).

141 The Tribunal then examined the consent clauses contained in the Listing Agreement and concluded that the consents permitted the disclosure of the data. This point will be expanded upon below.

(2) Burden of Proof

142 Before turning to the substance of this issue, the parties raise a point concerning the burden of proof.

143 The Commissioner and TREB agree that TREB is bound by the provisions of *PIPEDA*. However, TREB contends that it was the Commissioner's burden to disprove TREB's assertion that the VOW Policy was required by *PIPEDA*. We do not agree. Neither this contention, nor the law, shifts the legal or evidentiary burden to the Commissioner to disprove the assertion that the policy is necessary as a matter of regulatory compliance.

144 The normal evidentiary burden applies. The party who asserts must prove: *Simpson v. Mair*, 2008 SCC 40 (S.C.C.) at para. 30, [2008] 2 S.C.R. 420 (S.C.C.). TREB has offered no compelling reason as to why this principle should not apply in respect of a business justification under section 79. In consequence, if TREB seeks to establish that regulatory compliance would be compromised, the onus is on it to lead the relevant evidence as part of its evidentiary burden, and to establish the consequential legal conclusions as part of its argument.

(3) A Business Justification was not Established

145 To begin, we reject the argument that the Tribunal did not consider the possibility that independent of motivation, regulatory compliance with *PIPEDA* could constitute a justification. Having reviewed the law, the Tribunal concluded that the business justification analysis was "subject to the important caveat that legal considerations, such as privacy, may provide a legitimate justification for an impugned practice" (TR at para. 302).

146 However, earlier in its reasons, the Tribunal wrote that "legal considerations, such as privacy laws, [may] legitimately justify an impugned practice, provided that the evidence supports that the impugned conduct was primarily motivated by such considerations" (TR at para. 294). We appreciate TREB's point that the Tribunal's reasons on this issue are equivocal. In our view, to the extent that the Tribunal required regulatory compliance to be the motivation behind the VOW Policy, it did so in error. If it can be established that a business practice or policy exists as a matter of a statutory or regulatory requirement, whether compliance was the original or seminal motivation for the policy is of no consequence.

147 This does not, however, eliminate the burden on the corporation to establish a factual and legal nexus between that which the statute or regulation requires and the impugned policy.

148 In order to establish a business justification within the meaning of paragraph 79(1)(b) of the Competition Act, a party must establish "a credible efficiency or pro-competitive rationale for the conduct in question, attributable to the respondent, which relates to and counterbalances the anti-competitive effects and/or subjective intent of the acts": *Canada Pipe* at para. 73. Proof of a "valid business justification ... is not an absolute defence for paragraph 79(1)(b)"; it must provide an explanation why the dominant corporation engaged in the allegedly anti-competitive conduct: *Canada Pipe* at paras. 88 - 91. As this Court explained in *Canada Pipe* at paragraph 87:

> [87] ...A business justification for an impugned act is properly relevant only insofar as it is pertinent and probative in relation to the determination required by paragraph 79(1)(*b*), namely the determination as to whether the purpose for which the act was performed was a predatory, exclusionary or disciplinary negative effect on a competitor. ... [A] valid business justification can, in appropriate circumstances, overcome the deemed intention arising from the actual or foreseeable negative effects of the conduct on competitors, by demonstrating that such anti-competitive effects are not in fact the overriding purpose of the conduct in question. In this way, a valid business justification essentially provides an alternative explanation as to why the impugned act was performed, which in the right circumstances might be sufficient to counterbalance the evidence of negative effects on competitors or subjective intent in this vein.

149 In sum, two facts must be established before an impugned practice can shelter behind paragraph 79(1)(b). First, there must be a credible efficiency or pro-competitive rationale for the practice. Second, the efficiencies or competitive advantages, whether on price or non-price issues, must accrue to the appellant. Put otherwise, the evidence must demonstrate how the practice generates benefits which allow it to better compete in the relevant market.

150 The Tribunal assessed the evidence before it according to the correct principles and found it lacking. The Tribunal concluded that TREB was motivated by a desire to maintain control over the disputed data in an effort to forestall new forms of competition, and not by any efficiency, pro-competition, or genuine privacy concerns (TR at paras. 369, 389 - 390). It was fair for the Tribunal to consider that, had regulatory compliance been a concern, there would have been evidence of such communications. It concluded that there was "no evidence" that TREB's privacy policies received much, if any, consideration during the development of TREB's VOW Policy and Rules.

151 The evidence, some of which we have summarized earlier, is compelling. As leave to challenge these findings was not sought, the Tribunal's conclusion that there were no procompetitive business or efficiency justifications for the policy is reasonable and will not be disturbed. This sets the stage for TREB's second and, we believe, principal argument.

(4) Privacy Obligations under PIPEDA

152 TREB submits that the Tribunal erred in failing to engage in a stand-alone assessment of TREB's responsibilities under *PIPEDA* regarding the collection and use of personal information.

153 In its reasons, the Tribunal considered *PIPEDA* and whether its requirements mandated the policy. In this regard, it looked at the extent to which TREB engaged with the Privacy Commissioner and considered the provisions of *PIPEDA*. It also examined the nature and scope of the consent clause in the Listing Agreement. It proceeded on the understanding that the data was confidential and then considered the scope and effect of the consents governing its use. It concluded that the consents were effective.

154 In our view, the role of the Tribunal was to interpret the scope of the consents under the ordinary law of contract, as informed by the purpose and objectives of *PIPEDA*. This is what it did, and we find no error in the conclusion reached.

(a) The Standard of Review

155 As a preliminary matter, we consider that in reviewing the consent in the Listing Agreements, the Tribunal was interpreting a standard form contract. As such, the standard of review is correctness.

156 Generally speaking, contractual interpretation involves questions of mixed law and fact and, thus, is reviewable on a deferential standard: *Creston Moly Corp. v. Sattva Capital Corp.*, 2014 SCC 53S.C.C. at para. 50, [2014] 2 S.C.R. 633 (S.C.C.) (*Sattva*). The interpretation of standard form contracts is an exception to this rule. Their interpretation constitutes a question of law and, thus, is reviewable for correctness: *Ledcor Construction Ltd. v. Northbridge Indemnity Insurance Co.*, 2016 SCC 37 (S.C.C.) at para. 46, [2016] 2 S.C.R. 23 (S.C.C.) (*Ledcor*). Determining the interplay between a statutory provision and a contractual term is also an exception and is reviewable for correctness: *Canada (Office of the Information Commissioner) v. Calian Ltd.*, 2017 FCA 135 (F.C.A.) at para. 37, (2017), 414 D.L.R. (4th) 165 (F.C.A.) (*Calian*). Statutory rights of appeal do not necessarily convert a reasonableness standard to a correctness one-it depends on the exact language of the legislative provision: *Edmonton (City) v. Edmonton East (Capilano) Shopping Centres Ltd.*, 2016 SCC 47 (S.C.C.) at para. 31, [2016] 2 S.C.R. 293 (S.C.C.).

157 MLS Rules specify that brokers cannot change or delete any part of clause 11 of the Listing Agreement (Rule 340). The *Frequently Asked Privacy Questions* provided by CREA states that "[b]oth current and historical data is essential to the operation of the MLS® system and by placing your listing on the MLS® system you are agreeing to allow this ongoing use of listing and sales information". The Listing Agreement is, at least for the purposes of these proceedings, a contract of adhesion or standard form.

(b) The Consents

158 *PIPEDA* requires that individuals consent to the collection, use, and disclosure of their personal information (sch. 1, clause 4.3.1). This consent must be informed (sch. 1, clause 4.3.2). Amendments in 2015 to this principle specified that for consent to be informed, the person must understand the "nature, purpose and consequences of the collection, use or disclosure of the personal information" (s. 6.1).

159 As noted earlier, the Tribunal proceeded on the basis that the sale price of property is personal information and therefore subject to the terms of *PIPEDA*, which mandates informed consent to the use of personal information.

160 While the Listing Agreement used by TREB provides consent to some uses of personal information, TREB asserts that had the Tribunal examined it more closely, it would have found that the Listing Agreement did not provide sufficiently specific wording to permit disclosure of personal information in the VOW data feed. Specifically, TREB contends that the consents do not permit the distribution of the data over the internet, and that is qualitatively different from the distribution of the same information by person, fax, or email.

161 The Listing Agreement contains a clause governing the "Use and Distribution of Information". TREB focuses on the consent to the collection, use, and disclosure of information for the purpose of listing and marketing of the Property itself but

omits that part of the consent (in the same clause) that says the real estate board may "make such other use of the information as the Brokerage and/or real estate board(s) deem appropriate, in connection with the listing, marketing and selling of real estate during the term of the listing and thereafter." The Commissioner contends that this latter part of the consent (in the same clause) is the pertinent part and that it is sufficient to permit the ongoing use and disclosure of information, even after the listing is no longer active. We agree with the Commissioner's position.

162 The Tribunal had before it the Listing Agreements used from 2003 to 2015. Although there is data in the MLS database dating back to 1986, Listing Agreements prior to 2003 were not before the Tribunal or this Court. Therefore, this Court expresses no opinion regarding the information obtained prior to 2003 or any information that may have entered the database without being subject to the 2003 to 2015 Listing Agreements.

163 The Listing Agreement was created by the Ontario Real Estate Association and recommended by TREB to its members (TR at para. 64). In the most recent version before the Court, the relevant section of the Use and Distribution of Information clause reads:

> The Seller acknowledges that the database, within the board's MLS System is the property of the real estate board(s) and can be licensed, resold, or otherwise dealt with by the board(s). The Seller further acknowledges that the real estate board(s) may, <u>during the term of the listing and thereafter</u>, distribute the information in the database, within the board's MLS System to any persons authorized to use such service which may include other brokerages, government departments, appraisers, municipal organizations and others; market the Property, at its option, <u>in any medium, including electronic media</u>; <u>during the term of the listing and thereafter</u>, compile, retain and publish any statistics including historical data within the board's MLS System and retain, reproduce and display photographs, images, graphics, audio and video recordings, virtual tours, drawings, floor plans, architectural designs, artistic renderings, surveys and listing descriptions which may be used by board members to conduct comparative analyses; and make such other use of the information as the Brokerage and/or real estate board(s) deem appropriate, in connection with the listing, marketing and selling of real estate <u>during the term of the listing and thereafter</u>.
>
> (emphasis added)

164 The wording in the Listing Agreements from 2003 onwards is substantially similar to that quoted above. However, the phrase "during the term of the listing and thereafter" (underlined above), first appears in 2012. The Use and Distribution of Information clause in the Listing Agreement is broad and unrestricted. Sellers are informed that their data could be used for several purposes: for distribution in the database to market their house; to compile, retain, and publish statistics; for use as part of comparative market analysis; and any other use in connection with the listing, marketing, and selling of real estate. Nothing in the text implies the data would only be used during the time the listing is active. Indeed, the use of data for historical statistics of selling prices necessitates that the data will be kept. The Tribunal noted that TREB's policies 102 and 103 add that, apart from inaccurate data, "[n]o other changes will be made in the historical data" (TR at para. 401). We note as well that clause 11 of the Listing Agreement allows for the property to be marketed "using any medium, including the internet".

165 *PIPEDA* only requires new consent where information is used for a new purpose, not where it is distributed via new methods. The introduction of VOWs is not a new purpose-the purpose remains to provide residential real estate services and the Use and Distribution of Information clause contemplates the uses in question. The argument that the consents were insufficient-because they did not contemplate use of the internet in the manner targeted by the VOW Policy-does not accord with the unequivocal language of the consent.

(c) Conduct of the Parties

166 The conduct of the parties may be considered in the interpretation of a contract. Given our conclusion as to the correct interpretation of the consents, it is not necessary to consider the contextual elements or conduct of the parties. However, we choose to do so here because it illuminates and reinforces our conclusion arising from the terms of the contract itself.

167 In *Sattva*, the Supreme Court of Canada stated that, with some limitations, a contract's factual matrix includes "absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable [person]" (*Sattva* at para. 58 citing *Investors Compensation Scheme Ltd. v. West Bromwich Building Society*, [1997] UKHL 28, [1998] 1 All E.R. 98 (U.K. H.L.) at 114). Thus, the conduct of the parties forms part of the factual matrix of the contract and can, subject to some restrictions, inform the interpretation of its terms.

168 The extent to which the factual matrix, including the parties' conduct, may inform the interpretation is subject to the "overwhelming principle" (formulated in *Sattva*, but characterized as such in *Teal Cedar Products Ltd. v. British Columbia*, 2017 SCC 32 (S.C.C.) at para. 55, (2017), 411 D.L.R. (4th) 385 (S.C.C.) (*Teal Cedar*)). There are two elements to the overwhelming principle. The factual matrix cannot be given excessive weight (so as to "overwhelm" the contract); and the factual matrix cannot be interpreted in such isolation from the text of the contract such that a new agreement is effectively created (*Sattva* at para. 57; *Teal Cedar* at paras. 55 - 56, 62).

169 In *Calian*, this Court observed that "the clear language of a contract must always prevail over the surrounding circumstances" (*Calian* at para. 59). Further, the factual matrix may only be considered to the extent that it helps determine the "mutual and objective intentions of the parties as expressed in the words of the contract" (*Sattva* at para. 57). Indeed, only evidence revealing "knowledge that was or reasonably ought to have been within the knowledge of both parties at or before the date of contracting" may inform the interpretation of the contract (*Sattva* at para. 58). For example, the subjective intention of one party cannot be relied upon to interpret the meaning of a contract (*Sattva* at para. 59; *ING Bank N.V. v. Canpotex Shipping Services Ltd.*, 2017 FCA 47 (F.C.A.) at paras. 112, 121, (2017), 277 A.C.W.S. (3d) 281 (F.C.A.) (*ING Bank*)). Reliance of that sort would offend the parol evidence rule, i.e., that evidence external to the contract that would "add to, subtract from, vary, or contradict a contract that has been wholly reduced to writing" is inadmissible (*Sattva* at para. 59; *ING Bank* at paras. 112, 121).

170 As far as standard form contracts are concerned, the factual matrix is less relevant (*Ledcor* at paras. 28, 32). This is in keeping with the rationale underlying the correctness standard for standard form contracts: that contracts of this nature are not negotiated, but rather offered on a "take-it-or-leave-it" basis. However, in *Ledcor* Wagner J. observed at paragraph 31 that some surrounding circumstances, such as the purpose of the contract, the nature of the relationship it creates, and the market or industry in which it operates, may be considered:

> [31] I agree that factors such as the purpose of the contract, the nature of the relationship it creates, and the market or industry in which it operates should be considered when interpreting a standard form contract. However, those considerations are generally not "inherently fact specific": *Sattva*, at para. 55. Rather, they will usually be the same for everyone who may be a party to a particular standard form contract. This underscores the need for standard form contracts to be interpreted consistently, a point to which I will return below.

171 Applying these principles to the facts as found by the Tribunal, there is nothing in the evidence that would suggest that TREB considered that the consents were inadequate or that TREB drew a distinction between the means of communication of information. To the contrary, TREB's conduct, as well as the testimony of its CEO, are only consistent with the conclusion that it considered the consents were sufficiently specific to be compliant with *PIPEDA* in the electronic distribution of the disputed data on a VOW, and that it drew no distinction between the means of distribution.

172 We note as well that TREB's position that *PIPEDA* mandates the VOW Policy is inconsistent with some of its own evidence. For example, TREB refused a request by a seller to remove the seller's MLS listing information, noting that its policy respected *PIPEDA* requirements (TR at para. 400).

173 The Tribunal also noted that TREB sought legal advice with respect to whether the consents were adequate to address the privacy issues related to the posting of photographs of the interior of homes, and, consequentially changed the consent to provide express authorization with respect to images. There was no evidence that similar steps were contemplated or taken with respect to the sold or pending sold information. Similarly, TREB sought legal advice with respect to the provision of sold data

to members. That advice noted that "a strong argument can be made that the words 'conduct comparative market analyses'" in the consents authorised disclosure of selling price information to prospective clients.

174 Finally, the Tribunal's view on the scope of consents is consistent with the direction of the Supreme Court of Canada in *Royal Bank of Canada v. Trang*, 2016 SCC 50 (S.C.C.) at paras. 36 - 42, [2016] 2 S.C.R. 412 (S.C.C.). There the Court held that a mortgage balance was less sensitive information because the principal, the rate of interest, and due dates were all publicly available under provincial land registry legislation. In this case, the selling price of every home in Ontario is publicly available under the same legislation. When the consents are considered in light of the nature of the privacy interests involved, the Tribunal's conclusion that they were sufficient takes on added strength.

175 This ground of appeal therefore fails and we now turn to the last issue raised by the appeal.

D. Copyright in the MLS Database

176 TREB and CREA submit that the Tribunal erred in finding that TREB does not have copyright in the database. In our view this ground of appeal fails. In light of the determination that the VOW Policy was anti-competitive, subsection 79(5) of the Competition Act precludes reliance on copyright as a defence to an anti-competitive act. This is sufficient to dispose of the appeal in respect of copyright.

177 While not strictly necessary to do so, we will address CREA's contention that the Tribunal applied the incorrect legal test to determine whether copyright exists. On this point we agree. It is, however, an error of no consequence. The same result is reached on the application of the correct law.

178 We turn to the Subsection 79(5) issue. Subsection 79(5) of the Competition Act provides:

> **Exception**
>
> **79** (5) For the purpose of this section, an act engaged in pursuant only to the exercise of any right or enjoyment of any interest derived under the *Copyright Act*, *Industrial Design Act*, *Integrated Circuit Topography Act*, *Patent Act*, *Trade-marks Act* or any other Act of Parliament pertaining to intellectual or industrial property is not an anti-competitive act.
>
> **Exception**
>
> **79** (5) Pour l'application du présent article, un agissement résultant du seul fait de l'exercice de quelque droit ou de la jouissance de quelque intérêt découlant de la *Loi sur les brevets*, de la *Loi sur les dessins industriels*, de la *Loi sur le droit d'auteur*, de la *Loi sur les marques de commerce*, de la *Loi sur les topographies de circuits intégrés* ou de toute autre loi fédérale relative à la propriété intellectuelle ou industrielle ne constitue pas un agissement anti-concurrentiel.

179 Subsection 79(5) seeks to protect the rights granted by Parliament to patent and copyright holders and, at the same time, ensure that the monopoly and exclusivity rights created are not exercised in an anti-competitive manner. The language of subsection 79(5) is unequivocal. It does not state, as is contended, that any assertion of an intellectual property right shields what would otherwise be an anti-competitive act.

180 Parliament clearly signaled, through the use of the word "only", to insulate intellectual property rights from allegations of anti-competitive conduct in circumstances where the right granted by Parliament, in this case, copyright, is the sole purpose of exercise or use. Put otherwise, anti-competitive behaviour cannot shelter behind a claim of copyright unless the use or protection of the copyright is the sole justification for the practice.

181 TREB attached conditions to the use of its claimed copyright rights in the disputed data. For the reasons given earlier, we see no error in the Tribunal's findings as to the anti-competitive purpose or effect of the VOW Policy. The Tribunal found that the purpose and effect of those conditions was to insulate members from new entrants and new forms of competition. The purpose, therefore, of any asserted copyright was not "only" to exercise a copyright interest.

182 While this is sufficient to dispose of this ground of appeal, as noted earlier, we will, for the sake of completeness, address the second alleged error in the Tribunal's analysis of copyright.

183 Copyright is a creature of statute. The *Copyright Act* provides that copyright exists for "every original literary, dramatic, musical and artistic work" created by Canadians (section 5). This phrase is defined at section 2 to include compilations, which is in turn defined to include works "resulting from the selection or arrangement of data". The classification of the database as a compilation is not contested on appeal.

184 The meaning of the word "original" in section 5 of the Copyright Act was considered by the Supreme Court in *CCH Canadian Ltd. v. Law Society of Upper Canada*, 2004 SCC 13, [2004] 1 S.C.R. 339 (S.C.C.) [*CCH*]:

> [16] ... For a work to be "original" within the meaning of the Copyright Act, it must be more than a mere copy of another work. At the same time, it need not be creative, in the sense of being novel or unique. What is required to attract copyright protection in the expression of an idea is an exercise of skill and judgment. By skill, I mean the use of one's knowledge, developed aptitude or practised ability in producing the work. By judgment, I mean the use of one's capacity for discernment or ability to form an opinion or evaluation by comparing different possible options in producing the work. This exercise of skill and judgment will necessarily involve intellectual effort. The exercise of skill and judgment required to produce the work must not be so trivial that it could be characterized as a purely mechanical exercise. For example, any skill and judgment that might be involved in simply changing the font of a work to produce "another" work would be too trivial to merit copyright protection as an "original" work.

185 The point of demarcation between a work of sufficient skill and judgment to warrant a finding of originality and something less than that - a mere mechanical exercise - is not always self-evident. This is particularly so in the case of compilations. It is, however, within the parameters of the legal test, a highly contextual and factual determination.

186 This is not a new observation. In *Édutile Inc. v. Automobile Protection Assn. (APA)*, [2000] 4 F.C. 195, 6 C.P.R. (4th) 211 (Fed. C.A.) the Court acknowledged that "[i]t is not easy in compilation situations to draw a line between what signifies a minimal degree of skill, judgment and labour and what indicates no creative element" (at para. 13). Although decided before *CCH*, the observation remains apposite.

187 There is, however, guidance in the case law as to the criteria relevant to the determination of whether the threshold of originality is met. In *Red Label Vacations Inc. v. 411 Travel Buys Ltd.*, 2015 FC 18, 473 F.T.R. 38 (F.C.), Manson J. noted that "when an idea can be expressed in only a limited number of ways, then its expression is not protected as the threshold of originality is not met" (at para. 98, citing *Delrina Corp. v. Triolet Systems Inc.* (2002), 58 O.R. (3d) 339 (Ont. C.A.) at paras. 48-52, (2002), 17 C.P.R. (4th) 289 (Ont. C.A.), leave to appeal to S.C.C. refused, 29190 (28 November, 2002) [2002 CarswellOnt 4080(S.C.C.)]).

188 In *Tele-Direct* the Court found a compilation not to be original in part because it was done in accordance with "commonplace standards of selection in the industry" (paras. 6 - 7). Although *Tele-Direct* predates *CCH*, the proposition that industry standards may be relevant to the originality analysis is a legitimate, residual consideration (see e.g. *Harmony Consulting Ltd. v. G.A. Foss Transport Ltd.*, 2011 FC 340 (F.C.) at paras. 34, 39, 65, 77, 182-188, (2011), 92 C.P.R. (4th) 6 (F.C.), aff'd 2012 FCA 226 (F.C.A.) at paras. 37-38, (2012), 107 C.P.R. (4th) 1 (F.C.A.) (*Harmony* FCA); *Geophysical Service Inc. v. Encana Corp.*, 2016 ABQB 230 (Alta. Q.B.) at para. 105, 201638 Alta. L.R. (6th) 48 (*Geophysical*)).

189 Applying the guidance of the Supreme Court in *CCH*, it is important to view adherence to industry standards as, at best, one factor to be considered amongst many. In. *Geophysical*, Eidsvik J. explained there is no steadfast rule that "there is no entitlement to copyright protection ... where the selection or arrangement is directed by accepted and common industry practices" (at paras. 100-101):

> ... these cases [that considered "common industry practices"] do not stand for such steadfast rules or copyright criteria. Certainly, these considerations were part of the analysis in those cases in deciding whether the production was an original

> work, but they are not the test. The judge in each case made a factual determination about whether sufficient skill and judgment was brought to the work to merit the "original" finding.

190 However, if observing industry standards amounts merely to "mechanical amendments", originality will not be found (*Harmony* FCA at para. 37).

191 In *Distrimedic Inc. v. Dispill Inc.*, 2013 FC 1043, 440 F.T.R. 209 (Eng.) (F.C.), de Montigny J. (as he then was) wrote that "when the content and layout of a form is largely dictated by utility and/or legislative requirements, it is not to be considered original" (at para. 324). He continued and observed that compilations

> will not be considered to have a sufficient degree of originality when the selection of the elements entering into the work are dictated by function and/or law, and where their arrangement into a tangible form of expression is not original. Only the visual aspect of the work is susceptible to copyright protection, if original (at para. 325).

192 In this context, TREB and CREA argue that the Tribunal wrongly required proof of creativity and went beyond the appropriate test for originality. After reviewing the MLS database, the Tribunal noted the "absence of a creative element" (TR at para. 732). Further, while the Tribunal cited *CCH* for the correct originality test in paragraph 733, it then relied on *Tele-Direct* to invoke and apply the element of creativity which, post-*CCH*, is not the correct test (*CCH* at para. 25).

193 We agree with the appellants on this point. However, in view of the Tribunal's findings of fact, applying the correct test, we reach the same result.

194 The Tribunal considered a number of criteria relevant to the determination of originality (paragraphs 737 - 738 and 740 - 745). Those included the process of data entry and its "almost instantaneous" appearance in the database. It found that "TREB's specific compilation of data from real estate listings amounts to a mechanical exercise" (TR at para. 740). We find, on these facts, that the originality threshold was not met.

195 In addition, we do not find persuasive the evidence that TREB has put forward relating to the use of the database. How a "work" is used casts little light on the question of originality. In addition, we agree with the Tribunal's finding that while "TREB's contracts with third parties refer to its copyright, but that does not amount to proving the degree of skill, judgment or labour needed to show originality and to satisfy the copyright requirements" (TR at para. 737).

196 We would therefore dismiss this ground of appeal.

VI. Conclusion

197 For the reasons above, we would dismiss the appeal with costs.

***D. G. Near J.A.*:**

I agree.

Appeal dismissed.

1992 CarswellNat 1630
Competition Tribunal

Canada (Director of Investigation & Research) v. Hillsdown Holdings (Canada) Ltd.

1992 CarswellNat 1630, [1992] C.C.T.D. No. 4, 41 C.P.R. (3d) 289

In the Matter of an application by the Director of Investigation and Research for orders pursuant to section 92 of the Competition Act, R.S.C., 1985, c. C-34, as amended

In the Matter of the acquisition by Hillsdown Holdings (Canada) Limited of 56% of the common shares of Canada Packers Inc.

The Director of Investigation and Research, Applicant and Hillsdown Holdings (Canada) Limited Maple Leaf Foods Inc. Nine-Five Investments Limited Ontario Rendering Company Limited, Respondents

Clarke Member, Reed J., Sarrazin Member

Heard: November 25, 1991
Heard: December 19, 1991
Judgment: March 9, 1992
Docket: CT-91/1

Counsel: Randal T. Hughes, Peter J. Cavanagh, Rory R. Edge, Andrea Safer, for Applicant
Glenn F. Leslie, Neil R. Finkelstein, John J. Quinn, Jeffrey W. Galway, for Respondents

Decision of the Board:

I. Introduction

1 An application is brought by the Director of Investigation and Research ("Director") pursuant to subparagraph 92(1)(e)(ii) of the *Competition Act*, [1] to require the respondent Hillsdown Holdings (Canada) Limited ("Hillsdown") to divest itself of the business operated by the respondent Ontario Rendering Company Limited ("Orenco") or to divest such assets as the Tribunal may designate.

2 The application was triggered by Hillsdown's acquisition on July 4, 1990 of Canada Packers Inc. As a result of that acquisition Hillsdown obtained control of Orenco, a rendering company previously controlled by Canada Packers Inc. Hillsdown already controlled, through its wholly-owned subsidiary, Maple Leaf Mills Limited, a rendering business carried on by its rendering division, Rothsay. It is alleged that the common control of these two businesses is likely to result in a substantial lessening of competition in the non-captive red meat rendering market in southern Ontario.

3 Subsequent to the acquisition, Canada Packers Inc. and Maple Leaf Mills Limited were amalgamated and continued under the name Canada Packers Inc. This name was subsequently changed to Maple Leaf Foods Inc. Orenco is presently operated as a wholly-owned subsidiary of Nine-Five Investments Limited which is in turn a wholly-owned subsidiary of Maple Leaf Foods Inc.

4 Orenco operates a rendering facility in Dundas, Ontario. Rothsay operates a facility in Moorefield, Ontario. The two sites are within approximately 60 miles of each other. Orenco and Rothsay (Moorefield) are approximately 40 miles west and 90 miles northwest of Toronto respectively. Rothsay also operated until recently a rendering facility at a lakeshore location in downtown Toronto ("Rothsay (Toronto)"). This property was expropriated by the City of Toronto on July 26, 1988. The facility was finally closed on November 30, 1990 after Rothsay had moved its Toronto business to the Orenco plant in Dundas and elsewhere.

5 The interaction of the expropriation and the merger is a major complicating factor in this case. The respondents argue that significant efficiencies occurred as a result of the merger. The applicant contends that the moving of the Rothsay (Toronto) business to Orenco and elsewhere was not a rationalization arising as a result of the merger but a response to the expropriation notice which Rothsay (Toronto), at this time, was under. The transfer of the Rothsay (Toronto) business to Orenco occurred before the Director filed his application on February 15, 1991, seeking divestiture of the Orenco business. Thus, the interim order requiring that the two businesses be held separate and apart was obtained only after the integration of Rothsay (Toronto) and Orenco had been underway for some time. An additional important consideration in this case is the contracting nature of the red meat rendering business. The respondents say it is declining. The applicant says it is flat.

II. The Rendering Business

6 Rendering involves the processing of the left-over parts of livestock such as cattle, hogs and poultry which are either unfit or unsuitable for human consumption. The primary sources of supply for renderable materials are slaughterhouses, meat packing plants, poultry processing plants, abattoirs, grocery stores and butcher shops. The materials include: fresh packing house material (such as beef and pork heads, feet, offal, bones, fat and blood); material such as fat and bone discarded in preparing cuts for the retail consumer trade; and poultry material including offal and feathers. Renderable material is also obtained from deadstock, that is, from animals which have died or been killed outside the slaughtering process.[2] Such animals may have died as a result of disease or accident on the farm or in transit to the slaughterhouse.

7 The quantity of renderable material available depends on the number of cattle, hogs and poultry which are killed in the market area served by the renderer. This in turn will vary with consumer demand for beef, pork and poultry products. Slaughterhouses are required to have all renderable materials produced as a result of a day's kill removed before they can commence operation the following day. The value of the renderable material compared to the value of a cattle beast or hog is insignificant.[3] Thus, the supply of renderable material does not depend on the price paid by the renderer for the material. The supply of renderable material is essentially inelastic in response to the price paid for it.

8 Two types of renderers exist. One is the "integrated renderer" which processes material produced in the slaughtering, packing or processing activities of affiliates in a vertically integrated operation (captive material). The other is the "non-integrated renderer" which collects and processes renderable material obtained from suppliers who are not affiliated with the renderer (non-captive material). Integrated renderers may or may not also process renderable material that is non-captive. Both Orenco and Rothsay are integrated renderers that also process non-captive material.

9 Non-captive material is picked up in specially equipped trucks. The renderer either pays the supplier for the renderable material or charges the supplier for its collection. Whether the material is purchased or a charge is levied depends upon a number of factors including the type of renderable material involved, the volume being acquired, and transportation and processing costs. Deadstock is often picked up from the farm by deadstock collectors rather than by the renderer directly. The collectors remove the hide for tanning and debone the carcass to provide meat for pet food. The rest of the carcass is then delivered to the rendering facility or picked up at the deadstock plant by the renderer.

10 At the rendering plant the material which has been collected is graded, sorted and dumped into receiving pits. It is then processed through either a continuous or batch rendering cooker. This involves cooking the material in a pressure cooker and feeding it through a press. Blood can either be rendered with other red meat by-products or separately. Poultry feathers are processed in specialized equipment (a hydrolyzer) and are processed separately.

11 Two products are produced from the rendering process: tallow and protein meal. Tallow is used in the production of soaps, animal feeds, cosmetics, paints, rubbers and in a variety of other consumer and industrial products. It is produced in a variety of grades (for example, top white, bleachable fancy, special, yellow grease, pet food grade). The grade or quality of the tallow depends upon the type of renderable material from which it comes. Beef tallow is the highest quality, white in colour and has a comparatively high melting point (titre point). Tallow produced from poultry material is yellow in colour and has a lower melting point. Tallow produced from pork materials is of an intermediate quality.

12 The meal produced from the rendering process is used primarily in animal feed, fertilizers and pet food manufacturing. It also comes in a variety of grades depending upon its protein value. Blood meal is the highest quality. Meal rendered from poultry material is of a higher quality than meal rendered from red meat material.

13 Both the tallow and the meals compete with products such as coconut oil, palm oil, soya oil and soya meal which are sold on the commodities markets. The prices at which the products produced by the rendering process can be sold, then, are determined by the international market. A bulletin is published weekly in Ontario by a brokerage house called Eastern Packinghouse Brokers Ltd. It lists the current prices for at least some of the various grades of tallow and protein meal. The protein meal is listed as Unground Dried Rendered Tankage (U.D.R.T.) and its price varies with its protein content. The renderer thus is a "price-taker" with respect to these products.

III. Expropriation Then Merger

14 On July 26, 1988 an expropriation notice was issued by the City of Toronto transferring ownership of the land on which the Rothsay (Toronto) facility [4] was located to the Corporation of the City of Toronto. The City notified Rothsay that it required possession of this property by November 1, 1988.

15 Rothsay negotiated with the City for an extension of the time limit to enable it to find alternate premises from which to operate its business. Rothsay did not vacate the premises on November 1, 1988 and a lease with the City was eventually signed on December 19, 1989. That lease was stated to be for the period November 1, 1988 to June 30, 1990. A clause which would have required Rothsay to waive any right to apply, at the end of the lease period, for a postponement of the City's claim for possession was explicitly deleted from the lease.

16 Rothsay sought information concerning possible sites for the relocation of its Toronto business. The Hamilton harbour area was identified as the best. Rothsay commenced negotiations with the Hamilton Harbour Commission. Appropriate sites were identified and the Hamilton Harbour Commission was willing to accept Rothsay as a tenant. Unfortunately, the Harbour Commission was slow in acquiring the property required for the relocation. Rothsay also began exploring the possibility of expanding its Moorefield facility in order to accommodate the Toronto volumes.

17 By March 1990, Rothsay was still waiting for the Hamilton Harbour Commission to come forward with a proposal. As an alternative it decided to "fast track" expansion of its Moorefield facility. Any expansion of the Moorefield facility required approval from the provincial Ministry of the Environment which would entail at some point a public meeting to explain and discuss the proposal. Rothsay estimated that Ministry of the Environment approval might be obtained by December 31, 1990 and construction of the expanded facilities completed nine to twelve months thereafter. It therefore sought an extension of its lease with the City of Toronto until December 31, 1991. [5] The City granted an extension to August 31, 1990 with the indication that any further extension would be considered after discussion with its business consultants. A further extension to September 30, 1990 was granted because the City's business consultants were not available to consult during July and August.

18 On May 29, 1990 a representative of Rothsay met with Orenco for the purpose of seeing if that company could process the Rothsay (Toronto) volumes. It is clear that the possibility of a Hillsdown acquisition of Canada Packers Inc. was known. An attempt was made to characterize this meeting as having as its primary purpose the assessment of Pat Jones, who was general manager of Orenco, to see if he would fit into the Rothsay organization after a merger should such occur. That is not a credible characterization of the purpose of the meeting. The notes of Joseph F. Kosalle, Vice-President, Finance, Agribusiness Group of Maple Leaf Foods Inc., regarding the meeting make it clear that the primary purpose was to seek a solution for rendering the Rothsay (Toronto) volumes. The assessment of Mr. Jones as a potential employee was an unexpected afterthought.

19 The documentary evidence makes it clear that Orenco contemplated during the second half of its 1990 fiscal year upgrading certain components of its rendering equipment. The equipment in place was old and the company was operating at or above capacity. [6] Adequate time for preventive maintenance was not available and when breakdowns occurred the company

was vulnerable to losses arising therefrom. Part of the planned expansion involved installation of a hydrolyzer to enable Orenco to process poultry feathers.

20 Mr. Jones told Rothsay that Orenco was prepared to process the Rothsay (Toronto) volumes "with or without a merger". As of May 29, 1990, Orenco estimated that it would take six months for it to put certain equipment in place so that it could render the additional red meat material and if some of Rothsay's Toronto equipment was used for this purpose, the time frame would be even shorter. Thus, should Rothsay have been required by the City to leave the Toronto harbour area before either a new facility was built in Hamilton or Moorefield expanded, an available option was to have Orenco process the Toronto volumes for the interim period. It is clear that tolling agreements between renderers are not uncommon in the industry.

21 In June 1990, Rothsay submitted reports concerning environmental concerns (water pollution and odour control) to the Ministry of the Environment regarding the proposed expansion of Moorefield. Ministry of the Environment concept approval for the expansion and an expression of support with respect thereto were eventually communicated to Rothsay sometime in or prior to November 1990. The public hearing necessary before final approval could be given was never held since sometime before November 30, 1990, Rothsay had moved a significant portion of its Toronto volumes to Orenco and relinquished what was by that time its month-by-month lease to the City.

22 A reorganization of the collection and processing of renderable material took place after the merger and the relinquishment of the Toronto premises. This resulted in renderable materials east of Oshawa, which had previously been collected by both Orenco and Rothsay (Toronto), being collected by Rothsay's rendering facility near Montreal, Laurenco, for processing at that plant. Prior to the merger, Rothsay (Laurenco) had been losing money due to low volumes. [7] Oshawa is approximately 270 miles from Montreal. Some materials which had previously been rendered at Rothsay (Moorefield) were sent to Orenco. Rothsay (Moorefield) was able then to process one-third of the remaining Rothsay (Toronto) volumes and Orenco processed the other two-thirds.

IV. Market Definition

23 In order to determine the likely effects of any merger or acquisition it is first necessary to determine the boundaries of the *relevant* market. A *relevant* market is that product or service with respect to which after a merger there is likely to be a substantial lessening of competition. Once the *relevant* market is defined, an assessment can be made as to the likely effect of the merger or acquisition on that market. Market boundaries, however, are not static. They expand and contract in response to price. One can conceptually think of a series of concentric areas whereby as the price rises the radii lengthen. The very definition of the market boundaries therefore carries with it an assessment as to whether the merged firm has or is likely to have market power. While the various elements relevant in considering the effect of a merger, first market boundaries and then whether a substantial lessening of competition is likely to occur, will be discussed in a linear fashion, the non-linear aspect of the analysis should be kept in mind. [8]

24 It is useful to refer to the explanation of the concept of a *relevant* market set out in the monograph *Horizontal Mergers: Law and Policy*:

> For purposes of assessing the likelihood that a merger will create or enhance single-firm market power, market definition has been characterized as "an analytical construct enabling us to compensate for our inability to measure market power directly." Areeda and Turner explain:
>
> > Market definition becomes crucial only when there are no other discoverable facts establishing the existence and degree of market power more directly and with tolerable accuracy. One would never need to define the market if he could accurately establish the firm's demand and cost curves - the quantities that could be sold at various prices, and the costs of producing those quantities. That information would directly establish both the presence of market power and the magnitude of potential monopoly profits. The firm's demand curve would reflect the availability of any substitutes, without further need for identifying them or their closeness.

> Because direct measurement of a firm's market power is extraordinarily difficult, a two-step indirect measurement process has evolved: first define the relevant market, and then infer power within the market through the use of proxies such as market shares and other factors. [9] (footnotes omitted)

25 The identification of the relevant market in which it is alleged a substantial lessening of competition is likely to occur is normally assessed from two perspectives: the product or products with respect to which a merged firm acting alone or in concert with others is likely to be able to exercise market power and the geographic area within which such power is likely to be exercised. [10] The term "product" is used in the legal and economic literature relevant to competition law as meaning the output (product or service) which the producer (seller) provides to the consumer (purchaser). Thus, the use of that term should not be taken as excluding services. [11]

A. Product Dimension (Product Market)

26 Conceptually, the product in issue in this case can be thought of as the renderable material obtained by the renderers from the suppliers of that material or it can be thought of as rendering services provided by the renderers to slaughterhouses, meat processing plants, grocery stores, etc. If the first characterization is used then the analysis for competition purposes focuses on the possible monopsony power of the renderers as buyers of the raw materials. If the second characterization is used then the analysis focuses on the possible market power of the renderers as sellers of the rendering service. No significant difference results from the two characterizations. The Tribunal accepts that the more convenient way of describing the product is the latter, that is, as the sale of rendering services. This is more convenient because it avoids the conceptual awkwardness which arises from the fact that sometimes the renderer pays for the renderable materials and sometimes charges for its collection.

27 In determining the product dimensions of the market, the first step is to identify the product or products with respect to which, prior to the merger, the two firms were competitors. The second step is to ask whether there are any close substitutes to that product to which consumers could easily switch if prices were raised (an indication of demand elasticity). If two products appear to be close substitutes when both are sold at marginal cost, then the two should be included in the same product market.

28 At the time of the acquisition, Rothsay (Moorefield) rendered red meat by-products, blood, deadstock, poultry offal and feathers. Orenco rendered red meat by-products, blood, deadstock and grease but not poultry offal or feathers. Rothsay (Toronto) rendered the same kind of materials as Orenco.

29 The grease rendered by both Rothsay (Toronto) and Orenco is in general "restaurant grease" which has been used for deep frying certain foods. Although both Rothsay (Toronto) and Orenco processed grease it is processed differently from other renderable materials, usually in different equipment, and it is collected independently of the other renderable materials. Rothsay (Moorefield) has not and does not render grease. Little evidence was led with respect to grease or as to how the merger affected competition in this segment of the industry. Thus, it has not been established that it should be considered as part of the relevant product market.

30 The Director has not suggested that poultry offal and feathers should be included in the relevant market. Orenco did not process such material before the merger. It lacked the equipment required to process poultry feathers. Special equipment is not required to render poultry offal. While there is some documentation which indicates that prior to the merger Orenco was planning to acquire equipment to enable it to process poultry feathers, it has not been suggested by the Director that the merger would lead to any substantial lessening of competition with respect to rendering services for producers of that material.

31 Prior to the acquisition approximately 30% of the material rendered by Orenco came from affiliated Canada Packers Inc. operations. The remaining 70% was acquired from non-captive sources. Approximately 14% of Rothsay's material came from affiliated Maple Leaf Mills Limited operations. The remaining 86% was acquired from non-captive sources. There is no dispute that captive materials are not included in the product dimension of the relevant market.

32 It is clear that there are few "product substitutes", that is, alternatives available to the consumer of rendering services (demand elasticity is low). Some deadstock presumably might be buried but this is not a viable option for a significant amount of renderable material. [12] Landfill-site regulations often prohibit the disposal of renderable material at those locations and, as noted above, slaughterhouses require that renderable materials be removed on a daily basis.

33 While conceptually it would seem that supply elasticity with respect to the product dimensions of the market should also be included in defining the market, these factors are often considered when assessing whether the merger is likely to lessen competition substantially in the relevant market. Supply elasticity would be high and market power therefore would not likely be significant if other firms could immediately respond to a price rise by flooding the market with the relevant product either because they have excess capacity or because they can easily switch their production facilities to produce the relevant product. Those factors will be considered when the likelihood of substantial lessening of competition is assessed. [13]

34 The Tribunal accepts the Director's contention that the product dimension of the relevant market is the provision of rendering services for non-captive red meat renderable material which includes deadstock materials and blood.

B. Geographic Dimension (Geographic Market)

35 Determining the geographic dimensions of the relevant market is similar to determining the product dimensions; one asks whether there is a geographic area within which the merged firm either alone or in concert with others is likely to have market power. This requires identifying some area such that the merged firm has an advantage based on geographic considerations over firms not inside that area. Frequently this advantage results from transportation costs but often other factors may also be relevant, such as differing labour costs in the two areas or governmental restrictions and regulations. [14]

36 An assessment of geographic boundaries requires an assessment as to whether a significant number of consumers within the alleged area are willing to turn to suppliers outside of that area to obtain, in this case, rendering services and whether there are suppliers outside the proposed boundary who could supply consumers within that area with rendering services, as effective competitors to the merged firm (indicators of demand elasticity and supply elasticity respectively). It is clear that such switching or "substitutability" is more likely to occur on the edges of the defined geographic boundaries as the distance between the consumer of rendering services and the merged plant increases, provided there is another supplier of rendering services in the vicinity. Clearly, geographic boundaries of adjacent markets overlap and they are neither static nor precise. As in the case of the product market dimensions, a useful starting point for their definition is the existing pattern or patterns of competition which existed pre-merger.

37 The geographic dimensions of the market in issue in this case will be discussed by reference to three factors: distance, borders and consumer preference.

(1) Distance

38 The Director adopted submissions which were made to him on behalf of the respondents as accurately describing the distances applicable in defining the geographic dimensions of the relevant market:

> A good indicator of the relevant geographic market of a renderer is its current collection area. In general, the distance a renderer will travel to collect raw material is directly related to the value of the material available. There are three factors that affect the value of raw material and, thus, delineate the geographic area from which a renderer can effectively collect raw material: the type of raw material available, the perishable nature of the raw material and the cost of collection.
>
> . . .
>
> The interplay of these factors sets the distance from a rendering plant that a renderer will travel to get raw material. The need for product freshness sets a maximum collection distance. In general, waste is not [to] be shipped more than a few

hundred miles because of the need for freshness. Because of transportation costs, a renderer will only travel that far for a large supply of high quality materials. For small amounts, the maximum distance might only be 75 to 100 miles.

. . .

The only possible overlap in the collecting areas between Rothsay Rendering and CP is in Southern Ontario based on a maximum collection distance of 300 miles from a plant. (In fact, the maximum collection distance may be much shorter for different types of by-products.) Consequently, in this submission we will only consider the effects of the merger in Ontario.

In Southern Ontario, Rothsay has two plants; one in Toronto and a larger one in Moorefield which is north of Kitchener-Waterloo. The Orenco plant is located in Dundas which is just west of Hamilton. The major collection area for both Rothsay and Orenco for most by-products is bounded by Windsor to the west, Kingston to the east, Owen Sound to the north and Northern New York State to the south. Orenco has a collection company called Liberty Reductions which collects raw material in the Buffalo area and delivers it to Orenco.

In the case of Orenco, from Dundas, Ontario it is about 193 miles to Windsor, 169 miles to Owen Sound and 204 miles to Kingston, so a 200 mile limit is a fairly accurate measure of the realistic collection distance of a Southern Ontario renderer. As for the Southern limit of Orenco's area, it is about 155 miles to Rochester, New York. Orenco will, however, go as far as Sault Ste Marie for a pick-up of high yielding waste (a distance of nearly 400 miles), but a service call of that distance is unusual.

Thus, we submit the relevant geographic market is the area within a 200-mile radius of the Rothsay and Orenco facilities. This area includes at least Southern Ontario, Northern New York State (the sector bounded by Rochester to the east and Jameston to the south) and South-Eastern Michigan (Port Huron, Detroit and their environs). [15]

. . .

Because of the low value-to-weight ratio of raw material for rendering, and its perishability, the cost of collection is relatively high in comparison with the value of the end product. A renderer will only pick up raw material where it is economical to do so. Whether it is economical in a given case depends on several factors, namely the type of material available, the amount of material available, and the distance to be travelled. While no fixed maximum economical distance can be established, for the reasons set out in our Submission it is appropriate to consider as a bench-mark a range of 200 miles (about 320 kilometres). [16]

39 Despite these initial submissions, the respondents called evidence to demonstrate that some renderers can and do travel over 200 miles to collect renderable material. Reference was made to the fact that Baker Commodities Inc. ("Baker") has a plant in Lowell, Massachusetts [17] and collects red meat material at a distance of 500 miles from that location. Most of the plant's tonnage, however, is collected from within 350 miles of the plant. Transfer depots are used in collecting the materials. Transfer depots are large collection containers into which material collected locally is dumped so that only full trailer loads travel the long distances. Transportation costs are a significant factor in this industry. [18]

40 Lomex Inc. ("Lomex"), also referred to as "Couture", has begun very recently to collect red meat material in Toronto for its plant in Montreal over 300 miles away. It is allegedly trying to establish a transfer depot outside Toronto but has not yet done so. Evidence was also given that Phil's Recycling, [19] a low overhead (mainly deadstock) collector with a non-unionized work force has transported materials for a distance of up to 600 miles and on a regular basis takes material 400 miles from Toronto to Montreal at a profit.

41 The Tribunal is reluctant to place much emphasis on the activity of Baker out of Lowell, Massachusetts, since it relates to another market area. The geographic dimensions of the relevant market have to be determined by reference to the economic factors existing in the relevant area. Thus, the evidence of Baker operating out of Massachusetts and into Quebec is of limited

usefulness. Counsel states that the evidence is only being put forward to demonstrate that it is physically possible in some circumstances to collect from such distances and the Tribunal accepts it for that purpose.

42 Insofar as Lomex is concerned, it is collecting two full truck loads from two fairly large slaughtering operations and this activity is of very recent origin.[20] The Tribunal heard evidence that in the opinion of one industry participant Lomex was trying to "buy" its way into the Toronto market. Lomex's activity is more consistent with a market entry *initiative*[21] rather than being evidence of a viable competitor which is established in the relevant market.

43 Phil's Recycling which operates out of Peterborough, Ontario is a unique and somewhat specialized operation. The profitability of its collection and delivery operation is aided by carrying "haul backs" (e.g., firewood from Quebec for the Toronto market, white stone from Perth). More importantly, Phil's Recycling is not a renderer. It is not Phil's Recycling which must be assessed as an effective competitor to the merged firm but the renderers to whom it sells. Phil's Recycling sells to renderers located in southern Ontario as well as to renderers located in Quebec. It collects about 100 to 150 metric tonnes a week and sells about one-half of that to Quebec renderers. The activity of Phil's Recycling is peripheral in nature.

44 It is clear that there has not been and there is not now much vigorous and effective competition to Rothsay (Moorefield) and Orenco from renderers located more than 200 miles away. Particularly significant is the fact that when Rothsay (Toronto) was faced with expropriation it did not choose to send its Toronto volumes (i.e., those collected west of Oshawa) to Rothsay (Laurenco) near Montreal for rendering despite the fact that that plant had and continues to have low volumes.

(2) Borders

45 In addition to a 200 mile distance limitation, the Director argues that both provincial and international borders create boundaries to the geographic dimensions of the relevant market. This assertion will be considered from two perspectives: United States restrictions respecting the importation of renderable material and Canadian federal and provincial legislation respecting the handling and disposition of the renderable material.

46 Insofar as United States restrictions are concerned, the practice of the United States Department of Agriculture ("USDA") with regard to the importation of renderable material from Canada is allegedly set out in a letter from Robert Melland to counsel for the respondents. That letter states:

> Animal products originating from a Canadian-approved slaughterhouse that are accompanied by a sanitary certificate of origin issued by the Canadian Government are allowed unrestricted entry into the United States.
>
> Animal products that do not originate from a Canadian-approved slaughterhouse and for which the exporter is unable to obtain a Government certificate attesting to the origin of the materials must be consigned directly from the port of entry under USDA seal to an approved rendering plant in the United States.
>
> There are several USDA-approved rendering facilities authorized to receive animal products of Canadian origin.[22]

47 Counsel for the Director objected to this evidence being relied upon because it had not been adduced through a witness and therefore could not be subjected to cross-examination.[23] The Tribunal takes cognizance of that defect.

48 Canadian federal legislation is found in the *Meat Inspection Act*,[24] and in the regulations promulgated pursuant to that Act. Sections 7 and 8 of the Act provide:

> 7. <u>No person shall export a meat product [includes the carcass of an animal or a product or by-product of a carcass] out of Canada unless</u>
>
> > (a) it was prepared or stored in <u>a registered establishment</u> that was <u>operated in accordance with this Act</u> and the regulations;

(b) that person provides an inspector with evidence satisfactory to the Minister that the meat product meets the requirements of the country to which it is being exported; and

(c) that person obtains a certificate from an inspector authorizing the export of that meat product.

8. No person shall send or convey a meat product from one province to another unless

(a) it was prepared or stored in a registered establishment that was operated in accordance with this Act and the regulations; and ...

(underlining added) [25]

49 The *Meat Inspection Regulations, 1990*, however, provide:

3.(1) Sections 7 to 9 of the Act do not apply in respect of

. . .

(k) a meat product that has not been condemned and is destined for inedible rendering.

. . .

(3) Section 8 of the Act does not apply in respect of the following meat products:

. . .

(c) a meat product that has been condemned and is destined for inedible rendering in accordance with paragraph 54(1)(b); [26]

50 Thus, there is no prohibition arising from federal legislation which prevents renderable material being taken across either provincial or international borders unless it is condemned material. Also, condemned material is not prohibited from being moved interprovincially. However, since section 7 of the *Meat Inspection Act* applies to such material, it cannot be exported unless it originates in a federally licensed slaughterhouse or meat processing plant (a registered establishment). [27]

51 Insofar as provincially licensed slaughterhouses and meat processors are concerned, s. 108 of *Regulation 607*, promulgated pursuant to the *Meat Inspection Act (Ontario)* [28] provides:

108. Where this Regulation prescribes that,

(a) an animal be condemned and killed;

(b) a carcass or a part or organ thereof be condemned; or

(c) inedible offal and meat that is not food be disposed of,

an inspector shall direct that such animal, carcass, part, organ, inedible offal or meat that is not food be disposed of by,

(d) delivery to a rendering plant,

(i) licensed under the *Dead Animal Disposal Act*, or

(ii) approved under the *Meat Inspection Act* (Canada),

in a vehicle constructed and equipped in accordance with the *Dead Animal Disposal Act*;

(e) burying with a covering of at least sixty centimetres of earth;

(f) incineration by a method approved by the Director [Director of Veterinary Service Branch of the Ministry of Agriculture and Food;

(g) rendering in a plant that is equipped with high temperature rendering facilities approved by the Director; or

(h) any other method approved by the Director. [29]

52 While subparagraph 108(d)(ii) seems to contemplate the licensing of renderers under the federal *Meat Inspection Act*, in fact no such licensing is done and all Ontario renderers are provincially licensed. Thus, under Ontario law provincially licensed slaughterhouses must deliver condemned materials, inedible offal and meat that is not food to provincially licensed renderers. There is no evidence suggesting that paragraph 108(g) or 108(h) has been used to broaden this restriction.

53 Provincial legislation also imposes restrictions on the disposition of deadstock by collectors of that material. Section 4 of the Ontario *Dead Animal Disposal Act* [30] requires that dead animals (horses, goats, sheep, swine, cattle) be collected by licensed collectors and provides:

> (2) No collector shall give, sell or deliver a dead animal to any person other than the holder of a licence as an operator of a receiving plant or a rendering plant under this Act.

And section 5 requires:

5.(1) No person shall engage in the business of,

(a) a broker;

(b) a collector;

(c) an operator of a receiving plant; or

(d) an operator of a rendering plant,

without a licence therefor from the Director.

(2) No person shall collect a dead animal unless he is the holder of a licence as a collector.

Thus, Ontario law prevents deadstock being delivered to a renderer who is outside Ontario (i.e., who is not provincially licensed).

54 Federally inspected slaughterhouses account for 80% of the cattle slaughtered in the southern Ontario region and for 90% of the hogs slaughtered. [31] Deadstock and condemned material comprise from 5 to 10% of the total red meat renderable materials available for rendering.

55 There is evidence that the regulatory constraints described above do not impose a significant impediment to the movement of most renderable materials across the Canada-United States border. In 1975-76, Rothsay (Moorefield) had a contract with a pork slaughterer in Detroit whereby renderable material was brought across the border for rendering. Mr. Kosalle gave evidence that the handling of deadstock and condemned material caused no problems. These were simply put in a separate container by the slaughterer and picked up under a side agreement which Rothsay had with a Detroit renderer. There is no reason to suppose that a similar arrangement would not work with respect to material flowing into the United States from Canada. The Detroit contract was lost when a renderer closer to the slaughterer obtained the account. Rothsay (Moorefield) had become uncompetitive when the exchange rate changed.

56 Orenco operated a collection service called Liberty Reduction Inc. in the Buffalo area for some time. The material collected was brought to Orenco in Dundas for rendering. This operation was eventually sold to Darling & Company, Ltd ("Darling") on January 7, 1991. The volumes were not high enough for it to make economic sense for Orenco to continue that operation. It was not discontinued as a result of difficulties arising because of regulatory constraints related to crossing the border. Darling closed its Buffalo plant a few months later because of low volumes.

57 When Darling had labour difficulties at its Toronto plant sometime during 1988-89, materials were taken to Darling's Detroit and Buffalo plants for rendering. Also, there is evidence that some material (grease) is now being taken from Sault Ste. Marie to Detroit. While it is clear that Darling has consistently brought materials from the London and Windsor areas to its Toronto plant rather than taking it to the Detroit facility, this is not necessarily evidence that difficulty exists in taking materials across the border.[32] That behaviour can result, for example, from factors related to the capacity utilization of the various Darling plants.

58 Baker has been importing renderable material from Quebec to the United States since June 1991 and is currently importing 227 metric tons of material a week including packinghouse material, bone and fat, and deadstock. (Quebec legislation respecting deadstock may be different from that in Ontario.) Baker has experienced delays at the border on two occasions. One problem was resolved when the letter referred to above[33] was given to border officials and they verified its contents with authorities in Washington. The other problem was clerical in nature and was quickly resolved.

59 It is clear that there has been some but not a great deal of cross-border transportation of renderable materials. In the Toronto-Hamilton area this was probably largely due to the fact that until recently Darling had a rendering plant in Buffalo, New York. Thus, the lack of cross-border activity can be attributed to market configuration rather than to regulatory or other practical constraints arising from the existence of the Canada-United States border.

(3) Consumer Preferences

60 It is suggested that consumers are unwilling to turn to a supplier whose rendering plant is more than 200-250 miles distant or whose rendering plant is located in the United States. Since renderable materials must be removed on a daily basis, there is a need for reliable service. The Tribunal is not convinced that the alleged consumer preferences play much of a role in the market definition. To the extent that such preferences exist the Tribunal considers them as resulting more from lack of supplier recognition than from any innate reason related to distance or borders. In fact, Lomex has acquired two customers and it operates from a distance of over 250 miles away.

C. Conclusion

61 The purpose of determining the product and geographic dimensions of the relevant market is of course to allow for identification of the competitors to the merged firm and the calculation of the respective market shares of the market participants. It is important to emphasize, however, that market boundaries cannot and will not in many instances be precise. They can only be approximations. As long as market share statistics are not taken as the only indicators of the existence of market power, the exact location of those boundaries becomes less important. Restraints on a merged firm's (alleged) market power can come from both inside and outside the market as defined.

62 It is useful to refer to some comments set out in the text entitled *Competition Law* by Whish. While that text is directed to the difficulties in defining the product dimensions of a market, they equally apply to geographic dimensions:

> The idea of interchangeability [substitutability] is simple enough. In practice of course one finds that identification of the relevant product [geographic] market can give rise to great difficulty. The reason for this is that the concept of the relevant market is just that - a concept; it is a useful theoretical device which facilitates an understanding of the problem of monopoly, but it is not to be supposed that it is reflective of the real commercial world.[34]

And further:

> The difficulties associated with the relevant product [geographic] market issue can be overcome provided that definition of the market is not thought to be of fundamental significance: in particular it is vital that having identified the relevant market, competitive pressures which come from outside that market should still be considered. The mistake is to suppose that in the commercial world there is a whole series of independent, discrete relevant product [geographic] markets which exert no influence on one another. In fact in business there exists a complex web of interlocking markets and sub-markets which may have an influence on one another in a more or less tangential way. Once that has been recognized, the danger of defining the market too narrowly ceases to be a problem, because the identification of the market is seen to be only a staging post on the way to the really important question which is whether a firm is in a position to behave independently of its competitors. For this purpose it is relevant to consider not only the position of firms within the defined product [geographic] market but also the competitive pressure that can be exerted from those in other markets. ... If this approach is [not] adopted, then immense strain is imposed on the meaning of the relevant product [geographic] market, greater than the concept can realistically bear. [35]

63 In the present case, as has been noted, the product dimensions of the relevant market are easy to define: the provision of rendering services for non-captive red meat renderable material which includes deadstock materials and blood. The geographic dimensions, however, are more uncertain. This uncertainty arises because of the inherent ambiguity with respect to where market boundaries begin and end and, more importantly in this case, because of changes which have been occurring in the market since the merger. [36]

64 With respect to the geographic dimensions the Tribunal considers that transportation and other costs related to operating at a distance are such that a renderer located over 200-250 miles from Rothsay-Orenco should not be included in the relevant market. While it is clear that the Canada-United States border will result in some additional costs for renderers who engage in the cross-border collection of the material as a result of required paper work and possible delays at the border, the Tribunal is of the view that renderers located within the United States but close to the border could provide effective competition to the merged firm.

65 In the present case regardless of whether one defines the geographic market as the Ontario market (as the Director contends) or as the Ontario market plus parts of northern New York State and southeastern Michigan (as the respondents contend), the market is still highly concentrated. [37]

D. Identification of Competitors

66 The purpose of defining the relevant market is of course to facilitate identification of the merged firm's competitors and to assess the market share of the relevant market which each holds vis-à-vis the merged firm. A significant difficulty in identifying the merged firm's competitors in the present case arises because of the dramatic changes which have taken place and are taking place independent of the merger. It is relatively easy to identify Rothsay and Orenco's competitors at the time of the merger in July 1990. These were Darling (Toronto), F.W. Fearman Company Limited ("Fearman"), Banner Packing Limited ("Banner"), J.M. Schneider Inc. ("Schneider"), and Ray Bowering. In addition, it was anticipated that Central By-Products would soon become a competitor. [38]

67 As of the date of the merger, Darling had rendering plants in Buffalo, Toronto and Detroit. Darling is the largest independent renderer in North America and has thirty-four rendering plants throughout the United States and one in Canada. Darling has been experiencing financial difficulties. Darling closed its Buffalo plant some time during either the winter or spring of 1991. Darling's Toronto plant was situated on land leased from the Toronto Harbour Commission. On the most recent expiration of the lease (October 31, 1990) the Commission refused to renew. A court order for vacant possession by January 7, 1992 was obtained. Even without the cancellation of this lease, there was speculation that Darling intended to leave the harbour area because of the costs involved in meeting environmental requirements. [39] Whether that company will relocate in Canada is not clear. Thus, at present the only Darling plant whose existence can be relied upon to provide competition to the merged firm is in Detroit.

68 Fearman was a competitor prior to the merger but it was bought by Canada Packers Inc. (now Maple Leaf Foods Inc.) on February 18, 1991. That acquisition has not been challenged by the Director. Fearman is therefore no longer a competitor and must be treated as part of the Rothsay-Orenco group. Fearman was and is a pork slaughterer whose rendering operation was mainly devoted to processing captive materials although more recently some non-captive material is being processed.

69 Banner remains a competitor to the merged firm. It is a fairly small renderer located in downtown Toronto. Much of its finished product material (tallow and meal) goes into its own pet food operation. It was a vigorous competitor to Orenco, Rothsay (Toronto) and Darling (Toronto). At the same time, its costs of operation have risen as a result of amounts which must be spent to meet environmental concerns and revenue is dropping because of the depressed state of prices for the finished products (tallow and meal).[40] Prices charged by Banner to its customers for rendering services have accordingly been rising. Banner has indicated an interest in selling its Toronto rendering facility since it moved its pet food operation to Trenton, Ontario.[41]

70 Schneider is located in Kitchener, Ontario and it remains a competitor in the market. Its rendering facility until recently were used to process only captive material. As a result of the closure of its beef slaughtering operations in Ontario, capacity became available to render non-captive materials and it entered the non-captive red meat rendering market.

71 Ray Bowering, a deadstock collector located in Melbourne, Ontario, remains a competitor. He operates a small batch cooker and renders very small volumes.

72 Central By-Products is not yet in operation but the evidence indicates that it soon will be. It is being constructed by David T. Smith and James W. Murray. Messrs. Smith and Murray operate deadstock businesses. They decided in February 1990 to construct their own rendering facility near Hickson, Ontario, on land owned by Mr. Murray. He operates Oxford Deadstock Limited and presently uses Darling as a renderer. Mr. Smith operates a deadstock collecting and processing operation as well as a pet food business, Atwood Pet Food Supplies Ltd and presently uses Orenco as a renderer.

73 There is no evidence that Baker's plant in Rochester, New York has historically been a competitor of Rothsay and Orenco in southern Ontario. That plant, like Darling, is also part of a large multi-plant firm. It is the second largest renderer on the North American continent. The Baker (Rochester) plant is within geographical reach of the relevant market, being located 135 miles from Orenco's plant in Dundas. It is clear that both Baker (Rochester) and Darling (Detroit) would become increasingly competitive in the southern Ontario market served by the merged firm (insofar as geographical location is concerned) in proportion to any supra-competitive price rise which might be exacted. Since Baker (Rochester) has not historically been in the market and since it is not immediately adjacent to the border, it may be that it should be considered a potential entrant rather than a competitor in the market. Its relationship to the merged firm will be considered from both points of view.

74 Lomex commenced operating in the Toronto market in the summer of 1991[42] and, as has been noted, is taking two full truck loads from two of the larger Toronto area producers of renderable materials to Lomex's plant outside Montreal. The Tribunal has not classified Lomex as a competitor within the market but recognizes that as a potential entrant Lomex will provide some discipline on the merged firm's ability to raise prices.

V. Substantial Lessening of Competition

75 Market power in the economic sense is the ability to maintain prices above the competitive level for a considerable period of time without such action being unprofitable. In a competitive market prices will tend towards marginal cost. Market power can be viewed as the ability of a firm to deviate profitably from marginal cost pricing. In assessing the likely effects of a merger, one considers whether the merged firm will be able to exercise market power additional to that which could have been exercised had the merger not occurred. A merger will lessen competition if it enhances the ability of the merging parties to exercise "market power" by either preserving, adding to or creating the power to raise prices above competitive levels for a significant period of time. One considers the degree of any such likely increase and whether by reference to the particular facts of the case it should be characterized as substantial.

76 Whether an enhancement of market power exists as a result of a merger and whether it is substantial is determined by reference to a number of factors. Market share data can give a *prima facie* [43] indication as to whether such is the case.

A. Market Concentration

77 The market concentration in the relevant market can be measured by reference to a number of different indicia. What measure will be chosen will depend upon the nature of the industry in question and the data available. In this case two measures have been used: the amount of renderable material actually processed in the recent past by the firms (historical output) and the plant capacity of the competitors (productive capacity). With respect to firms which have not previously been active in the market but which as a result of changes are now considered to be competitors, only the second method of measurement can be used.

78 A market share measurement based on pre-merger volumes of renderable material processed in southern Ontario indicates that Orenco and Rothsay were each servicing approximately 30% of that non-captive red meat rendering market. Darling's Toronto plant was processing 13%. Banner was processing 12% and Fearman 2%. An extrapolation from those data indicates that after the merger the merged Rothsay-Orenco firm will hold approximately 62-63% of the southern Ontario market. The next largest firm, Darling, for the moment at least would hold approximately 12-13%. Banner would hold 11-12%. Schneider and Ray Bowering would continue to process small amounts of non-captive material.

79 While the increased market share concentration calculated on that basis can be seen at a glance, two tools which have been developed in the United States for measuring market concentration in a summary fashion were referred to in evidence: the four-firm concentration ratio [44] and the Herfindahl-Hirschman Index ("HHI"). The four-firm concentration ratio measures market concentration by adding together the market shares of the four largest firms in the market. If the post merger concentration is very high and the merged firm accounts for a significant proportion thereof, then the merger is one which if assessed solely by reference to market shares will be considered to lead to a substantial lessening of competition. The HHI is computed by adding together the squares of the market shares of all the firms in the market. [45] The HHI can theoretically range from near zero to 10,000 (100 × 100) for a monopoly. In the context of anti-trust enforcement in the United States, it is generally thought that if a market has an HHI over 1,800 it is highly concentrated. An HHI between 1,000 and 1,800 is of medium concentration and below 1,000 relatively unconcentrated. [46] If the increase in HHI as a result of the merger exceeds 100 and the post merger HHI for the market exceeds 1,800, according to the Director's expert, one should assume (at least on a *prima facie* basis) that the merger will substantially lessen competition. [47]

80 Thomas W. Ross, who gave expert evidence on behalf of the Director, noted that the pre-merger four-firm concentration ratio for the total red meat renderable materials (captive and non-captive) in southern Ontario was 86.8% measured by reference to the volume of renderable materials processed each week by the firms. [48] The post-merger four-firm concentration ratio for these materials is 90.4%. The pre-merger ratio for non-captive materials only was 90.4% and post-merger is 91.6%. [49] While the application of this method of measurement clearly demonstrates how highly concentrated the markets are, it tells little about the effects of the merger. It demonstrates the inadequacies of the four-firm concentration ratio as a measure of increased concentration [50] in a case such as the present where the changes resulting from the merger are primarily occurring among the top four firms.

81 David D. Smith, who also gave expert evidence on behalf of the Director, did an analysis applying the HHI to measure increased concentration and using as a measure of market share the volume of non-captive red meat renderable material being processed in July 1990 by Ontario renderers. This analysis led to a finding that the increase in the HHI as a result of the merger with respect to the rendering of red meat by-products and deadstock was 1,594 points to a total HHI for that market of 3,608. Insofar as non-captive material is concerned, it is estimated that the increase is 1,526 points to a market total of 3,791.

82 The second variable by reference to which the position of the various competitors was assessed is plant capacity. This allows some measurement to be made with respect to Baker (Rochester) and Darling (Detroit) as competitors even though they have not historically been such. The capacity of some of the plants is not greatly in dispute: Darling (Detroit) can process approximately 1,600 metric tonnes per week; Baker (Rochester) can process approximately 1,600 metric tonnes per week; Schneider can process approximately 800 metric tonnes per week; Banner can process approximately 510 metric tonnes per week; Central By-Products will be able to process approximately 363 metric tonnes and Ray Bowering has capacity for 23 metric tonnes; Fearman's capacity is approximately 450 metric tonnes per week, which should now be added to that of the merged firm. [51]

83 The capacity of the Orenco and Rothsay (Moorefield) plants are subject to more dispute. The respondents say Orenco's capacity is approximately 2,500 metric tonnes per week; the Director argues that it is approximately 2,900 metric tonnes. It is not necessary to consider in detail the dispute with respect to Orenco's capacity because the difference is small. However, the positions of the two parties vary greatly with respect to the capacity which should be attributed to Rothsay (Moorefield). The respondent argues that insofar as the equipment at that plant is presently used for rendering poultry materials, it should not be considered to be capacity available to render red meat. Rothsay (Moorefield) has two cookers; one is used full- time to render poultry materials and the other part-time for poultry offal and part-time for red meat. Approximately 200 metric tonnes per week of poultry offal is processed on the second cooker. This occupies approximately 17 to 18 hours per week with an additional seven hours required for cooking and cleaning the equipment when it is switched over.

84 The Tribunal accepts the position that capacity for present purposes should be assessed by reference to the equipment that is able to render red meat materials rather than to the purpose for which it is presently being used. The Tribunal understands from the evidence that this is the basis on which the capacities of the other plants, at least Baker (Rochester) and Darling (Detroit), were assessed. The extent to which Rothsay (Moorefield) would actually switch from processing poultry materials to processing red meat is more appropriately considered in assessing the significance of market share and plant capacity estimates, particularly in the context of assessing the import of excess capacity. Accordingly, for present purposes the Rothsay (Moorefield) red meat rendering capacity is approximately 3,200 metric tonnes per week.

85 On this basis the merged firm including Fearman would hold approximately 56% of the total productive capacity of the market if both Baker (Rochester) and Darling (Detroit) are considered to be competitors and approximately 66% if only the latter is included. Dr. Smith did a number of HHI calculations based on plant capacity. These were based on a number of different possible scenarios with respect to who was in and who was out of the market. While such calculations could be done by reference to the capacities which the Tribunal has accepted, it is not obvious that they add much in the present case.

86 The various measurements indicate that the merger increases market share considerably in an already highly concentrated market and gives rise to at least an initial concern that the merger will likely substantially lessen competition in that market.

B. Excess Capacity - Increasing Available Capacity by Switching Rendering Equipment Presently Used for Poultry - Increasing Capacity by Easy Expansion of Existing Facilities

87 As has already been noted, market share is not necessarily a reliable determinant of market power. As an indicia of such it may either overstate or understate a firm's market power. If other firms in the market have excess capacity, they can respond to a supra-competitive price rise by flooding the market at a lower price level. As a result, the best question to ask when assessing market power, in some circumstances, is whether the respondents' current competitors have capacity available to serve what otherwise would be the merged firm's customers. One of the most significant sources of high supply elasticity is the excess capacity of competing firms. The respondents argue that Rothsay-Orenco competitors have extensive excess capacity in comparison to the merged firm and therefore the merged firm will not be able to exercise significant market power.

88 Insofar as the alleged excess capacity of Rothsay-Orenco's competitors is concerned, the situation of Darling is quite problematic. As has been noted, it has lost its Toronto lease and will have to move. Mr. Kosalle's view is that Darling will stay in the Toronto-Hamilton area and probably construct a new plant. He is also of the view that Darling will transport Toronto

materials to its Detroit plant in the interim. Darling was processing approximately 850 metric tonnes per week at its Toronto plant; 40% of this was collected west of Lambeth which is near London, Ontario. For the purpose of assessing excess capacity (existing or likely to exist in the near future) the Tribunal is not willing to place much reliance on Darling constructing a new plant in the Hamilton area. At the same time, since Darling is a large multi-plant firm with plants in Cleveland, Ohio, Detroit, Michigan, Coldwater, Michigan and Milwaukee, Wisconsin, the Tribunal accepts the argument that a considerable amount of capacity could be opened up at the Detroit location by shifting volumes between the Cleveland, Coldwater and Milwaukee facilities.

89 The Tribunal heard evidence that Banner was operating at capacity (approximately 500 metric tonnes per week) but could increase that capacity by approximately 390 metric tonnes per week if $400,000 was spent on additional equipment.

90 Schneider also has excess capacity as a result of closing its Ontario cattle slaughtering operations. Its capacity is estimated to be approximately 800 metric tonnes per week of which approximately 400 metric tonnes is presently being used. Central By-Products is installing a plant with the capacity to render approximately 360 metric tonnes. It will use only 113 metric tonnes per week for its captive materials. Baker (Rochester) could open up excess capacity of approximately 400 metric tonnes.[52] Lomex in Montreal is thought to have excess capacity and Rothsay (Laurenco) at that same location is known to have excess capacity of approximately 800 metric tonnes. Although, as has been noted, the Tribunal has not considered the Montreal plants to be in the relevant market.

91 Insofar as the merged firm's excess capacity is concerned, it is alleged that after the merger Orenco will have only 233 metric tonnes excess capacity per week and Rothsay (Moorefield) will have only 78. These figures appear to significantly understate the excess capacity of those establishments. In the first place, this estimate assumes that Fearman's rendering plant will be closed and the material previously rendered at that plant will be rendered in the future at Rothsay (Moorefield) and Orenco. The decision to close Fearman's rendering plant and thereby reduce Rothsay and Orenco's excess capacity is a matter which is within the control of the Agribusiness Group of Maple Leaf Foods Inc. It is a decision which apparently was only discussed two or three weeks prior to the Tribunal's hearing. This alleged decision, at the moment, is speculative.

92 In addition, the excess capacity of Rothsay (Moorefield) has been calculated on the assumption that priority will be given to the rendering of poultry materials at the expense of red meat materials. The excess capacity figures for Moorefield are calculated by excluding usage of the equipment which is presently dedicated to processing poultry materials. It is assumed that the equipment will continue to be used for that purpose. With respect to whether Rothsay (Moorefield) would switch its equipment to rendering poultry material if rendering red meat material became more profitable, there is much reason to think that it would not. While poultry offal does not produce high quality tallow, poultry feathers do produce a high quality meal.[53] In addition, much of Rothsay's poultry volumes are captive materials for which disposal would have to be provided in any event.

93 It is known that Maple Lodge Farms Ltd, a poultry processing firm not related to Maple Leaf Foods Inc., has entered the poultry material rendering business and might expand this activity. Maple Lodge Farms Ltd produces 36-38% of Ontario's poultry.[54] It is estimated that Maple Lodge Farms Ltd was processing 23 metric tonnes per week in June 1990, and in October 1991 it was processing 218 metric tonnes per week. To the extent that that firm ceases to use Rothsay (Moorefield) to process its renderable materials, capacity would be freed up. Most important with respect to the respondents' estimates of their excess capacity is a letter written in December, 1990. It states:

> ... Rothsay (Moorefield) and Orenco have sufficient cooking capacity to handle all the raw material currently processed by Rothsay, Orenco and Darling & Co. in Ontario. This cooking capacity could be fully utilized if relatively inexpensive modifications were made to the Rothsay Moorefield and Orenco plants to de-bottleneck their production lines. For example, Orenco could increase its capacity by installing additional press equipment.[55]

94 It is clear that in general in this industry it is fairly easy for renderers to increase their capacity or when they are a multi-plant firm to shift the renderable material among different plants to open up capacity at a given plant when it is needed. Some of the larger firms, at least, plan their plants with a view to being able to respond quickly in this way. With respect to the ease with

which the firms can increase or reallocate their capacity, this can be seen in the reallocation which took place among Rothsay (Laurenco), Rothsay (Moorefield) and Orenco after the merger in response to the expropriation of Rothsay (Toronto). With respect to the ability to move material between plants and thereby free up capacity, Joseph G. Huelsman, General Manager, Baker Commodities Inc., gave evidence as to how this could be done at the Baker (Rochester) plant if it was deemed advisable to do so in order to enable that firm to enter the southern Ontario market. There appears to be significant excess capacity in the industry generally and the merged firm is not capacity-constrained. The excess capacity of firms both within and outside the relevant market will provide a degree of competitive pressure on the merged firm and restrain to a considerable extent its ability to raise prices.

C. Market Environment

95 A significant factor in this case is the changes which are taking place in the red meat rendering market. The Director describes the market as flat, the respondents describe it as declining. The Tribunal finds the respondents' description persuasive, particularly the evidence of Erna H.K. van Duren. [56] She estimates that the supply of renderable red meat material resulting from cattle slaughter in Ontario is likely to decline by 4% per year until at least 1995. She estimates that the renderable red meat material from pork slaughter is expected to decline 0.3% per year over the same period. Poultry materials are expected to increase by approximately 3.2% per year. As has been noted, beef materials are sought-after because they produce high quality tallow. Poultry feathers, however, produce high quality protein meal.

96 Dr. van Duren's opinion is based on several factors. Firstly, consumer preference for red meat has been declining since 1970. This change in consumer taste from red meat to poultry and non-meat products results from concern that eating red meat is not as healthy as eating the other products. The relative price of red meat vis-à-vis other products is also referred to as a factor.

97 Secondly, insofar as Ontario is concerned, there has been a marked decline in cattle-rearing activity in the province. Such activity has been shifting westward to the provinces of Alberta and Saskatchewan. The trend westward is due to the increased size of herds needed to stay competitive. These can be raised much more economically in Alberta and Saskatchewan than in Ontario.

98 The shift of cattle-rearing operation westward has been accompanied by a movement to locate slaughter operations close to where the cattle are raised. Instead of transporting either live cattle or cattle carcasses east, the various cuts for the consumer trade are more likely to be prepared at a slaughterhouse located close to where the cattle have been reared. Transportation costs are less for what is known as boxed beef than for live animals or carcasses.

99 There was some discussion before the Tribunal about projections prepared by Agriculture Canada for Canada East and Canada West which projected a much smaller decline in cattle slaughter in Canada East than Dr. van Duren estimates. Dr. van Duren notes that the Canada East and Canada West models are merely mirrors of each other and thus the Agriculture Canada model is one that really pertains to Canada as a whole and says little about the Ontario situation. [57]

100 The Director argues that the market may have been declining but that there is no reason to assume that the past trend will continue. Dr. van Duren, on the other hand, argues that there is little indication that the restructuring of the North American red meat industry which has been occurring is likely to stop, especially in Canada. Thus, it is argued that it is likely that the Canadian industry will continue to consolidate and increase its geographic concentration westward with a consequent decline of beef slaughter in Ontario. The Tribunal accepts Dr. van Duren's opinion.

101 Reference was also made to the trends and restructuring which have been occurring in the industry generally, particularly in the United States markets since the 1970s. While the Tribunal is reluctant to put much weight on events which occur in other markets, in this instance it agrees that industry trends in general provide some relevant information concerning the context within which the industry as a whole is operating. Since 1970 there has been a decline in the number of independent renderers in the United States from over 600 to under 350. This decline has been particularly noticeable in large metropolitan areas. The New York Metropolitan Area has seen a reduction from seven to two rendering facilities since the early 1980s. In the Los Angeles Metropolitan Area, the amount of rendering has dropped from four plants operating 24 hours a day, six days a week, to two

plants operating at two-thirds capacity. Finally, in the Chicago Metropolitan Area the amount of rendering has been reduced from nine large plants, including the largest in the world, plus several smaller plants in 1975 to only one small plant. [58] While it is true that a city or state boundary may tell one little about the geographical dimensions of the relevant markets, the reduction in the number of plants in the larger metropolitan areas does give some indication of the trends in this market.

102 Decline in the volumes of red meat material available for rendering in Ontario, of course, opens up additional excess capacity for renderers, thus providing an additional incentive for renderers to compete aggressively for material in their current collection areas and to increase the size of those collection areas. There is also incentive as volumes decline to purchase adjacent renderers in order to acquire the requisite volumes.

103 In addition to the decline in red meat materials, this industry faces increasing costs as a result of environmental concerns and as a result of changes in what is considered to be appropriate use for the land on which some rendering plants are located (or for the land proximate thereto). These factors force changes in market configurations. For example, both Rothsay (Toronto) and Darling have lost their Toronto harbourfront property and lease respectively. The Toronto harbourfront location afforded proximity to the major suppliers of renderable materials in the Toronto area and access to port facilities from which tallow could be shipped to the international market in which it is sold. It is argued that environmental concerns would lead to difficulties with respect to any proposed expansion of Rothsay (Moorefield). While the Tribunal is not convinced that this would necessarily be the case, it is clear that failure to meet environmental standards in the past has been the subject of much adverse publicity for that plant. Banner also has experienced increased costs as a result of environmental considerations. [59]

104 Another factor which is having a negative impact on this industry is the relatively depressed prices at which tallow and meal are being sold. The respondents state that the protein meal which is produced from the rendering process is, in general, sold within Canada but that the tallow products are exported. It is noted that there is an abundant supply of alternative non-animal based products which compete with the tallows and which are being promoted as preferable to the animal-based products.

105 In general, then, the industry is one in which there has been and is a decreasing supply of quality renderable materials, costs have been rising and there is little ability to control the price at which the finished products (tallow and meal) are sold. Renderers have been increasing their prices to customers, for example, by charging for the pick-up of materials which previously had been collected without charge and by picking up but ceasing to pay for materials which previously had been purchased. While some of the witnesses see these changes as resulting from the merger, the evidence indicates that such is not the case. These changes are a result of the increasing costs and decreasing revenues which the renderers are experiencing. Rendering is a necessary service and thus renderers are not likely to disappear completely from an urban area. The pressures on the industry, however, have led to increasing consolidation. [60]

D. Barriers to Entry

106 In the absence of significant entry barriers it is unlikely that a merged firm, regardless of market share or concentration, could maintain supra-competitive pricing for any length of time. An attempt to do so would cause competitors to enter the market and the additional supplies created in that manner would drive prices back to the competitive level.

107 As has been noted above, whether one classifies a firm which has not previously been active as a competitor to the merged firm as a competitor in the relevant market or as a potential entrant whose existence restrains the merged firm from levying supra-competitive prices is not of great importance. The respondents argue that entry can be defined in a number of ways: to include new firms entering the market, firms expanding their activities into the relevant market from another geographic area, local firms beginning to offer the relevant product (which did not do so before), and firms already in the relevant market (sometimes called "fringe firms") expanding their output. [61] The Tribunal has chosen not to classify the expansion of output by existing firms, be they "fringe firms" or major competitors, as entry decisions. The Tribunal considers entry to be either the establishment of a new firm in the market whether entirely new to the industry or new to the geographic area (e.g., the Tribunal has already indicated that it considered Lomex to be attempting entry) or local firms which previously did not offer the product in question commencing to do so (e.g., deadstock operators or slaughterhouses commencing to also operate a rendering facility). [62]

108 The Director has alleged that barriers to entry into the relevant market consist of: the environmental and regulatory requirements which must be met; the difficulty which exists with respect to acquiring sufficient supplies to become viable; the sunk costs involved in starting a rendering plant.

(1) Environmental and Regulatory Constraints

109 There is no doubt that provincial Ministry of the Environment, Ministry of Agriculture and Food and municipal approvals are needed to start a rendering plant and that some locations are simply not available for this use. Many sites in urban areas or sites close to urban areas are not likely to be available. Environmental and regulatory approvals can more easily be obtained, however, if an appropriate site is chosen, for example, a site in an industrially-zoned area of a large municipality. Mr. Kosalle testified that the Hamilton Harbour Commission has several sites suitable for rendering facilities and that the Hamilton Harbour Commission is amenable to leasing a site for such a facility. These sites are particularly attractive as they provide access to a wharf which allows for the economical transportation of finished products. [63]

110 Reference was made to the fact that Central By-Products had been delayed in opening its newly constructed facility as a result of the need to comply with environmental requirements. Central By-Products commenced construction of its facility in February 1990 without obtaining prior environmental approval. Professional engineers were not retained to design air and water treatment until after construction had been started. Ministry of the Environment approval for the new plant is expected shortly. [64] The experiences of that firm demonstrate the difficulties which an inexperienced entrant into the market can encounter.

111 The Tribunal does not put much weight on the length of time Rothsay took in trying to locate a new site when faced with the expropriation of its Toronto plant. There would be good reasons for Rothsay to try to retain its Toronto location for as long as possible. The Tribunal is of the view that *de novo* entry would likely take approximately 18 months to accomplish. At the same time, entry by a supplier from an adjacent geographic market through expansion of its collection area would not entail this difficulty. Also, forward integration on a small scale by the larger slaughterhouses would likely be less difficult if land were available at the site and the slaughterhouse already located in an appropriately zoned area.

(2) Sufficient Supplies

112 Insofar as obtaining sufficient supplies are concerned, the amount of material needed will depend on the size of the plant in question. Central By-Products clearly is of the view that 113 metric tonnes is sufficient. [65] A slaughterer or deadstock operator who establishes a rendering plant at the same location as his slaughtering or deadstock operation, will incur less costs in rendering material produced therefrom than a non-integrated renderer since no collection costs will be involved. Fearman, for example, has been operating a rendering plant for its captive pork products having a capacity of 450 metric tonnes per week. Schneider has a capacity of approximately 800 metric tonnes per week. Banner which has no captive material operates a plant having a capacity of approximately 510 metric tonnes per week.

113 Better Beef and Quality Meat Packers are examples of slaughterers with sufficient supply to establish at least a small scale rendering operation. They respectively produce approximately 900 and 1,000 metric tonnes of renderable material per week. Groups of smaller suppliers might also have the requisite minimum volume to justify construction of a rendering plant. [66]

114 Such enterprises, of course, would not be able to establish a rendering facility of the scale of Orenco or Rothsay. What is more, given the contracting nature of the industry one can question whether or not much entry is in fact likely to occur as a result of forward-integration by slaughterers such as Better Beef and Quality Meat Packers or by a group of smaller companies. But this is clearly more than just a mere possibility. Central By-Products has taken this initiative recently and insofar as poultry is concerned, Maple Lodge Farms Ltd appears to have done so. The test as to whether potential entry will discipline the market is whether such entry is likely to occur, not merely whether it could occur.

(3) Sunk Costs

115 Insofar as sunk costs are concerned, there is little evidence as to the proportion of the investment which is sunk in a rendering plant. There is evidence, however, that the total investment required can vary considerably depending on the size of the facility. Central By-Products has recently built a plant in Hickson, Ontario at a cost of $1.1 to $1.2 million. Ray Bowering is a small collector who originally sold material to Phil's Recycling. Ray Bowering built his own plant which can render 23 metric tonnes of material per week. [67] At the other end of the scale, however, Rothsay has estimated that $10 million would be reasonable as an estimate for the cost of a new plant. [68] While there is no direct evidence concerning the proportion of costs which would be sunk, it is clear that some must be involved, for example, the costs of obtaining regulatory approvals, the specialized equipment and building required which on resale would command a lower price than that for which they were bought.

(4) Conclusion

116 The extent of the barriers to entry depends upon the would-be-entrant. They are moderately high for a *de novo* entrant. The regulatory and environmental approvals which are required together with the construction time involved, as has been noted, would probably mean that approximately 18 months would be required to effect entry. In addition, the obtaining of sufficient volumes, unless one purchased such from an existing competitor in the market, as well as the fact that some sunk costs would be involved would discourage such entry. Indeed, given the state of this market one would not expect *de novo* entry.

117 As has been noted, entry on a small scale by forward integration of the larger slaughterhouses or groups thereof cannot be dismissed as a possible source of entry particularly if they are located in an area where such industry is accepted and where adjacent physical space is available. The experience of Messrs. Murray and Smith in constructing Central By-Products indicates that the investment required for a small operation can be relatively modest; sunk costs did not deter that initiative. While the Tribunal heard evidence that the small slaughterhouses would not contemplate attempting to render their own materials, there is no evidence that this is so for the larger ones. At the same time, the Tribunal does not rely on forward integration by the larger slaughterhouses as a significant source of probable entry. The most probable source of entry in response to a price rise is entry by existing suppliers already established in adjacent regions. Barriers to entry would not preclude entry by such renderers in response to a price rise. Also they might in any event attempt to do so in order to expand their collection area because of low volumes.

E. Renderable Materials Are Not Homogeneous

118 Renderable materials are not homogeneous. That is, they vary as to quality and in the distance at which they are located from the rendering plant. Some are picked up; some are delivered to the plant by the producer of the material or by others. The price paid for the material or the pick-up charge levied will differ depending on the quantity and the quality of the material. Quality will differ, for example, as between beef and pork material, as among shop bones and fat (e.g., material from supermarkets), packing house materials, low grade deadstock materials, blood. The quality will also vary depending upon the freshness of the material. There are no published price lists relating to the collecting of renderable materials. While the main thrust of the Director's case has been that the merged firm will become a dominant firm, insofar as any increased market power might be alleged to lead to collusion or tacit price following rather than from dominant firm behaviour, the non-homogeneous nature of renderable materials (including differences in quality, quantity and distance from the rendering plant) would make such behaviour difficult.

F. Conclusion

119 It is clear that a lessening of competition will result from the merger. What will constitute a likely "substantial" lessening will depend on the circumstances of each case. It is difficult to articulate criteria which might be applicable apart from the obvious ones of degree and duration. The degree of lessening can in some circumstances be assessed by reference to factors such as the number of competitors left in the market, the amount of harm which can be done before the market is likely to again become competitive, for example, as a result of new entry. Various tests have been proposed: a likely 5% price rise sustainable

for one year; a 5% price rise sustainable over two years; a small but significant and non-transitory price rise. The Tribunal does not find it useful to apply rigid numerical criteria although these may be useful for enforcement purposes.

120 In addition to the lessening which will occur as a result of the merger, lessening is also occurring as a result of changes in the market independent of the merger. It seems clear that the Toronto area was the most competitive in North America. The competition was driven largely by the aggressiveness of Darling (Toronto) and Banner. A highly competitive situation existed between three firms all located within the City of Toronto (Darling, Rothsay and Banner) and one located 40 miles distant (Orenco). That competitive situation of course cannot be re-established.

121 The Tribunal is asked to assess the effects of the merger in the light of the new situation because it will be within that context that the merged firm will operate. The merger of the two largest firms and the closure of the Darling (Toronto) plant will substantially change the structure of the market. Even if Darling remains in the market and competes from Detroit it will not be as effective a competitor from that location as it was when it had a plant located in Toronto. Darling will take on the character of a fringe firm rather than a major competitor. While, as has been noted, the view has been expressed that Darling will build a plant in Hamilton, there is no verifiable evidence of such intention. One would have thought that if Darling intended to maintain a plant in that area it would have taken concrete steps with respect thereto before now.

122 Dr. Ross expressed the opinion that with the merger and the departure of the Darling plant from the Toronto-Hamilton area, the merged firm would likely assume the behaviour of a dominant firm with the remaining firms functioning as a competitive fringe. He expressed the view that the price increases which would follow could be very high because the elasticity of demand is so low (producers of renderable material must dispose of it). That conclusion depended upon a number of assumptions including high barriers to entry and limited excess capacity in the hands of the merged firm's competitors.

123 The respondents argue that the likely effects of the merger should be assessed by reference to a longer time frame than two years. Given the declining state of the market it is argued that in the not too far distant future (the respondents say five years) there will only be enough red meat renderable material to support one plant and some smaller specialty fringe firms. It is also argued that with or without the merger, given the projected increase in poultry materials together with the decline in red meat materials, Rothsay (Moorefield) will be dedicated to processing poultry materials and will be out of the red meat material rendering business.[69]

124 The decision in *United States v. General Dynamics Corp.*[70] is cited for the proposition that in assessing a merger one must consider changes that are occurring in the market and that are likely to occur in the future. That case concerned the coal industry. The United States government relied on statistical evidence to show that there was concentration in that industry, that the concentration was increasing, and that the acquisition in question would increase the market share of General Dynamics Corp. and contribute to the concentration trend. The Supreme Court upheld a finding of a lower court that despite this statistical evidence there would be no lessening of competition because of the acquired firm's current production and its much more limited potential for future production as a result of its depleted reserves.

125 While market share statistics are high and barriers to *de novo* entry are moderately high, the Tribunal cannot ignore the fact that a significant source of competitive discipline will exist from those firms which border geographically on the relevant market and which would be prepared to expand their area of collection in the face of a price rise by the merged firm. Indeed, such firms may find it necessary to do so in any event in order to obtain sufficient volumes for themselves. The fact that there is excess capacity everywhere in the relevant market and in the rendering plants proximate thereto means that constraint will exist on the merged firm's ability to raise prices.

126 It is true that the merger was not caused by a need to rationalize the firms as a result of lower volumes. Nor did the merger happen for the purpose of limiting competition in the market. The merger "just happened" as part of the larger acquisition of Canada Packers Inc. by Hillsdown. At the same time, the declining nature of the market is a significant factor to be taken into account since it will lead to increased excess capacity and increased expansion of existing collection areas.

127 In the light of these considerations, the Tribunal finds that it has not been convinced, on the balance of probabilities, that a substantial lessening of competition is likely to arise as a result of the merger of the two rendering businesses. This decision is very much a borderline one and the difficulty relates to the dynamic changes which are occurring in the market.

128 In addition, the effectiveness of any divestiture order which might be given is a relevant consideration. It will be discussed below after discussion of the evidence and arguments respecting efficiencies are considered.

VI. Efficiencies

129 Section 96 of the *Competition Act* provides:

> 96. (1) The Tribunal shall not make an order under section 92 if it finds that the merger or proposed merger in respect of which the application is made has brought about or is likely to bring about gains in efficiency that will be greater than, and will offset, the effects of any prevention or lessening of competition that will result or is likely to result from the merger or proposed merger <u>and that the gains in efficiency would not likely be attained if the order were made</u>.
>
> (2) In considering whether a merger or proposed merger is likely to bring about gains in efficiency described in subsection (1), the Tribunal shall consider whether such gains will result in
>
> (a) a significant increase in the real value of exports; or
>
> (b) a significant substitution of domestic products for imported products.
>
> (3) For the purposes of this section, the Tribunal shall not find that a merger or proposed merger has brought about or is likely to bring about gains in efficiency by reason only of a redistribution of income between two or more persons.
>
> (underlining added)

130 Section 96 recognizes the fact that mergers which result in or are likely to result in a substantial lessening of competition may have beneficial consequences as well as detrimental and anti-competitive ones. Mergers can increase the efficiency of firms, for example, by enabling them to benefit from economies of scale (the unit cost of production decreases as the amount of output product increases); economies of scope (when lower costs are included in producing two or more products together than in producing them separately); dynamic efficiencies which arise because of improvements to product quality or innovation. [71]

A. Assessment of Cost Savings Claimed as Efficiencies

131 Three types of efficiencies are claimed by the respondents as arising out of the merger: administrative cost savings; transportation savings; and manufacturing costs savings.

(1) Administrative Cost Savings

132 The total annual administrative cost savings alleged is $1,101,337. These arise from a reduction in the number of positions which are no longer required at Orenco allegedly as a result of the merger, positions such as a marketing manager, an accountant, a route service manager, three grease salesmen. The cost savings arise from the money which would have been spent on salaries and associated benefits as well as expenses (e.g., travel expenses). The numerical amount claimed as cost savings is not in dispute. What is disputed is whether these savings arose from the merger or from some other cause. Also, a consideration not raised in argument is why, if grease is not now considered to be in the relevant market, savings with respect to grease salesmen are included in the efficiency calculations.

133 The Director's experts challenge these administrative cost savings as efficiency gains arising out of the merger on the ground that: (i) information relating to them is entirely in the hands of the respondents and it is easy in the context of a merger to camouflage the dismissal of redundant employees; (ii) these kinds of savings are due to spreading fixed costs over larger

output and thus they could have been obtained through means other than the merger, e.g., internal growth, joint venture, or as a result of another merger. The Director's position is that cost savings that do not arise *uniquely* out of the merger are not to be considered as efficiency gains. The respondents' position is that the test to be applied is whether the efficiency gains would *likely* have been realized in the absence of the merger. The Tribunal accepts the respondents' position.

134 The most significant difficulty in assessing whether these cost savings arose as a result of the merger, however, arises because they are based on assumptions with respect to the likely structure of the market had the merger not occurred and those assumptions do not appear to be the appropriate ones. This same consideration arises with respect to at least some of the transportation cost savings and will be addressed in discussing them.

(2) Transportation Cost Savings

135 Three sources of savings on transportation costs are identified: the rationalization of truck routes in Western Ontario; the rationalization of routes in Toronto; and the savings arising from transporting material to Orenco in Dundas rather than to Rothsay (Moorefield). With respect to Western Ontario, since Rothsay (Moorefield) and Orenco covered much of the same territory in Western Ontario, it is possible after the merger to use fewer trucks to collect the same amount of material, resulting in savings of mileage, labour and capital. The total annual savings from these is calculated to be $241,433.46. There is no serious argument that these figures and savings are not accurate. Insofar as the savings respecting the Toronto routes are concerned, these routes were serviced prior to Rothsay (Toronto) volumes being moved to Dundas out of Rothsay (Toronto) and Orenco. Combining these routes resulted in savings in mileage, labour and capital of $1,451,522.69.

136 The respondents claim only one-third of these (an annual cost saving of $483,841) as being attributable to the merger. This apportionment is based on the assumption that Rothsay would not have solved its expropriation problems by expanding Moorefield or by obtaining a location on the Hamilton Harbour, but would have had to relinquish two-thirds of its Toronto business. Since it could accommodate one-third of the business at Moorefield without expansion of its existing facility, it claimed only one-third of the savings arising under this heading. A similar one-third allocation was made with respect to the savings claimed as arising out of transporting material from Toronto to Orenco in Dundas rather than from Toronto to Moorefield. One-third of $519,905 was claimed ($173,302) as an annual cost savings.

137 There is little quarrel with the numbers which are claimed. The validity of the claims with respect to the last two categories of transportation savings, however, is based on the assumption that Rothsay would have responded to the expropriation notice it was under by moving as much material as it could to Moorefield (i.e., one-third of the Toronto volume) and abandoning the rest.[72] This is not a credible assumption. Mr. Kosalle's evidence was that the most likely solution to the expropriation notice would have been for Rothsay to have constructed a new plant in the Hamilton Harbour area. In addition, notices given to drivers who were terminated from the Rothsay (Toronto) plant on transfer of the Toronto volumes to Rothsay (Moorefield) and Orenco were told that their termination was the result of the expropriation of the Toronto plant. Mr. Kosalle admitted that it was impossible to distinguish cost savings which might have arisen as a result of the merger from those which arose as a result of the restructuring which occurred in response to the expropriation. Insofar as efficiency gains likely to arise from the merger are concerned, the burden of proof is on the respondents. The respondents have not met that burden with respect to the claimed efficiency gains insofar as such claims depend upon the assumption that Rothsay would have responded to the expropriation by moving one-third of its Toronto volumes to Moorefield and by abandoning the rest.

(3) Manufacturing Cost Savings

138 The savings in manufacturing costs which are alleged to result from the merger relate to Orenco's purchase before the merger of approximately 6 million pounds of bleachable fancy tallow to mix with its raw material in order to produce higher quality tallow. This tallow was purchased from Taylor By-Product in the United States. It cost Orenco $184,400 more annually than would have been the case had it purchased the tallow locally. In addition, the cost of heating, milling and refining the tallow was $33,600 annually. It is alleged that Orenco can now produce the same product using Rothsay raw materials.

139 The Tribunal is not convinced that this is a saving arising out of the merger. It is argued that Orenco could not buy the quantity of tallow required in Canada before the merger because it was not available in the amounts required and that it could not buy the raw material to itself produce this grade of tallow because at the time it was operating at full operational capacity. It seems clear that the savings in question arose because Orenco upgraded its machinery, thereby increasing its capacity, and not as a result of the merger. This should therefore not be considered to be an efficiency gain. [73]

140 Donald G. McFetridge prepared expert evidence assessing the deadweight loss [74] which likely could arise from the merger and compared it to the efficiencies claimed by the respondents. He assumed for the purposes of this analysis a 20% (and alternatively a 30%) decrease in the price paid by the renderers to the suppliers of renderable material. He also did an analysis based on a 40% increase with an elasticity of 0.1. On the basis of that analysis he concluded that the claimed efficiency gains outweighed the deadweight loss. Dr. McFetridge chose the 20% figure as a starting point because on examination for discovery the Director's representative, Stephen Peters, had referred to this percentage. It is clear that the percentage decreases which were used may not be very realistic for this industry. The prices can vary from a fairly small amount (e.g., three cents per pound) to a charge being levied for pick-up. In any event, given the Tribunal's findings elsewhere it is not necessary to express any conclusions with respect to this analysis.

(4) Conclusion

141 It is first necessary to address the question of the burden of proof which must be met by respondents when alleging efficiency gains. Counsel for the respondents seemed to argue that once they had established the claimed efficiency gains on a *prima facia* basis, that was sufficient to transfer the onus of disproving them to the Director. He argued that if on the balance of probabilities there was uncertainty, the doubt should be resolved in the respondents' favour. The Tribunal does accept that argument. The respondents have the onus of proving the existence of the efficiencies claimed, or the likelihood of their existence when the merger has not been consummated, on the balance of probabilities in the normal way. Many of the claimed efficiency gains in this case, as has been noted, have not been proven to have arisen out of the merger as opposed to having arisen as a result of the restructuring caused by the expropriation. More importantly, however, the respondents based their trade-off analysis on a legal interpretation of section 96 which the Tribunal does not think is correct. That interpretation will be discussed below.

B. Legal Interpretation of Subsection 96(1)

142 In order to understand the arguments which were presented to the Tribunal respecting the proper interpretation of section 96, it is necessary to refer to a distinction which is made by economists between two different types of detrimental effects which may result from a firm having a monopoly or a dominant position in a market. If the merger results in the merged entity being able to raise prices above what would exist in a competitive market, then a transfer of funds (the wealth transfer) from the consumer to the producers is likely to occur. While this will be detrimental to individual consumers personally, it is not necessarily classified by economists as detrimental to society as a whole. This thesis postulates that there is no reason to suppose that the wealth transfer in the hands of the purchaser (consumer) would be used for any more socially beneficial purpose than would be the case if it were in the hands of the producer (seller). What is important under this economic value judgment, is the detrimental effects which arise from the merger which lead to losses for society as a whole. [75]

143 Detriment to society as a whole is said to arise, for example, when consumers because of the higher prices choose an alternate and less appropriate substitute product for the use they have in mind. They substitute a product which would have been their second choice in a competitive market. This inefficient substitution is seen as a misallocation of resources; it is seen as a loss to society as a whole. It is referred to as allocative inefficiency or the deadweight loss.

144 Both the Director and the respondents argue that subsection 96(1) directs the Tribunal to balance "the gains in efficiency" which will arise from the merger against this allocative inefficiency or deadweight loss. [76] The Director's *Merger Enforcement Guidelines* states:

Section 96(1) requires efficiency gains to be balanced against "the effects of any prevention or lessening of competition that will result or is likely to result from the merger or proposed merger". Where a merger results in a price increase, it brings about both a neutral redistribution effect and a negative resource allocation effect on the sum of producer and consumer surplus (total surplus) within Canada. The efficiency gains described above are balanced against the latter effect, i.e., the deadweight loss to the Canadian economy. [77] (footnote omitted)

This interpretation of section 96 is also found in the text *Mergers and the Competition Act* by Crampton. [78] The Tribunal [79] has difficulty accepting this interpretation.

145 In the first place, the Tribunal is directed by subsection 96(1) of the *Competition Act* to balance "the gains in efficiency" against the "effects of any prevention or lessening of competition that will result or is likely to result". [80] If only allocative inefficiency or the deadweight loss to the Canadian economy was intended by Parliament to be weighed in the balance then one would have thought that the section would have been drafted to specifically so provide. The interpretation which both the Director and the respondents put on section 96 requires a reading down of the phrase "effects of substantial lessening of" so that it does not include the transfers from consumers to producers which will generally be the largest effect of the substantial lessening. [81]

146 Indeed, earlier bills respecting proposed revisions to the *Combines Investigation Act*, which preceded the *Competition Act*, contained clauses which made it clear that efficiency gains were to be given precedence without any necessity to weigh them against the total effects arising out of a substantial lessening of competition occurring by reason of the merger. For example, Bill C-42 read:

(5) The Board shall not make an order under subsection (3) where it is satisfied by the parties to a merger or proposed merger to which this section applies that the merger or proposed merger has brought about or that there is a high probability that it will bring about substantial gains in efficiency, by way of savings of resources for the Canadian economy that are not reasonably attainable by means other than the merger. [82]

And, Bill C-29 provided:

31.73 The court <u>shall not</u> make an order under section 31.72

. . .

(c) where it finds that the merger or proposed merger has brought about or is likely to bring about <u>gains in efficiency that will result in a substantial real net saving of resources for the Canadian economy</u> and that the gains in efficiency could not reasonably be expected to be attained if the order were made. [83]

(underlining added)

147 But these clauses were not enacted and the text of subsection 96(1) does not provide that if substantial efficiency gains exist the merger should be allowed. Rather, the subsection requires a weighing of "efficiency gains" against the "effects of any prevention or lessening of competition that will result or is likely to result from the merger".

148 A description of the various purposes served by competition law in relation to efficiency gains is found in the text entitled *Competition Law*. [84] It is noted that one traditional purpose has been to protect the consumer from being charged supra-competitive prices. While one can argue that this is insignificant from the point of view of loss to the economy as a whole, Whish notes that there is a powerful political argument for preventing such accretions of wealth at the consumer's expense. Another purpose which has traditionally been seen as served by competition law is to encourage the dispersal of power and the distribution of wealth:

> Aggregations of resources in monopolists or multinational corporations or conglomerates could be considered a threat to the whole notion of democracy, individual freedom of choice and economic opportunity. This argument has been influential in the US where for many years there was fundamental mistrust of big business, and it was under the antitrust laws that the world's largest corporation, AT and T, was eventually dismembered. [85]

A third objective of competition law is seen as that of protecting the small firm against more powerful rivals:

> Somehow the competition authorities should hold the ring and ensure that the 'small guy' is given a fair chance to succeed. This idea has had a strong appeal in the US, in particular during the period when Chief Justice Warren led the Supreme Court. However it has to be appreciated that the arrest of the Darwinian struggle, whereby the most efficient succeed and the weak disappear, in order to protect small business can run directly counter to the idea of consumer welfare. It may be that competition law is used to preserve the inefficient and to stunt the performance of the efficient. Bork has been particularly scathing of the 'uncritical sentimentality' in favour of the small guy in the US and in recent years US law has been developing in a noticeably less sentimental way. Meanwhile the current darling of the European Commission is the 'small and medium sized undertaking', indicating that the little guy is still in favour on this side of the Atlantic. [86] (footnote omitted)

149 These objectives can run counter to the fourth objective which is that of furthering the efficiency of the economy as a whole:

> Also it is important to appreciate that economic and political fashions change and that the priority of objectives over a period can alter. In the US a fundamental change is taking place and yesterday's naked restraint of competition may turn out to be tomorrow's precondition for efficiency. [87]

150 With this background in mind, then, one turns to the purpose clause of the *Competition Act*. That clause makes it clear that several objectives are meant to be served by the Act. The clause states that:

> 1.1 The purpose of this Act is to maintain and encourage competition in Canada in order <u>to promote the efficiency and adaptability of the Canadian economy</u>, in order to expand opportunities for Canadian participation in world markets while at the same time recognizing the role of foreign competition in Canada, in order to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the Canadian economy <u>and in order to provide consumers with competitive prices</u> and product choices.
>
> (underlining added).

151 The interpretation of section 96 which both parties adopt requires a selective reading of that clause. It requires that one give precedence to the instruction that the Act be interpreted "in order to promote the efficiency ... of the Canadian economy" over the instruction that the Act be interpreted "in order to provide consumers with competitive prices". Equally, the instruction that the Act be interpreted "in order to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the Canadian economy" is accorded lesser significance. The Tribunal has not been referred to any jurisprudence which indicates that in a listing of objectives in the purpose clause of a statute that which is listed first is to be given greater weight than those which follow. Also, there is nothing in the text of the purpose section which indicates that such preference is to be given. Indeed, in debates in the House of Commons, the Minister responsible for the Act indicated that it was the fourth objective which was of overriding concern:

> The fourth but not the least objective is to provide consumers with competitive prices and product choices. As such, this objective becomes the common denominator in what we are trying to achieve. This is the ultimate objective of the Bill. [88]

152 Reference is made by Crampton[89] to the evidence given before the Legislative Committee on Bill C-91.[90] In that forum it was pointed out that the efficiency section was unclear because it required a balancing of two different things. The response at 11:40 reads as follows:

> Mr. Ouellet: I have a question to ask to the Parliamentary Secretary. As Professor Stanbury has pointed out to us, proposed section 68 contemplates a trade-off between gain and [sic] efficiency, and the lessening of competition. According to the government, which of the two is most important?
>
> Mr. Domm: I thing it goes back to a former statement I made in response to your original motion. It is a balancing defence we are looking for. It is not a question of which one, but rather a balancing defence for the benefits against the costs.
>
> Mr. Ouellet: Do you agree that, as Professor Stanbury indicated to us, the matters which the tribunal will have to consider under this clause are not comparable, since one involves a redistribution of income and the other involves real gain and resource savings? Because Parliament does not seem to give any guidance to the tribunal and its priorities and the way to be applied to lessening competition and gaining efficiency, it seems it would be very difficult for the tribunal to choose. It seems clear there might be some gain of efficiency in any take-over, in any merger. Is this what government feels is more important, to the detriment of lessening competition?

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> Mr. Domm: The provision we are asking for provides "a simple redistribution of income shall not be considered to be a gain in efficiency."
>
> Mr. Ouellet: In their presentation the Canadian Federation of Independent Business suggests guidelines in regard to the efficiency defence be embodied in the legislation. Why are you not giving some guidance precisely to the tribunal in this regard?
>
> Mr. Domm: I would refer you to proposed subsection 68.(2). Proposed subsection 68.(2) directs the tribunal to consider if the gains will result in a significant increase in the real value of exports or substitution of domestic products or importer producers.

153 It is to be noted that the answers which were given relate to a determination of what should be considered as an efficiency gain and not to a clarification of what such gains, however they might be defined, should be balanced against.

154 The Tribunal is not unaware of the debate which has raged south of the border as to whether allocative efficiency should be the only goal of merger policy.[91] The debate in the United States is well described in *Horizontal Mergers: Law and Policy*.[92] It is useful to quote a summary set out therein of the various positions relating to efficiencies:

> *Absolute Defense*. Muris may be the leading proponent of an absolute efficiencies defense. Although he concedes that a full efficiencies defense would "somewhat complicate merger proceedings and economies can not always be demonstrated," Muris nevertheless believes that merger law must be based on economic theory and that that premise dictates consideration of efficiencies.
>
> *Partial Defense*. Some commentators believe that efficiencies ought to be considered on a case-by-case basis, but suggest that the scope of an efficiencies defense may be limited to minimize the extent of judicial resources necessary to resolve such claims. Areeda and Turner would limit the defense to certain types of efficiencies (i.e., plant size and plant specialization where there is product complementarity) which they feel are most likely to result in significant cost savings. Former FTC Chairman Miller similarly would recognize an efficiencies defense, but only for efficiencies related to economies of scale.

Sullivan also favors a partial efficiencies defense, but he would limit it according to an evidentiary standard rather than by types of efficiencies:

> An alternative, not leading the Court into an unbearably complex or value laden area of judgment, would be to say that where cost saving efficiencies are clear, and arise in a context where market forces will oblige the seller to pass them on to consumers, and where competitive harm is only speculative ... the wise course is to risk the possible social harm for the certain benefit. Even if the Court is not ready to weigh the social benefit of efficiencies against the social harm of competitive injury when both seem similarly likely or certain to eventuate, it might nevertheless value a significant and likely social benefit higher than a much more doubtful harm.

Similarly, some commentators would require that claimed efficiencies be of a certain minimum size before being subject to litigation.

In an effort to integrate efficiency considerations with traditional antitrust concerns, Rogers writes that "efficiencies are relevant as a procompetitive factor only when they produce a more competitive market. This condition is likely to be satisfied, he suggests, where a merger involves two moderate-sized firms in a market dominated by larger firms with identifiable efficiency advantages. A corollary is that efficiencies in other situations may make a market less rather than more competitive and therefore should not be considered a defense in those circumstances.

Prosecutorial Discretion. One method for accommodating efficiencies without placing the issue squarely before the courts is to allow the enforcement agencies to consider efficiencies in deciding whether to challenge a transaction. Under this approach, efficiency claims would not be entertained once a suit is brought. Williamson suggests that enforcement authorities should decline to bring cases in which "a reasonably plausible showing of real economies can be made," but he do[es] not think it feasible or rewarding for the courts to entertain explicitly an economies defense involving a full-blown trade-off assessment. This approach is outlined in the FTC Statement and, apparently, in the 1984 Merger Guidelines.

One could expect, however, to see parties attempt to urge district courts to revisit the efficiencies issue when the prosecutor decides that the claim is not sufficient to justify the merger. It has been suggested, for example, that parties will present evidence of efficiencies to the courts in any event and may even argue that it would be arbitrary and capricious for the enforcement authorities but not the courts to consider such evidence.

Raise Enforcement Thresholds. Other commentators, while sympathetic to the notion that efficiencies are desirable and can sometimes justify otherwise harmful mergers, believe that the costs of fully litigating a vast range of efficiency claims would impose an intolerable burden on the judicial system. Moreover, even if efficiencies could be quantified with precision, it might still be impossible to quantify a merger's competitive costs, against which the efficiencies must be balanced.

The proponents of this view generally assert that most efficiency-enhancing mergers will be permitted if the general standards under the Merger Guidelines are set at such a level as to balance market power and efficiency effects. Fisher and Lande, citing evidence of the high cost of business uncertainty and of litigating efficiency claims, conclude:

> [W]e would incorporate efficiency concerns by adjusting the Guidelines' threshold for challenging mergers and urging the government and the courts to follow them with practically no exceptions. This change would have the effect of allowing more merger efficiencies and weeding out many of the mergers whose effect on market power was unduly speculative, without increasing litigation and business adjustment costs excessively.

The commentators who advocate setting of the general standards with efficiency goals in mind generally do not suggest specific numerical thresholds. Some of the material cited above was published prior to the 1982 Guidelines, so it is unclear how the revised standards would affect the commentators' views. For example, Areeda and Turner have supported a partial efficiencies defense because mergers with combined market shares in the 10 to 13 percent range - which would likely have been subject to challenge under the 1968 Guidelines, but not under the 1982 or 1984 Guidelines - could frequently involve efficiencies. Another observer points out that, according to a study by Scherer, firms in eleven out of twelve industries studied could achieve most if not all advantages of multiplant size with a national market share of 14 percent or less - a level unlikely to be challenged under the current Guidelines. [93] (footnotes omitted)

155 With respect to subsection 96(1) of the *Competition Act*, it is argued that if the words "effects of substantial lessening of competition" are not limited to deadweight loss then there will be a significant number of efficiency enhancing mergers that will not be allowed. Whether this is the case or not is not a matter which can be determined on the evidence given in this case. Certainly, one interpretation which is open on the basis of the wording of subsection 96(1) is to weigh any alleged efficiency gains against the degree of likelihood that detrimental effects (both wealth transfers and allocative inefficiency) will arise from the substantial lessening of competition. That is, in those cases where such effects are likely but not positively certain to follow, one could give more weight to efficiency gains than where the reverse is true. The likely detrimental effects of a merger may on some occasions be moderate in extent, in others they may be quite extreme. It is not unreasonable to expect that a balancing of the alleged efficiency gains could be assessed by references thereto. To the extent that the efficiency gains would be likely to lead to lower prices for consumers this would likely be determinative. [94]

156 One other consideration arises with respect to the arguments concerning the efficiency defence. The parties both rely on the judgment that the wealth transfer is a neutral one. A question posed during argument and which will be repeated here is, is this always so. If, for example, the merging parties in question were drug companies and the relevant product market related to a life-saving drug would economists say that the wealth transfer was neutral. The Tribunal does no more than raise this as a question. Another question respecting the alleged neutrality of the wealth transfer is: if the dominant firm which charges supra-competitive prices is foreign-owned so that all the wealth transfer leaves the country, should the transfer be considered neutral? Dr. McFetridge referred to this in his affidavit and concluded that a decision that such was not neutral would be discriminatory. The Tribunal does no more than raise these questions since for the reasons expressed above it is not necessary to make a decision on them in the present context.

VII. Order for Divestiture - Effectiveness

157 It has been argued that an order for divestiture would not be effective in this case. For an order to be effective Rothsay must respond to it by taking positive steps to ensure that it remains a vigorous competitor in the red meat rendering business. The Director assumes that Rothsay will do so. Rothsay asserts that it will not.

158 Since the divestiture requires the removal from Orenco of the Rothsay (Toronto) volumes which are now being processed at Orenco, this implicitly requires that Rothsay either expand its Moorefield facility or construct a new facility, for example, in Hamilton. While counsel for the Director suggested that some other arrangement might be made, for example, the continued processing of materials at Orenco under contract, it is difficult to conclude that this would be a viable long term solution. While Orenco would undoubtedly be willing to process such materials under a tolling agreement on a temporary basis if Rothsay were constructing additional facilities, it is difficult to accept that Orenco under independent management would agree to such an arrangement on a permanent basis, rather than insisting that Rothsay sell the relevant contracts to Orenco.

159 An order cannot now be given which will put Rothsay and Orenco back in the position in which they were pre-merger. At the time of the merger Rothsay was vigorously pursuing a solution to the expropriation of its Toronto plant. There is no reason to assume that Rothsay would not have been allowed to stay in the Toronto location until new facilities were constructed. Mr. Kosalle, at least, is of the opinion that the solution would have been the construction of a new facility on the Hamilton Harbour Commission lands. With the merger the momentum towards that solution died.

160 Orenco has changed its facility so that a significant amount of the Rothsay (Toronto) volumes are being accommodated at that plant. Orenco has not purchased a hydrolyzer nor moved into the processing of poultry feathers. A divestiture of Orenco would leave all the captive materials originating from both Hillsdown's and Canada Packers Inc.'s red meat and poultry processing operations with Rothsay (Moorefield). Approximately 680 metric tonnes per week of captive red meat material are processed by Orenco. The merger of the upstream red meat and poultry processing operations of Hillsdown and Canada Packers Inc. has been approved. The merger of those operations does not raise competitive concerns. With a divestiture order the total

volume of captive materials would be processed by Rothsay (Moorefield). In the absence of the expansion of Moorefield this would occupy a significant amount of available capacity.

161 In addition to the captive red meat materials, Maple Leaf Foods Inc., Rothsay's upstream poultry processing operation, processes 40% of the poultry processed in the province of Ontario. Since the supply of poultry materials is expected to increase, the Moorefield facility over time will be required to process additional captive poultry materials and it is argued that it is likely to elect to concentrate on rendering poultry, both captive and non-captive, rather than compete with Orenco in providing rendering services for red meat materials. Thus, it is argued that Rothsay (Moorefield) will cease to be a vigorous competitor for red meat material in the relevant market in any event.

162 The Tribunal accepts the respondents' argument that the continued decline in red meat material together with other changes in the market make construction of a new plant in Hamilton less attractive now than it was in 1989-90. Insofar as Rothsay's Moorefield facility is concerned, while the Tribunal is not convinced that expansion of that facility would be impossible as a result of environmental concerns and community opposition, the question is whether Rothsay would choose to pursue that option.

163 If there had been no expropriation of the Toronto plant the question of the effectiveness of a divestiture order would not have arisen. In the particular circumstances of this case, however, the Tribunal doubts that an order for divestiture would be effective to preserve a significant degree of competition in the relevant market for a sufficient period of time to justify its issuance.

164 The Tribunal does not want to leave the impression that merely because the respondents have changed their positions in response to the merger before the application for an interim order was brought by the Director, the Tribunal is reluctant to order divestiture. That is clearly not the case. The Tribunal's comments on the likely ineffectiveness of a divestiture order pertains only to the particular facts of this case including the particular market conditions. The Tribunal is not convinced that issuing an order which depends for its effectiveness on one of the parties constructing additional facilities in a market where there is already excess capacity and shrinking volumes would accomplish a pro-competitive result.

VIII. Order

165 FOR THESE REASONS, THE TRIBUNAL HEREBY ORDERS THAT the application for a divestiture order is denied.

APPENDIX

Information Note [95]

The Director of Investigation and Research v. Hillsdown Holdings (Canada) Limited

March 9, 1992. The Competition Tribunal today handed down its decision in the Hillsdown Holdings (Canada) Limited ("Hillsdown") case. The Tribunal panel, composed of Madame Justice Barbara Reed, Madame Marie-Hélène Sarrazin and Mr. Victor L. Clarke, has refused to order Hillsdown to divest itself of the business operated by Ontario Rendering Company Limited ("Orenco"). The unanimous decision results from an application by the Director of Investigation and Research under the merger provisions of the *Competition Act*.

Hillsdown obtained control of Orenco when it acquired 56% of the common shares of Canada Packers Inc. in July 1990. Hillsdown already controlled, through its wholly-owned subsidiary Maple Leaf Mills Limited, the Rothsay rendering business. Orenco operates a rendering facility in Dundas, Ontario. Rothsay operates a rendering facility in nearby Moorefield, Ontario. Rothsay also operated a facility in Toronto but the property was expropriated by the City and that facility closed in November 1990. Rothsay then moved its Toronto business to the Orenco plant in Dundas and elsewhere. The Director argued that Hillsdown's control of both the Rothsay and Orenco businesses is likely to result in a substantial lessening of competition in the non-captive red meat rendering market in southern Ontario.

The Tribunal was not convinced that a substantial lessening of competition is likely to arise as result of the merger of the Orenco and Rothsay businesses. A significant factor in arriving at this decision is the declining nature of the red meat rendering market, mainly due to a switch in consumer preference from red meat and a shift in cattle-rearing from Ontario to Saskatchewan and Alberta. Decreasing supply of quality renderable materials, increased costs and decreasing revenues have resulted in increasing consolidation in the industry. Given the market conditions, the Tribunal found that there will be a significant source of competitive discipline from potential competitors in adjacent markets that would be likely to expand their collection areas if the merged firm (Rothsay/Orenco) should raise prices above a competitive level.

The Tribunal also considered the effectiveness of a divestiture order under the particular circumstances of this case. The Tribunal took into account that as result of the expropriation of Rothsay's Toronto facility such an order would implicitly require Rothsay to either expand its Moorefield facility or build a new one. The Tribunal was not convinced that an order which depends for its effectiveness on the expansion of existing capacity in a declining market where volumes of renderable material are shrinking should be issued.

Footnotes

1 R.S.C., 1985, c. C-34, as amended.

2 Often referred to in the evidence as "fallen animals".

3 The ratio of the value of the renderable material as a percentage of carcass cost, as of June 1991, was estimated as 1.15% for beef and 0.38% for hogs.

4 Maple Leaf Mills Limited was the legal entity that held title to the property which was expropriated.

5 Applicant's Selected Documents, vol. 1, tab 19 at 43 (Exhibit A-7); vol. 2, tab 185 at 2 (Exhibit A-8).

6 Joint Book of Documents, vol. 15B, tab 56 at 9, 11, 50 (Exhibit JB-15B).

7 The transfer of approximately 150,000 lbs (68 metric tonnes) per week to that location did not appreciably improve Laurenco's financial situation because volumes have continued to decline. (Transcript at 703 (3 December 1991)).

8 H. Hovenkamp, *Economics and Federal Antitrust Law* (St. Paul, Minn.: West, 1985) at 58:
The correlation between market share and market power can be vigorously expressed in a formula. However, the formula contains *three* relevant variables: market share, market demand elasticity, and the elasticity of supply of competing and fringe firms. If the two elasticity variables remain constant, then market power would be proportional to market share. In the real world, however, market elasticities vary greatly from one market to another. Thus in order to estimate a firm's market power we must gather some information not only about a firm's market share, but also about the demand and supply conditions that it faces.

9 ABA Antitrust Section, Monograph No. 12, (1986) at 62-63.

10 *Ibid.* at 59-61 for a discussion of relevant markets.

11 Subsection 2(1) of the *Competition Act* expressly provides that for the purposes of the Act "product" includes an article and a service.

12 Ronald L. Dancey gave evidence that when Orenco started charging seven cents a pound for the collection of blood rather than picking it up at no charge, his company, Morrison's Meat Packers Limited, started routing the blood into a holding tank to be pumped out as sewage. (Transcript at 130, 158 (26 November 1991)).

13 A discussion of three different ways of treating supply substitution, i.e., when defining the market, when determining market shares or when assessing the significance of market share figures, is found in G.J. Werden, "Market Delineation and the Justice Departments' Merger Guidelines" [1983] Duke L.J. 514 at 518-20.

14 The United States jurisprudence indicates that the definition of the geographic dimension of the relevant market has been determined by reference to tests such as: the area where "the effect of the merger on competition will be direct and immediate" or "the area in which the acquired firm is an actual direct competitor". (*United States v. Marine Bancorporation*, 418 U.S. 602, at 619, 622 (1973)).

15 Applicant's Selected Documents, vol. 1, tab 6 at 5-7 (Exhibit A-7).

16 *Ibid.*, tab 13 at 4.

17 More accurately, Tewksbury, Massachusetts.

18 Fred D. Bisplinghoff, speaking of North American markets generally, states in his expert affidavit:

Normally renderers can only economically pick up raw material within a seventy-five mile radius of the plant. There is a point of diminishing returns due to overtime hours, spoilage of raw material, and insufficient time to maintain trucks. The above conditions have led to building receiving stations, which can be constructed approximately 125-150 miles from the plants. Two to four straight trucks can operate from this facility, dump their loads onto an open top semi-trailer which can be pulled to plant by a tractor. This enables the renderer to service an area approximately 200 to 250 miles from the plant, but it significantly increases the hauling costs as it adds reload and station costs to the route cost. This appreciably increases the overall haul cost but is an economical alternative to operating several plants at less than one-half capacity. (Expert Affidavit of Fred D. Bisplinghoff at 7-8 (Exhibit R-8)).

19 Until recently named Phil's Rendering Service Inc.

20 While it is not entirely clear when the activity commenced, the evidence indicates that it was probably during the summer of 1991.

21 The concept "entry" is defined in *Director of Investigation and Research v. Laidlaw Waste Systems Ltd.*, (20 January 1992), CT-91/2, Reasons for Order (Competition Trib.) at 77.

22 Letter dated 25 November 1991 to Jay D. Kendry from Robert Melland, Administrator, United States Department of Agriculture (Exhibit R-6).

23 Especially since the respondents had refused to allow the Director to rely on pages from the relevant USDA manual without calling a witness to attest to the procedure set out therein.

24 R.S.C. 1985 (1st Supp.), c. 25, as amended.

25 Limitations also exist with respect to the importation of meat products. Section 9 provides:

9. (1) No person shall import a meat product into Canada unless

(a) at the time it was prepared for export, the country from which it originated and any country in which it was processed had meat inspection systems, those systems and the relevant establishments in those countries were approved in writing by the Minister before that time and the approvals were valid at that time;

(b) that person provides an inspector with evidence satisfactory to the Minister that it meets the prescribed standards for imported meat products;

(c) it meets the prescribed standards for imported meat products; and

(d) it is packaged and labelled in the manner prescribed.

(2) Every person who imports a meat product into Canada shall, as soon as possible, deliver it, in its imported condition, to a registered establishment for inspection by an inspector.

(3) No person shall have in his possession an imported meat product that the person knows

(a) has been imported into Canada in contravention of subsection (1);

or

(b) has not been delivered to a registered establishment for inspection as required by subsection (2).

26 SOR/90-288, as amended.

27 There are also certain conditions which must be met in dealing with condemned materials. For example, paragraph 54(1)(b) of the *Meat Inspection Regulations, 1990* provides that federally registered slaughterers must identify condemned material, convey it to the inedible products area of their establishments, and then either render it themselves or denature it and convey it either to another registered establishment *or* to a rendering plant. Notably though, paragraph 54(1)(b) does not seem to place any interprovincial restrictions on the location of the rendering plant to which the condemned materials are shipped.

28 R.S.O. 1980, c. 260, as amended.

29 R.R.O. 1980, Reg. 607, s. 108.

30 R.S.O. 1980, c. 112, as amended.

31 Transcript at 173 (26 November 1991).

32 James A. Ransweiler, Vice-President and Division Manager of the Great Lakes Division of Darling & Company, Ltd., gave evidence with respect to the past and present activities of Darling. That evidence was given in confidence. Where the facts found in these reasons do not coincide with that evidence this should not be taken as a reluctance to refer to Mr. Ransweiler's evidence because it was given in confidence but rather as a decision by the Tribunal that it does not wish to give that evidence much weight.

33 *Supra*, note 21.

34 R. Whish, *Competition Law* (London: Butterworths, 1985) at 216.

35 *Ibid.* at 218-19.

36 *Infra* at 40ff.

37 Expert Affidavit of David D. Smith at para. 32 (Exhibit A-4); Expert Affidavit of Thomas W. Ross at para. 38 (Exhibit A-1).

38 A small amount of material was also being taken out of the market to Quebec by Phil's Recycling. As has been noted, the Tribunal does not consider Quebec renderers to be established in the relevant market.

39 Applicant's Selected Documents, vol. 1, tab 14 at 11 (Exhibit A-7).

40 Transcript at 246 (26 November 1991).

41 *Ibid.* at 500 (2 December 1991).

42 *Supra*, note 19.

43 *Prima facie* is being used in its ordinary dictionary meaning of "at first sight" or "on first impression". This does *not* signify that the Director has by merely proving market share thereby proved his case subject to whatever rebuttal evidence the respondents might adduce. A responsibility still remains with the Director despite the market share evidence to adduce some evidence regarding barriers to entry.

44 Sometimes referred to in the evidence as "CR4".

45 The HHI was derived from oligopoly theory; see G.J. Stigler, *The Organization of Industry* (Homewood, Ill.: R.D. Irwin, 1983) at 31; Expert Affidavit of David D. Smith at para. 43 (Exhibit A-4).

46 H. Hovenkamp, *supra*, note 8 at 304-305.

47 Expert Affidavit of David D. Smith at para. 44 (Exhibit A-4). In the United States, if the HHI increases by more than 100 as a result of the merger and the post-merger HHI is between 1,000 and 1,800, then the merger is likely to be challenged. If the post-merger

HHI is over 1,800 and the increase as a result of the merger is over 50, then the merger is likely to be challenged. (*1984 [U.S.] Justice Department Merger Guidelines*, 49 Fed.Reg. 26,823 (1984) at para. 3.11(b)). Thus, the Director's expert is applying a higher test than pertains in the United States, an approach which will likely be more appropriate for Canadian industries which will often already be highly concentrated.

48 Expert Affidavit of Thomas W. Ross, table 1 at 15 (Exhibit A-1). Dr. Ross' analysis assumes market boundaries of 200-250 miles and one restricted by the Canada-United States border.

49 Orenco, Rothsay and Fearman were treated as one entity post-merger for the purposes of this analysis and Fearman is added to the Rothsay volumes pre-merger because that acquisition has not been challenged.

50 Transcript at 337 (27 November 1991).

51 The Tribunal has selected what we consider to be reasonable approximations although we should point out that a range of numbers was given to us respecting plant capacities and utilization.

52 This assumes that there is an ability to shift material between Rochester, N.Y. and Lowell, Mass. (see Transcript at 1080-81 (10 December 1991)).

53 On average red meat material yields 22% tallow and 24% meal. Poultry offal yields 8% (low quality tallow) fat and 20% meal. Raw feathers yield about 26-30% feather meal. (Applicant's Selected Documents, vol. 1, tab 6 at 2 (Exhibit A-7)).

54 Transcript at 523-24 (2 December 1991).

55 Applicant's Selected Documents, vol. 1, tab 38 at 1 (Exhibit A-7).

56 Expert Affidavit of Erna H.K. van Duren (Exhibit R-11).

57 Dr. van Duren noted that the amount of renderable material which would be available in the future depends upon: (i) the number of animals slaughtered; (ii) the carcass size; and (iii) the proportion of the carcasses which is renderable. She assumed a carcass size for her model that was equal to the 1990 levels. She noted that insofar as the proportion of renderable material to carcass size is concerned, over the years there have been significant reductions in this regard as leaner and leaner cattle have been bred. The most significant factor for present purposes, however, is the drop in cattle slaughter which has occurred and is occurring in Ontario as a result of both the decrease in consumer demand for red meat and the shift westward of cattle-rearing and slaughtering operations. She looked at the declines which have occurred between 1981 and 1990 and made estimates for the next five years on the assumption that such trends would continue.

58 Expert Affidavit of Fred D. Bisplinghoff at paras. 23, 39-41, 66 (Exhibit R-8).

59 Transcript at 246ff (26 November 1991).

60 See also Joint Book of Documents, vol. 17A, tab 74 at 36 (Exhibit JB-17A Confidential):

We are in a mature market. The only way a renderer can significantly increase his supply of raw material is by obtaining an existing supply. Hence, we do expect to see further rationalizations of the industry. These changes will see packer renderers no longer rendering, and independent custom renderers being bought-out by larger competitors.

61 *R. v. J.W. Mills & Son Ltd. et al.* (1968), 56 C.P.R. 1 (Ex. Ct.) at 37; *United States v. Baker Hughes, Inc.*, 908 F. 2d 981 (D.C. Cir. 1990); *United States v. Syufy Enterprises*, 903 F. 2d 659 at 666 (9th Cir. 1990); *United States v. Waste Management, Inc.*, 743 F. 2d 976 (2d Cir. 1984); *United States v. Calmar, Inc.*, 612 F. Supp. 1298(D.C.N.J. 1985); *Re The Echlin Manufacturing Company*, 105 FTC 410 (1985).

62 *Supra*, note 21.

63 Transcript at 45-46 (4 December 1991) (confidential); 495 (2 December 1991).

64 Transcript at 223-25 (26 November 1991).

65 This may not be entirely accurate as deadstock volumes have dropped considerably since Messrs. Murray and Smith decided to build their plant. The drop in deadstock coincided with the decision to start charging for the pick-up of deadstock. (Transcript at 220 (26 November 1991)).

66 Transcript at 217-18 (26 November 1991); 1012 (9 December 1991); 568-69 (2 December 1991).

67 Transcript at 219 (26 November 1991); 1012 (9 December 1991); Tables Referred to in Testimony of Joseph Kosalle, tables XVIII and XX (Exhibit R-4).

68 For a lower figure, see Joint Book of Documents, vol. 17A, tab 74 at 39 (Exhibit JB-17A Confidential).

69 Discussed further *infra* at 101-102.

70 485 U.S. 486 (1974).

71 P. Areeda & L. Kaplow, *Antitrust Analysis: Problems, Text, Cases*, 4th ed. (Boston, Toronto: Little, Brown, 1988), ¶120.

72 Supplemental Affidavit of Donald G. McFetridge at para. 11 (Exhibit R-20).

73 With respect to the admonition in subsection 96(3) of the Act that a gain in efficiency shall not be considered appropriate for a decision if it arises "by reason only of a redistribution of income between two or more persons", while this is not relevant given the conclusion that the Tribunal has reached with respect to the cause of the cost saving in question, it is useful to refer to the comments of the former Director of Investigation and Research in a speech on October 15, 1988. These provide content to the subsection 96(3) exception:

... gains in efficiency that are pecuniary in nature, that is arising as a result of a distribution of income between two or more persons, are unacceptable.

By way of illustration, cost savings that result when a firm is able to use increased bargaining leverage to extract volume discounts from suppliers are not eligible per se for consideration. The fact that the purchaser is able to obtain products at a reduced cost in these circumstances is only a transfer of income from suppliers. However, cost savings resulting from larger volume orders, which enable the purchaser to attain economies of scale or incur lower transaction costs, may reflect real efficiency gains and consequently may be accepted for consideration. If the placement of larger volume orders also enables the supplier to reduce costs, part of which are transferred to the purchaser in the form of lower prices, then that part may also qualify as real efficiency gains. Other examples where such pecuniary gains in efficiency may arise, and are thus not allowable, might be found in labour procurement situations and tax savings matters. (C.S. Goldman, "Mergers, Efficiency and the Competition Act: Notes for an Address", Commercial and Consumer Workshop, Faculty of Law, McGill University, Montreal, Quebec, October 15, 1988).

And an explanation found in Areeda also sheds light on this concept:

In addition to the "technological" economies of scale ..., many large firms enjoy "pecuniary" economies of scale to some degree, for example, higher discounts for volume advertising or lower rates for heavy utility use not related to resource savings. Unlike technological economies, these pecuniary economies do not represent long-run savings in the use of socially valued resources. And they may raise barriers to entry in some cases. Indeed, pecuniary economies may be a euphemism for the surplus profits made possible by monopoly on the buyer's side of the market. Monopsony, as buyer monopoly is called, spoils economic efficiency just as seller monopoly does. Consequently, restructuring of large firms can hardly be resisted on the ground that it would deprive them of pecuniary economies. (*Supra*, note 69 at 36.)

74 Described *infra* at 88.

75 O. Williamson, "Economics as an Antitrust Defence: The Welfare Tradeoffs" (1968) 58 Am. Econ. Rev. 18 at 21-23; "Economics as an Antitrust Defense Revisited" (1977) 125 U. of Pa. L. Rev. 699, at 710ff.

76 For explanations of the economic theory, see: H. Hovenkamp, *supra*, note 8 at 295-99; B. Dunlop, D. McQueen & M. Trebilcock, *Canadian Competition Policy: A Legal and Economic Analysis* (Toronto: Canada Law Book, 1987) at 160-65.

77 Director of Investigation and Research, Information Bulletin No. 5, March 1991 (Supply and Services Canada, 1991) at 49.

78 P.S. Crampton, *Merger and the Competition Act* (Toronto: Carswell, 1990) at 520-31, especially 524-31.

79 When the word Tribunal is used here and elsewhere in these reasons and the decision relates to a matter of law alone that decision has been made solely by the presiding judicial member.

80 The French text speaks of "des gains en efficience" against "les effets de l'empêchement ou de la diminution de la concurrence qui résulteront ou résulteront vraisemblablement".

81 Whether one would expect to see terms such as "allocative inefficiency" or "deadweight loss" in the text of the statute does not matter; these concepts can be phrased in less technical terms.

82 Bill C-42, *An Act to amend the Combines Investigation Act and to amend the Bank Act and other Acts in relation thereto or in consequence thereof*, 2d Sess., 30th Parl., 1976-77.

83 Bill C-29, *An Act to amend the Combines Investigation Act and the Bank Act and other Acts in consequence thereof*, 2d Sess., 32d Parl., 1983-84.

84 *Supra*, note 34 at 12-15.

85 *Ibid.* at 30.

86 *Ibid*.

87 *Ibid.* at 15.

88 House of Commons Debates, 7 April 1986 at 11927.

89 *Supra*, note 76.

90 *Minutes of Proceedings and Evidence of the Legislative Committee on Bill C-91, Issue No. 11* (May 21, 1986) at 11:34.

91 A.A. Fisher & R.H. Lande, "Efficiency Considerations in Merger Enforcement" (1983) 71 Calif. L. Rev. 1582; H. Hovenkamp, *supra*, note 8 at 41-42.

92 *Supra*, note 9 at 219-32.

93 *Ibid.* at 229-32.

94 For a recent discussion of such an analysis see: A.A. Fisher, F.I. Johnson & R.H. Lande, "Price Effects of Horizontal Mergers" (1989) 77 Calif. L. R. 777.

95 This is an unofficial summary prepared by the Registry of the Tribunal. Copies of the full text of the decision are available on request. (Tel. (613) 957-3172)

1995 CarswellNat 708
Federal Court of Canada — Appeal Division

Canada (Director of Investigation & Research) v. Southam Inc.

1995 CarswellNat 1312, 1995 CarswellNat 708, [1995] 3 F.C. 557, [1995] F.C.J. No. 1091, 127 D.L.R. (4th) 263, 185 N.R. 321, 21 B.L.R. (2d) 1, 57 A.C.W.S. (3d) 22, 63 C.P.R. (3d) 1

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

AND Re direct and indirect acquisitions by Southam Inc. of equity interests in the businesses of publishing The Vancouver Courier, the North Shore News and the Real Estate Weekly

THE DIRECTOR OF INVESTIGATION AND RESEARCH v. SOUTHAM INC., LOWER MAINLAND PUBLISHING LTD., RIM PUBLISHING INC., YELLOW CEDAR PROPERTIES LTD., NORTH SHORE FREE PRESS LTD., SPECIALTY PUBLISHERS INC. and ELTY PUBLICATIONS LTD.

Isaac C.J., Pratte and Robertson JJ.A.

Heard: February 13-16, 1995
Judgment: August 8, 1995
Docket: Doc. A-1093-92

Counsel: *Neil Finkelstein* , *Glenn Leslie* and *John Quinn* , for respondents.
Stanley Wong , *J. Kevin Wright* , and *Donald B. Houston* , for appellant.

The judgment of the court was delivered by *Robertson J.A.* :

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I — Introduction

2 This appeal is brought by the Director of Investigation and Research (the "Director") from that part of the decision of the Competition Tribunal (the "Tribunal") dated June 2, 1992 (the "decision") wherein the Tribunal dismissed the Director's

application for an order under s. 92 of the *Competition Act* , R.S.C. 1985, c. C-34 (the "Act") requiring Southam Inc. ("Southam") to divest itself of two community newspapers published in the lower mainland of British Columbia. The Director was unable to persuade the Tribunal that Southam's acquisition of the two community newspapers and its ownership of the only two daily newspapers published in the lower mainland was likely to prevent or lessen competition substantially in the retail print advertising market.

3 This appeal is of significance, not only because it is the first contested merger case under s. 92 of the Act to reach this Court, but because it also raised three fundamental issues. The first stems from the Director's allegation that the Tribunal erred in failing to apply its stated approach to product market definition. As will become apparent, the analytical framework for determining whether the products produced by two merging firms are sufficiently close substitutes so as to be placed in the same product market is critical to the achievement of the objectives underlying the merger provisions of the Act. The second and third issues represent two of Southam's principal responses to the Director's allegation.

4 First, while denying that the Tribunal committed any reviewable error, Southam maintains that the question of market definition is one of fact for which leave to appeal is required pursuant to subs. 13(1) of the *Competition Tribunal Act* , R.S.C. 1985, c. 19 (2nd Supp.). Such leave not having been sought, it is maintained that this Court lacks the requisite jurisdiction to review the Tribunal's Decision. Second, and alternatively, even if market definition is found not to be a question of fact, Southam maintains that the Tribunal's findings on this issue fall squarely within its area of expertise and, accordingly, its decision must be treated with the degree of curial deference prescribed by the Supreme Court of Canada in *Bell Canada v. Canada (Canadian Radio-Television and Telecommunications Commission)*, [1989] 1 S.C.R. 1722 , and more recently in *Pezim v. British Columbia (Superintendent of Brokers)*, [1994] 2 S.C.R. 557 . Implicit in this argument is the understanding that "correctness" is not the appropriate standard of review in this appeal.

II — Background

1. The Litigation

5 Southam is a diversified Canadian communication company whose principal business is newspaper publishing. Through a wholly-owned subsidiary, Pacific Press Limited, Southam currently owns the two Vancouver area daily newspapers, the "Vancouver Sun" and the "Province" (the "Pacific Dailies"). Both papers are circulated in the Lower Mainland of British Columbia and throughout the rest of the province. In a series of transactions carried out in 1989 and 1990, Southam acquired a direct or indirect controlling interest in thirteen community newspapers in the lower mainland, including the "North Shore News" and the "Vancouver Courier". As well, Southam acquired three distribution businesses, two printing businesses and the "Real Estate Weekly", a real estate advertising publication. Prior to the acquisitions, there were two independent competitors in the North Shore market for print real estate advertising: the "Homes" supplement of the "North Shore News" and the North Shore edition of the "Real Estate Weekly".

6 Following these acquisitions, the Director applied to the Tribunal for an order pursuant to s. 92 of the Act requiring Southam to dispose of its interests in the two community newspapers identified above, as well as the "Real Estate Weekly". The Director alleged that control by Southam of the two community newspapers was likely to lessen or prevent competition substantially in the supply of print *retail* advertising services in various markets throughout the Lower Mainland. He also alleged that the acquisition of the "North Shores News", with its Homes Supplement, and the North Shore edition of the "Real Estate Weekly" would lessen or prevent competition substantially with respect to print *real estate* advertising services on the North Shore. In this appeal, we are not concerned with the dispute regarding Southam's acquisition of the "Real Estate Weekly". That issue is the subject of an appeal initiated by Southam for which separate reasons have issued (see *Canada (Director of Investigation and Research) v. Southam* , A-1668-92, August 8, 1995 [reported at p. 68, post]). Accordingly, these reasons apply solely to that part of the Tribunal's decision [now reported at (1992), 43 C.P.R. (3d) 161] dealing with the acquisition of the two community newspapers and the print retail advertising services which they and the Pacific Dailies offer.

2. Lower Mainland Newspaper Industry

7 An important source of revenue for the Pacific Dailies is the sale of advertising to retailers. In 1991, the "Vancouver Sun" and the "Province" generated in excess of $98 and $46 million respectively in advertising revenues. Prior to the acquisitions, Southam had no interest, direct or indirect, in any community newspaper in the Lower Mainland.

8 The "North Shore News" is a controlled distribution community newspaper delivered free of charge three times a week to approximately 62,000 households in areas of Vancouver collectively referred to as the North Shore. It is common ground that this is an extremely affluent area of Vancouver and thus of particular interest to Lower Mainland advertisers. Of the approximately 1,000 community newspapers in Canada, the "North Shore News" is one of the largest (Decision at 242). In 1989, this newspaper generated gross advertising revenues of $9 million.

9 The "Vancouver Courier" is also a community newspaper distributed free of charge to households on the West side of the City of Vancouver every Wednesday and Sunday. The Sunday edition, however, is distributed to households on the East and West sides of Vancouver, thereby increasing circulation to approximately 120,000. This community newspaper went into receivership in 1979 after attempting to publish on a daily basis, but subsequently was revitalized. In 1989, it generated gross advertising revenues of $4.5 million.

10 The daily newspaper industry has been in decline throughout North America over the last decade where average household penetration (the number of copies sold per 100 households) has fallen, as has the industry's share of total net advertising revenues (Decision at 170-71). This phenomenon is equally applicable to the Pacific Dailies in the Lower Mainland. The "Sun"'s average household penetration in its given city zone fell from 43% to 33% between 1985 and 1990. The "Province's" penetration dropped from 25% to 22% during the same period (Decision at 173).

11 While the Pacific Dailies are said to be "uncommonly weak" in the Lower Mainland, the Tribunal found that the community newspapers are "uncommonly strong" (Decision at 268). Unlike any other Canadian city, there are prospering community newspapers in all parts of the Pacific Dailies' city zone. The relative strength of these community newspapers is attributed to the growing trend of retail advertisers for targeted marketing. Retailers place a premium on advertising vehicles that allow them to focus their message on specific trading areas with high household penetration. Daily newspapers, with their broad geographic circulation and comparatively low household penetration levels, are said to be ill-suited to meeting those targeted needs (Decision at 271-72, 277-78).

12 The decline of the Pacific Dailies in relation to the community newspapers was also explained by the Pacific Dailies' high and largely fixed costs. One group of advertisers use the community newspapers because they obtain local penetration in their trading areas at a lower cost than is possible with the Pacific Dailies (Decision at 189-90, 277-78). The comparatively high cost of advertising in the Pacific Dailies has also caused many large multi-outlet retailers to shift their print advertising from "run-of-press" display ads to pre-printed inserts or what are commonly referred to as "free-standing flyers". These cost less to produce and offer advertisers more control over printing, quality design and distribution (Decision at 246). Most flyer advertisers require high levels of penetration in their targeted markets, which the Pacific Dailies alone cannot provide. By comparison, community newspapers are ideally suited to meet the distribution demands of flyer advertisers (Decision at 272).

13 In an attempt to improve the performance of the Pacific Dailies, Southam implemented a number of measures beginning in 1987. First, Southam introduced "Flyer Force", a flyer distribution business which competed with the flyer services of the community newspapers. In so doing, Southam attempted to address the existing shortcoming in circulation and penetration by establishing an extended market coverage system in the Lower Mainland that would supplement the Pacific Dailies' reach by delivering flyers on behalf of the papers' advertisers to both subscribers and non-subscribers. "Flyer Force" lost an average of $2 million per year while in operation and was terminated in early 1991 following Southam's acquisitions, with losses totalling approximately $10 million (Decision at 194). Part of the 1989-1990 acquisitions included three flyer distribution businesses which Southam believed to be the only ones considered reliable by advertisers (Decision at 240-41).

14 As a further measure to improve the performance of the Pacific Dailies, Southam decided, in 1988, to build a new plant in Surrey. The primary purpose of the new plant was to introduce a more modern, lower cost facility than the existing one. However,

the Surrey Plant proposal offered the additional rationale of contributing to the launch of zoned supplements by Southam as a means of competing with the community newspapers (Decision at 195-96). A zoned supplement is a section of a daily newspaper containing advertising and editorial content of specific interest to a geographic community within the newspaper's circulation area. Southam did in fact proceed with one such supplement, the "North Shore Extra", which was made part of the "Vancouver Sun" on the North Shore. It was also distributed by "Flyer Force" as a stand-alone publication to households on the North Shore which were not "Vancouver Sun" subscribers. The "North Shore Extra" was launched in September, 1988, but discontinued in April, 1990. Prior to its discontinuance, the "North Shore Extra" was losing $20,000 per month (Decision at 197). Following the acquisitions, Southam did not proceed with its plan for zoned supplements in other parts of the Lower Mainland.

15 The community newspapers respondent to these so-called "product innovations" introduced by Southam by forming groups offering advertisers the opportunity to purchase multiple advertising at a discount in one or more of the community newspapers within the group (see Decision at 257-59). The first successful effort was the formation of "MetroVan" in 1988 which included both the "Courier" and "North Shore News". Later in 1988, the "MetroVan" newspapers formed "MetroGroup" with ten community newspapers owned by Trinity Holdings Inc. Trinity Holdings also co-ordinated its papers' discount rates through "MetroValley". The purpose of "MetroGroup" was to challenge the Pacific Dailies for national and major retail advertising revenues in the Lower Mainland. The "North Shore News" and the "Vancouver Courier" remained members of the "MetroGroup" until acquired by Southam which, in 1990, established another community newspaper group: "VanNet Group". That group consisted of twelve of the thirteen community newspapers acquired by Southam, including the "Courier" and the "North Shore News", as well as a number of other publications.

III — The Parties' Position Before The Tribunal

1. The Director

16 On July 8, 1991, the Director filed an amended application for an order requiring, inter alia, the divestiture of the "North Shore News" and the "Vancouver Courier" on the ground that their acquisition by Southam was likely to prevent or lessen competition substantially in the market for "newspaper retail advertising services" in the North Shore and the City of Vancouver respectively. As to a "lessening of competition, the Director alleged that the merger was "likely to enable Southam to unilaterally impose and maintain a material price increase in a substantial part of the [relevant retail advertising market] for a substantial period of time" (Amended Notice of Application, Appeal Case Vol. 1, pp. 100 and 206). The Director argued that there were two ways in which a price increase could be implemented by Southam. First, it could raise the advertising rates in the "North Shore News" and the "Vancouver Courier" to supra-competitive levels. Alternatively, the Pacific Dailies as well as the two community newspapers could raise their rates (Decision at 269).

17 The Director also alleged that the acquisition of the two community newspapers in question was likely to "prevent" competition substantially "for the supply of multi-market newspaper retail advertising services throughout the Lower Mainland" (Amended Notice of Application, Appeal Case Vol. 1, p. 215). The thrust of this argument is that the acquisition of the two community newspapers in question, which were the strongest community newspapers in the Lower Mainland, prevented the formation of an effective community newspaper group that was independent of the Pacific Dailies (Decision at 287). In short, the "Courier" and the "North Shore News" would not be participating in a community newspaper group which could offer effective competition against the Pacific Dailies. The Director also alleged that the acquisitions would prevent entry by a new daily using the "North Shore News" or a successful community newspaper group as a springboard (Decision at 207).

2. Southam

18 Southam's initial argument was that the Pacific Dailies and the community newspapers are not in the same product market. That is to say that retail print advertising services in the Pacific Dailies is not a close substitute for that available from community newspapers, which offer higher household penetration at a lower cost when compared with the Pacific Dailies (Amended Response, Appeal Case Vol. I, p. 247). During the course of argument before the Tribunal, Southam maintained that retailers advertising in the community newspapers would not be sensitive to changes in price because they are using what they regard as a superior product, a product for which retail advertising in the Pacific Dailies is not a substitute (Decision at 276).

Alternatively, Southam argued that if the product market was found to embrace pring advertising in both the Pacific Dailies and community newspapers then it would be appropriate to broaden the market to include all other advertising channels, including television, radio, free-standing flyers (Decision at 178-79). Failing these arguments, Southam maintained that the acquisitions did not substantially lessen or prevent competition in the relevant market.

IV — The Tribunal's Decision

19

1. Analytical Framework (Decision at 171-183)

20 The Tribunal stated that the central concern underlying merger analysis is whether the impugned merger will create, increase or preserve market power, which is defined as the ability of a firm or group of firms to maintain prices above the competitive level (Decision at 177-78). As a framework of analysis, the Tribunal accepted that it is first necessary to determine the relevant market within which market power can be measured. A relevant market has both a product and geographic dimension.

21 Since the geographic dimension of the market was not contested, the Tribunal addressed the product dimension in terms of whether the products offered by the merging firms are close substitutes. In turn, it was recognized that substitutability could be measured, at least in principle, by the extent to which buyers would switch from one product to another in response to changes in relative prices. As direct evidence of such, known as cross-elasticity of demand, was not available the Tribunal determined that it was necessary to draw on more "indirect evidence". At p. 179, [43 C.P.R. (3d)], the Tribunal set out the framework that was to be followed:

> Whether two or more goods or services are close substitutes can in principle be measured by the extent to which buyers would switch from one to another in response to a change in relative prices. This measurement, the cross elasticity of demand, is rarely available. In practice it is usually necessary to *draw on more indirect evidence such as the physical characteristics of the products, the uses to which the products are put, and whatever evidence there is about the behaviour of buyers that casts light on their willingness to switch from one product to another in response to changes in relative prices. The views of industry participants about what products and which firms they regard as actual and prospective competitors are another source of evidence that is sometimes available* . In this case, the views of industry participants — newspaper suppliers and advertisers, including representatives from advertising agencies — have been the main source of information. This has been supplemented by the view of experts concerning the extent to which media and advertising vehicles may be substituted. The Director has relied very heavily on the views expressed in the internal documents of Southam and Pacific Press regarding competition between the dailies and the community newspapers and the means of confronting that competition. (emphasis added)

22 The Tribunal's extensive analysis (300 pages) deals initially with five topics: similarities and differences between daily and community newspapers in terms of product configuration; views and be haviour of Southam; views and behaviour of individual community newspapers in the Lower Mainland; views and behaviour of retail advertisers; and evidence relating to community newspaper groups. After arriving at certain critical conclusions regarding product market, the Tribunal proceeded to canvass two other topics: entry into community newspaper publishing and the matter of substantial lessening and prevention of competition.

23 Before reviewing the topics set out above, the Tribunal considered what was meant by "newspaper retail print advertising services" which had been alleged by the Director to be the relevant product market. The Tribunal held that it consisted of retail advertising using display, or "run-of-press" advertising, which is advertising interspersed with editorial content. By definition, classified advertising was excluded as was national advertising because of "price discrimination", a concept which need not be addressed herein (Decision at 181). However, the Tribunal also found that the product in question included flyers inserted into newspapers or otherwise delivered (Decision at 183).

2. Similarities/Differences between Dailies/Community Newspapers (Decision at 184-90)

24 In the context of retail print advertising, the Tribunal found that the most important differences between daily and community newspapers are circulation, penetration and cost. Community newspapers offer high penetration in local areas, which the Tribunal found to be a relative strength over dailies. Differences in penetration and circulation also translate into different advertising rate structures for the Pacific Dailies and community newspapers. While the former's advertising rates are much higher than the latter's, the Tribunal found it difficult to make price comparisons because of the different attributes of the respective newspapers. Despite that difference, the Tribunal concluded that many retailers are willing to use either the Pacific Dailies or the community newspapers, or both, and that for them the critical considerations relate to coverage and penetration (Decision at 187).

25 The Tribunal also found that many advertisers in community newspapers are local retailers who draw their customers exclusively or primarily from the area covered by the community newspaper. These local advertisers are attracted to the lower cost and higher penetration offered by community newspapers (Decision at 189). The Tribunal found that 50% of the advertisers in the community newspapers were local advertisers whose trading area was too small to use the Pacific Dailies profitably. The Tribunal excluded this group of advertisers from the relevant market because these advertisers would not switch to the Pacific Dailies in response to small changes in relative price in the community newspapers. At pp. 189-190 [43 C.P.R. (3d)], the Tribunal reasoned:

> There is therefore no debate about the existence of a significant volume of advertising by retailers that do not qualify as part of the relevant market. The relative size and the price sensitivity of this group of advertisers are critical to a determination of the likely effects of the acquisitions. This group disciplines the ability of the community newspapers to raise prices in a way that is independent of competition with the dailies. If the community newspapers were to raise prices, roughly 50% of their retail advertisers (by revenue) would either swallow the increase or reduce their volume in part or altogether. While they might move to other vehicles, the dailies would not benefit.

26 In light of this finding, the Tribunal indicated that it remained to be determined whether the remaining 50% of advertisers that use or might use the Pacific Dailies regard them and the community newspapers as substitutes "in the sense that these advertisers would change the volume of advertising from one vehicle to another in response to small changes in relative price" (Decision at 190).

3. Views and Behaviour of Southam (Decision at 191-213)

27 The Tribunal found that Southam was concerned by the strength of the community newspapers in the Lower Mainland. However, it also held that the fact that Southam may have regarded the community newspapers as competitors was not in and of itself sufficient to place them both in the same product market: "Competition means many things to many people" (Decision at 191). The issue remained whether the Pacific Dailies and community newspapers are effective substitutes for retail print advertising services. The Tribunal did acknowledge, however, that the views expressed by Southam were an "important source of information" and that the Director had relied heavily on the views expressed by Southam in its internal documents (Decision at 179 and 191).

28 In this regard, the Tribunal reviewed: (a) a consulting report prepared for Southam; (b) Southam's introduction of a flyer distribution business and a zoned supplement on the North Shore; (c) Southam's concern with respect to price sensitivity of advertisers; (d) Southam's reasons for acquiring the "Courier" and the "North Shore News"; and (e) marketing to the Pacific Dailies.

(a) The Urban Report (Decision at 192-193)

29 In 1986, Dr. Christine Urban, a newspaper industry consultant, was hired by Southam to prepare a study and to recommend strategies for improving the performance of the Pacific Dailies. Dr. Urban found that the community newspapers were at least partly responsible for the relatively low advertising revenues earned by the Pacific Dailies when compared to dailies operated by Southam in other parts of the country. In her report she stated (Decision at 192):

> What is the reason for this substantial difference in market performance seen between Vancouver and other markets? We believe strongly that it is the large number of aggressive weeklies in Vancouver, which are siphoning revenues (logically) due to the Sun and/or Province by virtue of their readership and market presence.

30 Dr. Urban's report also considered several strategies for improving the performance of the Pacific Dailies. Ultimately, she recommended that Southam adopt a strategy to reduce the Pacific Dailies' high costs. Although not part of her principal strategy, Dr. Urban also recommended that Southam "construct a strategy" to compete with the community newspapers. At p. 192 of its Decision, the Tribunal reproduced the relevant portion of her report:

> Despite these factors, Pacific Press must consciously and proactively construct a strategy to aggressively compete with the weeklies: a strategy that, at worst, will continue to preserve the dailies' 27% share and, at best, blunt the weeklies' ability to form better/stronger confederations. It would be especially dangerous if the weeklies were given any "open" period of time in which to operate with impunity, consolidating the gains they may have made with major advertisers and having the opportunity to teach advertisers new comparative criteria for their selection of print media.

31 With respect to this passage, the Tribunal made two initial comments. First, the reference by Dr. Urban to the 27% share consisted of "total local advertising dollars spent on all media" in the Lower Mainland which suggested a broad view of the market. On the other hand, the Tribunal observed that "there is no discussion in the report that relates to media or advertising vehicles other than community newspapers." The Tribunal accepted the fact that the community newspapers continued to gain strength after 1985 as evidenced by the fact that they had an increasing share of overall advertising revenues. The Tribunal concluded that the community newspapers in the Lower Mainland continued to grow relative to the Pacific Dailies (Decision at 193).

(b) Flyer Force and North Shore Extra (Decision at 193-200)

32 As discussed earlier, Southam adopted a number of measures in an attempt to attract more advertising. The first was the introduction of "Flyer Force", a flyer delivery system delivering to households in a given circulation area, including those that do not subscribe to the Pacific Dailies. The Tribunal found that while "Flyer Force" was in existence, the Pacific Dailies and the community newspapers were in the same relevant product market and that it was most likely that "Flyer Force" was discontinued for financial reasons and not because of the acquisitions (Decision at 195 and 197).

33 The second step adopted by Southam was the introduction of a zoned supplement. When the decision was taken in 1988 to build a new printing plant, one of the additional rationales offered for the project was that the plant could contribute to the planned launch of zoned supplements as a means of competing with the community newspapers. This rationale was offered by Mr. Perks, a Southam executive, in a document reproduced in part by the Tribunal at p. 195 of its Decision:

> As shown in the 1986 Urban Report ... the community newspapers in 1986 held an abnormally high share of the Lower Mainland print medium advertising and flyer distribution business.
>
> Despite the introduction of Flyer Force, which in 1988 will produce $2 million positive swing in the contribution of inserts to Pacific Press, *the community newspapers continue to consolidate their position* . [This statement of Flyer Force's contribution seems highly exaggerated in light of the available information on the Sun's insert revenues discussed above.]
>
> Pacific Press has delayed plans to launch the first "Sun Plus", which is the working title for a series of weekly zoned products. Profit pressure in 1988 caused this delay. *Unless we are prepared to concede (forever?) a substantial portion of what is normally daily newspaper business to the community newspapers, this project must be activated in 1989* .

(emphasis added)

34 Mr. Perks testified that he included the references to the zoned supplement at the request of the Pacific Dailies' management and that he did not believe that the zoned supplement could succeed in regaining lost business. His view was that an "irreversible flow" to the community newspapers had occurred (Decision at 196).

35 The "North Shore Extra" was the only community newspaper launched by Southam but was discontinued shortly after the acquisition of the "North Shore News". With respect to the "North Shore Extra", the Tribunal concluded that its introduction indicated that the Pacific Dailies, in their traditional format, were not in the same product market. The Tribunal asked: "If the dailies and the community newspapers are already in the same market, why would the dailies consider starting community newspapers?" (Decision at 200). [The issue is not whether daily and community newspapers are in the same product market as suggested by this passage: see also Decision at 274-75 and the Tribunal's ultimate conclusion on this point at 278.]

(c) Price Sensitivity of Advertisers (Decision at 200-201)

36 At p. 200 of its Decision, the Tribunal reproduced a portion of a Southam document suggesting that if one of the Pacific Dailies, the "Province", were to raise its advertising rates substantially, that paper would lose its "low-end" advertisers. That document reads in part:

> But none of these reasons will entice clients who cannot afford Pacific Press rates. They will be forced to go to the weeklies. If the Province were to dramatically raise its ad rates, Pacific Press would then be leaving the low end of the market to the weeklies.

37 The Tribunal concluded that this type of evidence was not useful in deciding whether two products are close substitutes in the sense that "... a small change in the price of *either* product will result in a shift of purchases" [Tribunal's emphasis]. Evidence with respect to advertisers for whom affordability was not a problem was felt to be a better indicator of substitutability. The full reasoning of the Tribunal is found at pp. 200-201:

> Even this bald statement is not free of ambiguity with respect to substitutability between the dailies and the community newspapers. While some form of substitution is implied in the quotation, it is not of the sort that one ordinarily looks for in deciding that two products are close substitutes and therefore in the same market, namely, that a small change in the price of *either* product will result in a shift of purchases. The quotation implies that advertisers would be forced by limited budgets to switch from the dailies to the community newspapers. At least as important as the expressed concern about these advertisers in the absence of any reference to a loss of advertisers for whom affordability was not an issue. Movement by those advertisers to the community papers consequent upon a daily increase would more clearly indicate substitutability.

(d) Reasons for Acquisitions — Prices Paid (Decision at 201-209)

38 The Tribunal considered whether the acquisition of the two community newspapers in question was for investment purposes or whether the motivation was to eliminate these newspapers as competitors of the Pacific Dailies and to preclude other potential buyers from taking advantage of the former's strategic value (Decision at 201). One strand of evidence consisted of documents but prepared by Southam executives. Another strand related to the prices paid for the two community newspapers.

39 With respect to the documentary evidence, the Tribunal turned to a memorandum prepared by Mr. Perks and distributed to other executives in preparation for a meeting with the Southam board regarding the acquisition of the community newspapers. That document together with the testimony of Mr. Perks led the Tribunal to conclude that the acquisitions were intended to achieve three strategic purposes: (1) to prevent the possibility of the "North Shore News" being purchased for the purpose of launching a third daily in competition with the Pacific Dailies; (2) to preclude financial losses to the Pacific Dailies and a corresponding benefit to the community newspapers in the event of the former experiencing further labour problems; and (3) to prevent the formation of a hostile community newspaper group (Decision at 202).

40 As to the strategic importance of the "North Shore News" as a springboard to a third daily, the Tribunal held that this evidence was not relevant to the issue of product market. Rather it went to the question of whether the acquisitions had the effect of substantially preventing competition (Decision at 202).

41 With respect to the second strategic purpose, the Tribunal acknowledged the permanent losses suffered by Southam as a result of a number of labour strikes. The Pacific Dailies had been shut down by a strike in November, 1978, to July, 1979, and again for two months in 1984. A rumoured strike in 1987 never materialized. During these periods, the community newspapers benefitted greatly as "[c]ustomers of the dailies flocked to [the community newspapers] to fulfil their newspaper advertising needs" (Decision at 204). However, the Tribunal characterized the fact that advertisers turned to community newspapers during strikes as "very weak evidence of substitutability since they had little choice" (Decision at 204). Such evidence merely established that, in the short run, community newspapers are the closest substitutes for the Pacific Dailies. [These conclusions do not relate to the question originally posed. As for the third strategy, it was inexplicably dealt with under the issue "prices paid".]

42 The evidence disclosed that Southam had paid a premium price for both the "North Shore News" and the "Vancouver Courier" (Decision at 208). The Director argued that this evidence supported the view that these community newspapers were acquired for strategic or anti-competitive reasons and not for investment purposes. The Tribunal concluded that the two community newspapers were not purchased solely as stand-alone investments (Decision at 209). The Tribunal then went on to determine that the evidence was inconclusive as to whether they were purchased for the purpose of defeating a hos tile community newspaper group. The evidence merely showed that the "Vancouver Courier" and "North Shore News" were more valuable in combination than when operated and marketed separately (Decision at 209).

(e) Marketing of the Pacific Dailies (Decision at 209-213)

43 In support of his argument that the Pacific Dailies and the community newspapers are in the same product market, the Director referred to market research efforts by the Pacific Dailies and to brochures and other marketing aids prepared for the use of their sales representatives when dealing with advertising clients. Generally, the Tribunal did not find the evidence helpful as the research efforts embraced all types of advertising and not just the print media (see Decision at 208-12).

44 Another strand of evidence related to the efforts of the Pacific Dailies to track those persons who were advertising in the community newspapers and the flyers carried by them for the purpose of identifying potential advertisers. While Southam's witness testified that tracking had been confined to advertising in the flyers, the Tribunal accepted the evidence of the Director's witness that tracking had been carried out with regard to both. The Tribunal concluded, however, that this evidence involved "only one of many strands bearing on the delineation of the product market" (Decision at 213).

4. Community Newspapers Viewpoint (Decision at 213-18)

45 The Tribunal found that the sales department of the "North Shore News" monitors all media on the North Shore for leads, including magazines, television and radio, in addition to the Pacific Dailies. The only significant conclusion of the Tribunal is found at page 216:

> Thus, it is apparent that North Shore News sales staff continue to approach all major daily advertisers. The North Shore News continues to survey its readers in order to develop arguments that their representatives can use when soliciting advertisers that use the dailies, with particular emphasis on comparative penetration.

5. Views and Behaviour of Advertisers (Decision at 218-57)

46 The Tribunal considered the anecdotal evidence of a number of advertisers regarding their use of electronic media and print advertising. With respect to the former, the Tribunal concluded that it was a weak substitute for print advertising and therefore these two products were not in the same market. The Tribunal reasoned that there are two ways to establish substitutability between print advertising and electronic media. One is through "a direct response to a price change that leads to a change in the use of advertising vehicles" (Decision at 221). On this point, the Tribunal found that the witnesses did not refer to "single"

where a switch was prompted by a change in prices. The other means of establishing substitutability was by reference to indirect evidence that the two vehicles are used for the same purpose. The Tribunal found that multiple price/product advertising cannot be produced effectively other than in print and particularly in newspaper display advertising and flyers. Accordingly, advertising on television and radio was found not to be close substitutes for display advertising purposes (Decision at 224-25).

47 As for those using display advertising, the Director produced several witnesses in support of his argument that retail advertisers in the Lower Mainland regard the Pacific Dailies and community papers as interchangeable vehicles for conveying their advertising message to consumers. The Tribunal found that the Director's advertising witnesses were not always clear on the rationale for their print advertising strategies. As well, the Tribunal observed that the Director did not systematically pursue the question of price sensitivity as between daily and community newspapers (Decision at 235-36). Some witnesses were not asked how they would respond to a hypothetical price increase in either the Pacific Dailies or the community newspapers. Some who were so asked testified that they would not return to the daily newspapers even if confronted by a rate increase because of the latter's poor penetration in the trading areas (Decision at 236-37).

48 The only other evidence of price sensitivity was a survey conducted by Angus Reid on behalf of Southam (see Decision at 251-257). However, the Tribunal held that the results of the survey could not be relied upon because of a serious methodological error made in the course of the survey. Consequently, the survey's results were ignored by the Tribunal.

49 In the final analysis, the Tribunal found that there was no direct evidence that display advertisers would switch between the Pacific Dailies and community newspapers in response to a change in relative prices. With respect to indirect evidence of substitutability, the Tribunal held that the similar purposes achieved by advertising in the Pacific Dailies and the community newspapers should not be adopted when evaluating substitutability. At p. 238, the Tribunal reasoned:

> As with substitution between the print and electronic media, substitution between daily and community newspapers can be shown directly or indirectly. The first type of evidence has not been apparent in the testimony of the Director's advertiser witnesses. The changes in newspaper use were not prompted by any discernible change in prices. With respect to indirect evidence of the use of both for the same purpose, it is a matter of determining whether "purpose" can be inferred from the content of the advertisement and the circumstances related to the use of a particular vehicle. Almost by definition it can be said that community newspapers are used to reach customers in the respective areas where the papers are distributed and that dailies are used to reach customers throughout the Lower Mainland. It is not helpful to adopt this notion of purpose when evaluating whether dailies and community newspapers are effective substitutes.

6. Community Newspaper Groups (Decision at 257-268)

50 In considering evidence relating to community newspaper groups, the Tribunal noted that it was not possible to determine whether the new business attracted to the community newspapers was a result of the availability of group discounts or "simple adjustments in the way existing advertisers deal with the various community newspapers" (Decision at 262). The Tribunal concluded that while there was an increase in group sales, there was no evidence to suggest that such sales constituted new advertising business. In light of the data, it was reasonable to infer that the increased sales came from existing customers who would normally have placed their advertising directly with the community newspapers (Decision at 262). The Tribunal's formal conclusion at this stage read as follows (at p. 267):

> In conclusion, on the basis of the available evidence the tribunal is not convinced that the multi-paper discount is an important factor in the community newspapers' ability to attract business from the dailies or, in fact, that the new business coming to the community newspapers through the groups would otherwise advertise in the dailies.

7. Conclusions Regarding Product Market (Decision at 268-279)

51 The Tribunal found that "community newspapers are uncommonly strong in the Lower Mainland and the dailies are uncommonly weak", a fact which concerned the Pacific Dailies and which caused them to seek "means of coping with the attraction of the community newspapers for advertisers" (Decision at 269). In broad terms, the Tribunal concluded that

the Pacific Dailies and the community newspapers were in competition but that "a more focussed analysis" was required to determine whether they were in the same market.

52 In dealing with the product dimension of the relevant market, the Tribunal referred to two "conceptual frameworks" that ran throughout the evidence and argument (Decision at 270). The so-called narrow framework focussed on Southam's post-merger ability to exercise market power and raise prices for print retail advertising in the Lower Mainland. [Presumably, this framework relates to the issue of whether the merger is likely to lessen or prevent competition substantially as the Tribunal made no further reference to same.] The broader framework was found to embrace all dimensions of competition between the Pacific Dailies and the community newspapers and consists of two parts.

53 One part addressed the Director's argument that the strength of the community newspapers could be attributed to the Pacific Dailies' inability to compete more effectively and that the success of the community newspapers at the expense of the Pacific Dailies was proof that both were in the same product market. By acquiring the community newspapers, Southam was avoiding the need to compete more effectively (Decision at 270). On this issue, the Tribunal concluded that the reasons underlying the present strength of the community newspapers was of secondary importance to the evidence that bore directly on whether the products of the respective newspapers are substitutes for one another (Decision at 272).

54 The second part of the broad approach is directed at the two ways in which the Pacific Dailies and the community newspapers could conceivably compete for advertising dollars. One is through product modifications which make the respect newspapers more attractive to purchasers, the other is with respect to price.

55 Turning to product modifications in the context of the community newspapers, the Tribunal noted that one possibility was to increase the number of weekly editions thereby providing advertisers with a broader choice and thus matching more closely what the Pacific Dailies have to offer. The second product modification referred to by the Tribunal was the creation of community newspaper groups and the attempt to attract more advertising dollars through group buys. In response, the Tribunal concluded that the evidence failed to demonstrate that this product modification was successful in attracting advertisers of the Pacific Dailies to the community newspapers (Decision at 273).

56 Turning to the product modifications introduced by the Pacific Dailies, the Tribunal acknowledged that Southam's "Flyer Force" was in the same market as the community newspapers at the time of the acquisitions. By contrast, Southam's introduction of the "North Shore Extra" was found not to be related to the main business of the Pacific Dailies and therefore the zoned supplement constituted a separate product (Decision at 274). The Tribunal concluded that the introduction of a zoned supplement did not prove that the Pacific Dailies and community newspapers were in the same market (Decision at 274-75). [At p. 278, the Tribunal held that with the introduction of the "North Shore Extra", the Pacific Dailies and the community newspapers were in the same market with respect to display advertising on the North Shore.]

57 With respect to price competition, the Tribunal was not convinced that the community newspapers, either individually or through group discounts, geared their advertising rates to the Pacific Dailies. While acknowledging that Southam was concerned that if the Pacific Dailies' advertising rates increase appreciably small advertisers would be forced to go to the community newspapers, the Tribunal deemed this weak evidence of price sensitivity because only the smaller advertisers would be so affected (Decision at 275).

58 The Tribunal then referred to the evidence of Mr. Perks who had testified to the fact that the smaller advertisers had left the "Vancouver Sun" some time ago and that there was no chance they would shift their advertising back to that paper. After stating that this evidence was consistent with the conclusion that the business lost by the Pacific Dailies to the community newspapers was part of a "one-way flow" (Decision at 196), the Tribunal posited that if "it was high rates that drove the smaller advertisers away, then lower rates could bring them back" (Decision at 275). It is at this point in its reasons that the Tribunal began its extensive analysis relating to cross-elasticity.

59 The Tribunal stated the "key question" as follows (Decision at 276):

> The key question regarding the shift from the dailies to the community newspapers is whether this is the kind of substitution that occurs when a better product is introduced, or whether it reflects the weighing of combinations of characteristics of two products that are seen as offering very similar value per dollar. In the first scenario the superior product gradually replaces the existing product. While it may appear that the products are in the same market, they are not; customers are insensitive to prices and would not return to the old product in response to a small change in relative prices.

60 The above passage raises the central issue in terms of whether advertisers are insensitive to "small change[s] in relative prices" because they view advertising in the community newspapers as a superior product for which the Pacific Dailies are not a substitute. The Tribunal then outlined the Director's position (Decision at 276):

> On the other hand, the Director's allegations imply that a sufficiently large segment of users of community newspapers and dailies are sensitive to the relative cost of the two vehicles and would significantly change which vehicle they use in response to fairly small changes in price. Counsel for the Director argues that advertising decisions are complex and that advertisers have difficulty pinpointing the role of relative prices in their decisions. This is undoubtedly true. Price i s just one of many variables that the advertisers have to take into account because advertising vehicles are highly differentiated products. Are the products in question here too highly differentiated for buyers to respond to small price changes? There are obvious differences and similarities between the dailies and the community newspapers. There is no reason to review them.

61 After stating that there are obvious differences between the Pacific Dailies and the community newspapers, the Tribunal concluded that the onus was on the Director to demonstrate that advertisers regard the two products as highly similar and that there is high demand elasticity. At pp. 276-277, the critical issue was formulated as follows:

> In light of the differences, *it is incumbent on the Director to show that buyers regard the two products as highly similar and that small changes in relative price would cause a significant shift in advertising volume between the two vehicles. Evidence showing that advertisers use one or the other vehicle mainly because of the characteristics of the particular vehicle suggests the opposite* . (Emphasis added)

62 The last sentence in the above passage indicates that advertisers remain insensitive to price changes because of the advantages or disadvantages associated with advertising in one type of newspapers as opposed to the other. Continuing on at p. 277, the Tribunal concluded:

> *There is in fact no evidence before the tribunal that advertisers are highly sensitive to the relative prices of the dailies and the community newspapers* . With community newspapers throughout the Lower Mainland, with two and sometimes three editions per week, with apparently good overall quality including secure distribution, the community newspapers appear to have become the preferred vehicle for many advertisers that formerly relied solely on the dailies. The evidence is that the ability to obtain very high household penetration in the areas from which they draw customers is a major advantage that advertisers find in community newspapers. They are unlikely to be willing to give that up simply because the cost of advertising in the dailies goes down. With their present product configurations the dailies and community newspapers are at best weak substitutes for some advertisers. (emphasis added)

63 The Tribunal's negative finding on price sensitivity was based, in part, on its finding that a "high" proportion of advertisers in the community newspapers are "... not candidates for the dailies: their trade is too local." As to "high reach" or "multi-outlet", advertisers who use both the Pacific Dailies and the community newspapers there was some evidence of price sensitivity but no evidence that it was greater than among the small advertisers in the community newspapers. [Presumably, the Tribunal was referring to the two groups of advertisers discussed earlier in its reasons; see supra at 15-16, and Decision at 189-90.] This conclusion is found at p. 277:

> A high proportion of advertisers in the community newspapers are not candidates for the dailies: their trade is too local. While there is *some* price sensitivity vis-à-vis dailies and community newspapers among multi-outlet or high reach advertisers, there is no evidence that it is greater than among the smaller advertisers in community newspapers vis-à-vis the alternatives that are open to them.

64 At page 278, the Tribunal reiterated its earlier conclusion that the evidence does not support the contention that "small changes in relative prices" would induce advertisers to shift from one type of newspaper to the other:

> Thus, the evidence regarding the demand for newspaper advertising leads the tribunal to conclude that the community newspapers and the dailies are very weak substitutes: small changes in relative prices are not likely to induce a significant shift by advertisers from one type of newspaper to the other. Although community newspapers have over time succeeded in attracting business from the dailies, this has been caused more by changes in the conditions facing advertisers than by their responses to changes in price.

65 In reaching this conclusion the Tribunal did acknowledge that the Pacific Dailies and the community newspapers had been competing for advertisers though product modifications. In regard to "Flyer Force" and the "North Shore Extra", the Pacific Dailies and the community newspapers were in the same product market with respect to display advertising. Nonetheless, the Pacific Dailies and the community newspapers were found to be too weak substitutes to be considered part of the same product market. At p. 278, the Tribunal reasoned:

> Examined solely as an unchanging product at a given point in time, the dailies and the community newspapers are too weak substitutes to be considered part of the same market. Yet, there is little doubt that they have been striving to attract many of the same advertisers. This competition has taken the form of modifications to their product offerings to take advantage of the changes in market conditions. With Flyer Force and the North Shore Extra, the Sun and the community newspapers were in the same market with respect to flyer delivery through much of the Lower Mainland and in the same market with respect to display advertising on the North Shore.

66 In passing, the Tribunal noted that advertising in the electronic media is too weak a substitute to be considered part of the relevant product market and that flyers delivered by reliable distributors are "clearly" in the same market. Finally, the Tribunal noted that the existence of community newspaper groups did not affect this conclusion as they had not had a significant impact on competition with the Pacific Dailies (Decision at 278-79).

8. Entry Into Community Newspaper Publishing (Decision at 279-285)

67 After deciding that retail print advertising services in the Pacific Dailies was not in the same product market as the community newspapers, the Tribunal went on to discuss at length certain conditions affecting entry into the community newspaper publishing business. The Tribunal commented that it was not difficult to enter this market, but that it was difficult to survive. In this regard, the Tribunal noted that the preferred method of entry was by acquisition, as evidenced by the actions of Southam. The Tribunal went on to hold that in order to make a finding that entry into the market is difficult, two factors would have to be addressed: "economies of scale" and "sunk costs". Neither factor by itself was held to be a sufficient barrier to entry.

68 Economies of scale suggests, for example, that once a community newspaper acquires a lead in circulation and in size (e.g. "North Shore News"), it gains a decisive advantage over new entrants into the market. The term "sunk costs" signifies costs incurred in starting a business but which are not recoverable in the event that it fails. The Tribunal made no finding with respect to whether either of those conditions were satisfied. After discussing the evidence relating the failure of the "North Shore Today", a short-lived competitor of the "North Shore News", the Tribunal concluded that new competitors could enter a market where an existing community newspaper was poor and entry was otherwise rewarding. At p. 284, the Tribunal reasoned:

> It is reasonable to conclude that there are a significant number of would-be entrants, such as Mr. Hopkins [editor of the short-lived North Shore Today], who would try to seize an opening created by a poor community newspaper in a community that had the potential to offer significant rewards.

9. Substantial Lessening/Prevention of Competition (Decision at 285-288)

69 After discussing the issue of market entry, the Tribunal went on to conclude that there was only a marginal likelihood that Southam's acquisitions of the "North Shore News" and the "Courier" would result in significantly higher advertising rates in the geographic markets alleged by the Director (Decision at 285):

> Since the dailies and community newspapers are weak substitutes the likelihood of the acquisitions resulting in significantly higher prices is very low. Moderate changes in relative prices are not likely to affect advertisers' choices in a significant way. Thus, if the object of the acquisitions is to protect the dailies, this can only be done through fairly dramatic changes in the prices of the community newspapers, considered collectively. Southam would have to concentrate its price increases in the Courier and the North Shore News as all the other papers it owns face significant competition from a rival community newspaper. Advertisers would switch to the rival before considering the dailies. Raising prices would undoubtedly be costly to the Courier and the North Shore News but *might* be profitable to Southam as a whole if the dailies were able to maintain prices at a higher level than they otherwise could or, alternatively, to slow down the drift of advertisers to the community newspapers. Southam does not have the market power to follow this course.

70 The Tribunal then turned to two arguments advanced by the Director with respect to whether the merger was likely to *prevent* competition. With respect to the Director's argument that the acquisitions frustrated the formation of an effective community newspaper group, the Tribunal noted that that argument could not succeed once it was found that the Pacific Dailies and community newspapers were not in the same product market. As to the Director's allegation that Southam's acquisitions prevented the possibility of another person acquiring one of the community newspapers for the purpose of launching a daily, the Tribunal rejected it on the basis that it was not likely such an event would occur (Decision at 287-88).

V — Issues/Analysis

71 The Director submits that the Tribunal erred in concluding that the Pacific Dailies and community newspapers are not in the same product market. Specifically, it is argued that: (1) the Tribunal failed to properly apply its own stated approach to defining the relevant product market by requiring direct evidence of high price sensitivity on the part of advertisers; and (2) in concluding that a group of community newspapers would not be in the same product market as the Pacific Dailies, the Tribunal ignored relevant indirect evidence. Alternatively, the Director submits that the Tribunal erred in failing to consider whether, but for the acquisitions, the Pacific Dailies and community newspapers would have become close competitors for retail advertising services.

72 Southam's position is relatively straightforward. The Tribunal did not err in its stated approach nor in its assessment of the evidence. As to the alternative ground of appeal, Southam maintains that the Director neither pleaded the issue nor raised it in argument before the Tribunal. In any event, Southam maintains that this Court lacks the jurisdiction to deal with the matter of market definition as it is a question of fact for which leave has not been sought as required by law. Southam also submits that the issues under appeal come within the Tribunal's area of expertise and, for that reason, its Decision is owed curial deference. I propose to deal initially with the latter two arguments advanced by Southam.

1. Market Definition — Question of Fact or Law?

73 If the issue of market definition is merely a question of fact then it necessarily follows that this Court lacks jurisdiction to hear this appeal. Subsection 13(2) of the *Competition Tribunal Act* dictates that an appeal on a question of fact cannot be brought without leave of this Court and no such leave has been sought by the Director. In my opinion, however, such leave was not required in this case.

74 The test or analytical framework that is to be adopted in determining whether products offered by two merging firms are "close substitutes", and therefore in the same product market, is a question of law. For example, as will be discussed more fully below, there are a number of tests or analytical frameworks that can be adopted for purposes of defining a relevant market. "Cross-elasticity" and "reasonable interchangeability of use" are two examples. The adoption of the appropriate framework and its proper application remain a question of law. Whether the facts in a particular case satisfy the requirements of any one framework is a question of fact or more precisely a question of mixed law and fact. Admittedly, the task of applying facts to

a legal definition or framework is more often than not labelled a question of fact. This is so principally because the ultimate decision is one which requires the exercise of personal judgment on the part of the decision-maker, as is the case when arriving at primary determinations of fact.

75 I prefer to use the term mixed law and fact for two reasons. First, it avoids confusion in cases such as the one before us where jurisdiction is dependent on the type of question under review. Questions of fact, in my view, should be though of in terms of primary facts to be established before the law can be applied, e.g. facts which are observed by witnesses and proved by testimony; see *Moreno v. Canada (Minister of Employment & Immigration)* (1993), [1994] 1 F.C. 298 (C.A.) at pp. 311-312. Whether these facts, once established, satisfy some legal definition or requirement is essentially a question of mixed law and fact. My second and principal reason for employing the term "mixed law and fact" is that it accords with subs. 12(1) of the *Competition Tribunal Act* . That subsection distinguishes between questions of law, questions of mixed law and fact, and questions of fact for jurisdictional purposes, a matter which will be dealt with more fully below under the topic of curial defence:

> 12.(1) In any proceedings before the Tribunal,
>
> (*a*) *questions of law* shall be determined only by the judicial members sitting in those proceedings; and
>
> (*b*) *questions of fact or mixed law and fact* shall be determined by all the members sitting in those proceedings. (emphasis added)

76 The confusion which exists over what is a question of law as opposed to a question of fact is further exacerbated in cases where the legal test ultimately selected is one which requires the decision-maker to engage in an analysis involving an assessment and weighing of factors intimately tied to the facts of the case. For example, in the present case, the Tribunal was obligated to turn from direct evidence of demand cross-elasticity to indirect evidence of substitutability as reflected in the "practical indicia" outlined in its Decision: e.g., physical characteristics of the products; uses to which products are put; behaviour and views of buyers, etc. Admittedly, such a legal framework gives the decision-maker a broad or flexible basis on which to formulate an opinion; so much so that it is analogous to cases where the decision-maker is called on to make primary determinations of fact. That approach to market definition does not, however, undermine the understanding that there are other appropriate evaluative frameworks and that the adoption of the correct legal framework for establishing substitutability remains a question of law. The argument of the Director is that the Tribunal erred when it expressly adopted one approach (practical indicia) but applied another (high demand cross-elasticity). But, as stated above, whether the test or analytical framework actually adopted or applied is the proper one remains a question of law.

77 It cannot be denied that there is dictum which holds that the task of delineating a relevant market is a question of fact. But, in my view, subject to the recent unreported decision of this Court in *Upper Lakes Group Inc. v. National Transportation Agency* , May 5, 1995, A-162-94, there is nothing in the relevant case law which cannot be explained in the manner I have outlined.

78 The understanding that market definition is a question of fact can be traced to the decision of *R. v. Hoffman-La Roche Ltd. (Nos. 1 & 2)* (1981), 125 D.L.R. (3d) 607 (Ont. C.A.) , where the Ontario Court of Appeal considered para. 34(1)(*c*) of the former *Combines Investigation Act* , a criminal provision relating to predatory pricing. In that case, the appellant pharmaceutical company was giving a drug it sold, Valium, free to hospitals. Both the appellant and its competitor provided Valium to hospitals, retail pharmacies, physicians, clinics and government institutions, and it was argued that the market in which the firms competed consisted of all purchasers of Valium, not just hospitals. The Trial Judge held that the hospital market was the relevant market. Martin J.A., speaking for the Ontario Court of Appeal, agreed and further held, at p. 619 [125 D.L.R. (3d)], that what constitutes a relevant market is a question of fact:

> What constitutes a relevant market is essentially a question of fact depending on the circumstances underlying the particular offence alleged.

79 As support for this proposition, Martin J.A. cited *R. v. J.W. Mills & Son Ltd.*, [1968] 2 Ex. C.R. 275 , at p. 305, aff'd (1971), 14 D.L.R. (3d) 464 (S.C.C.) . In that case, paras. 32(1)(*a*) and (*c*) of the *Combines Investigation Act* were at issue regarding the charge of limiting or preventing competition. Gibson J. considered whether a relevant market had been established in the

indictment. In the course of his judgment, he held that a relevant market "... is a matter of judgment based upon the evidence" (at p. 305). Gibson J., however, went on to provide a non-exhaustive list of factors relevant in defining a relevant market (see discussion, infra, at 53 et seq.). In certain respects, this approach to market definition resembles that adopted by the Tribunal herein. But, as noted earlier, the "practical indicia" formulation is but one of several frameworks and its adoption remains a question of law as does the question of whether the Tribunal properly applied it.

80 There are at least two decisions which, in my view, strengthen the position that market definition is not a question of fact of the kind contemplated by subs. 13(1) of the *Competition Tribunal Act* . One is a decision of the Supreme Court of Canada, the other a decision of this Court. I turn first to the reasons of Gonthier J. in *R. v. Nova Scotia Pharmaceutical Society*, [1992] 2 S.C.R. 606 , which highlight the distinction between questions of law and questions of fact (or what the *Competition Tribunal Act* labels as mixed law and fact).

81 In *Nova Scotia Pharmaceutical* , the Supreme Court had to consider para. 32(1)(*c*) of the former *Combines Investigation Act* dealing with conspiracies to prevent or lessen competition unduly. In the course of his judgment, Gonthier J. held at pp. 646-647 that the meaning of the word "unduly" was a question of law which was reviewable by an appellate court:

> While the word unduly is not defined by statute and defies precise measurement, it is a word of common usage which denotes to all of us in one way or another a sense of seriousness. Something affected unduly is not affected to a minimal degree but to a significant degree.
>
> . . . . .
>
> According to the appellants, since the determination of whether the restriction on competition was undue is a question of fact, not subject to appellate review, no conclusion can be drawn from the case law. This argument rests on a mistaken perception of the distinction between questions of fact and questions of law.
>
> In the context of s. 32(1)(*c*), the *process followed and the criteria used to arrive at a determination of "undueness" are questions of law and as such are reviewable by an appellate court. The application of this process and these criteria, that is the full inquiry, often involving complicated economic issues, into whether the impugned agreement was an undue restriction on competition, remains a question of fact* . The general rule that appellate courts should be reluctant to venture into a re-examination of the factual conclusions of the trial judge applies with special force in a complex matter such as here. (emphasis added)

82 Gonthier J.'s judgment indicates that the process and criteria used by a lower tribunal to determine the legal meaning of statutory language is reviewable by an appellate court as a question of law. However, the application of that legal meaning to a particular case (i.e. the "full inquiry") is a question of fact or, more precisely, a question of mixed law and fact. Again this background it is not difficult to reconcile Gibson J.'s understanding that a relevant market is a question of judgment based on the evidence, as per Gonthier J.'s reasoning in *Nova Scotia Pharmaceutical* .

83 A similar analysis can be applied easily to the reasoning of this Court in *Tanguay v. Unemployment Insurance Commission* (1985), 68 N.R. 154 (Fed. C.A.) , wherein Pratte J.A. stated at pp. 155-156:

> It is true that it is sometimes said that the question of whether an employee was justified in leaving his employment is one of fact. *However, it is clear that where the question is as to the definition that must be given to the words "just cause" in s. 41(1), this is purely a question of law* . It follows that if a decision is made which cannot be reconciled with this definition, the decision is vitiated by an error of law. (However, as the definition attributable to the words "just cause" in s. 41(1) is not so exact that it is always possible to say with certainty whether the employee has left his employment without just cause, cases may arise which may be decided one way or the other without doing injury to the legal concept of "just cause". *The question is then said to be one of fact: it would be more correct to say that it is a matter of opinion* .) (emphasis added)

84 Finally, the notion that what constitutes a relevant market is a question of fact that has been challenged by at least one commentator. Paul Crampton in *Mergers and the Competition Act* (Toronto: Carswell, 1990) recognizes that relevant market

definition is a question of law and his extensive treatment of the issue should help lay to rest any doubt on this point (at pp. 261 et seq.). With respect to the legal significance of *Hoffman-La Roche* and *J.W. Mills* , he concludes (at p. 264, n. 9):

> It would appear from the context of the remarks in these cases that the learned judges meant that the question "what constitutes the relevant market *in a given case" is a question of fact* . The distinction is important, because the meaning of the notion "relevant market" does not change from one fact situation to another. (emphasis added)

85 I agree with this characterization but would reformulate it so that it reads "what constitutes the relevant market in a given case is a question of mixed law and fact". This refinement of Crampton's observation preserves the notion that the analytical framework for determining a relevant market does not change from one case to another and is consistent with s. 12 of the *Competition Tribunal Act* .

86 In conclusion, I am of the view that the question of market definition is one of law and not fact and, therefore, this Court possesses the requisite jurisdiction to hear this appeal. As noted earlier, I am aware of the recent decision of this Court in *Upper Lakes Group Inc., v. National Transportation Agency* , supra, at p. 31, where the majority in obiter adopts a contrary opinion. Our respectful differences of opinion on this issue are now a matter of public record.

2. The Standard of Appellate Review — Curial Deference

87 Southam relies on the jurisprudence of the Supreme Court of Canada in support of its argument that curial deference is owed to decisions of a specialized tribunal, such as the Competition Tribunal, on matters falling squarely within its expertise. Succintly stated, "correctness" is not the appropriate standard of review in this case. This is so notwithstanding the fact that the *Competition Tribunal Act* contains no privative clause but rather a statutory right of appeal on questions of law and mixed law and fact. I think it important to note that, by implication, Southam's argument forces us to consider Parliament's intention with respect to the role of the Federal Court of Appeal and, ultimately, the Supreme Court of Canada in the development and application of competition law in Canada.

88 The respondent's argument raises two distinct questions. First, are the decisions of the Tribunal involving questions of law, including that pertaining to market definition, owed curial deference? Second, assuming that deference is owed, what is the appropriate standard of review? I find it unnecessary to address the latter question for, in my opinion, the doctrine of curial deference is inapplicable to the case at bar. [As to the appropriate standard of review, see Gonthier J. in *Bell Canada* , supra, at p. 1746 [[1989] 1 S.C.R.], and Hugessen J.A. in *Upper Lakes Group Inc. v. National Transportation Agency* , supra, at p. 9].

89 The most recent pronouncement of the Supreme Court on the matter of curial deference in an appeal context is *Pezim v. British Columbia (Superintendent of Brokers)* , supra, at p. 9, wherein Iacobucci J. reviews the earlier jurisprudence commencing with the Supreme Court's decision in *Bell Canada v. Canada (Canadian Radio-television and Telecommunications Commission)* , supra, at p. 9. In the latter case, the Supreme Court was faced with a statutory right of appeal from a decision of the CRTC. In an unanimous judgment, Gonthier J. states at pp. 1745-1746:

> It is trite to say that the jurisdiction of a court on appeal is much broader than the jurisdiction of a court on judicial review. In principle, a court is entitled, on appeal, to disagree with the reasoning of the lower tribunal.
>
> However, within the context of a statutory appeal from an administrative tribunal, additional consideration must be given to the principle of specialization of duties. Although an appeal tribunal has the right to disagree with the lower tribunal on issues which fall within the scope of the statutory appeal, curial deference should be given to the opinion of the lower tribunal on issues which fall squarely within its area of expertise.

90 While acknowledging that curial deference should be afforded the opinion of a lower tribunal on issues falling squarely within its area of expertise, the Supreme Court concluded that no deference was due in *Bell Canada* as the issue there involved an analysis of the procedural scheme created by the *Railway Act* and the *National Transportation Act* . Since the CRTC was not created for the purpose of interpreting either piece of legislation, the impugned decision was not within its expertise. Implicit in

this finding is the understanding that curial deference would have been owed had the CRTC's decision turned on the interpretation of a provision of its enabling statute.

91 It is settled that the concept of specialization of duties requires deference to decisions of tribunals on matters falling squarely within their expertise. This point was reaffirmed in *C.J.A., Local 579 v. Bradco Construction Ltd.*, [1993] 2 S.C.R. 316 . Although *Bradco* was not a case involving a statutory right of appeal, the observations of Sopinka J., writing for the majority, were quoted with approval in *Pezim* . At p. 335 [[1993] 2 S.C.R.], Sopinka J. held:

> ... the expertise of the tribunal is of the utmost importance in determining the intention of the legislator with respect to the degree of deference to be shown to a tribunal's decision in the absence of a full privative clause. Even where the tribunal's enabling statute provides explicitly for appellate review, as was the case in *Bell Canada, supra* , it has been stressed that deference should be shown by the appellate tribunal to the opinions of the specialized lower tribunal on matters squarely within its jurisdiction.
>
> On the other side of the coin, a lack of relative expertise on the part of the tribunal *vis-à-vis* the particular issue before it as compared with the reviewing court is a ground for a refusal of deference.

92 In *Pezim* , Iacobucci J. took the opportunity to consolidate the extant law in what he termed a "pragmatic or functional approach" to the concept of curial deference in an appellate context. That approach had its genesis in the reasons of Beetz J. in *U.E.S., local 298 v. Bibeault*, [1988] 2 S.C.R. 1048 , where at p. 1088 he stated:

> ... the Court examines not only the wording of the enactment conferring jurisdiction on the administrative tribunal, but the purpose of the statute creating the tribunal, the reason for its existence, the area of expertise of its members and the nature of the problem before the tribunal.

93 In the present circumstances, the functional approach advocated in *Pezim* requires an analysis on three levels: (1) the purpose of the Act and the reasons for the Tribunal's existence: (2) the statutory provisions conferring jurisdiction on the Tribunal and, in particular, the composition of the Tribunal and the decision-making power of its constituent members; and (3) the nature of the problem before the Tribunal.

(a) The Purpose of the Act

94 One of the principal purposes of the Act is to promote efficiency and adaptability in the Canadian economy. It also seeks to provide consumers with competitive prices and product choices. That the Act aims at the public interest in preventing anti-competitiveness is rendered clear in s. 1.1 of the Act which reads as follows:

> 1.1 The purpose of this Act is to maintain and encourage competition in Canada *in order* to promote the efficiency and adaptability of the Canadian economy, *in order* to expand opportunities for Canadian participation in world markets while at the same time recognizing the role of foreign competition in Canada, *in order* to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the Canadian economy and *in order* to provide consumers with competitive prices and product choices. (emphasis added)

95 In 1986, Parliament divided jurisdiction over this public interest concern into two substantive parts. Under the current scheme, the superior courts of criminal jurisdiction, as well as the Trial Division of the Federal Court of Canada, have jurisdiction over the criminal provisions under Pt. VI of the Act. Meanwhile, the Tribunal has exclusive jurisdiction over the civil aspects found in Pt. VII of the *Competition Act* which deals with, inter alia, mergers. There can be no doubt that Parliament intended to establish a specialized Tribunal to deal with issues arising under Part VIII. That fact was noted by Gonthier J. in *Chrysler Canada Ltd. v. Canada (Competition Tribunal)*, [1992] 2 S.C.R. 394 , at p. 406:

> Section 8(1) *CTA* confirms the jurisdiction of the Tribunal over Part VIII. The civil part of the *CA* therefore falls entirely under the Tribunal's jurisdiction. It is readily apparent from the *CA* and the *CTA* that Parliament created the Tribunal as a

specialized body to deal solely and exclusively with Part VIII *CA* , since it involves complex issues of competition law, such as abuses of dominant position and mergers.

96 The Tribunal's specialized role is reflected in its broad remedial powers under s. 92 of the Act in respect of both proposed and completed mergers. Moreover, the Tribunal's powers under Pt. VIII are more effective in enforcing Parliament's concern for the long-term functioning of the free market than those under the criminal provisions, as noted by Gonthier J. in *Chrysler* at p. 407:

> The same concern for the proper long-term functioning of the free market lay at the very heart of the enactment of Part VIII in 1986. Civil remedies can be more finely attuned and stand a better chance of leading to lasting compliance with the *CA* than criminal convictions.

97 Consequently, the Tribunal's exclusive jurisdiction and broad powers in Pt. VIII are integral to the attainment of the objectives of the *Competition Act* and, in certain respect, more important than the criminal aspects of the Act. The broad powers of the Tribunal to act in the public interest suggest that curial deference is owed those decisions squarely within its expertise. Closer scrutiny of the scheme of the Act, however, is required before arriving at a final determination.

(b) Composition of Tribunal and Jurisdiction

98 Unlike any other federal tribunal, the Competition Tribunal is composed of both judicial and lay members. The relevant sections of the *Competition Tribunal Act* read as follows:

> 3.(2) The Tribunal shall consist of
>
> (*a*) not more than four members to be appointed from among the judges of the Federal Court — Trial Division by the Governor in Council on the recommendation of the Minister of Justice; and
>
> (*b*) not more than eight other members to be appointed by the Governor in Council on the recommendation of the Minister.
>
> (3) The Governor in Council may establish an advisory council to advise the Minister with respect to appointments of lay members, which council is to be composed of not more than ten members who are knowledgeable in economics, industry, commerce or public affairs and may include, without restricting the generality of the foregoing, individuals chosen from business communities, the legal community, consumer groups and labour.
>
> 4.(1) The Governor in Council shall designate one of the judicial members to be the Chairman of the Tribunal.
>
> 10.(1) Subject to section 11, every application to the Tribunal shall be heard before not less than three or more than five members sitting together, at least one of whom is a judicial member and at least one of whom is a lay member.
>
> (2) The Chairman shall designate a judicial member to preside at any hearing or, if the Chairman is present at a hearing, may preside himself.

99 While the Tribunal is composed of four "judicial members" (judges of the Trial Division of the Federal Court) and eight "lay members", the general practice is for the Tribunal to sit as a panel of three with the judicial member presiding, as required by subs. 10(2) of the *Competition Tribunal Act* . In theory, it is possible to have a panel of five composed of four judicial members and one lay member; see subs. 10(1). As to the expertise possessed by those appointed by the Governor in Council to the Tribunal, it is trite to note that the judicial members are not required by law to possess an expertise in competition law. (This is not to suggest that the judicial members do not bring to the Tribunal a legal expertise relevant to competition issues). Similarly, its lay members come to the Tribunal with diverse backgrounds. Some might possess an expertise in economics. Others are drawn from the business community because of their practical understanding of markets. Some lay members may well be perceived as representing the interests of opposing groups, e.g. business and labour.

100 Judicial and lay members are appointed for a seven-year term. Currently, of the eight lay members only one is retained on a full-time basis. The remaining serve on a part-time basis as required. The judicial members are relieved of their Federal Court duties only to the extent that it is necessary to fulfill their duties as members of the Tribunal. To those familiar with federal regulatory agencies such as the CRTC and National Transportation Agency, the statutory differences between these tribunals and the one under consideration are very real.

101 Not only does the *Competition Tribunal Act* distinguish between judicial and lay members, it does so for the express purpose of assigning jurisdiction with respect to three types of legal questions. Section 12 of the *Competition Tribunal Act* signifies a clear intent on the part of Parliament to divest the Tribunal's lay members of the jurisdiction to decide questions of law. The relevant provision reads as follows:

> 12.(1) In any proceedings before the Tribunal,
>
> (*a*) questions of law shall be determined only by the judicial members sitting in those proceedings; and
>
> (*b*) questions of fact or mixed law and fact shall be determined by all the members sitting in those proceedings.
>
> (2) In any proceedings before the Tribunal,
>
> (*a*) in the event of a difference of opinion among the members determining any question, the opinion of the majority shall prevail; and
>
> (*b*) in the event of an equally divided opinion among the members determining any question, the presiding member may determine the question.

102 While argument might have been directed at whether the issue of market definition is within the specialized expertise of the Tribunal's lay members, which in my opinion it is not, the fact remains that Parliament vested judicial members with sole responsibility for determining questions of law. Subsection 12(1) of the *Competition Tribunal Act* renders this patently clear while leaving questions of fact and questions of mixed law and fact to be decided by the members on a majority basis.

103 I hasten to add that the legislative history leading up to the passage of the *Competition Act* in 1986 reveals clearly that the Tribunal, as presently constituted with the jurisdiction of its respective members, reflects a compromise between those who sought to vest jurisdiction under Pt. VIII of the Act in a tribunal composed entirely of lay experts and those who sought to vest the courts with civil jurisdiction; see Bill C-256 (June 1971), Bill C-42 (March 1977), Bill C-13 (November 1977) and compare with Bill C-29 (April 1984). This compromise is reflected in the *Competition Tribunal Act* and, in my view, one which must be respected. I know of no other enabling legislation which goes so far as to prescribe in as much detail the respective roles of a tribunal's constituent members.

104 As stated above, the definition of product market is a question of law and therefore the criteria or factors used to circumscribe that definition must be questions which, if necessary, go to the judicial member of the Tribunal for determination. Given this statutory imperative, it cannot be said that the problem at hand falls squarely within the Tribunal's expertise. As a jurisdictional matter, Parliament has expressly decided otherwise. That much is evident from from Parliament's manifest intention to direct questions of law to the judicial member only, and who cannot be deemed to bring special expertise in competition law to the Tribunal. Hence, it follows that curial deference is not owed and that the standard of appellate review is correctness.

(c) Nature of the Problem

105 I have already determined, for jurisdictional purposes, that the adoption and application of a framework for market definition is a question of law. But there are also strong policy reasons why the issue of market definition should be subject to ordinary appellate review.

106 Market definition is a legal construct, not an economic one. It must be recognized that although the term "relevant market" is referred to in subs. 93(*g*) of the Act, it remains undefined as is the case in comparable legislation found in other jurisdictions; e.g. s. 7 of the *Clayton Act* , 15 U.S.C. 18 (U.S.C.A. 1993). The omission is not an oversight on the part of Parliament but an implied recognition of the fact that the term is and always has been a judicial construct informed by economic principles and now guided by the practical experience of those familiar with the operation of markets — lay members of the Tribunal: see generally G.J. Werden, "The History of Antitrust Market Delineation" (1992) 76 Marquette L. Rev. 123; Comment, "The Market: A Concept in Anti-Trust" (1954) 54 Colum. L. Rev. 580; and Darrel Macdonald, Comment, "Product Competition in the Relevant Market Under the Act" (1954) 53 Mich. L. Rev. 69; see also *United States v. Columbia Steel Co.*, 334 U.S. 495 (1948) at pp. 508, 519, 520 and 527; *Times-Picayune Publishing Co. v. United States*, 345 U.S. 594 (1953) at p. 612, n. 31.

107 It cannot be forgotten that market definition is vital to merger analysis and Parliament's concern over the exercise of market power. A definition which is too narrow may well have the de facto effect of repealing the merger provisions of the Act. Once it is held that the products of two merging firms are not within the product market then the issue of whether the merger is likely to cause a substantial lessening of competition is simply rendered moot. Conversely, a definition which is too broad is just as apt to enjoin mergers which do not undermine the objectives of the Act.

108 In conclusion, I am of the view that no curial deference is owed decisions of the Tribunal involving market definition.

3. Market Definition — Background

109 For purposes of merger analysis, a relevant market has three dimensions: product, geographic and temporal. The parties are agreed as to the geographic dimension. As will become evident, the temporal aspect remains a theoretical concern. It is the concept of product market which has proven problematic. The Tribunal's initial framework for assessing relevant product market was embodied in the concept of demand elasticity, but supposedly abandoned once it was recognized that "direct evidence" was unavailable and therefore the void would have to be filled by "indirect evidence" of substitutability.

110 Indirect evidence took the form of several factors or practical indicia which would be examined in arriving at a conclusion as to whether the Pacific Dailies and community newspapers are in the same product market with respect to retail print advertising services. The substance of the Director's argument is that the Tribunal failed to weigh the evidence relating to each of the indicia identified, but rather based its decision on the Director's failure to adduce statistical or anecdotal evidence as to whether "small changes in relative prices" would cause advertisers to move their retail print advertising from one newspaper to another. In adopting that approach the Tribunal, it is argued, ignored all other relevant evidence.

111 In alleging that the Tribunal failed to apply its stated approach to market definition, it has been presumed that that approach embodies the correct legal framework. It is my understanding that the parties had agreed on the analytical framework to be applied and that the Tribunal was prepared to evaluate the evidence and render a decision on the basis of that common understanding, as reflected in the practical indicia outlined by the Tribunal. The immediate problem is that the Tribunal's reasons do not even reflect that underlying agreement.

112 During argument on appeal, counsel for the Director indicated that the origins of the market definition employed by the Tribunal could be found in the affidavit of Dr. Globerman, an economist who testified on behalf of Southam (Appeal Case Vol. 24 at 9026). The affidavit refers sparingly to the Director's 1992 Merger Enforcement Guidelines which set out "evaluative criteria" for assessing, inter alia, relevant product markets. Southam's Memorandum of Appeal also cites those guidelines and, as well, the affidavit of Dr. Globerman in support of its position that the Tribunal adopted the correct "legal standard" and that that approach is consistent with the position both parties advanced before the Tribunal (see Respondents' Memorandum of Fact and Law, para. 61).

113 In my view, the principal issue raised by the Director cannot be addressed properly without first attempting to explain the origins of the practical indicia approach to market definition and the relevance of the Director's Guidelines. That such guidelines are binding on no one and are merely intended to explain the government's enforcement policy and the review function performed within the Bureau of Competition Policy is not questioned. What is of significance is the fact that the Director's Guidelines build

upon those promulgated by enforcement agencies in the United States. In turn, the American guidelines were drafted having regard to the extensive United States jurisprudence surrounding the interpretation of s. 7 of the *Clayton Act* which proscribes mergers resulting in a substantial lessening of competition. However, the Director's Guidelines are not even referred to in the Tribunal's Decision; on this point, see C.S. Goldman and J.D. Bodrug, "The *Hillsdown* and *Southam* Decisions: The First Round of Contested Mergers under the *Competition Act* " (1993) 38 McGill L.J. 724 at p. 751.

114 If we are to make any headway with respect to the issue of market definition in Canada then it is necessary to provide an analysis which discloses existing theoretical and legal frameworks. The ensuing analysis covers the following topics: (a) market power paradigms; (b) American jurisprudence; (c) Canadian jurisprudence; and (d) merger enforcement guidelines in both the United States and Canada. Following that analysis, I shall deal with the substantive error alleged by the Director.

(a) Market Power - The Paradigms

115 It is universally accepted that a merger must be examined in terms of its likely effect on competition within a relevant market. The central concern is with respect to exercise of market power by a single dominant firm or a group of firms acting collectively. In turn, market power is recognized as the ability to profitably raise prices above competitive levels without losing a significant portion of business to rival firms or firms that may become rivals as a result of the price increase: see Decision at 177 quoting G.A. Hay, "Market Power in Antitrust" (1992) 60 Antitrust L.J. 807 at p. 808; R. Pitofsky, "New Definitions of Relevant Market and the Assault on Antitrust" (1990) 90 Colum. L. Rev. 1805 at 1807-08 (hereafter "Pitofsky"); and ABA Antitrust Section, Monograph No. 12, Horizontal Mergers: Law and Policy (1986) at 62 (hereafter "Horizontal Mergers").

116 Since it is not possible to measure market power directly, the analysis of whether a merger will give rise to market power focuses initially on determining the relevant market. Once the relevant market has been defined then it is necessary to infer market power within that market though the use of proxies such as market shares or concentration (subject to the limitations prescribed by subs. 92(2) and s. 93 of the Act). With respect to product market definition, there are several paradigms used to explain how one goes about determining whether products are sufficiently close substitutes and therefore to be included in the same product market. Two are of particular relevance to the appeal at hand: the "hypothetical monopolist" and "cross-elasticity". The latter is outlined in the Tribunal's reasons while the former is embraced in the Director's Guidelines.

117 Under the hypothetical monopolist paradigm one asks what would happen if a hypothetical monopolist seller of a group of products imposed a "significant and non-transitory price increase". In the event a sufficient number of buyers were to shift to other products such that the monopolist would find the price increase unprofitable then that group of products is deemed too narrow to constitute a market. Accordingly, the market is expanded to embrace the next best substitute. The analysis is repeated until one is able to identify the smallest group of products for which the hypothetical monopolist could profitably impose a price increase. The geographic market is determined in an analogous manner; see generally Horizontal Mergers at 105, Crampton at 280 and Director's Guidelines at 7 and 9.

118 The cross-elasticity paradigm has both demand and supply dimensions. Demand elasticity refers to the effect which a change in the price of one product has on the demand of another. It measures the rate at which consumers increase or decrease their consumption of one product in response to the price change of another. Under this paradigm, if a change in the price of one product causes a significant change in the quantity demanded of another then the cross-elasticity of demand is said to be high and both products are treated as being in the same product market. Conversely, if a price change in one product causes little or no change in demand for the other product the cross-elasticity is said to be low and hence the products cannot be said to fall within the same product market. The process is repeated with respect to other products until the product dimensions of the market have been settled.

119 Supply elasticity focuses on the ability of *existing* companies to alter their production facilities to produce a product which competes with that produced by another hypothetical monopolist in response to a significant and non-transitory price increase imposed by the latter. The supply side of the equation is viewed as relevant because it is assumed that a monopolist contemplating a price increase will be constrained by the knowledge that others are capable of entering the market if it would

be profitable to do so. Whether or not existing firms will enter a particular market and therefore be deemed part of the relevant market, is dependent on whether there are any barriers to entry.

120 In evaluating supply elasticity, consideration is given to examples of both successful and unsuccessful entry into a product market (see Crampton at 293-94). It would appear that supply elasticity does not directly affect the question of whether one product is a substitute for another. Its primary purpose is to identify all of the firms that are within the relevant market. Consequently, this factor takes on greater significance when consideration is given to the matter of market shares or concentration (the more firms that comprise the market the less the market share) and whether the merger is likely to lessen competition substantially. I hasten to add that barriers to market entry may also be relevant in the context of whether the merger is likely to *prevent* competition in the sense that they act as deterrents with respect to potential competitors.

121 To the extent that either paradigm is seen as a practical tool in merger analysis, it remains necessary to establish in concrete terms what constitutes a "small but significant non-transitory increase in price". Typically, the literature refers to a 5% threshold increase in price sustained over a period of one year. Invariably, the 5% threshold can be adjusted, depending on the nature of the industry. The hypothesized price increase has significant policy implications by virtue of the fact that the percentage increase is directly related to the potential market power that is to be tolerated before merger enforcement is invoked. At the same time, it has been suggested that any threshold level is necessarily arbitrary and based on intuition; see Werden, "Market Delineation and the Justice Department's Merger Guidelines" (1983) Duke L.J. 514 at 550; and Horizontal Mergers at 118, citing Elzinga & Hogarty, "The Problem of Geographic Market Delineation in Antimerger Suits" (1973) 18 Antitrust Bulletin 45, 74.

122 The hypothetical monopolist and cross-elasticity paradigms are the two theoretical frameworks most commonly employed to explain the concept of a relevant market. Armed with that understanding, the real issue is whether either paradigm is of any practical significance when it comes to the task of delineating the boundaries of a product market. The major criticism of the hypothetical monopolist paradigm is that it offers little guidance regarding its practical application; see Crampton at 282 and Horizontal Mergers at 109. The majority of criticisms, however, are reserved for the cross-elasticity paradigm. Crampton offers a convenient summary of existing criticism (at pp. 277-78):

> As one commentator has observed, "(t)he difficulty of measuring demand elasticities has made it appear that it is hopeless to try to define economically meaningful industries." This is so for many reasons. First, one must gather empirical data regarding the variation of quantities demanded or supplied as a result of changes in the price of other goods. This is extremely difficult in the best of cir cumstances. Second, these measures assume that the price of the good that is being examined, together with all other factors which are capable of influencing demand/supply for this good, remain constant. Third, apart from these practical difficulties that are associated with measuring cross elasticities in the "real world", "(t)here is no magic value of cross-elasticity measure which divides 'close' substitutes from 'distant' substitutes." Indeed, the choice of where to locate the dividing line is completely arbitrary. In addition, since the monopolist cares only about the proportionate amount by which *his* sales decrease as price rises, particular cross-elasticities may provide a misleading indication of the ability of the market as a whole to constrain monopolistic behaviour. "Many very small cross-elasticities may do more to keep a monopolist from raising price than one large elasticity." Finally, several weaknesses in the correspondence between cross elasticity and substitutability have been identified. For example, there are situations in which this correspondence is not one to one. Accordingly, although courts, commissions and/or administrative authorities in several countries have referred to the need to include in the same market products with high cross-elasticities of demand or supply, the difficulties that would be associated with employing cross-elasticity as a *bona fide* framework of analysis would be great.

123 The most obvious limitation on the applicability of either the hypothetical monopolist or cross-elasticity paradigm is the unavailability of direct (i.e. statistical) evidence. With respect to the latter paradigm, it is widely acknowledged that the statistical data necessary to compute cross-elasticity is rarely, if ever, available. Thus, it is not surprising that various frameworks or tests have evolved. It is in the American jurisprudence that one begins to appreciate why it is that the issue of market definition remains so problematic and controversial.

(b) American Jurisprudence

124 Merger analysis in the United States is a two-step process. The first is to define the relevant market. The second is to determine whether there has been a substantial lessening of competition as required by s. 7 of the *Clayton Act* . With respect to the latter determination, the primary consideration is that of the market share held by the merging firms. Thus, for those accused of antitrust behaviour the legal strategy is to convince the decision-maker that the products of the two merging firms are not close substitutes and therefore not in the same product market. Failing that argument, the merging firms will seek to have the market expanded to include as many products or firms as possible so as to diminish their market share. Government strategy is to argue the converse.

125 It is within the above context that one begins to appreciate the fundamental significance of the market definition issue in the United States and the ability of American courts to carve out narrow or broad markets depending on the definitional framework so adopted. I hasten to point out, however, that our Act differs from the *Clayton Act* in several material respects. Subsection 92(2) of our Act expressly prohibits a finding that a merger is likely to lessen competition "solely on the basis of evidence of concentration or market share". Moreover, s. 93 of the Act provides a non-exhaustive list of factors that must be considered by the Tribunal before arriving at its conclusion.

126 For purposes of this appeal, it is sufficient to canvass three of the seminal decisions of the United States Supreme Court. Together they reflect the general framework on which market analysis is undertaken in that country.

127 The first of the decisions is *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377 (1956) (hereafter "*Cellophane* "), where the Supreme Court articulated the product market tests of "cross-elasticity of demand" and "reasonable interchangeability of use". Du Pont was charged with monopolizing the manufacture of cellophane in violation of s. 2 of the *Sherman Act* . The Government argued that the relevant product market was limited to cellophane. Du Pont produced almost 75% of the cellophane sold in the United States, but less than 20% of all flexible packaging material. Although there were findings that there were significant differences between cellophane and other flexible packaging materials in terms of physical characteristics and price levels, and that cellophane was the only packaging material suitable to the needs of certain users (e.g. cigarette manufacturers), a majority of the Supreme Court concluded that the proper market included all flexible packaging materials and thus the government had failed to discharge the burden of proof in establishing a monopoly on the part of du Pont. In reaching this conclusion, the Court's approach to market delineation embraced two tests: "reasonable interchangeability" and "cross-elasticity". The Court explained (at pp. 394-95, 400 and 404):

> **IV. The Relevant Market.**
>
> When a product is controlled by one interest, without substitutes available in the market, there is monopoly power. Because most products have possible substitutes, we cannot, as we said in *Times-Picayune Co. v. United States*, 345 U.S. 594 , 612, give "that infinite range" to the definition of substitutes. Nor is it a proper interpretation of the Sherman Act to require that products be fungible to be considered in the relevant market.
>
> . . . . .
>
> What is called for is an appraisal of the "cross-elasticity" of demand in the trade. See Note, 54 Col. L. Rev. 580. The varying circumstances of each case determine the result. In considering what is the relevant market for determining the control of price and competition, no more definite rule can be declared than that *commodities reasonably interchangeable by consumers for the same purposes* make up that "part of the trade or commerce," monopolization of which may be illegal. As respects flexible packaging materials, the market geographically is nationwide.
>
> . . . . .
>
> *An element for consideration as to cross-elasticity of demand* between products is the responsiveness of the sales of one product to price changes of the other. If a slight decrease in the price of cellophane causes a considerable number of customers of other flexible wrappings to switch to cellophane, it would be an indication that a high cross-elasticity of demand exists between them; that the products compete in the same market. The court below held that the "[g]reat sensitivity of customers in the flexible packaging markets to price or quality changes" prevented du Pont from possessing monopoly control over price. 118 F. Supp., at 207. The record sustains these findings. See references made by the trial court in Findings 123-149.

> We conclude that cellophane's interchangeability with the other materials mentioned suffices to make it a part of this flexible packaging material market.
>
> . . . . .
>
> The "market" which one must study to determine when a producer has monopoly power will vary with the part of commerce under consideration. *The tests are constant. That market is composed of products that have reasonable interchangeability for the purposes for which they are produced — price, use and qualities considered* . While the application of the tests remains uncertain, it seems to us that du Pont should not be found to monopolize cellophane when that product has the competition and interchangeability with other wrappings that this record shows. (emphasis added)

128 *Cellophane* is the only case that I am aware of where a finding of high demand elasticity was made on the basis of statistical market data. There are two other aspects of *Cellophane* which have attracted attention.

129 First, the reasoning of the majority is widely believed to be seriously flawed because of what is now termed the "Cellophane fallacy". In reaching their decision, it is maintained that the majority ignored the fact that du Pont's profits on cellophane were unusually high and therefore demand elasticity should not have been evaluated at the monopoly price. Critics contend that the reason why many con sumers of cellophane may have been willing to switch to other products was that du Pont was already charging supra-competitive prices, this extracting monopoly profits on its cellophane sale. However, it has been questioned whether merger analysis is susceptible to the so-called cellophane fallacy. Professor Posner (now Posner) has argued:

> The problem does not arise in a merger case, where the issue is not whether the current price exceeds the competition level but whether the merger might result in a further deterioration of competitive conditions. If there are good substitutes in consumption or production at the *current price* , it is a detail whether that price is competitive or monopolistic. (R. Posner, "Antitrust Law: An Economic Perspective", 128-129 (1976), cited in Horizontal Mergers at 125-26)

130 Thus, the true concern is with respect to the ability of the merging firms to impose further price increases upon their customers.

131 The one aspect of *Cellophane* which has attracted support is the majority's refusal to carve out a separate market in cellophane simply because there were some classes of users for whom cellophane was a preferred product. As Pitofsky states at 1814 [90 Colum. L. Rev.]:

> As long as substantial classes of customers existed who were in a position to switch easily and promptly in response to price increases or decreases ("precarious users"), the ability of those users to switch protected the competitive interests of those with a strong preference for cellophane over any substitutes ("captive users").

132 Six years after *Cellophane* , the Supreme Court rendered its decision in *Brown Shoe Co., Inc. v. United States*, 370 U.S. 294 (1962), which has been described as the Rosetta Stone of market definition. *Brown Shoe* was the first s. 7 merger case under the *Clayton Act* to be decided by the Supreme Court. In that case, the issue was whether a merger of *Brown Shoe* and *Kinney* , two shoe manufacturers with retail outlets, would lessen competition substantially in the supply of retail shoes. In the end, the Supreme Court condemned the merger for both its horizontal and vertical impacts.

133 Noting that Congress had not adopted any particular test for measuring the relevant market, the Supreme Court cited with approval both the "cross-elasticity of demand" and the "reasonable interchangeability of use" tests articulated in *Cellophane* . The Court then immediately went on to hold that within a broad market there may exist well defined substitutes which, in themselves, constitute a product market for antitrust purposes. The seminal passage giving rise to the concept of a submarket within a market, determined by reference to a number of practical indicia, is found at p. 325:

> The outer *boundaries of a product market* are *determined by the reasonable interchangeability of use* or the *cross-elasticity of demand* between the product itself and substitutes for it. However, within this broad market, well-defined submarkets may exist which, in themselves, constitute product markets for antitrust purposes. *United States v. E.I. du Pont de Nemours & Co.*, 353 U.S. 586 , 593-595. The *boundaries* of such a submarket *may be determined by examining such practical indicia*

> *as industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors* . Because §7 of the Clayton Act prohibits any merger which may substantially lessen competition "in any line of commerce" (emphasis supplied), it is necessary to examine the effects of a merger in each such economically significant submarket to determine if there is a reasonable probability that the merger will substantially lessen competition. If such a probability is found to exist, the merger is proscribed. (emphasis added)

134 In *Brown Shoe* , the Supreme Court upheld the District Court's finding that there were three separate product markets: men's, women's and children's shoes. Resorting to four of the seven practical indicia, the Supreme Court found that each of these product lines were: (1) recognized by the public; (2) manufactured in separate plants; (3) characterized by uses peculiar to themselves; and (4) directed toward a distinct set of customers. Although one of the practical indicia was distinct prices, the Supreme Court refused to sanction a further division of product lines based on price/quality differences as it would simply be "unrealistic" (at p. 326). *Brown Shoe* had argued that men's shoes priced over $9 did not compete with those selling below that price. The Court did, however, conceded that price and quality differences may be important in determining the likely effect of a merger but felt that (at p. 326):

> ... the boundaries of the relevant market must be drawn with sufficient breadth to include the competing products of each of the merging companies and to recognize competition where, in fact, competition exists.

135 The delineation of submarket boundaries by reference to practical indicia such as those articulated in *Brown Shoe* was not well received. The submarket concept has been levelled "an intellectual monstrosity" with little "economic justification"; see Werden, supra, at p. 160. On a more charitable tone, one commentator notes that the indicia list "is presented without any indication of priority or right to specific factors and it unquestionably has worked a good deal of mischief in relevant market definition in merger cases"; Pitofsky at p. 1815. Nonetheless, the submarket concept has been used as a mechanism for excluding reasonably interchangeable products from a relevant market. Typically, reliance is placed on some but not all of the practical indicia; see Horizontal Mergers at p. 76.

136 Apparently in the two decades following the Supreme Court's decision in *Brown Shoe* , the submarket concept and the practical indicia nominated thinking on market delineation in the lower courts; see Werden, supra, at p. 172. In particular, government agencies employed the indicia to narrow the market and facilitate a finding that a merger was unlawful. However, reasonable interchangeability of use remains as an independent framework for market delineation in light of the decision in *United States v. Continental Can Co.*, 378 U.S. 441 (1964).

137 In *Continental Can* , the government challenged the acquisition by Continental Can, the second largest producer of metal containers in the United States, of Hazel-Atlas Glass, the third largest producer of glass containers in that country. Although he District Court had found that there was competition among metal, glass and plastic containers with respect to end uses, it held that it was not the type of competition contemplated by the *Clayton Act* . The Supreme Court disagreed and concluded that the product market consisted of metal and glass containers even though end use competition also included manufacturers of plastic and paper containers. This particular aspect of *Continental Can* produced strident criticism, including the accusation that:

> "The Court appears to have taken a result-oriented approach to definitions of the market gerrymandering of the boundaries" so as to maximize the prospect of invalidating the challenged acquisition. Note: The Supreme Court, 1963 Term, 78 Har. L. Rev. 143, 274-75 (1964).

138 Leaving aside this flawed aspect of the Supreme Court's reasoning *Continental Can* stands for the proposition that a finding of significant end use or inter-industry competition can overcome evidence of price differentials and low price sensitivity. Such facts, while relevant, are not determinative of the product market issue. At pp. 453-456, the Court reasoned:

> Interchangeability of use and cross-elasticity of demand are not to be used to obscure competition but to "recognize competition where, in fact, competition exists." *Brown Shoe Co. v. United States*, 370 U.S., at 326 . In our view there is and has been a rather general confrontation between metal and glass containers and competition between them for the

same end uses which is insistent, continuous, effective and quantityiwise very substantial. Metal has replaced glass and glass has replaced metal as the leading container for some important uses; both are used for other purposes; each is trying to expand its share of the market at the expense of the other; and each is attempting to preempt for itself every use for which its product is physically suitable, even though some such uses have traditionally been regarded as the exclusive domain of the competing industry. In differing degrees for different end uses manufacturers in each industry take into consideration the price of the containers of the op posing industry in formulating their own pricing policy. Thus, though the interchangeability of use may not be so complete and the cross-elasticity of demand not so immediate as in the case of most intra-industry mergers, there is over the long run the kind of customer response to innovation and other competitive stimuli that brings the competition between these two industries within §7's competition-preserving proscriptions.

Moreover, price is only one factor in a user's choice between one container or the other. That there are price differentials between the two products or that the demand for one is not particularly or immediately responsive to changes in the price of the other are relevant matters but not determinative of the product market issue. Whether a packager will use glass or cans may depend not only on the price of the package but also upon other equally important considerations. The consumer, for example, may begin to prefer one type of container over the other and the manufacturer of baby food cans may therefore find that his problem is the housewife rather than the packer or the price of his cans. This may not be price competition but it is nevertheless meaningful competition between interchangeable containers.

139 Reasonable interchangeability of use (functional interchangeability) emphasizes two factors: the product's uses and its physical characteristics. While demand cross-elasticity focuses on the sensitivity of buyers of one product to changes in the price of another, reasonable interchangeability focuses initially on the extent to which different products have similar qualities that allow them to be used for the same end use.

140 In determining whether products are substitutes for one another, the qualities of the products are not to be viewed in the abstract. Products which seem similar may be found not to be substitutes while products that appear very different may serve the same end use and be considered in the same product market. At the same time, the fact that two products are found to be functionally interchangeable does not necessarily lead to a finding that they are in the same product market. If buyers do not regard the products as substitutes for each other if only to a marginal degree then a broad market definition may be rejected on the basis that effective end use competition does not exist; see generally Kalinowski, Sullivan and McGuirl, *Antitrust Laws and Trade Regulation* , Vol. 3 (1994) at 18.02 et seq.

141 The American jurisprudence with respect to the proper application of the interchangeability of use test reveals that where the intended use of the product is the same, products have been placed in the same market notwithstanding the following factors: different price levels, different physical characteristics in composition appearance or quality, different customer classes or customer preferences and dissimilar production facilities or marketing and distribution methods; see Horizontal Mergers at p. 73, and cases collected at n. 359.

(c) Canadian Jurisprudence

142 The issue of market definition in Canadian jurisprudence has not receive the extensive treatment that it has in the United States. Before 1986, Canadian competition law, and merger law in particular, was largely based on the criminal provisions of the former *Combines Investigation Act* . Consequently, the issue of market definition was never pursued in terms of the economic and social policies generally associated with a civil scheme of regulating anti-competitiveness. Thus, the old criminal cases dealing with market definition are of little assistance in fashioning a modern product market definition under Pt. VIII of the Act. Since the new Act came into force, the Tribunal has had to deal with market definition in only two cases. Regrettably, as discussed below, neither of those cases is of assistance in resolving the issue under appeal.

143 Four of the old criminal cases which touch on market definition are note-worthy as they demonstrate that market definition was not a well-developed concept in Canadian law. All of these cases, however, do focus on the central concept of product market definition — substitutability. Yet, none offer a framework for determining how substitutability is to be assessed.

144 In *R. v. Hoffmann-La Roche Ltd.* , noted earlier, the defendant, who was accused of predatory pricing by distributing the drug Valium to hospitals free of charge, argued that the market in which the firms competed consisted of all purchasers of their product (e.g. pharmacies, physicians) and not just hospitals. The Trial Judge held that the hospital market was the relevant market. On appeal, it was alleged that the Trial Judge had failed to recognize the availability of substitute products when circumscribing the relevant market. The argument was rejected on the ground that substitutability was an irrelevant factor in view of the fact that the accused had provided Valium free to hospitals for the purpose of eliminating a competitor.

145 In *R. v. Canadian Coat and Apron Supply Ltd.*, [1967] 2 Ex. C.R. 53 , the accused, who were in the business of applying "linen towels" and controlled 85% to 90% of the market, were charged under subs. 32(1) of the *Combines Investigation Act* for conspiring to fix prices. They argued unsuccessfully that the product market should be expanded to include paper towels and other substitute products. The argument was rejected on the basis of customer preference for linen towels. At p. 82 Gibson J. concluded:

> ... that the market was the section of the public on the Island of Montreal that needed and wanted not paper towels, or other substitute products, but cleaned, ironed, pressed, ready to use linen towels ... and for whom paper towels and other substitute products were not satisfactory products;

146 In *R. v. Canadian General Electric Company Ltd.* (1976), 15 O.R. (2d) 360 (H.C.) , the three largest manufacturers of "large lamps", controlling 95% of the Canadian market, were found guilty of conspiracy to lessen competition in the market contrary to para. 32(1)(*c*) of the *Combines Investigation Act* , R.S.C. 1970, c. C-23. This case is of particular interest because it implicitly adopts the submarket analysis articulated in *Brown Shoe* . The Court found that large lamps, a class of light bulbs, were the relevant market based largely on industry perception and functional interchangeability (at p. 372):

> Large lamps were treated by each of the accused as a distinct segment of the industry for the purposes of manufacture and sale. They constituted a significant portion of the sales of all lamps in Canada during the period in question. Looked at from any angle, the manufacture or sale of large lamps may be said to constitute a class or species of business in itself.
>
> Large lamps are basically homogeneous products. There was little product differentiation among the large lamps of the three defendants. The public purchasing large lamps would be faced with comparable lines from each of the accused with the same physical characteristics and designed for the same use. The degree of substitutability or cross-elasticity is, for all practical purposes, non-existent.
>
> The distribution of large lamps may therefore be considered a relevant market for the purpose of s. 32(1)(*c*) of the Act. It is a special class of business and is a distinguishable range of lamps within the total variety of lamps produced. The market has not been artificially created to suit the purposes of the present charges but flows from the nature of the product, its lack of cross-elasticity or substitutability with other products, and the treatment given the product through a special mode of distribution and a distinctive sales policy.

147 Perhaps the most significant case on market definition is the decision of Gibson J. in *R. v. J.W. Mills & Sons Ltd.* , supra. That case turned on paras. 32(1)(*a*) and (*c*) of the *Combines Investigation Act* , R.S.C. 1952, c. 34, involving conspiracies to prevent or lessen competition. The accused were in the "import pool" business. They shipped goods that arrived in Vancouver from the Orient by ship to other points in Canada by use of a special category of railway car called "Pool cars". The accused argued, inter alia, that the Crown had not proved beyond a reasonable doubt the relevant market which they maintained should be expanded to include other competitors such as the railways and truckers. Gibson J. concluded otherwise after setting out a comprehensive list of market assessment factors. His analysis at pp. 305-307 is worthy of replication:

> Defining the relevant market in any particular case, therefore, requires a balanced consideration of a number of characteristics or dimensions to meet the analytical needs of the specific matter under consideration.
>
> At one extremity, an ill-defined description of competition is that every service, article, or commodity, which competes for the consumer's dollar is in competition with every other service, article, or commodity.

At the other extremity, is the narrower scope definition, which confines the market to services, articles, or commodities which have uniform quality and service.

In analyzing any individual case these extremes should be avoided and instead there should be weighed the various factors that determine the degrees of competition and the dimensions or boundaries of the competitive situation. For this purpose the dimensions or boundaries of a relevant market must be determined having in mind the purpose for what it is intended. For example, two products may be in the same market in one case and not in another.

And many characteristics or dimensions may be considered in defining the relevant market. All are not of the same order. And, in any particular case, usually, not all of the many characteristics or dimensions will have to be considered. In some instances, the definition may turn on only one characteristic or dimension or two (see again cases in Schedule "B"). However, in order to make a correct choice of the appropriate characteristics or dimensions, it may be necessary to review several types before selecting the proper one or ones.

Hereunder are noted some pertinent characteristics or dimensions that may be considered in defining a relevant market, but this list is not exhaustive. The classification also may be arranged in various ways.

(a) Product substitutability.

(The term economists use for this is "cross-elasticity of demand". The terms "substitutability" and "cross-elasticity" are synonymous. As an example, the demands for two products have a high cross-elasticity if a change in the price of one results in a large measure, in purchasers substituting it for the other. How to measure the degree of cross-elasticity in any given case is usually difficult).

(b) Actual and potential competition.

(The problem sometimes in competition analysis is whether to confine the "relevant market" to existing competition or to consider potential (sometimes called "poised") competition as well).

(c) Geographical area.

(The geographical dimensions of a market frequently an important factor in competitive analysis — e.g., should the relevant market be analyzed on a national basis, a regional or local area).

(d) Physical characteristics of products or service.

(Selecting products that have the same physical characteristics, or services that have the same features, is the simplest basis for defining a relevant market. But in some cases, for example, it may be correct legally to consider products with fairly dissimilar physical characteristics or services with somewhat dissimilar elements, as in the same market).

(e) End uses of products.

(The factor of end uses is closely related to physical characteristics in defining the relevant market. For example, if a product has different end uses in the hands of buyers, the definition of the relevant market may not be based solely on physical specifications. Also, for example, consideration of differences in uses is particularly important in studying markets for services).

(f) Relative prices of goods or services.

(The prices of goods or services may define the relevant market).

(g) Integration and stages of manufacture.

(Because of differences between the activities of competitors, problems of integration arise. In determining the relevant market, the problem is what products at what stage of manufacture to include or exclude).

(h) Methods of production or origin.

(Methods of production and the product resulting, and origin of material, as e.g., whether or not imported, are often important factors to consider in defining the relevant market).

148 The foregoing list is, of course, a rudimentary guideline representing a compendium of relevant market concepts prevalent at the time the case was decided (1968). Gibson J. made no further attempt to address any of the practical indicia. His final reasoning and conclusion on product market focused on lack of substitutability (at p. 314):

> In my view, firstly, there were no substitute services for this service business in which the accused operated, that is to say, the facilities solely by ship and solely by air and the transportation business in connection therewith in relation to articles and commodities transported from the said designated area of the Orient to Toronto and Montreal were and are in another market and not the market in which these accused carried on their business.

149 The only significant treatment of market definition under the *Competition Act* is found in the decisions of the Tribunal in *Canada (Director of Investigation and Research) v. Hillsdown Holdings (Canada) Ltd.* (1992), 41 C.P.R. (3d) 289 (Competition Tribunal) , and, to a lesser extent, in *Canada (Director of Investigation and Research) v. Chrysler Canada Ltd.* (1989), 27 C.P.R. (3d) 1 . I shall deal with the latter case first.

150 In *Chrysler Canada Ltd.* , the Director sought an order under s. 75 of the Act requiring the respondent to accept the complainant as a customer. The complainant carried on the business of exporting parts for Chrysler automobiles to markets outside of North America. One of the issues before the Tribunal was whether the product market consisted of Chrysler auto parts sold in Canada, Chrysler parts sold in the United States or auto parts in general. In defining the terms "product" and "market", the Tribunal specifically noted that the approach to market definition under s. 75 was not to be equated with that involving mergers where the ultimate test is whether there will be a substantial lessening of competition. In cases involving para. 75(1) (*a*), the ultimate test concerned the effect on the business of the person who is denied supplies. The Tribunal concluded that as the complainant's customers specified genuine Chrysler parts and would not accept substitutes, the product in question was Chrysler auto parts. Moreover, since the price paid for Chrysler parts sold in Canada was lower than that paid in the United States, the product was defined as Chrysler auto parts sold in Canada.

151 *Hillsdown* is the only other decision of the Tribunal which touches on the issue of market definition. In that case, the Tribunal considered the merger of the two largest meat rendering companies in Southern Ontario. The Tribunal had little difficulty in accepting the Director's argument that the product market was the provision of rendering *services* for certain red meat materials. Such services involve the collection of left-over parts of livestock which are unsuitable for human consumption but which can be processed into tallow and protein meal. The Tribunal's approach to market definition is brief (at p. 299):

> In determining the product dimensions of the market, *the first step is to identify the product or products with respect to which, prior to the merger, the two firms were competitors. The second step is to ask whether there are any close substitutes to that product to which customers could easily switch if prices were raised* (an indication of demand elasticity). If two products appear to be close substitutes when both are sold at marginal cost, then the two should be included in the same product market. (emphasis added)

152 In *Hillsdown* , the Tribunal appeared to assume that the merging firms were, prior to the merger, competitors with respect to rendering services, thereby eliminating the first step in the analysis. In fact, the merging firms carried out the same rendering business, with the exception that one dealt with both red meat and poultry, and the other only with red meat. But it is apparent that the Tribunal was not concerned with whether the services actually offered by the firms were close substitutes having regard to such factors as price and quality. Its analysis focused on the geographic dimension of the product market. Strictly speaking,

however, if the reasoning in *Hillsdown* were applied to the case at bar, the Director's appeal would have to be allowed as both the Pacific Dailies and the community newspapers offer the same service — retail print advertising.

153 To date, the Tribunal has not been asked to articulate any framework under the "first step", to determine whether the products of two merging firms are in the same market. That, of course, is the very issue before us. I turn first, however, to the matter of merger enforcement guidelines which were to have informed the Tribunal's approach to market definition.

(d) Merger Enforcement Guidelines

154 The first American guidelines were issued in 1968 and attempted to enunciate principles for market delineation in light of the Supreme Court jurisprudence at that time. These guidelines rejected the submarket concept articulated in *Brown Shoe* , but failed to take account of supply elasticity considerations. In 1982, and again in 1984, new guidelines were issued. These guidelines attempted to offer a complete analytical framework which could be used to identify those mergers that would create or enhance market power. The guidelines' threshold for significant market power is phrased in terms of the magnitude of the price increase that would be imposed by a hypothetical monopolist. Despite the attempt to avoid the practical indicia approach to market definition, the guidelines ultimately offered a non-exhaustive list of factors relevant to the task of market delineation. In 1982, they read as follows:

> (1) Evidence of buyers' perceptions that the products are or are not substitutes, particularly if those buyers have shifted purchases between the products in response to changes in relative price or other competitive variables;
>
> (2) Similarities or differences between the products in customary usage, design, physical composition and other technical characteristics;
>
> (3) Similarities or differences in the price movements of the products over a period of years; and
>
> (4) Evidence of sellers' perceptions that the products are or are not substitutes, particularly if business decisions have been based on those perceptions.

155 The 1984 American Guidelines contain no material changes. However, the issuance of new guidelines in 1992 has proved controversial because of an apparent shift in approach to market delineation and one which arguably reflects a more non-interventionist approach on the part of American enforcement agencies; See J. Simons and M. Williams, "The Renaissance of Market Definition", supra, and G.J. Werden, "Market delineation under the Merger Guidelines: a tenth anniversary retrospective", (1993) The Antitrust Bulletin 517. It is unnecessary to become embroiled in that debate and thus I turn to the Canadian guidelines.

156 In 1992, the Director issued the first Canadian Merger Guidelines for the purpose of promoting a better understanding of merger enforcement policy and to provide a unifying framework for evaluating the likely impact of mergers on competition in Canada. They also serve the stated purpose of articulating to the business and legal communities the approach used by the Bureau of Competition Policy in reviewing merger transactions. In certain respects, the Director's Guidelines build upon those issued in 1982 and 1984 in the United States. The hypothetical monopolist paradigm is expressly adopted. Thus, the critical concern is with respect to the ability of the merging firms to exercise market power by profitably raising prices.

157 The Director's Guidelines acknowledge that direct evidence in the form of statistical measures of cross-elasticities is rarely available and thus consideration must be given to nine evaluative criteria which provide indirect evidence of substitutability: (1) views, strategies, behaviour and identifying of buyers; (2) trade views, strategies and behaviours; (3) end use; (4) physical and technical characteristics; (5) buyers' switching costs; (6) price relationships and relative price levels; (7) cross-elasticity of supply considerations; (8) supply elasticity considerations; and (9) existence of second hand, reconditioned or leased products. Admittedly, there are similarities between the practical indicia referred to in *Brown Shoe* and those listed above. But any comparison must end here.

158 The Director's Guidelines are intended to provide a rational framework for delineating market boundaries. The central issue is framed in terms of the hypothetical monopolist paradigm and hence the ability of the merging firms to impose profitable price increases. Apparently, the value of the paradigm does not lie in its practical application. Its true function is to ensure that the task of market delineation does not lose sight of the principal concern — the ability of the merging firms to profitably impose price increases.

159 Unlike the practical indicia found in *Brown Shoe* , or the decision under appeal, the Director's Guidelines elaborate on each of the indicia and their relevance. Specifically, they reject the submarket concept as an independent framework of analysis, while recognizing that there is no one simple approach to market definition. The Director's Guidelines also accept functional interchangeability as a criterion for determining relevant product market. It is generally a necessary, but not sufficient, condition to be met before two products will be placed in the same market. Likewise, while direct evidence of cross-elasticity or price sensitivity of buyers remains a relevant consideration, the Director's Guidelines do not make it a necessary condition to a finding that two products are in the same product market.

160 It is instructive to reproduce those portions of the Director's Guidelines which were to have informed the Tribunal's reasoning but which remain non-binding on this Court:

> **3.2 The Product Dimension**
>
> **3.2.1 General Approach**
>
> The following approach to relevant market analysis is applied separately to each of the products in relation to which the merging parties appear to compete or are likely to compete. The analysis of the product scope of specific relevant markets commences by focussing upon what would happen if one of the merging parties attempted to impose a significant and nontransitory price increase in relation to the product. If the price increase would likely cause buyers to switch their purchases to other products in sufficient quantity to render the price increase unprofitable, the product that is the next best substitute will be added to the relevant market. The Bureau will then ask what would happen if the seller of this product and the merging party in question, acting as a hypothetical monopolist, attempted to impose a significant and nontransitory price increase with respect to the two products in the group. The process of adding the product that is the next best substitute for the products already included within the market continues until it would be possible for the sellers of these products, acting as a hypothetical monopolist, to profitably impose and sustain a significant price increase for a nontransitory period of time.
>
> **3.2.2 Evaluative Criteria**
>
> In assessing the nature and magnitude of likely supply and demand responses to a future price increase in the context of particular cases, all relevant information is considered. However, particular weight is given to the factors highlighted below, which provide indirect evidence of substitutability. Direct evidence, in the form of statistical measures of cross-elasticities of demand and supply, is rarely available. In some situations, the results of the analysis of each of these factors are not consistent with single conclusion. When this occurs, an attempt is made to arrive at the market definition that is most supportable by the available information.
>
> ***3.2.2.1 Views, Strategies, Behaviour and Identity of Buyers***
>
> The views, strategies and behaviour of buyers are often among the most important sources of information considered in the assessment of whether buyers will likely switch to another product in the event of the postulated significant and nontransitory price increase. What buyers state they are likely to do, what they have done in the past, and their strategic business plans, often provide a reliable indication of whether the postulated price increase is likely to be imposed and sustained. Where buyers have not substituted product B for product A in the past, and indicate that they would not likely do so in the event of the price increase, it may be inappropriate to conclude, on the basis of hypothetical considerations,

that these products compete in the same relevant market. The same can be true where two products are sold to buyers that have distinct characteristics. e.g., where product A is sold to consumers and product B is sold to businesses.

3.2.2.2 Trade Views, Strategies and Behaviour

Helpful information regarding historical and likely future developments in the relevant market is often provided by third parties knowledgeable about the industry, such as persons who supply the sellers of the relevant product. Similarly, industry surveys often provide data that assists the analysis. Another source of useful information is the past behaviour of the merging parties, or others who sell the relevant product, in relation to other products that are alleged to provide a significant constraining influence. For example, modifications to product design or packaging that follow similar developments made to a second product may suggest that the two products are in the same relevant market,

3.2.2.3. End Use

The extent to which two products are functionally interchangeable in end use is an important source of information regarding whether substitution between them is likely to occur. Indeed, functional interchangeability is generally a necessary, but not a sufficient, condition that must be met for two products to warrant inclusion in the same relevant market. Products that are purchased for similar end uses may be in the same relevant market notwithstanding the fact that they have very different physical characteristics, e.g., matches and disposable lighters.

Two products are more likely to be found to be in separate relevant markets as the difference between their prices increases or as their individual end users are, or are perceived to be, more unique. For example, premium products such as gold plated lighters, luxury cars and writing instruments may be found to be in separate relevant markets from discount lighters, compact cars and disposable pens, respectively, notwithstanding that the premium and discount products have similar end uses.

3.2.2.4 Physical and Technical Characteristics

Although two products with unique physical or technical characteristics *may* be found to be in the same relevant market on the basis of functional interchangeability, such products are often found to be in separate relevant markets. In general, the greater is the value that buyers place on the actual or perceived unique physical or technical characteristics of a product, the more likely it is that the product will be found to be in a distinct relevant market. Product warranties, post-sales services, order turn-around time, etc., are all included in the bundle of characteristics that make up a product.

161 Against this background, we are now in a position to deal with the substantive issue raised on appeal.

4. The Alleged Error

162 The Director has framed the principal issue in terms of whether the Tribunal erred in its application of the stated approach to product market definition by requiring statistical or anecdotal evidence of price sensitivity on the part of advertisers to the exclusion of other evidence substitutability. In order to analyze that alleged error, it is necessary to elaborate on the distinction between direct and indirect evidence of substitutability.

163 Products can be said to be in the same market if they are close substitutes. In turn, products are close substitutes if buyers are willing to switch from one product to another in response to a relative change in price, i.e. if there is buyer price sensitivity. Direct evidence of substitutability includes both statistical evidence of buyer price sensitivity and anecdotal evidence,[1] such as the testimony of buyers on past or hypothetical responses to price changes. However, since direct evidence may be difficult to obtain, it is also possible to measure substitutability and thereby infer price sensitivity through indirect means. Such indirect evidence focuses on certain practical indicia, such as functional interchangeability and industry views/behaviour, to show that products are close substitutes.

164 To the extent that it is possible to adduce statistical evidence of high demand elasticity, such evidence is virtually conclusive that two products are in the same product market. Evidence of price sensitivity can also come in anecdotal form which is a less conclusive, although still a persuasive factor tending to show that products are close sub stitutes. The fact that there is no direct evidence of substitutability, i.e. no statistical or anecdotal evidence of price sensitivity, does not show conclusively that products are not close substitutes. Put another way, evidence of price sensitivity is not a condition precedent for finding that two products are in the same product market. On this point, the decision in *Continental Can* is instructive. There, there was vigourous competition between the metal and glass industries for the business of various manufacturers. The evidence, however, disclosed a low demand elasticity. Nonetheless, the United States Supreme Court was prepared to conclude that the two products were in the same product market because of inter-industry competition. It must be recognized that there are simply too many factors other than price which can affect a buyer's choice and which can explain a low demand elasticity at any one point in time. As the Tribunal stated at p. 276: "... advertising decisions are complex and ... advertisers have difficulty in pinpointing the role of relative prices in their decisions." I turn now to the substance of the Director's argument.

165 The Director's argument that the Tribunal erred by requiring direct evidence of substitutability rests initially on a passage found at pp. 276-277 of the Decision:

> There are obvious differences and similarities between the dailies and the community newspapers. There is no reason to review them. In light of the differences, *it is incumbent on the Director to show that buyers regard the two products as highly similar and that small changes in relative price would cause a significant shift in advertising volume between the two vehicles* . Evidence showing that advertisers use one or the other vehicle mainly because of the characteristics of the particular vehicle suggests the opposite.
>
> *There is in fact no evidence before the tribunal that advertisers are highly sensitive to the relative prices of the dailies and community newspapers* . (emphasis added)

166 The Director maintains that the reference to "no evidence" in the last sentence quoted means direct evidence and therefore the Tribunal failed to consider the indirect evidence embraced by the practical indicia. Southam responds by noting that there is no express reference in the above quote to direct evidence, nor anything in the reasons of the Tribunal which would lead one to conclude that the Tribunal considered the absence of buyers' behavioural evidence of price sensitivity as decisive. Southam insists that the success of this appeal cannot hinge on an isolated passage from a decision totalling more than 300 pages in length. Reading the Tribunal's decision as a whole, Southam maintains that it is clear that the Tribunal reached its conclusion with respect to market definition only after carefully weighing all evidence, be it direct or indirect. I do not agree.

167 For the reasons below, I find that the Tribunal erred by requiring statistical or anecdotal evidence of high price sensitivity, and ignoring other relevant evidence of substitutability. It is apparent to me that the Tribunal ignored or overlooked the significance of certain indirect evidence which it was required to consider as a matter of law. Given this error of law, I feel that this is an appropriate case in which to exercise the Court's power under para. 52(*c*)(i) of the *Federal Court Act* to make the determination that ought to have been made by the Tribunal. There are no conflicting evidentiary issues which remain to be resolved as far as product market is concerned and the Tribunal has provided an exhaustive record of the evidence. In my view, the Court is entitled to make the determination that the Tribunal should have rendered on the product market issue.

168 It should be noted that there is a distinction between a Tribunal's role in establishing facts on the one hand, and applying them to a legal framework on the other. With respect to the former, it is clear that the Tribunal is in a better position than the Court to fulfil those roles. However, it is evident that the Tribunal in this case ignored relevant evidence with respect to two important matters: functional interchangeability and inter-industry competition.

169 First, the Tribunal erred in ignoring evidence of functional interchangeability by summarily dismissing the relevance of that factor. In my opinion, functional interchangeability is a vital feature of substitutability and therefore an indispensable component of product market definition.

170 The Tribunal's stated approach to product market definition noted that end use was a factor to be considered in the indirect framework. However, the Tribunal clearly failed to consider the importance of functional interchangeability, which is not simply one of many criteria to be considered but a central part of the framework. The only passage in which the Tribunal considered the matter of functionality interchangeability or end use is found at page 238:

> With respect to indirect evidence of the use of both for the same purpose, it is a matter of determining whether "purpose" can be inferred from the content of the advertisement and the circumstances related to the use of a particular vehicle. Almost by definition it can be said that community newspapers are used to reach customers in the respective areas where the papers are distributed and that dailies are used to reach customers throughout the Lower Mainland. It is not helpful to adopt this notion of purpose when evaluating whether dailies and community newspapers are effective substitutes.

171 The Tribunal considered the matter of functional interchangeability in two contexts — the first relating to substitution between electronic and print advertising and, second, in substitution between daily and community newspaper advertising. With respect to the first context, the Tribunal concluded that print and electronic media were not functionally interchangeable because "multiple price/product" advertising could not be produced in the electronic media (Decision at 224).

172 With respect to advertising in the Pacific Dailies and the community newspapers, the Tribunal appears to have held that they were not functionally interchangeable because advertising in these publications did not serve the same purpose. As indicated in the quotation above, the Tribunal simply found that "purpose" could not be inferred from the content and circumstances of advertising in the Pacific Dailies and community newspapers. This, in my view, was an error.

173 If "multiple price/product" advertising is a relevant purpose for distinguishing between print and electronic media then it must also be relevant as between advertising in daily and community newspapers. The Tribunal found that this notion of purpose was not "helpful" because community newspapers are more local than the Pacific Dailies. But the fact that the community newspapers were more local in nature does not go to the question of functional interchangeability, but to the behaviour of buyers as to preference for geographical scope. This latter subjective factor should not be mingled with the purely objective factor of functional interchangeability which focuses on use or purpose. In my view, "multiple price/product" advertising is a sufficient use or purpose to conclude, on an objective basis, that advertising is the Pacific Dailies and the community newspapers are functionally interchangeable. This conclusion is further supported by the various product modifications, such as "Flyer Force" and the formation of community newspaper groups, which were intended to increase the similarities in use between the daily and community newspapers.

174 Generally, functional interchangeability will be regarded as a necessary but not sufficient condition to be met before products will be placed in the same market. There are other factors which may tend to reinforce, or undermine, a finding that two products are functionally interchangeable. It is appropriate here to discuss the second indirect matter of evidence that the Tribunal ignored —

175 Referring to competition between the Pacific Dailies and the community newspapers for advertisers, the Tribunal found that "there is little doubt that they have been striving to attract many of the same advertisers" (Decision at 278). The Tribunal also found that the community newspapers were successful in attracting advertisers away from the Pacific Dailies and that the Pacific Dailies were concerned by the strength of the community newspapers (Decision at 268). However, the Tribunal inexplicably rejected this evidence of "broad" competition in favour of a more focused analysis (Decision at 268):

> **Conclusions Regarding Product Market**
>
> The community newspapers are uncommonly strong in the Lower Mainland and the dailies are uncommonly weak. Unlike in any other Canadian city, there are prospering community newspapers in virtually all parts of the dailies' city zone, The relative strength of the community newspapers outside the city zone is even greater. These facts concerned the Pacific Press and it sought means of coping with the attraction of the community newspapers for advertisers. In broad terms, this shows that the two kinds of newspapers are "in competition". However, a more focused analysis is required to determine whether they are in the same market, pursuant to s. 93 of the Act:

176 That "focused analysis" ultimately turned on *two* and only two strands of evidence — relating to product modifications and price sensitivity (see discussion supra at 23-27 and Decision at 268-79). In my view, the Tribunal erred in ignoring the evidence of "broad" competition. The evidence of broad competitiveness is sufficient to show that there is competition in fact between the Pacific Dailies and the community newspapers. Southam's subjective concerns were reflected in actions it undertook to compete with the community newspapers such as the introduction of "Flyer Force" (Decision at 274). The Tribunal appeared to dismiss the evidence of inter-industry competition because the loss of Southam's advertisers to the community newspapers was part of a "one-way flow" and that many advertisers who had switched to the community newspapers would not switch back to the Pacific Dailies in response to a price change. That "one-way flow" argument focuses entirely on the concept of price sensitivity.

177 Southam, at the very least, had an interest in stopping or slowing the one-way flow or even reversing it. Moreover, Southam introduced product modifications towards those ends. By focusing entirely on "one-way flow", the Tribunal ignored evidence that there was competition for both present, and possibly, future advertisers. In short, there was competition in fact and the Tribunal erred in dismissing this evidence of "broad" competition.

178 I conclude that the Tribunal in ignoring: (1) evidence of functional interchangeability between the Pacific Dailies and the community newspapers; and (2) evidence of inter-industry competition. In my view, when these factors and the supporting evidence are considered in conjunction, it is clear that the Pacific Dailies and the community newspapers are in the same product market. The superior product argument, advanced by Southam and implicitly adopted by the Tribunal does not, in my view, defeat that conclusion.

179 It will be recalled that in the chapter on "Conclusions Regarding Product" the Tribunal stated that: "the key question regarding the shift from the Pacific Dailies to the community newspapers is whether this is the kind of substitution that occurs when a better product is introduced ... the superior product generally replaces the existing product" (Decision at 276). The superior product argument rests on the common sense understanding that although two products may be functionally interchangeable, they may be highly differentiated in other material respects such that any changes in price cannot reasonably be regarded as having an effect on buyer choice. For example, the differences between disposable and gold plated lighters, Timex and Rolex watches, or Lada and Rolls Royce automobiles, are such that it is simply unrealistic to place the respective products in the same market. In these examples, the primary differences are reflected in price, quality and brand name recognition. However, the fact that product differentiation exists does not automatically lead to the conclusion that each product is in a separate market; see Areeda, *Antitrust Law* , (1995) Vol. IIA, at para. 563.

180 The "superior product" argument is an exception to the general framework of market definition analysis and cannot be used to mask competition where competition exists. All products try to provide superior characteristics because that is they very nature of the competitive market place and the entrepreneurial spirit. As a result of innovation and improvement, products can build a market, sometimes at the expense of existing products. That is what appears to have happened in the Lower Mainland where community newspapers introduced a cheaper and apparently more effective product which achieved the same ends as the one offered by the Pacific Dailies. The best evidence that competition really existed was Southam's preoccupation with the unparalleled success of the community newspapers and the combative measures which Southam initiated in response. By contract, one would not expect Rolex executives to be overly concerned with the loss of customers to Timex or vice versa. In my opinion, evidence of inter-industry competition renders the superior product argument inapplicable to the case at bar.

VI Conclusion

181 While evidence of substitutability through functional interchangeability and inter-industry competition was adduced, the Tribunal ultimately ignored such evidence. In doing so, the Tribunal adopted an overly narrow approach to substitutability as it dismissed "broad" conceptions of interchangeability and inter-industry competition. In doing so, the Tribunal erred in focusing predominantly on price sensitivity. In this case, the similarity of use between Pacific Dailies and community newspapers, and the competitiveness which existed between them, is sufficient to place both in the same product market.

182 This conclusion, of course, is not dispositive of this appeal. While the Pacific Dailies and the community newspapers are in the same product market, it remains to be determined whether the impugned merger would have the effect of lessening or preventing competition. This is the second step in the analysis under ss. 92 and 93 of the Act which requires the Tribunal to make an evaluative judgment. It should be emphasized that merger analysis in Canada requires this two-step process. Otherwise, the factors listed in ss. 92 and 93 of the Act for the purpose of evaluating the effects of a merger are rendered obsolete. The first step, the product market issue, in particular evidence of price sensitivity, must not be allowed to eclipse the vital evaluative aspect of Canadian merger law.

183 While the Tribunal went on to conclude that the Southam acquisition would not result in a substantial lessening of competition, it did not assess market shares or concentration and failed to evaluate that evidence having regard to the limitations found in subs. 92(2) of the Act. Nor did the Tribunal turn its attention to the factors listed in s. 93 of the Act as required by that section. Those matters will have to be dealt with by the Tribunal.

184 Finally, it is necessary for me to make note on the issue of prevention of competition. The Director argued before the Tribunal that Southam's acquisition prevented competition for two reasons. First, the acquisition prevented the formation of an effective community newspaper group. Second, the acquisition prevented the entry of a new daily, using one of the community newspapers as a springboard. The Tribunal rejected the first argument because of its finding that the community newspapers and the Pacific Dailies were not in the same product market, so that formation of a community newspapers group was irrelevant to the competition with Pacific Dailies. In light of my determination that community newspapers and the Pacific Dailies are in the same product market, the Tribunal will have to consider that first argument put forth by the Director respecting prevention of competition.

185 On appeal before this Court, the Director presented a third argument that Southam acquisition prevented competition. This argument suggests that the continuation of non-price competition between the Pacific Dailies and the community newspapers would have ultimately resulted in their becoming close substitutes (Appellant's Memorandum of Fact and Law, para. 152-157). As I understand it, that argument posits that the Southam acquisition eliminated the incentive for the community newspapers to engage in further product modifications, such as increasing the number of weekly editions, that would have made them closer substitutes for the Pacific Dailies. Since this argument was not raised in the pleadings below, nor before the Tribunal, it cannot be considered here.

VII Disposition

186 Pursuant to para. 52(*c*)(ii) of the *Federal Court Act* , the appeal is allowed; the decision of the Tribunal dated June 2, 1992 (excepting that portion dealing with the print real estate market on the North Shore) is set aside; and the matter remitted to the Tribunal for determination by a differently constituted panel in a manner consistent with these reasons. In accordance with the decision of this Court in *Canada (Director of Investigation and Research) v. Air Canada* (1988), 89 N.R. 241, 23 C.P.R. (3d) 178 (Fed. C.A.) , the appellant is entitled to his costs on appeal.

Appeal allowed.

Footnotes

1 There is some confusion over whether anecdotal evidence of price sensitivity is to be classified as direct as opposed to indirect evidence. At p. 179 of its Decision, the Tribunal classified anecdotal evidence relating to buyers' willingness to switch products in response to price changes as indirect evidence. But, at p. 238, it referred to the testimony of the Director's advertising witnesses adduced for the purpose of determining substitutability as evidence falling within the direct category. On appeal, the Director referred to anecdotal evidence of price sensitivity as indirect evidence. To avoid further confusion, I have employed the term direct evidence to include statistical and anecdotal evidence of price sensitivity.

1997 CarswellNat 368
Supreme Court of Canada

Canada (Director of Investigation & Research) v. Southam Inc.

1997 CarswellNat 368, 1997 CarswellNat 369, 1997 J.E. 632, [1996] S.C.J. No. 116, [1997] 1 S.C.R. 748, 144 D.L.R. (4th) 1, 209 N.R. 20, 50 Admin. L.R. (2d) 199, 69 A.C.W.S. (3d) 586, 71 C.P.R. (3d) 417, J.E. 97-632

Southam Inc., Lower Mainland Publishing Ltd., RIM Publishing Inc., Yellow Cedar Properties Ltd., North Shore Free Press Ltd., Specialty Publishers Inc., and Elty Publications Ltd., Appellants v. Director of Investigation and Research

Lamer C.J.C., La Forest, L'Heureux-Dubé, Sopinka, Gonthier, Cory, McLachlin, Iacobucci and Major JJ.

Oral reasons: March 20, 1997
Docket: 24915

Proceedings: Reversing (1995), 127 D.L.R. (4th) 263, 21 B.L.R. (2d) 1, 63 C.P.R. (3d) 1, [1995] 3 F.C. 557, (sub nom. *Director of Investigation & Research, Competition Act v. Southam Inc. (No. 1)*) 185 N.R. 321 (C.A.); Affirming (1995), 127 D.L.R. (4th) 329, 21 B.L.R. (2d) 68, 63 C.P.R. (3d) 67, (sub nom. *Director of Investigation & Research, Competition Act v. Southam Inc. (No. 2)*) 185 N.R. 291 (Fed. C.A.)

Counsel: *Neil Finkelstein, Glenn Leslie* and *Mark Katz*, for appellants.
Stanley Wong, André Brantz and *J. Kevin Wright*, for respondent.

The judgment of the court was delivered by *Iacobucci J.*:

1 The principal question raised by this appeal is whether a decision of the Competition Tribunal (the Tribunal) is entitled to curial deference. Following the approach outlined by this Court in its recent jurisprudence, I conclude that the particular decision of the Tribunal here at issue is entitled to deference.

1. Facts

2 Two daily newspapers serve the region in and around Vancouver. They are the *Vancouver Sun* and the *Vancouver Province*. The appellant Southam Inc., through its subsidiary Pacific Press Limited, owns both.

3 In addition to the two dailies, many smaller community newspapers circulate in the Lower Mainland of British Columbia. These community newspapers differ from the daily newspapers in a few respects: they serve smaller regions, they are distributed free of charge to all households in the regions they serve, and they are published only once, twice, or at most three times weekly. Community newspapers have been more successful in the Lower Mainland than in any other comparable region of Canada. Daily newspapers, by contrast, have been less successful in Vancouver than in other major Canadian cities.

4 In 1986, Southam consulted Dr. Christine Urban, an American expert, about the problems its Vancouver dailies were facing. Dr. Urban identified Vancouver's strong community newspapers as the cause of the dailies' malaise. She advised Southam to act to stem the growing power of the community newspapers.

5 In September, 1986, Southam introduced a flyer delivery service to the Lower Mainland. Known as Flyer Force, the new service offered delivery of flyers to even the households that did not receive a Southam newspaper. In 1988, several community newspapers, whose business included the delivery of flyers, joined to form a group whose geographic reach would rival Flyer Force's. This group was initially called the MetroVan Group. Later in 1988, the MetroVan Group expanded and changed its name to MetroGroup.

6 In September, 1988, Southam began to publish the *North Shore Extra*. This was a bi-weekly publication whose editorial focus was on the North Shore district of the Lower Mainland. The *Extra* was inserted as a supplement into copies of the *Vancouver Sun* bound for households in the North Shore. Additionally, the *Extra* was delivered to North Shore households that did not receive the *Sun*.

7 In January, 1989, Southam began to acquire community and specialized newspapers in the Lower Mainland. By May, 1990, the company had acquired a controlling interest in 13 community newspapers, a real estate advertising publication, three distribution services, and two printing concerns. Among its acquisitions were the Lower Mainland's two strongest community newspapers, the *North Shore News* and the *Vancouver Courier*, as well as the *Real Estate Weekly*.

8 In April, 1990, Southam discontinued the *North Shore Extra*.

9 On November 20, 1990, the respondent, the Director of Investigation and Research, applied for an order requiring Southam to divest itself of the *North Shore News*, the *Courier*, and the *Real Estate Weekly*. The Director's reason for taking this step was that Southam's acquisition of these publications was likely to lessen competition substantially in the retail print advertising and real estate print advertising markets in the Lower Mainland.

10 In early 1991, Southam shut down Flyer Force.

2. Relevant Statutory Provisions

11 Section 92 of the Competition Act, R.S.C. 1985, c. C-34 (Competition Act) addresses the problem of mergers that are likely to lessen competition substantially:

> *92.* (1) Where, on application by the Director, the Tribunal finds that a merger or proposed merger prevents or lessens, or is likely to prevent or lessen, competition substantially
>
> (*a*) in a trade, industry or profession,
>
> (*b*) among the sources from which a trade, industry or profession obtains a product,
>
> (*c*) among the outlets through which a trade, industry or profession disposes of a product, or
>
> (*d*) otherwise than as described in paragraphs (*a*) to (*c*),
>
> the Tribunal may, subject to sections 94 to 96,
>
> (*e*) in the case of a completed merger, order any party to the merger or any other person
>
> (i) to dissolve the merger in such manner as the Tribunal directs,
>
> (ii) to dispose of assets or shares designated by the Tribunal in such manner as the Tribunal directs, or
>
> (iii) in addition to or in lieu of the action referred to in subparagraph (i) or (ii), with the consent of the person against whom the order is directed and the Director, to take any other action, ...

12 Various sections of the Competition Tribunal Act, R.S.C. 1985, c. 19 (2nd Supp.), create and provide for the constitution of the Tribunal:

> *3.* ...
>
> (2) The Tribunal shall consist of

(*a*) not more than four members to be appointed from among the judges of the Federal Court — Trial Division by the Governor in Council on the recommendation of the Minister of Justice; and

(*b*) not more than eight other members to be appointed by the Governor in Council on the recommendation of the Minister.

(3) The Governor in Council may establish an advisory council to advise the Minister with respect to appointments of lay members, which council is to be composed of not more than ten members who are knowledgeable in economics, industry, commerce or public affairs and may include, without restricting the generality of the foregoing, individuals chosen from business communities, the legal community, consumer groups and labour.

. . . . .

4. (1) The Governor in Council shall designate one of the judicial members to be Chairman of the Tribunal.

. . . . .

10. (1) Subject to section 11, every application to the Tribunal shall be heard before not less than three or more than five members sitting together, at least one of whom is a judicial member and at least one of whom is a lay member.

(2) The Chairman shall designate a judicial member to preside at any hearing or, if the Chairman is present at a hearing, may preside himself.

13 Sections 12 and 13 divide questions before the Tribunal into questions of law, questions of fact, and questions of mixed law and fact, and assign responsibility for resolving those questions, both in the first instance and on appeal:

12. (1) In any proceedings before the Tribunal,

(*a*) questions of law shall be determined only by the judicial members sitting in those proceedings; and

(*b*) questions of fact or mixed law and fact shall be determined by all the members sitting in those proceedings.

(2) In any proceedings before the Tribunal,

(*a*) in the event of a difference of opinion among the members determining any question, the opinion of the majority shall prevail; and

(*b*) in the event of an equally divided opinion among the members determining any question, the presiding member may determine the question.

. . . . .

13. (1) Subject to subsection (2), an appeal lies to the Federal Court of Appeal from any decision or order, whether final, interlocutory or interim, of the Tribunal as if it were a judgment of the Federal Court — Trial Division.

(2) An appeal on a question of fact lies under subsection (1) only with the leave of the Federal Court of Appeal.

3. Judgments in Appeal

A. Competition Tribunal

(i) On the merits (1992), 43 C.P.R. (3d) 161, with additional reasons (1993), 48 C.P.R. (3d) 224

14 Following 40 days of hearings, the Tribunal found that the acquisition by Southam of the community newspapers and affiliated businesses did not substantially lessen competition in the market for retail print advertising in the Lower Mainland. The Tribunal did find, however, that Southam's purchases had substantially lessened competition in the market for real estate print advertising in the North Shore region. After hearing argument on the issue of remedies, the Tribunal ordered Southam to divest itself, at its option, of either the *North Shore News* or the *Real Estate Weekly*. The Tribunal rejected Southam's proposed remedy, which was to sell the real estate section of the *North Shore News*.

15 During the hearing, the Tribunal heard from 50 witnesses and received literally volumes of documents in evidence. That the Tribunal paid heed to this prodigious body of evidence is clear from its written reasons, which occupy some 147 pages in a law report. Fortunately, it is not necessary for purposes of this appeal to reproduce the Tribunal's reasons in any detail.

16 The principal underlying question for the Tribunal was whether Southam's daily newspapers and its newly acquired community newspapers are in the same market. Its approach to this problem was to ask whether the two kinds of products are close substitutes for one another. The traditional economic measure of substitutability is cross-elasticity of demand, which is the extent to which consumers will switch from one product to another in response to slight changes in their relative prices. However, the Tribunal recognized that direct statistical evidence of cross-elasticity of demand will rarely be available. Accordingly, the members determined that recourse should be had to "indirect evidence" of substitutability. Indirect *indicia* of substitutability include (at p. 179) "the physical characteristics of the products, the uses to which the products are put, and whatever evidence there is about the behaviour of buyers that casts light on their willingness to switch from one product to another in response to changes in relative prices". Also relevant are "the views of industry participants about what products and which firms they regard as actual and prospective competitors".

17 Almost 100 pages of the Tribunal's decision are taken up with a painstaking review and evaluation of the evidence. On the strength of this, the Tribunal concluded that daily newspapers and community newspapers, though remarkably similar at first glance, serve different retail print advertising markets. Daily newspapers, which circulate widely but reach only a relatively small percentage of households, appeal to the advertising needs of large national firms that serve customers throughout a metropolitan region. Community newspapers, by contrast, circulate only within small communities but typically reach all of the households within those communities. These newspapers appeal to local advertisers whose customers live only within a certain district. In support of this conclusion, the Tribunal presented an informal survey of the behaviour of selected advertisers in the Lower Mainland.

18 The Tribunal also cited considerable evidence to suggest that Southam regarded the community newspapers as its chief competitors. In one document, Dr. Christine Urban, an American newspaper consultant retained by Southam, identified strong community newspapers as the root of Southam's problems in the Lower Mainland. In another document quoted in the Tribunal's decision at p. 195, an official of Southam warned against the danger of conceding forever to the community newspapers "a substantial portion of what is normally daily newspaper business". However, the members did not regard this evidence of what they called "inter-industry competition" as decisive. In their view, it showed that Southam believed that it was competing with the community newspapers. But simply to state that something is believed does not guarantee that it is so, and in this case the Tribunal found that Southam's belief was unfounded. "With the present product configurations", concluded the Tribunal at p. 277, "the dailies and community newspapers are at best weak substitutes for some advertisers".

19 Because the two kinds of newspapers were at best only weak substitutes, the Tribunal concluded that they were not in the same relevant product market and therefore that the acquisition by Southam of several community newspapers and affiliated businesses did not substantially lessen competition in the market for retail print advertising in the Lower Mainland.

20 However, the Tribunal did find that the acquisition by Southam of both the *North Shore News*, with its weekly real estate supplement, and the *Real Estate Weekly*, with its North Shore edition, gave Southam monopoly power over the market for real estate print advertising on the North Shore. The result was to lessen competition substantially in that market. The Tribunal ordered the parties to appear at a later date to consider the question of the remedy.

(ii) As to remedy 199247 C.P.R. (3d) 240

21 Having heard argument on the question, the Tribunal found that the test of a proposed remedy in contested proceedings is whether it will restore the competitive situation as it existed before the merger and is not, as Southam submitted, whether it will eliminate any substantial lessening of competition that the merger may have produced. However, the Tribunal found that, even accepting Southam's proposed test, Southam's proposed remedy of selling the weekly real estate supplement to the *North Shore News* still would not be effective. The Tribunal thought it likely that the real estate supplement would founder on its

own; certainly it would not be as substantial a presence in the North Shore as a stand-alone publication as it had been as part of the *North Shore News*. The Tribunal noted that Southam had offered to reach an accommodation with any prospective buyer concerning the continuation of the supplement's association with the *North Shore News*. The Tribunal members concluded, however, that they lacked the jurisdiction to order Southam to reach an accommodation. And in any event, the Tribunal doubted whether such a negotiated association would be conducive to the fostering of a competitive environment. Accordingly, the Tribunal ordered Southam to divest itself, at its option, of either the *North Shore News* or the *Real Estate Weekly*.

B. Federal Court of Appeal

(i) On the merits, [1995] 3 F.C. 557

22 The Director of Investigation and Research appealed the Tribunal's decision on the merits and Southam appealed the Tribunal's decision on the remedy. The Federal Court of Appeal allowed the first appeal and dismissed the second.

23 Robertson J.A., writing for the court, concluded that the Tribunal, though it had stated the correct formula, had nonetheless applied the wrong legal test. He accepted the Tribunal's account of the kinds of evidence that it had to consider, but stated that the Tribunal had failed to consider all of these. He found, in particular, that the Tribunal had not considered evidence that daily newspapers and community newspapers are functionally interchangeable and evidence that the owners of the daily newspapers considered themselves to be in competition against the community newspapers. Failure to consider relevant factors, he said, is an error of law. And to his mind, the Tribunal is entitled to no deference on a question of law.

24 By way of buttressing this conclusion, he emphasized that the *Competition Tribunal Act* mandates an unusual division of labour among the members of the Tribunal. Each panel of the Tribunal, he observed, must have at least one judicial member and the judicial members of any panel are entirely responsible for the settling of such legal questions as may arise in the course of a proceeding. Section 12 of the Act provides:

> *12.* (1) In any proceedings before the Tribunal,
>
> (*a*) questions of law shall be determined only by the judicial members sitting in those proceedings; and
>
> (*b*) questions of fact or mixed law and fact shall be determined by all the members sitting in those proceedings.

Consequently, an appeal from the Tribunal on a question of law is akin to an appeal from the Trial Division of the Federal Court. What is more, an appeal lies from any decision of the Tribunal on a question of law, and no privative clause protects the Tribunal's decisions. The *Competition Tribunal Act* provides:

> *13.* (1) Subject to subsection (2), an appeal lies to the Federal Court of Appeal from any decision or order, whether final, interlocutory or interim, of the Tribunal as if it were a judgment of the Federal Court — Trial Division.

Robertson J.A. further stressed that the judicial members of the Tribunal are not more expert in matters of law than are judges of the Federal Court of Appeal.

25 Invoking the power of the Federal Court of Appeal to substitute its own findings for those of a tribunal, Robertson J.A. held that the evidence before the Tribunal of the functional interchangeability of daily and community newspapers and of inter-industry competition was more than sufficient to show that the two kinds of newspapers are in the same market. Accordingly, he remitted the matter back to the Tribunal with instructions that it should inquire whether the acquisition of the *North Shore News*, the *Vancouver Courier*, and the *Real Estate Weekly* had resulted in a substantial lessening of competition in the market for retail print advertising in the Lower Mainland of British Columbia.

(ii) As to remedy 199247 C.P.R. (3d) 240

26 Turning to Southam's appeal of the remedy, Robertson J.A. declined to decide what the appropriate test for a remedy is, because Southam's proposed remedy failed regardless of the test applied. In answer to Southam's protest that the Tribunal

had imposed a penalty on it, Robertson J.A. observed that the Tribunal had sought only to impose an *effective* remedy. To his mind, this way of proceeding could not be objectionable. Against the complaint that the Tribunal had wrongly placed the burden of proving the effectiveness of its proposed remedy on Southam, Robertson J.A. invoked the maxim that he who asserts must prove. To Southam's argument that the Tribunal had wrongly dismissed its proposed remedy as ineffective, he said that curial deference was due to the Tribunal on this, a finding of mixed law and fact.

4. Issues

27 This appeal raises two issues. The first is whether the Federal Court of Appeal erred in concluding that it owed no deference to the Tribunal's finding about the dimensions of the relevant market and in subsequently substituting for that finding one of its own. The second is whether the Federal Court of Appeal erred in refusing to set aside the Tribunal's remedial order.

5. Analysis

28 The principal question in this appeal concerns the limits that an appellate court should observe in deciding a statutory appeal from a decision like the one that the Tribunal reached in this case. Ultimately, this comes down to a question about the standard of review that an appellate court should apply in a case such as this one. In the reasons that follow, the answer given is that the Competition Tribunal should be held to the standard of reasonableness *simpliciter*. In other words, a court, in reviewing the Tribunal's decision, must inquire whether that decision was reasonable. If it was, then the decision should stand. Otherwise, it must fall.

29 The secondary question is whether the Tribunal chose an appropriate remedy. My conclusion is that, even though the Tribunal imposed too strict a test, its chosen remedy is appropriate.

A. Statutory Right of Appeal

30 In *Pezim v. British Columbia (Superintendent of Brokers)*, [1994] 2 S.C.R. 557, a decision which, like this one, concerned a decision of an expert tribunal that was subject to a statutory right of appeal, the Court declared that the standard of review is a function of many factors. Depending on how the factors play out in a particular instance, the standard may fall somewhere between correctness, at the more exacting end of the spectrum, and patently unreasonable, at the more deferential end. See pp. 589-590.

31 An appellate court must consider the factors with a view to determining the approach that it should take as a court sitting in appeal of the decision of the tribunal. There is no privative clause, and so jurisdiction is not at issue. The tribunal enjoys jurisdiction by virtue of its constating statute and the appellate court enjoys jurisdiction by virtue of a statutory right of appeal. The legislative intent is clear. The question is what limits an appellate court should observe in the exercise of its statutorily mandated appellate function.

32 I wish to emphasize that in cases like the instant appeal no question arises about the extent of the tribunal's jurisdiction. Where the statute confers a right of appeal, an appellate court need not look to see whether the tribunal has exceeded its jurisdiction by breaching the rules of natural justice or by rendering a decision that is patently unreasonable. The manner and standard of review will be determined in the way that appellate courts generally determine the posture they will take with respect to the decisions of courts below. In particular, appellate courts must have regard to the nature of the problem, to the applicable law properly interpreted in the light of its purpose, and to the expertise of the tribunal.

33 I propose to consider each of the relevant factors in turn.

B. The Nature of the Problem Before the Tribunal

34 The parties vigorously dispute the nature of the problem before the Tribunal. The appellants say that the problem is one of fact. The respondent insists that the problem is one of law. In my view, the problem is one of mixed law and fact.

35 Section 12(1) of the Competition Tribunal Act contemplates a tripartite classification of questions before the Tribunal into questions of law, questions of fact, and questions of mixed law and fact. Briefly stated, questions of law are questions about what the correct legal test is; questions of fact are questions about what actually took place between the parties; and questions of mixed law and fact are questions about whether the facts satisfy the legal tests. A simple example will illustrate these concepts. In the law of tort, the question what" negligence" means is a question of law. The question whether the defendant did this or that is a question of fact. And, once it has been decided that the applicable standard is one of negligence, the question whether the defendant satisfied the appropriate standard of care is a question of mixed law and fact. I recognize, however, that the distinction between law on the one hand and mixed law and fact on the other is difficult. On occasion, what appears to be mixed law and fact turns out to be law, or *vice versa*.

36 For example, the majority of the British Columbia Court of Appeal in Pezim, , concluded that it was an error of law to regard newly acquired information on the value of assets as a" material change" in the affairs of a company. It was common ground in that case that the proper test was whether the information constituted a material change; the argument was about whether the acquisition of information of a certain kind qualified as such a change. To some extent, then, the question resembled one of mixed law and fact. But the question was one of law, in part because the words in question were present in a statutory provision and questions of statutory interpretation are generally questions of law, but also because the point in controversy was one that might potentially arise in many cases in the future: the argument was about kinds of information and not merely about the particular information that was at issue in that case. The rule on which the British Columbia Securities Commission seemed to rely — that newly acquired information about the value of assets can constitute a material change — was a matter of law, because it had the potential to apply widely to many cases.

37 By contrast, the matrices of facts at issue in some cases are so particular, indeed so unique, that decisions about whether they satisfy legal tests do not have any great precedential value. If a court were to decide that driving at a certain speed on a certain road under certain conditions was negligent, its decision would not have any great value as a precedent. In short, as the level of generality of the challenged proposition approaches utter particularity, the matter approaches pure application, and hence draws nigh to being an unqualified question of mixed law and fact. See R. P. Kerans, *Standards of Review Employed by Appellate Courts* (1994), at pp. 103-108. Of course, it is not easy to say precisely where the line should be drawn; though in most cases it should be sufficiently clear whether the dispute is over a general proposition that might qualify as a principle of law or over a very particular set of circumstances that is not apt to be of much interest to judges and lawyers in the future.

38 Part of the confusion in this case arises from the fact that the parties are arguing about two different questions. On the surface, it appears that the parties agree about the law: both say that, in determining the dimensions of the relevant market, the Tribunal must consider indirect evidence of cross-elasticity of demand. No one quarrels with the Tribunal's understanding of the kinds of indirect evidence it should consider.

39 However, the respondent says that, having informed itself correctly on the law, the Tribunal proceeded nevertheless to ignore certain kinds of indirect evidence. Because the Tribunal must be judged according to what it does and not according to what it says, the import of the respondent's submission is that the Tribunal erred in law. After all, if a decision-maker says that the correct test requires him or her to consider A, B, C, and D, but in fact the decision-maker considers only A, B, and C, then the outcome is as if he or she had applied a law that required consideration of only A, B, and C. If the correct test requires him or her to consider D as well, then the decision-maker has in effect applied the wrong law, and so has made an error of law.

40 The appellants, for their part, maintain that the Tribunal considered all the relevant kinds of indirect evidence, including the kinds that the respondent says it ignored. Accordingly, the appellants argue that if the Tribunal erred, it can only have been in applying the correct legal test to the facts. Such an error, say the appellants, is an error of fact. As authority for their position, they cite a passage from the decision of this Court in *Canada v. Pharmaceutical Society (Nova Scotia)*, (sub nom. *R. v.* Nova Scotia Pharmaceutical Society), [1992] 2 S.C.R. 606, at p. 647:

> In the context of s. 32(1)(*c*), the process followed and the criteria used to arrive at a determination of "undueness" are questions of law and as such are reviewable by an appellate court. The application of this process and these criteria, that

> is the full inquiry, often involving complicated economic issues, into whether the impugned agreement was an undue restriction on competition, remains a question of fact. The general rule that appellate courts should be reluctant to venture into a re-examination of the factual conclusions of the trial judge applies with special force in a complex matter such as here.

41 Both positions, so far as they go, are correct. If the Tribunal did ignore items of evidence that the law requires it to consider, then the Tribunal erred in law. Similarly, if the Tribunal considered all the mandatory kinds of evidence but still reached the wrong conclusion, then its error was one of mixed law and fact. The question, then, becomes whether the Tribunal erred in the way that the respondent says it erred.

42 Even a cursory reading of the Tribunal's reasons discloses that the Tribunal did not fail to consider relevant items of evidence. The respondent charges — and the Federal Court of Appeal agreed with him on this point — that the Tribunal ignored evidence of functional interchangeability and of inter-industry competition. But this overlooks the 14 pages that the Tribunal devoted to functional interchangeability, and the 28 pages that the Tribunal devoted to inter-industry competition. See pp. 191-218 and pp. 225-238. A great part, if not actually the bulk of the Tribunal's decision is taken up with an examination of the very factors that the respondent says it ignored. Therefore, the Tribunal did not err in law by failing to consider relevant factors.

43 The suggestion remains, however, that the Tribunal might have erred in law by failing to accord adequate weight to certain factors. The problem with this suggestion is that it is inimical to the very notion of a balancing test. A balancing test is a legal rule whose application should be subtle and flexible, but not mechanical. It would be dangerous in the extreme to accord certain kinds of evidence decisive weight as, for example, by saying that evidence of inter-industry competition should always be sufficient to prove that two companies are operating in the same market. A test would be stilted and impossible of application if it purported to assign fixed weights to certain factors as, for example, by saying that evidence of inter-industry competition should weigh 10 times as heavily in the Tribunal's deliberations as does evidence of physical similarities between the products in question. These sorts of things are not readily quantifiable. They should not be considered as matters of law but should be left initially at least to determination by the Tribunal. The most that can be said, as a matter of law, is that the Tribunal should consider each factor; but the according of weight to the factors should be left to the Tribunal.

44 It seems, then, that if the Tribunal erred, it was in applying the law to the facts; and that is a matter of mixed law and fact. This is especially so if, as here, the legal principle being applied involves a balancing test, because with a typical multi-factored balancing test so many factors weigh in the balance that a duplication of any one set of relevant circumstances in the future is unlikely. At the outside, the decision of the Tribunal in this case stands for the proposition that a large daily newspaper does not compete for retail advertising business with small community newspapers though probably it does not stand even for so general a proposition as that, because the Tribunal's decision rested in part on its assessment of the behaviour of *these* parties. Depending as it does so fully on the facts and circumstances of the case, the decision is too particular to have any great value as a general precedent.

45 In short, the Tribunal forged no new legal principle, and so its error, if there was an error, can only have been of mixed law and fact. It should be noted that no one has suggested that the Tribunal erred in its findings of fact. All of this tends to suggest that some measure of deference is owed to the decision of the Tribunal because, to paraphrase what Gonthier J. stated in Nova Scotia Pharmaceutical Society, , appellate courts should be reluctant to venture into a re-examination of the conclusions of the Tribunal on questions of mixed law and fact.

C. The Words of the Tribunal's Constating Statute

46 Section 13 of the Competition Tribunal Act confers a right of appeal from orders and decisions of the Competition Tribunal:

> *13.* (1) Subject to subsection (2), an appeal lies to the Federal Court of Appeal from any decision or order, whether final, interlocutory or interim, of the Tribunal as if it were a judgment of the Federal Court — Trial Division.
>
> (2) An appeal on a question of fact lies under subsection (1) only with the leave of the Federal Court of Appeal.

That Parliament granted such a broad, even unfettered right of appeal, as if from a judgment of a trial court, perhaps counsels a less-than-deferential posture for appellate courts than would be appropriate if a privative clause were present. However, as this Court has noted several times recently, the absence of a privative clause does not settle the question. See Pezim, ; Bell Canada v. Canada (Canadian Radio-Television & Telecommunications Commission)[1989] 1 S.C.R. 1722, at p. 1746.

D. The Purpose of the Statute that the Tribunal Administers

47 Parliament has described the purpose of the *Competition Act* in the following terms:

> *1.1* The purpose of this Act is to maintain and encourage competition in Canada in order to promote the efficiency and adaptability of the Canadian economy, in order to expand opportunities for Canadian participation in world markets while at the same time recognizing the role of foreign competition in Canada, in order to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the Canadian economy and in order to provide consumers with competitive prices and product choices.

Competition Act, s. 1.1, as am. by R.S.C. 1985, c. 19 (2nd Supp.), s. 19.

48 The aims of the Act are more "economic" than they are strictly "legal". The "efficiency and adaptability of the Canadian economy" and the relationships among Canadian companies and their foreign competitors are matters that business women and men and economists are better able to understand than is a typical judge. Perhaps recognizing this, Parliament created a specialized Competition Tribunal and invested it with responsibility for the administration of the civil part of the *Competition Act*. See Competition Tribunal Act, s. 8(1).

49 This Court has said in the past that the Tribunal is especially well- suited to the task of overseeing a complex statutory scheme whose objectives are peculiarly economic:

> Section 8(1) [of the *Competition Tribunal Act*] confirms the jurisdiction of the Tribunal over Part VIII. The civil part of the [*Competition Act*] therefore falls entirely under the Tribunal's jurisdiction. It is readily apparent from the [*Competition Act*] and the [*Competition Tribunal Act*] that Parliament created the Tribunal as a specialized body to deal solely and exclusively with Part VIII [of the *Competition Act*], since it involves complex issues of competition law, such as abuses of dominant position and mergers.

See Chrysler Canada Ltd. v. Canada (Competition Tribunal)[1992] 2 S.C.R. 394, at p. 406. Because an appellate court is likely to encounter difficulties in understanding the economic and commercial ramifications of the Tribunal's decisions and consequently to be less able to secure the fulfilment of the purpose of the *Competition Act* than is the Competition Tribunal, the natural inference is that the purpose of the Act is better served by appellate deference to the Tribunal's decisions.

E. The Area of the Tribunal's Expertise

50 Expertise, which in this case overlaps with the purpose of the statute that the tribunal administers, is the most important of the factors that a court must consider in settling on a standard of review. This Court has said as much several times before, though perhaps never so clearly as in the following passage, from C.J.A., Local 579 v. Bradco Construction Ltd.[1993] 2 S.C.R. 316, at p. 335:

> ... the expertise of the tribunal is of the utmost importance in determining the intention of the legislator with respect to the degree of deference to be shown to a tribunal's decision in the absence of a full privative clause. Even where the tribunal's enabling statute provides explicitly for appellate review, as was the case in *Bell Canada* ..., it has been stressed that deference should be shown by the appellate tribunal to the opinions of the specialized lower tribunal on matters squarely within its jurisdiction.

51 As I have already said, the Tribunal's expertise lies in economics and in commerce. The Tribunal comprises not more than four judicial members, all of whom are judges of the Federal Court - Trial Division, and not more than eight lay members,

who are appointed on the advice of a council of persons learned in "economics, industry, commerce or public affairs". See Competition Tribunal Act, s. 3. The preponderance of lay members reflects the judgment of Parliament that, for purposes of administering the *Competition Act*, economic or commercial expertise is more desirable and important than legal acumen.

52 The particular dispute in this case concerns the definition of the relevant product market — a matter that falls squarely within the area of the Tribunal's economic or commercial expertise. Undeniably, the determination of cross-elasticity of demand, which is in theory the truest *indicium* of the dimensions of a product market, requires some economic or statistical skill. But even an assessment of indirect evidence of substitutability, such as evidence that two kinds of products are functionally interchangeable, needs a variety of discernment that has more to do with business experience than with legal training. Someone with experience in business will be better able to predict likely consumer behaviour than a judge will be. What is more, indirect evidence is useful only as a surrogate for cross-elasticity of demand, so that what is required in the end is an assessment of the *economic* significance of the evidence; and to this task an economist is almost by definition better suited than is a judge.

53 All of this is not to say that judges are somehow incompetent in matters of competition law. Significantly, Parliament mandated that the Competition Tribunal should include judicial members, and that the Chairman should always be a judge. See Competition Tribunal Act, s. 4. Clearly it was Parliament's view that questions of competition law are not altogether beyond the ken of judges. However, one of the principal roles of the judicial members is to decide such questions of pure law as may arise before the Tribunal. Over those questions they have exclusive jurisdiction. See *supra* at s. 12(1)(a). But over questions of fact and of mixed law and fact, the judicial members share their jurisdiction with the lay members. See *supra* at s. 12(1)(b). Thus, while judges are able to pronounce on questions of the latter kind, they may do so only together with the lay members; and, in a typically constituted panel, such as the one that sat in this case, the lay members outnumber the judicial ones, so that in the event of a disagreement between the two camps, the lay members as a group will prevail. This makes sense because, as I have observed, the expertise of the lay members is invaluable in the application of the principles of competition law.

F. The Standard

54 In my view, considering all of the factors I have canvassed, what is dictated is a standard more deferential than correctness but less deferential than "not patently unreasonable". Several considerations counsel deference: the fact that the dispute is over a question of mixed law and fact; the fact that the purpose of the *Competition Act* is broadly economic, and so is better served by the exercise of economic judgment; and the fact that the application of principles of competition law falls squarely within the area of the Tribunal's expertise. Other considerations counsel a more exacting form of review: the existence of an unfettered statutory right of appeal from decisions of the Tribunal and the presence of judges on the Tribunal. Because there are indications both ways, the proper standard of review falls somewhere between the ends of the spectrum. Because the expertise of the Tribunal, which is the most important consideration, suggests deference, a posture more deferential than exacting is warranted.

55 I wish to emphasize that the need to find a middle ground in cases like this one is almost a necessary consequence of our standard-of-review jurisprudence. Because appeal lies by statutory right from the Tribunal's decisions on questions of mixed law and fact, the reviewing court need not confine itself to the search for errors that are patently unreasonable. The standard of patent unreasonableness is principally a jurisdictional test and, as I have said, the statutory right of appeal puts the jurisdictional question to rest. See *New Brunswick Liquor Corp. v. C.U.P.E., Local 963*, (sub nom. C.U.P.E., Local 963 v. New Brunswick Liquor Corp.), [1979] 2 S.C.R. 227, at p. 237. But on the other hand, appeal from a decision of an expert tribunal is not exactly like appeal from a decision of a trial court. Presumably if Parliament entrusts a certain matter to a tribunal and not (initially at least) to the courts, it is because the tribunal enjoys some advantage that judges do not. For that reason alone, review of the decision of a tribunal should often be on a standard more deferential than correctness. Accordingly, a third standard is needed.

56 I conclude that the third standard should be whether the decision of the Tribunal is unreasonable. This test is to be distinguished from the most deferential standard of review, which requires courts to consider whether a tribunal's decision is patently unreasonable. An unreasonable decision is one that, in the main, is not supported by any reasons that can stand up to a somewhat probing examination. Accordingly, a court reviewing a conclusion on the reasonableness standard must look to see whether any reasons support it. The defect, if there is one, could presumably be in the evidentiary foundation itself or in the logical process by which conclusions are sought to be drawn from it. An example of the former kind of defect would be an

assumption that had no basis in the evidence, or that was contrary to the overwhelming weight of the evidence. An example of the latter kind of defect would be a contradiction in the premises or an invalid inference.

57 The difference between "unreasonable" and" patently unreasonable" lies in the immediacy or obviousness of the defect. If the defect is apparent on the face of the tribunal's reasons, then the tribunal's decision is patently unreasonable. But if it takes some significant searching or testing to find the defect, then the decision is unreasonable but not patently unreasonable. As Cory J. observed in Canada (Attorney General) v. P.S.A.C.[1993] 1 S.C.R. 941, at p. 963, "[i]n the Shorter Oxford English Dictionary' patently', an adverb, is defined as 'openly, evidently, clearly'". This is not to say, of course, that judges reviewing a decision on the standard of patent unreasonableness may not examine the record. If the decision under review is sufficiently difficult, then perhaps a great deal of reading and thinking will be required before the judge will be able to grasp the dimensions of the problem. See National Corn Growers Assn. v. Canada (Canadian Import Tribunal)[1990] 2 S.C.R. 1324, at p. 1370, per Gonthier J.; see also Toronto (City) Board of Education v. O.S.S.T.F.,District *15*, S.C.C., No. 24724, February 27, 1997, at para. 47 [now reported at (1997), 144 D.L.R. (4th) 385] *per* Cory J. But once the lines of the problem have come into focus, if the decision is patently unreasonable, then the unreasonableness will be evident.

58 The standard of reasonableness *simpliciter* is the same standard that was applied in *Pezim*, and for good reason: the parallels between this case and that one are obvious. *Pezim* involved the decision of a securities commission, one of whose tasks was to be sensitive to and enhance capital market efficiency; this appeal involves the decision of the Competition Tribunal, one of whose tasks is to recognize and in its own way to promote the efficiency of the Canadian economy. In *Pezim*, appeals from decisions of the securities commission lay as of right; in this case, appeals from decisions of the Competition Tribunal lie as of right. The questions in *Pezim* were entirely within the competence of the commission to answer; the question in this appeal is entirely within the competence of the Competition Tribunal to answer. The principal difference between *Pezim* and this case is that *Pezim* involved what were called questions of law. However, as I have already explained, the questions in that case were questions of law only in a somewhat attenuated sense. The difference between the questions in the two cases is therefore not as great as it might at first seem.

59 The standard of reasonableness *simpliciter* is also closely akin to the standard that this Court has said should be applied in reviewing findings of fact by trial judges. In Stein v. “Kathy K” (The) (“Storm Point” (The))1975[1976] 2 S.C.R. 802, at p. 806, Ritchie J. described the standard in the following terms:

> ... the accepted approach of a court of appeal is to test the findings [of fact] made at trial on the basis of whether or not they were *clearly wrong rather than whether they accorded with that court's view on the balance of probability*. [Emphasis added.]

60 Even as a matter of semantics, the closeness of the" clearly wrong" test to the standard of reasonableness *simpliciter* is obvious. It is true that many things are wrong that are not unreasonable; but when "clearly" is added to" wrong", the meaning is brought much nearer to that of" unreasonable". Consequently, the clearly wrong test represents a striking out from the correctness test in the direction of deference. But the clearly wrong test does not go so far as the standard of patent unreasonableness. For if many things are wrong that are not unreasonable, then many things are clearly wrong that are not patently unreasonable (on the assumption that "clearly" and "patently" are close synonyms). It follows, then, that the clearly wrong test, like the standard of reasonableness *simpliciter*, falls on the *continuum* between correctness and the standard of patent unreasonableness. Because the clearly wrong test is familiar to Canadian judges, it may serve as a guide to them in applying the standard of reasonableness *simpliciter*.

61 Putting all of the foregoing considerations into the balance and taking my cue from this Court's decisions on the subject, including particularly relatively recent decisions, I am of the view that decisions of the Competition Tribunal should be subject to review on a reasonableness standard. That this standard is appropriate and sensible becomes clear when one considers the complexity of economic life in our country and the need for effective regulatory instruments administered by those most knowledgeable and informed about what is being regulated. It bears noting, however, that the standard I have chosen permits recourse to the courts for judicial intervention in cases in which the Tribunal has been shown to have acted unreasonably.

62 In the final result, the standard of reasonableness simply instructs reviewing courts to accord considerable weight to the views of tribunals about matters with respect to which they have significant expertise. While a policy of deference to expertise may take the form of a particular standard of review, at bottom the issue is the weight that should be accorded to expert opinions. In other words, deference in terms of a "standard of reasonableness" and deference in terms of "weight" are two sides of the same coin. In this respect, I agree with Kerans, supra, at p. 17, who has described deference to expertise in the following way:

> Experts, in our society, are called that precisely because they can arrive at well-informed and rational conclusions. If that is so, they should be able to explain, to a fair-minded but less well-informed observer, the reasons for their conclusions. If they cannot, they are not very expert. If something is worth knowing and relying upon, it is worth telling. Expertise commands deference only when the expert is coherent. Expertise loses a right to deference when it is not defensible. That said, it seems obvious that [appellate courts] manifestly *must give great weight* to cogent views thus articulated. [Emphasis added.]

G. Application of the Standard

63 The question, then, is whether the Tribunal acted unreasonably when it decided that Southam's daily newspapers and community newspapers are in different product markets. I conclude that it did not.

64 The Federal Court of Appeal identified what it thought were two defects in the Tribunal's decision. The first is that the Tribunal failed to consider evidence that daily newspapers and community newspapers are functionally interchangeable. The second is that the Tribunal failed to consider evidence that Southam considered the community newspapers to be its principal rivals in the Lower Mainland.

65 By "functional interchangeability", the Federal Court of Appeal apparently meant "end use" or" purpose". See pp. 636-37. The Tribunal, for its part, elaborated (at pp. 225-38) at great length on the use to which advertisers put daily and community newspapers. At the end of 14 pages, it came to the conclusion with which the Federal Court of Appeal would later take issue: that advertisers use daily newspapers to reach consumers throughout the entire Lower Mainland and use community newspapers to reach smaller, "local" audiences.

66 The Federal Court of Appeal quarrelled with this conclusion on several grounds. Its first, and most general objection, was to the weight that the Tribunal assigned to the criterion of functional interchangeability. In the court's view, at p. 635, the Tribunal gave this important criterion short shrift: "the Tribunal clearly failed to consider the importance of functional interchangeability, which is not simply one of many criteria to be considered but a central part of the framework". However, as I have already noted, the weighing of criteria in a balancing test must be largely a matter of discretion. The very purpose of a multi-factored test, such as the one that the Tribunal used to determine the dimensions of the relevant product market, is to permit triers of fact to do justice in diverse particular cases.

67 As a general matter, in cases like this one, the aims and objectives of the statute may not be served by assigning principal or overriding importance to any one factor. It cannot be said as a matter of law that evidence of functional interchangeability should weigh more heavily in the balance than other kinds of evidence. The question therefore must be whether the Tribunal's attention to functional interchangeability was reasonable on the facts of this case.

68 For my part, I cannot say that the Tribunal acted unreasonably to discount the evidence of functional interchangeability. It had its reasons for doing so, and those reasons cannot be said to be without foundation or logical coherence. In particular, the Tribunal seems to have thought that daily newspapers and community newspapers serve different purposes. The former appeal to large advertisers who wish to convey their message throughout a metropolitan region. The latter appeal to smaller advertisers, who wish to reach all or many of the consumers living in a particular neighbourhood or district of a city. See the Tribunal's decision at p. 238. While I might not agree, as a matter of empirical "fact", that this description of the purposes of the respective kinds of newspaper is exhaustive, I think that it is not without its reasons. It is reasonable, if only reasonable, to suppose that advertisers are sufficiently discerning about the media they employ that they are unlikely to respond to changes in the relative prices of the two kinds of newspaper by taking their business from the one to the other. Fortunately for the Tribunal, its decision need only be reasonable and not necessarily correct.

69 However, that does not finish the matter. The Federal Court of Appeal had two other difficulties with the Tribunal's approach, and they appear to go to the reasoning that underlies the Tribunal's conclusion. The first is that it is inconsistent to lump together daily newspapers and community newspapers for purposes of distinguishing them from broadcast media but then to separate the two kinds of newspapers for purposes of distinguishing them from one another. The second is that the Tribunal's conclusion confuses geographical scope with purpose. Both alleged difficulties turn out on closer inspection not to be troubling.

70 The Federal Court of Appeal, at p. 636, described the first alleged difficulty in these terms: "If 'multiple price/product' advertising is a relevant purpose for distinguishing between print and electronic media then it must also be relevant as between advertising in daily and community newspapers". But, with respect, this conclusion does not follow. It is perfectly consistent to distinguish between the broadcast media and the print media on one ground and to distinguish further between two kinds of print media on another ground. Broadcasters attract advertisers who want to convey an "image". See the Tribunal's decision at p. 221. Newspapers attract advertisers who want to convey a great deal of specific information about a variety of products all at once. See supraat p. 221. Accordingly, the two kinds of media serve different markets. However, from the fact that newspapers in general serve a certain broad class of advertiser, it does not follow that all newspapers serve precisely the same particular advertisers, or the same relevant advertising markets. Further division of the market is possible. Thus, daily newspapers serve advertisers who wish to reach even a relatively small proportion of people throughout a large region. Community newspapers serve advertisers who wish to reach a large proportion of people in a small region. See supra, at p. 238. These markets are at least possibly, and therefore reasonably, different.

71 If the identification of an overarching, broad purpose that two kinds of products serve were sufficient to place those products in the same market, then all products could be placed in the same market, because all products serve the general purpose of satisfying consumers' needs. Certainly, following the Federal Court of Appeal's reasoning it would be possible to argue that broadcast media and print media are in the same market because both kinds of media serve advertisers. But it is not so, and the Federal Court of Appeal admitted at p. 636 that it is not so. The trick is to settle on the correct level of generality. Canadian courts have recognized as much in the past:

> ... speaking generally, it is of importance to bear in mind that the term "market" is a relative concept. In one sense, there is only one market in an economy since, to some extent, all products and services are substitutes for each other in competing for the customer's dollar.
>
> In another sense, almost every firm has its own market since, in most industries, each firm's product is differentiated, to some extent, from that of all other firms.
>
> Defining the relevant market in any particular case, therefore, requires a balanced consideration of a number of characteristics or dimensions to meet the analytical needs of the specific matter under consideration.

J.W. Mills & Son Ltd. v. R.[1968] 2 Ex. C.R. 275, at p. 305.

72 What has to be kept in mind is that purposes are as various as markets, and both come in different sizes. Consequently it is unhelpful to suggest that once a purpose has been identified, all those products that serve that purpose should be considered to fall within a single market. It is the *correct* or *relevant* purpose that must be found, which is to say the broadest purpose that is consistent with a high cross-elasticity of demand. For example, cars and tanks both serve the general purpose of conveying people from place to place. But no one would suggest that cars and tanks are in the same market. The reason is that consumers do not modify their car-purchasing behaviour in response to slight changes in the price of tanks, and governments do not modify their tank-purchasing behaviour in response to slight changes in the price of cars. A person who is in the market for a station wagon does not shop with an eye on the price of armaments. Again, the Minister of National Defence does not check prices at local car dealerships before announcing an acquisition of new military hardware.

73 The relevant purpose is a function of the psychology of consumption or preference. Consequently, in order to choose the relevant purpose, the adjudicator must possess in advance some idea about the behaviour of consumers. In this way, the purpose inquiry is a little circular. Tribunals inquire into purpose in order to get a grip on the tendency of consumers to substitute

one product for another, but they will not hit on the right purpose unless they already have a notion of what consumers will substitute for what. This circularity does not, however, alter the fact that more is needed to establish functional interchangeability than citation of a common purpose. That daily newspapers and community newspapers both seek the trade of "multiple price/ product" advertisers does not show, without more, that they are competing in the same market. It was open to the Tribunal to conclude, after consulting evidence of the behaviour of advertisers, that purchasing decisions in the real world are taken on the basis of some more particular purpose than to convey information about several products at once.

74 The Federal Court of Appeal at p. 636 also took issue, at a theoretical level, with the Tribunal's attention to the geographic scope of the different kinds of newspapers:

> But the fact that the community newspapers are more local in nature does not go to the question of functional interchangeability, but to the behaviour of buyers as to preference for geographical scope. This latter subjective factor should not be mingled with the purely objective factor of functional interchangeability which focuses on use or purpose.

Immediately, any argument that depends on a classification of purpose as" objective" is suspect. Purpose is at least, in part, a matter of intention and so is at least, in part, "subjective". Presumably, almost any object can be put to a multitude of uses. An axe handle, for example, can serve as a bludgeon or as an axe handle. The purpose it serves depends on the intention of the person in whose hand it is. In like manner, the purposes daily newspapers and community newspapers serve depend on the intentions of their users.

75 In the right hands, both could function as birdcage liners or as wrapping for fish and chips. At times, both probably do. However, those functions are uninteresting because they are atypical, and the Tribunal was right not to mention them. But in order to exclude those purposes and settle on the relevant ones, the Tribunal had to consider, at least implicitly, the intentions of the users of the two kinds of newspaper. Therefore, it was not illegitimate for the Tribunal to look to what the Federal Court of Appeal at p. 636 called "preference for geographical scope". Reaching consumers throughout a large region is one purpose. Reaching consumers in a neighbourhood is another purpose. It does not matter that the difference between them is in the intention of the advertiser. Intention is a component of purpose. Of course, "objective" considerations also play a part. A newspaper cannot be an aircraft, however much someone might wish that it could be. And this is reflected in the Tribunal's distinction. A community newspaper cannot reach a large audience, however much an advertiser might wish that it could, and a daily newspaper cannot reach only the consumers in a small locality.

76 It appears, then, that the Tribunal considered at length, at much greater length than did the Federal Court of Appeal, whether daily newspapers and community newspapers serve the same purpose. It concluded that they do not, and gave reasons for its conclusion. The reasons that the Federal Court of Appeal offered for questioning that conclusion are, with respect, unconvincing. Accordingly, failing the appearance of some other basic objection to the Tribunal's conclusion about functional interchangeability, that conclusion should stand.

77 The Federal Court of Appeal also found fault with the Tribunal's treatment of evidence that Southam regarded the community newspapers as its chief competitors. In particular, it objected to the Tribunal's preference for a "more focused analysis" of the evidence of inter-industry competition. In the court's view at p. 638, "[t]he evidence of broad competitiveness is sufficient to show that there is competition in fact between the Pacific Dailies and the community newspapers". It was error, said the Federal Court of Appeal, for the Tribunal to ignore that evidence.

78 In fact, the Tribunal devoted 28 pages of its reasons (pp. 191-218) to the question of inter-industry competition. The Tribunal did not "ignore" evidence of broad inter-industry competition. It simply did not regard that evidence as decisive (at pp. 191-92):

> *... determining that Pacific Press regarded the community newspapers as "competitors" is not by itself enough to place them in the same market.* Competition means many things to many people. What the tribunal must establish is whether dailies and the community newspapers are in the same product market for the purposes of assessing the implications of the acquisitions in question in this case. As discussed above in general terms, that exercise involves resolving whether

> dailies and community newspapers are effective substitutes for newspaper retail advertising services. The actions taken and the views expressed by participants in the alleged market are recognized by both parties and by expert witnesses as an *important* source of information in trying to answer this question. [Emphasis added.]

In short, the Tribunal found that although evidence of inter-industry competition suggests a certain conclusion, it is not sufficient by itself to establish that conclusion. In this it relied on the elementary principle that thinking something is so does not make it so. A company can believe that it is competing with another company without it actually (or legally) being so.

79 It is possible that if I were deciding this case *de novo*, I might not dismiss so readily as the Tribunal did what is admittedly weighty evidence of inter-industry competition. In my view, it is very revealing that Southam's own expert, an American newspaper consultant, identified the community newspapers as the source of Southam's difficulties in the Lower Mainland. To find, in the face of such evidence, that the daily newspapers and the community newspapers are not competitors is perhaps unusual. In that sense, the Tribunal's finding is difficult to accept. However, it is not unreasonable. The Tribunal explained that, in its view, Southam was mistaken about who its competitors were; and though I may not consider that reason compelling, I cannot say that it is not a reason for which there is a logical and evidentiary underpinning. More generally, I notice that the Tribunal seems to have been preoccupied with the definition of the relevant market. It is possible that the members may occasionally have lost sight of the ultimate inquiry, which is whether the acquisition of the community newspapers by Southam substantially lessened competition. But again, I cannot say that the Tribunal's approach was unreasonable. Definition of the relevant market is indeed a necessary step in the inquiry; and the fact that the Tribunal dwelled on it is perhaps understandable if, as seems to have been the case, the bounds of the relevant market were not clear.

80 I wish to observe, by way of concluding my discussion of this issue, that a reviewer, and even one who has embarked upon review on a standard of reasonableness *simpliciter*, will often be tempted to find some way to intervene when the reviewer him- or herself would have come to a conclusion opposite to the tribunal's. Appellate courts must resist such temptations. My statement that I might not have come to the same conclusion as the Tribunal should not be taken as an invitation to appellate courts to intervene in cases such as this one but rather as a caution against such intervention and a call for restraint. Judicial restraint is needed if a cohesive, rational, and, I believe, sensible system of judicial review is to be fashioned.

81 Accordingly, the Tribunal's conclusion must stand.

H. Remedy

82 Having found that Southam's acquisitions had produced a substantial lessening of competition in the market for real estate print advertising on the North Shore, the Tribunal ordered Southam to divest itself, at its own option, of either the *Real Estate Weekly* or the *North Shore News*. The Federal Court of Appeal declined to disturb this remedy. I agree with the Federal Court of Appeal that the remedy settled upon by the Tribunal should be allowed to stand.

83 The appellants submit that the correct test for a remedy under the *Competition Act* is whether it eliminates any substantial lessening of competition that the merger may have caused. The appellants observe that this is the standard that has been applied in cases under s. 92(1)(e)(iii) of the Competition Act, in which the parties have consented to the remedy. See, e.g., *Canada (Director of Investigation& Research) v. Air Canada* (1989), 27 C.P.R. (3d) 476(Competition Trib.), at pp. 513–14. They observe also that substantial lessening of competition is the evil that Parliament has sought to address in the Act. Mergers themselves are not considered to be objectionable except in so far as they produce a substantial lessening of competition. Therefore, restoration to the pre-merger situation is not what is wanted. Indeed, presumably *some* lessening of competition following a merger is tolerated, because the Act proscribes only a *substantial* lessening of competition. The appellants object further to what they see as the punitive quality of the remedy that the Tribunal imposed, and to what they regard as the illicit shifting to them of the burden of showing that the proposed remedy would be effective.

84 The respondent, for his part, says that the test of a remedy is whether it restores the parties to the pre-merger competitive situation. I believe that the appellants' test is the better one.

85 The evil to which the drafters of the *Competition Act* addressed themselves is substantial lessening of competition. See Competition Act, s. 92(1). It hardly needs arguing that the appropriate remedy for a substantial lessening of competition is to restore competition to the point at which it can no longer be said to be substantially less than it was before the merger. This is the test that the Tribunal has applied in consent cases. The Tribunal attempted to distinguish this case from those cases on precisely the ground that here the Director did not consent to the appellants' proposed remedy. But the distinction is not a sensible one. I can think of only two reasons why the test should be more forgiving where the parties have consented to a remedy. The first is that parties who have not consented should be punished for their obduracy. The second, which is related to the first, is that the law should provide parties with an incentive to come to a consensual arrangement. Neither reason is valid on closer analysis. The burden of a harsh standard falls entirely on one of the parties: the company. No punishment falls on the Director when he or she is obdurate, and the harsh standard gives him or her no incentive to consent to a remedy. Therefore, even if there is a policy of encouraging consent and punishing obduracy, it is not well served by the imposition of a more stringent standard in cases in which the parties have not consented. The better approach is to apply the same standard in contested proceedings as in consent proceedings.

86 However, the appellants do not benefit by their proposed standard. The reason is that the Tribunal expressly found that, even accepting that the appropriate standard is the one used in consent proceedings, Southam's proposed remedy fails because it would not likely be effective in eliminating the substantial lessening of competition. Robertson J.A. accepted this finding, saying that it was entitled to deference. I agree.

87 The Tribunal's choice of remedy is a matter of mixed law and fact. The question whether a particular remedy eliminates the substantial lessening of competition is a matter of the application of a legal standard to a particular set of facts. Therefore, for reasons I have already given, the Tribunal's decision must be reviewed according to a standard of reasonableness.

88 Because the Tribunal did not decide unreasonably when it decided that Southam's proposed remedy would not be effective, its decision should be allowed to stand. What Southam proposed was that it should sell the real estate supplement that appears weekly in the *North Shore News*. But, as the Tribunal very properly pointed out, it is not clear that the supplement would prosper or even survive on its own. Even if the supplement continued to enjoy the advantages of a close association with the *North Shore News*, the closeness of the association would not tend to foster competition. See the Tribunal's decision, supra, at p. 252.

89 The appellants' other objections to the remedy are unconvincing. The remedy is not punitive, because the Tribunal found that it was the only effective remedy. If the choice is between a remedy that goes farther than is strictly necessary to restore competition to an acceptable level and a remedy that does not go far enough even to reach the acceptable level, then surely the former option must be preferred. At the very least, a remedy must be effective. If the least intrusive of the possible effective remedies overshoots the mark, that is perhaps unfortunate but, from a legal point of view, such a remedy is not defective. As for the claim that the Tribunal wrongly required the appellants to demonstrate the effectiveness of their proposed remedy, no more need be said than that he who asserts should prove, as Robertson J.A. so aptly put it ((1995), 127 D.L.R., (4th) 329) at p. 337.

90 Therefore, I would dismiss the appeal of the remedy.

6. Conclusion

91 The Tribunal decided that the acquisition by Southam of several community newspapers did not substantially lessen competition in the market for retail print advertising in the Lower Mainland of British Columbia. That decision is entitled to deference. Because it is not unreasonable, it must be allowed to stand.

92 Accordingly, I would allow the appeal on the merits with costs throughout, set aside the judgment of the Federal Court of Appeal, and restore the order of the Tribunal. I would dismiss the appeal on the remedy with costs.

Appeal from judgment on merits allowed; appeal from judgment on remedy dismissed.

1997 CarswellNat 3120
Competition Tribunal

Canada (Director of Investigation & Research) v. Tele-Direct (Publications) Inc.

1997 CarswellNat 3120, [1997] C.C.T.D. No. 8, 73 C.P.R. (3d) 1

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

The Director of Investigation and Research, Applicant and Tele-Direct (Publications) Inc. Tele-Direct (Services) Inc., Respondents and Anglo-Canadian Telephone Company NDAP-TMP Worldwide Ltd. and Directory Advertising Consultants Limited Thunder Bay Telephone, Intervenors

Lloyd Member, Roseman Member, Rothstein J.

Judgment: February 26, 1997
Docket: CT-94/3

Counsel: *James W. Leising*, *John S. Tyhurst*, *Gene Assad* and *George D. Hunter*, for applicant
Warren Grover, Q.C., *Glenn F. Leslie*, *Mark J. Nicholson*, *Diane M. Rogers* and *Andrea E. Redway*, for respondents
Russell W. Lusk, Q.C., and *Shawn C.D. Neylan*, for intervener, Anglo-Telephone Company
John F. Rook, Q.C. and *John M. Hovland*, for interveners NDAP-TMP Worldwide Ltd. and Directory Advertising Consultants Ltd.

Decision of the Board:

I. Introduction

1 This application is concerned, broadly speaking, with two aspects of telephone directory or, as it is commonly referred to "Yellow Pages", advertising. The first aspect is the provision of advertising space in a published directory or the publishing business. This aspect of the business encompasses activities such as the compilation, printing and distribution of the directory. The second aspect is the provision of the advertising services required to create a finished advertisement for publication in a directory. The services aspect of the business includes such elements as locating customers, selling advertising space, and providing advice and information to customers on the design, content, creation and placement of directory advertising.

2 The applicant in this case is the Director of Investigation and Research ("Director"), the public official charged with enforcement of the *Competition Act* ("Act").[1] The Director brings an application against the respondents, Tele-Direct (Publications) Inc. and Tele-Direct (Services) Inc., under sections 77 and 79 of the Act, the provisions dealing with, as they are commonly known, tied selling and abuse of dominant position:

> 77. (1) For the purposes of this section
>
> . . .
>
> "tied selling" means
>
> (a) any practice whereby a supplier of a product, as a condition of supplying the product (the "tying" product) to a customer, requires that customer to
>
> (i) acquire any other product from the supplier or the supplier's nominee, or

(ii) refrain from using or distributing, in conjunction with the tying product, another product that is not of a brand or manufacture designated by the supplier or the nominee, and

(b) any practice whereby a supplier of a product induces a customer to meet a condition set out in subparagraph (*a*)(i) or (ii) by offering to supply the tying product to the customer on more favourable terms or conditions if the customer agrees to meet the condition set out in either of those subparagraphs.

(2) Where, on application by the Director, the Tribunal finds that ... tied selling, because it is engaged in by a major supplier of a product in a market or because it is widespread in a market, is likely to

(a) impede entry into or expansion of a firm in the market,

(b) impede introduction of a product into or expansion of sales of a product in the market, or

(c) have any other exclusionary effect in the market,

with the result that competition is or is likely to be lessened substantially, the Tribunal may make an order directed to all or any of the suppliers against whom an order is sought prohibiting them from continuing to engage in ... tied selling and containing any other requirement that, in its opinion, is necessary to overcome the effects thereof in the market or to restore or stimulate competition in the market.

79. (1) Where, on application by the Director, the Tribunal finds that

(a) one or more persons substantially or completely control, throughout Canada or any area thereof, a class or species of business,

(b) that person or those persons have engaged in or are engaging in a practice of anti-competitive acts, and

(c) the practice has had, is having or is likely to have the effect of preventing or lessening competition substantially in a market,

the Tribunal may make an order prohibiting all or any of those persons from engaging in that practice.

3 In relation to section 77, the Director alleges that the respondents have engaged in a practice whereby, as a condition of supplying advertising space in telephone directories, they have required or induced customers seeking advertising space in telephone directories to acquire another product from them, namely telephone directory advertising services. As the respondents are allegedly major suppliers of advertising space, this practice of tied selling has allegedly impeded entry into or expansion of firms in the market because advertising agencies or others would provide the services or would expand to provide increased services, were space and services not tied together by the respondents. The result, it is alleged, is that competition has been, is, or is likely to be lessened substantially.

4 With respect to the alleged abuse of dominant position, the Director alleges that the respondents substantially or completely control the classes or species of business they engage in, namely the provision of advertising space and the provision of advertising services. The respondents, it is alleged, have engaged in or are engaging in a practice of anti-competitive acts in each of the markets for space and for services. In the advertising space market, the alleged practice focuses on the actions taken by the respondents upon entry by competing publishers of telephone directories into some of their markets. In the services market, the alleged practice includes acts directed by the respondents against alternative or independent suppliers of services. The acts alleged to be anti-competitive in the services market cover a wide gambit, including, among others, refusal to deal directly with certain service suppliers as agents for advertisers, providing space to independent service suppliers on less favourable terms than to the respondents' internal sales staff, "squeezing" the return available to independent service providers by restricting the availability of commission over time, and refusing to license its Yellow Pages trade-marks to competing service suppliers. These

practices allegedly have had, are having, or are likely to have the effect of preventing or lessening competition substantially in the markets for the provision of advertising space in telephone directories and advertising services, respectively.

5 The respondent Tele-Direct (Publications) Inc. is owned by Bell Canada and BCE Inc. It is comprised of two parts: a "directory" division and an "other business" division. The directory division embraces the directory publishing operations for Bell Canada in its territory, which covers most of Quebec and Ontario. The other business division is made up of various companies partly or wholly owned by BCE Inc., one of which is Tele-Direct (Services) Inc.[2] Tele-Direct (Services) Inc. publishes telephone directories under contract for non-Bell Canada telephone companies ("telcos") with discrete territories within Ontario,[3] for Télébec (owned by BCE Inc.) in parts of Quebec, and for other telcos outside of Ontario and Quebec. Tele-Direct (Services) Inc. also has international operations and includes Tele-Direct (Media) Inc., an accredited advertising agency specializing in Yellow Pages created by Tele-Direct in 1994. There is overlap between Tele-Direct (Services) Inc. and Tele-Direct (Publications) Inc. at the officer level but Tele-Direct (Services) Inc. has its own employees who run its business. In these reasons, except where the context requires separate identification, the two respondents will be referred to together as "Tele-Direct" or the respondents.

6 The respondents deny each of the allegations in the Director's application. In particular, regarding the tied selling allegation, the respondents' primary position is that advertising services and advertising space form an inseparable package for reasons of efficiency and revenue growth. In response to the abuse of dominance allegations, the respondents maintain that they do not substantially or completely control, or have market power in, the alleged market as there are many adequate substitutes for telephone directory advertising, namely other local advertising media. With respect to the specific alleged anti-competitive acts, the respondents take the position that the allegations relate to acts directed at three specific groups operating in separate markets: other directory publishers, Tele-Direct's accredited agents and non-accredited service providers. Save for publishers, they assert that they are not in competition with the groups against whom their acts are said to be directed.

7 Five requests for leave to intervene were received and granted in this proceeding although two of those were later discontinued.

8 NDAP-TMP Worldwide Ltd. ("NDAP") and Directory Advertising Consultants Limited ("DAC") are accredited Yellow Pages advertising agencies which provide services to clients who wish to advertise in telephone directories, particularly those published by or for the various telcos across Canada. They arrange for the preparation and placement of the advertisements in these directories on behalf of their clients. They presented final argument on the issues relevant to the role of agencies in the market.

9 The Anglo-Canadian Telephone Company ("Anglo-Canadian"), through one of its divisions, publishes Yellow Pages directories in British Columbia for BC Tel and in parts of Quebec for Quebec Tel. Anglo-Canadian licenses the Yellow Pages trade-marks from the respondents. Anglo-Canadian presented final argument only on the issues related to the possible compulsory licensing of the Yellow Pages trade-marks requested by the Director as part of the abuse of dominance case.

10 InfoText Limited ("InfoText"), a subsidiary of Newfoundland Tel, and Thunder Bay Telephone supply subscriber listing information to Tele-Direct for directory publication for subscribers in Newfoundland and Labrador and in the city of Thunder Bay, respectively. InfoText subsequently discontinued its intervention. Both InfoText and Thunder Bay Telephone requested intervenor status only to place their requests for leave to intervene on the record, which the Tribunal allowed.

11 White Directory of Canada, Inc. ("White") is a non-telco publisher of telephone directories in St. Catharines, Niagara Falls and Fort Erie. White discontinued its intervention prior to the commencement of the hearing.

Preliminary Comments of the Presiding Judicial Member

12 The notice of application in this matter was filed on December 22, 1994. The hearing commenced in September 1995 and ended at the beginning of March 1996. This decision has taken over 11 months to issue. In view of the Tribunal's usual practice of dealing with matters before it more expeditiously, some explanation is warranted.

13 There is no doubt that this has been the most complex case presented to the Tribunal since its inception. In addition to a strongly contested question of market definition, the case, in reality, consists of five cases, each requiring the Tribunal to address substantial competition issues (tied selling, abuse of dominance in respect of agents, consultants and publishers and trade-marks). Each of the five cases involves a multitude of sub-issues. Many of the Director's numerous specific allegations were multifaceted. To each allegation, the respondents raised a host of defences.

14 The record in this case provides a telling indication of its complexity. It consists of almost 15,000 pages of transcript taken over 70 days and involving 58 witnesses, including five expert witnesses. There were 36 volumes of documents produced in the joint book of documents alone. A further 156 exhibits not included in the joint book were entered in evidence by the parties. The parties submitted over 600 pages of written argument and oral argument took 11 days.

15 In many respects, the approach of the Director and respondents to this case does not result in a joining of issues. Counsel for the Director referred to their respective positions as "ships passing in the night". The result is that the Tribunal has often been left to identify and define, as well as resolve, the issues.

16 Indeed, the appropriate conceptual frameworks for the various issues have been very difficult to determine. The application included novel allegations of anti-competitive acts (for example, "targeting" in respect of publisher entrants) and inter-relationships between issues, such as the alleged anti-competitive acts against agents in the abuse of dominance case and tying, which required considerable deliberation.

17 Finally, there was the troubling issue of tying. This is the first case in which tying has been raised as a "principal" or substantial allegation.[4] This is a particularly difficult issue when related to services. There has been considerable debate among competition lawyers, economists and jurists about the difficulty of addressing alleged anti-competitive activity without adversely affecting efficiency in the context of tying, and the Tribunal was squarely faced with these issues in this case.

Summary of Conclusions

18

1. Telephone directory advertising is a distinct advertising medium without close substitutes and is therefore the relevant product market. Geographic markets are local, corresponding roughly to the scope of each of Tele-Direct's directories. Tele-Direct has an overwhelming share of the product market in all relevant local markets.

2. Tele-Direct has control or market power since the condition of easy entry required to overcome the presumption of market power arising from Tele-Direct's extremely large market share is not satisfied. Direct indicators of market power, such as the level of profits and methods of pricing, reinforce this conclusion.

3. With respect to the allegation of tied selling, telephone directory space and telephone directory advertising services constitute two products solely for national and regional advertisers and Tele-Direct has tied the supply of advertising space to the acquisition of advertising services for these customers. We have prohibited the practice of tied selling.

4. The allegation that Tele-Direct has engaged in a practice of anti-competitive acts against entrants into telephone directory publishing, particularly in the Sault Ste. Marie and Niagara regions, is rejected.

5. The allegation that Tele-Direct has engaged in a practice of anti-competitive acts directed against agents and resulting in substantial lessening of competition is rejected.

6. The allegation that Tele-Direct has engaged in a practice of discriminatory anti-competitive acts against consultants which have or are likely to result in a substantial lessening of competition is accepted. Tele-Direct is ordered to cease the practice. Other allegations respecting consultants are rejected.

7. The allegation that Tele-Direct's refusal to license its trade-marks to certain competitors is a practice of anti-competitive acts is rejected because the refusal is protected from being an anti-competitive act by subsection 79(5) of the *Competition Act* as a legitimate exercise of its rights under the *Trade-marks Act*.

II. Background Facts

A. Telephone Directory Advertising

19 A white pages telephone directory is a comprehensive list of all telephone subscribers in a specified area. A listing includes a name, address and telephone number. A classified telephone directory, historically printed on yellow paper (hence "Yellow Pages"), [5] includes all business telephone subscriber listings plus advertising arranged by heading or descriptive category. There are often multiple headings under which a directory user might search in order to find a certain type of business.

20 Tele-Direct's Yellow Pages directories generally cover the same geographic area as the corresponding white pages. Some white pages directories, however, cover a much broader area than the Yellow Pages; in those cases, there would be several different Yellow Pages directories for a single white pages. Tele-Direct also publishes even more narrowly-scoped Yellow Pages directories for individual "neighbourhoods" in Montreal and Toronto.

21 Telcos are required by the Canadian Radio-television and Telecommunications Commission ("CRTC") to distribute the appropriate up-to-date telephone directory for their district, both white and Yellow Pages, to telephone subscribers at no additional charge. Tele-Direct pays the various telcos for subscriber listing information and the right to publish and distribute the directories to subscribers. It makes its profits from the net advertising revenues. Tele-Direct publishes directories annually.

22 Every business telephone subscriber is entitled to receive in its Yellow Pages directory one light-type listing free of charge under the heading of its choice. Any features added to a listing, for example, bold type or extra lines, a second heading or another directory must be purchased. Actual advertisements in the Yellow Pages must, of course, also be purchased. For Tele-Direct's purposes, an "advertiser" is a subscriber who has a paid item in either the white pages (an enhanced listing) or Yellow Pages of a directory. Revenues from Yellow Pages advertising is far greater than any "advertising" expenditures in the white pages. [6]

23 Approximately 50 percent of business subscribers are "advertisers". The remainder are called "non-advertisers" or "non-ads". The percentage of advertisers is smaller in the largest centres such as Montreal and Toronto and larger in smaller centres. Excluding neighbourhood directories and agency clients, [7] average advertising expenditures in 1994 in Tele-Direct (Publications) Inc. directories were approximately $1,700, with advertisers spending that amount or less constituting around 30 percent of revenues but over 80 percent of advertisers. At the other end of the spectrum, the top 30 percent of revenues comes from only about two percent of advertisers, those who spend more than approximately $10,000 annually. A few very large advertisers spending an average of $113,000 provide 6.5 percent of revenues but represent only 0.1 percent of advertisers by number.

24 A number of different types of advertising can be purchased in a Tele-Direct Yellow Pages directory. Apart from the basic upgrades to its initial free listing (e.g., second heading, bold type), a business may purchase "in-column" or "display" advertising. The pages in Tele-Direct's directories are generally divided into four columns; an "in-column" advertisement fits within the confines of one of the columns with the variation being in the height of the advertisement. In-column advertisements are arranged alphabetically, interspersed among the simple listings.

25 A variation on the in-column advertisement is the trade item advertisement, including the trade-name, trade-mark and custom trade-mark advertisements (usually referred to together as "trade-marks" or "trade-mark advertisements"). In order to place this type of advertisement, the listed businesses must have authorization to use the trade-name or mark in their directory advertising. The trade-name or mark acts as the heading for the advertisement, followed by one or more listings of specific businesses.

26 Display advertisements range in size from a quarter column (1/16 of a page) to a full page. The placement of these advertisements is loosely alphabetical, as space on a page permits. Options like various types of borders, red, other colours, "white knockout" (white background instead of yellow) may be added to both in-column and display advertisements. They also feature a variety of design and layout techniques, print styles and sizes and graphics.

B. Publishers

27 Revenues from the telephone directory business in Canada amount to about $900 million to $1 billion annually. The vast majority of these are generated by the telco-affiliated directories. Apart from the Tele-Direct directories and other directories published by or on behalf of telcos, there are over 250 "independent" directories published in Tele-Direct's territory. These directories are independent in the sense that they have no connection to the provider of telephone service. They come in a wide variety of formats (size, subject, colour of paper) but can, generally, be characterized as two types: "niche" and "broadly-scoped" directories.

28 Niche directories operate in geographic areas which are substantially smaller than the areas covered by the corresponding telco directories. These directories have a generally smaller, more tightly-scoped distribution area than the telco directory, allowing a local retailer to advertise to a smaller geographic area at a lower cost. Niche directories are often directed at a particular religious, ethnic or demographic group.

29 Two independent publishers of broadly-scoped directories currently produce directories in parts of Tele-Direct's territory. White, which was for a brief time an intervenor in this proceeding, has published directories in the Niagara region since 1993. Dial Source Plus, Inc. ("DSP") publishes a directory in the Sault Ste. Marie area and has also done so since 1993.

C. Service Suppliers

30 Telephone directory advertising services, including the sale of space in Tele-Direct's directories, are provided by three groups: Tele-Direct's internal sales force, advertising agencies and consultants. More detail on each of these groups and their particular method of operation will be provided as appropriate throughout these reasons. For the moment, the following should suffice to introduce the various players.

31 The internal sales force of Tele-Direct consists largely of unionized sales representatives who are remunerated through a combination of salary, commission and other incentives. Services similar to those provided by Tele-Direct's internal sales force are also offered by outside advertising agencies. These include general advertising agencies which, if they deal with Yellow Pages at all, usually have a department devoted to that function, advertising agencies specializing in Yellow Pages only and in-house advertising agencies.

32 Agencies are not remunerated directly by the advertiser but, rather, through a commission paid by the publisher as a percentage of the value of the advertising purchased. While the agency receives commission, the agency's employees earn salary for providing services to the agency's clients. Agencies are restricted in the accounts that they can service as Tele-Direct only pays commission on accounts which meet certain criteria. Tele-Direct's commissionable account definition has undergone a number of changes over the years which will be discussed in further detail later. It is not controversial that fewer accounts meet the current criteria than met prior definitions. The current criteria were adopted in 1993 and are sometimes referred to as the "national" account definition.[8] In order to receive the 25 percent commission payable on these accounts, the agency placing the advertising must be accredited as a Certified Marketing Representative or "CMR" in accordance with the standards set by the Yellow Pages Publishers Association ("YPPA").

33 Services are also provided by Yellow Pages consultants. Consultants create advertisements for Yellow Pages advertisers and advise them on where and to what extent they should advertise in the Yellow Pages. Typically, consultants obtain cost savings on behalf of advertisers by advising the purchase of smaller or less colourful advertisements, more limited geographic placement of advertisements or by redesigning the advertising. They are not recognized by Tele-Direct, which refers to them

by the less complimentary term of "cut agents". Consultants do not receive commission. In general, consultants are paid by the advertiser out of the savings in advertising expenditures resulting from the adoption of the consultant's advice.

III. Time Limitations

34 The respondents argue that the Director is subject to three time constraints which limit the allegations of anti-competitive acts that can be advanced for the purposes of the Director's case under section 79. These arguments are that: the *Competition Act* is not retrospective; the Director's allegations are statute-barred by the *Crown Liability and Proceedings Act*;[9] and subsection 79(6) of the *Competition Act* further limits those allegations. Each argument will be dealt with in turn.

35 The particular allegations that are challenged relate to Tele-Direct's requirement of "issue billing" (payment from CMRs required at the time of issue of a directory as opposed to monthly payments when advertisers deal with Tele-Direct's general sales force) and its restricting of the commissionability criteria applicable to CMRs. The actual words at paragraph 65 of the application are:

> ... the Applicant says that the Respondents have engaged in the following anti-competitive acts:
>
> . . .
>
> (c) providing advertising space to independent advertising agencies on less favourable terms and conditions than to its own sales staff, including: ...
>
>> (ii) requiring that such independent agencies pay the total amount outstanding for a year's insertion of advertising in a given directory, while customers placing orders through internal sales staff may pay such amount monthly over the course of the year without interest charges; ...
>
> (d) squeezing the return available to independent advertising agencies by acts which include:
>
> . . .
>
>> (iv) further restricting the availability of commission to such agencies over time.

A. Retrospectivity

36 There is no apparent difference between the parties with respect to the broad legal principles regarding retrospectivity. The general rule is that statutes are not to be construed as having retrospective operation unless such a construction is expressly or by necessary implication required by the language of the particular statute.[10] Côté, one of the authorities cited by the respondents, states that a retrospective effect occurs when a new statute is applied "in such a way as to prescribe the legal regime of facts entirely accomplished prior to its commencement." He further states that it is *not* retrospective operation when a statute is applied to ongoing facts which began prior to the statute's commencement.[11] The Driedger text, also referred to by the respondents, describes ongoing facts or "continuing facts" as

> ... one or more facts that endure over a period of time, such as ownership or imprisonment or residency. A continuing fact can be any state of affairs or status or relationship that is capable of persisting over time....[12]

The dispute between the parties is whether the allegations advanced by the Director regarding issue billing and commissionability criteria imply retrospective application of the *Competition Act*.

37 The respondents submit that since no concept of an "anti-competitive act" existed before 1986, when the *Competition Act* came into force, no act which occurred prior to 1986 can now be characterized as anti-competitive for purposes of section 79. They also argue that section 79 on its terms can *only* be applied to discrete acts or events, of which there must be multiple instances to constitute a "practice".

38 With respect to commissionability, the respondents argue that the Director is alleging that they "narrowed" the definition by discrete acts which occurred in 1975 and again in 1993. The 1975 "narrowing" cannot be anti-competitive and the 1993 "narrowing" alone is only one act and cannot amount to a "practice". Likewise, they say that the Director has alleged that Tele-Direct's "decision" to require issue billing, another discrete act which took place long before 1986, cannot be an anti-competitive act. The fact that these decisions resulted in allegedly restrictive policies that have been applied continuously ever since, they submit, is irrelevant because there is no "new act" of "requiring issue billing" or of "narrowing" besides 1993.

39 The Director argues that the respondents have mischaracterized the pleadings. The Director submits that the current situation, the day-to-day restricted state of the commissionable market and the ongoing requirement of issue billing, are the focus of the allegations of anti-competitive acts, rather than the original decisions to implement these policies. The pre-1986 events, the Director submits, shed light on history, intent and progress. Thus, the Director says there is no question of retrospectivity.

40 We are of the view that section 79 is not restricted in its application to discrete acts or events as opposed to an ongoing course of conduct or state of affairs. The meaning of "practice" in subsection 79(1) was considered by the Tribunal in the *NutraSweet* case. [13] There, the Tribunal found that a practice may exist where there is more than an "isolated act or acts". It also observed that the examples of anti-competitive acts listed in section 78 could entail both a course of conduct over time as well as discrete acts:

> ... The anti-competitive acts covered in s. 78 run a wide gamut. Some almost certainly entail a course of conduct over a period of time, such as freight equalization in para. 78(*c*), whereas others consist of discrete acts, such as the setting of product specifications in para. 78(*g*). The interpretation of "practice" must be sufficiently broad so as to allow for a wide variety of anti-competitive acts. Accordingly, the tribunal is of the view that a practice may exist where there is more than an "isolated act or acts". For the same reasons, the tribunal is also of the view that different individual anti-competitive acts taken together may constitute a practice. [14]

41 We are satisfied that the practice contemplated by subsection 79(1) must be more than an isolated act or acts but can include a number of individual anti-competitive acts taken together or a course of anti-competitive conduct over time.

42 Clearly, the Director's pleadings contemplate the violation of subsection 79(1) of the *Competition Act* by a current practice of anti-competitive acts by the respondents. The fact that the act or acts giving rise to the current practice took place prior to 1986 does not make application of the subsection retrospective. In this case, the Director is not challenging the initial decisions by Tele-Direct to commence issue billing and to restrict commission in 1975 as discrete anti-competitive acts in and of themselves. Requiring payment from CMRs at time of issue of a directory may have been instituted in 1959 but it continued after 1986 and existed when the Director's application was filed. Similarly, the "narrow" commissionability market which commenced with a change in the commissionability rules in 1975 continued after 1986. While it may have been narrowed further in 1993, it is not the discrete act of narrowing that is in issue in this case. Rather, it is the ongoing narrow commissionability rules that existed when the Director's application was filed and that were, in the view of the Director, exacerbated in 1993 with further narrowing, that are the focus of the allegations of anti-competitive conduct. As such, there is no retrospective application of the *Competition Act* in this case.

43 Nor is it inappropriate in these circumstances to have regard to events occurring prior to 1986 to consider fully the allegations made under section 79. We take guidance from the approach adopted by the Supreme Court in *Gamble v. R.* Wilson J., speaking for the majority, states:

> ... Frequently an alleged current violation [of the *Charter*] will have to be placed in the context of its pre-*Charter* history in order to be fully appreciated.... Charter standards cannot be applied to events occurring before its proclamation but it would be folly, in my view, to exclude from the Court's consideration crucial pre-*Charter* history. [15]

44 It is clear from the words of the application, and from the way the case developed before the Tribunal, that the current state of affairs is the focus of the Director's allegations of anti-competitive conduct. The respondents have not argued that the

Director's pleadings misled them regarding the case they had to meet and that therefore they have suffered prejudice in preparing or presenting their case. Indeed, such an argument could not be advanced given the detailed and inclusive record regarding not only the current situation in the market but also the historical context.

B. Crown Liability and Proceedings Act

45 The respondents' second limitation argument is based on section 32 of the *Crown Liability and Proceedings Act* which reads:

> Except as otherwise provided in this Act or in any other Act of Parliament, the laws relating to prescription and the limitation of actions in force in a province between subject and subject apply to any proceedings by or against the Crown in respect of a cause of action arising in that province, and proceedings by or against the Crown in respect of a cause of action arising otherwise than in a province shall be taken within six years after the cause of action arose.

46 The respondents argue that the *Crown Liability and Proceedings Act* statutorily bars the Crown (here, the Director) from acting on a cause of action which arose more than six years before the issuing of the application, that is, prior to December 22, 1988. Thus, they argue, all references to changes made in commissionability criteria or any other alleged anti-competitive act after 1986, when sections 78 and 79 were enacted, but prior to December 22, 1988 (six years before the application was filed), are statute-barred.

47 The respondents did not press this point and it will be dealt with summarily. First, as argued by the Director, the respondents cannot rely on the *Crown Liability and Proceedings Act* as they did not plead it in their response. The law is clear that a limitation period does not terminate a cause of action but provides a defendant with a procedural means of defence which must be pleaded in the defence. [16]

48 Second, section 32 of the *Crown Liability and Proceedings Act* is simply not applicable to this case. The opening words of section 32 indicate that if there is a specific limitation period in the statute governing the cause of action involved, here the *Competition Act*, that limitation period applies. [17] It is only in the absence of a specific provision that either a provincial limitation period or the six-year limitation period in section 32 is considered. Subsection 79(6) of the *Competition Act*, to which the respondents have also made reference, provides a limitation period for proceedings brought under that section.

C. Subsection 79(6)

49 Subsection 79(6) of the *Competition Act* states:

> No application may be made under this section in respect of a practice of anti-competitive acts more than three years after the practice has ceased.

Again, the respondents did not plead this limitation period. Further, while they refer to subsection 79(6), the respondents made no effort to argue how it applies in this case. No more need be said.

IV. Impact of the Consent Order

50 The respondents argue that the Director is estopped from bringing this application before the Tribunal to the extent that it deals with issues adjudicated by the Tribunal in a previous proceeding. On November 18, 1994, the Tribunal issued an order, the terms of which were agreed to by the parties, as a result of an application brought by the Director against the Yellow Pages publishers in Canada. [18] We will refer to that order as the Consent Order. The respondents in the present proceedings were among the respondents named in that order.

51 In the application which resulted in the Consent Order, the Director alleged that the respondents in those proceedings had jointly engaged in a practice of anti-competitive acts within the meaning of sections 78 and 79 of the Act. The specific allegations levied against those respondents and found at paragraph 74 of the application were as follows:

> ... it is the Director's submission that the Respondents engaged in the following anti-competitive acts to impede or prevent a competitor's entry into or eliminating a competitor from a market. The anti-competitive acts of the Respondents constituted a practice of anti-competitive acts by the Respondents which had the effect of substantially preventing or lessening competition in the relevant product market of the Selling of National Advertising into Telephone Directories in Canada. The Respondents:
>
>> (i) agreed that only Publishers could Sell National Advertising directly into Telephone Directories;
>>
>> (ii) appointed each other as their exclusive Selling Companies for the Selling of National Advertising in Telephone Directories in each of their respective territories and therefore did not compete with such exclusive Selling Companies in those territories;
>>
>> (iii) agreed to a Head Office Rule, thus precluding the National Advertiser from either placing the advertisement directly with all the Respondents which actually published the advertisements or using an entity unrelated to any of the Respondents to place the advertising directly in each Respondent's Telephone Directories.

52 The Consent Order contains prohibitions designed to prevent the respondents who agreed to it from engaging in certain acts in the selling of national advertising in Yellow Pages telephone directories, including:

> With regard to the sale of national advertising in Yellow Pages telephone directories, each respondent shall be prohibited from:
>
> . . .
>
>> (f) agreeing with any other respondent on the criteria for determining which national advertising accounts are commissionable;
>>
>> (g) agreeing with any other respondent on the rate of commission payable, except during a transition period ending June 30, 1995 during which a minimum commission of 25% will be available to selling companies for national advertising which meets the commissionability criteria established by each respondent.... [19]

53 The parties appear to be in agreement with respect to the law of issue estoppel. The doctrine of issue estoppel precludes an action being brought against a party with respect to an issue which was already decided in an earlier proceeding. There are three requirements to be met before issue estoppel applies so as to bar a new proceeding. First, there must have been an earlier proceeding in which there was a determination of the same issue. Second, the determination of the issue in the earlier proceeding must have been a final decision. Finally, the parties to each of the two proceedings must be the same. [20] The doctrine of issue estoppel applies equally to issues decided in consent orders and in contested orders. [21]

54 The Supreme Court of Canada has held that the decision upon which a party relies for issue estoppel must have dealt directly and necessarily with the issue which is being raised for a second time:

> ... It will not suffice if the question arose collaterally or incidentally in the earlier proceedings or is one which must be inferred by argument from the judgment.... The question out of which the estoppel is said to arise must have been "fundamental to the decision arrived at" in the earlier proceedings. [22] (references omitted)

55 Tele-Direct argues that the issues relating to its commissionability criteria alleged by the Director in this case, namely, that its policy of offering commission only on accounts which meet its "national" definition is an anti-competitive act and constitutes tied selling, were dealt with by the Tribunal in the Consent Order. Tele-Direct's position is that the Director is estopped from re-litigating these issues in the present proceeding. According to Tele-Direct, the Director, and the Tribunal by virtue of its issuance of the Consent Order, were satisfied that any substantial lessening of competition in the sales of national advertising would be alleviated by the terms of the order. If the Director seeks to vary the Consent Order, the Director can only do so by

following the procedure for rescission and variation of consent orders which is governed by section 106 of the Act; this course was not pursued by the Director.

56 The respondents further argue that, by implication, the Consent Order authorizes them to set their own commissionability criteria without interference as long as they do not agree on the rate with any other publisher. Accordingly, they say that it is inconsistent for the Director to bring this proceeding, which could result in the Tribunal interfering with Tele-Direct's decisions relating to its commissionability criteria for national advertising.

57 The Director's position is that the issues raised in the two proceedings are not the same and that, therefore, the doctrine of issue estoppel does not apply. According to the Director, the anti-competitive acts which were the subject of the Consent Order were certain *joint* practices of the Canadian Yellow Pages Service ("CANYPS") members (the telco publishers) regarding the manner in which national advertising could be placed in their directories. It was the agreements between the respondents to the Consent Order which constituted the anti-competitive acts and resulted in a substantial lessening of competition which were remedied by the order. In the present proceeding, however, it is alleged anti-competitive acts of Tele-Direct itself which are the subject of review. There was no decision in the earlier proceedings regarding how Tele-Direct sets its own commissionability criteria or how it otherwise deals with independent agencies located in its territory.

58 The requirements for issue estoppel are not met in this case. While the Consent Order was a final decision of the Tribunal, the terms of which are binding on Tele-Direct, the issues which were dealt with in that proceeding are not the same as those in the present case. This is clear from the application and supporting documentation and the Consent Order. It was the substantial lessening of competition resulting from the respondents' joint practice of anti-competitive acts or joint abuse of dominance that the Director sought to remedy by the Consent Order. The instant case deals with entirely separate allegations of anti-competitive acts of Tele-Direct acting alone. The Consent Order prohibits the respondents named in it from agreeing amongst themselves on the rate of commission payable. That order does not address the commissionability criteria which an individual publisher may set. Nothing in the Consent Order limits the jurisdiction of the Tribunal to review the commissionability criteria set by Tele-Direct.

V. Trade-Marks

59 The Director alleges that the respondents, by "refusing to licence [their] trade-marks, such as the words 'Yellow Pages' and 'Pages Jaunes' and the walking fingers logo, to competing suppliers of advertising services", have engaged in a practice of anti-competitive acts contrary to section 79 of the Act. In particular, the Director seeks to prohibit the respondents' alleged practice of "selective licensing" whereby certain competitors are refused licences, allegedly arbitrarily or pursuant to an anti-competitive intent, and others are not. As a remedy, the Director seeks an order "that the respondents licence, at the request of independent advertising agencies, including consultants, and on commercially reasonable terms and conditions, the trade-marks registered for the respondents' own use in relation to telephone directories."

60 The Director's submissions raise two issues. First, the Tribunal must determine whether the refusal to license a trade-mark to certain persons or groups of persons is an anti-competitive act. Second, if it is an anti-competitive act, the Tribunal must determine whether it has jurisdiction to order the respondents to license their trade-marks. Having carefully considered the evidence and the submissions of counsel, the Tribunal is of the view that the selective refusal to license a trade-mark is not an anti-competitive act. Accordingly, the second question need not be answered.

61 The facts concerning the respondents' refusal to license their trade-marks are not disputed. The respondents license the use of their trade-marks to CMRs and other telco-affiliated directory publishers; they do not license other advertising agencies or consultants. The respondents aggressively defend their trade-marks against what they perceive to be infringement but they do not pursue every perceived infringement with equal zeal. The evidence is that Tele-Direct overlooks certain uses of its trade-marks but threatens to, or institutes, legal action against the use of its trade-marks by, for instance, consultants.

62 Both the *Trade-marks Act* [23] and the *Competition Act* are relevant. The purpose of a trade-mark is to distinguish the wares or services of the owner from those of others. [24] The *Trade-marks Act* provides that the owner of a trade-mark has the exclusive

right to its use.[25] Further, the owner of a trade-mark may license another to use that trade-mark, and that use is deemed to have the same effect as use by the owner.[26] Subsection 79(5) of the *Competition Act* provides:

> For the purpose of this section, an act engaged in pursuant only to the exercise of any right or enjoyment of any interest derived under the *Copyright Act, Industrial Design Act, Integrated Circuit Topography Act, Patent Act, Trade-marks Act* or any other Act of Parliament pertaining to intellectual or industrial property is not an anti-competitive act.

63 The Director submits that subsection 79(5) does not preclude a finding that "abuses" of intellectual property rights are anti-competitive acts. It is the Director's position that Tele-Direct's practice of selective licensing is an abuse of Tele-Direct's trade-mark rights. The Director asserts that an owner's "exclusive right to use" its trade-mark is not unlimited. The Director relies upon case law which has defined "use" not to include activities which are for purposes other than distinguishing wares or services of the owner from the wares or services of others.[27] Accordingly, the Director submits that the respondents' position that "any written use of the words 'Yellow Pages' would be dealt with" and the fact that the respondents have used their "superior resources" to assert this claim successfully is evidence of the respondents' exclusionary intent in respect of their trade-marks.

64 Tele-Direct argues that, as owner of the trade-marks, it has the statutory right to decide to whom it will or will not license those trade-marks, including the right to refuse to licence where it is not in its best interest to do so. It argues that there is no evidence that it has adopted a policy of refusing to license trade-marks to competitors for the purposes of restraining competition; rather, it does not make sense for Tele-Direct to license its trade-marks to consultants whose businesses are based on the premise that Tele-Direct "rips-off" its customers.

65 In support of his position, the Director relies on the decision of the United States District Court in *Car-Freshener Corp. v. Auto-Aid Manufacturing Corp.*, where the Court stated that there was "no doubt that a trade-mark may be utilized in such a manner as to constitute a violation of antitrust laws"[28] and offered several examples: the use of a strong trade-mark to unlawfully tie a weaker product, unlawful price discrimination exercised with respect to a trade-mark, or other illegal anti-competitive practices. The Tribunal is in agreement with the Director that there may be instances where a trade-mark may be misused. However, in the Tribunal's view, something more than the mere exercise of statutory rights, even if exclusionary in effect, must be present before there can be a finding of misuse of a trade-mark. Subsection 79(5) explicitly recognizes this.

66 The respondents' refusal to license their trade-marks falls squarely within their prerogative. Inherent in the very nature of the right to license a trade-mark is the right for the owner of the trade-mark to determine whether or not, and to whom, to grant a licence; selectivity in licensing is fundamental to the rationale behind protecting trade-marks. The respondents' trade-marks are valuable assets and represent considerable goodwill in the marketplace. The decision to license a trade-mark -- essentially, to share the goodwill vesting in the asset -- is a right which rests entirely with the owner of the mark. The refusal to license a trade-mark is distinguishable from a situation where anti-competitive provisions are attached to a trade-mark licence.

67 The owner's exclusive jurisdiction over licensing accords with the scheme of the *Trade-marks Act*. There is no statutory means by which a person can petition the Registrar of Trade-marks for a licence to use a trade-mark, implying that the decision to license rests with the owner of the mark. Furthermore, the licensing provisions of the *Trade-marks Act* provide that, in order to constitute a valid licence, the trade-mark owner should have "direct or indirect control of the character or quality of the wares or services" to which the licensee was attaching the mark. Indeed, in *Unitel Communications Inc. v. Bell Canada*,[29] the Court expunged trade-marks owned by Bell Canada, in part because Bell Canada had failed to exercise control over the use of its trade-marks by an independent telco. In the case at bar, the lack of control over the quality of the goods or services is particularly relevant since the Director is suggesting that the respondents' trade-marks should be licensed to consultants with whom the respondents do not share identity of interest.

68 While the evidence suggests that Tele-Direct is motivated, at least in part, by competition in its decision to refuse to license its trade-marks, the fact is that the *Trade-marks Act* allows trade-mark owners to decide to whom they will license their trade-marks. The respondents' motivation for their decision to refuse to license a competitor becomes irrelevant as the *Trade-marks Act* does not prescribe any limit to the exercise of that right.

69 The respondents' legitimate desire to protect the value of the goodwill vested in their trade-marks by refusing to license them does not amount to an anti-competitive act. In view of the strength of their trade-marks, the respondents can be expected to be, and are entitled to be, protective of their rights. Indeed, if the respondents did not protect their marks, they would risk having them lose their distinctiveness, as in *Unitel*. This is a real concern, given that the Yellow Pages trade-marks are no longer registered in the United States.

70 While independent advertising agencies and consultants may wish to use the respondents' trade-marks, there is simply no basis for granting an order requiring the respondents to license their trade-marks.[30] Although the respondents may have been zealous in protecting their trade-marks, both in refusing to license and in threatening litigation for infringement, the irrefutable fact is that the respondents have been, through the provisions of the *Trade-marks Act*, accorded the right to refuse to license their trade-marks, even selectively. The exercise of this right is protected from being an anti-competitive act by subsection 79(5) of the Act.

VI. Market Definition

71 A necessary first step in deciding this case is to define the relevant market. This must be done for purposes of section 79 in order to determine if Tele-Direct, as alleged by the Director, "substantially or completely control[s], throughout Canada or any area thereof, a class or species of business". The Tribunal decided in *Director of Investigation and Research v. D & B Companies of Canada*[31] that "class or species of business" means product market and "control" means market power. The remaining phrase, "throughout Canada or any area thereof", refers to the geographic market. Therefore, in order for section 79 to apply, the Tribunal must first conclude that Tele-Direct has market power.

72 A market must also be defined in order to consider the allegation of tying, brought under section 77. Under subsection 77(2), the Tribunal must find that "tied selling, because it is engaged in by a major supplier of a product in a market ... is likely to" have a number of detrimental effects. If Tele-Direct is found to have market power, it would qualify as a "major supplier".

A. Product Market

73 The argument and the evidence presented to us regarding the relevant product market focus on whether there are close substitutes for telephone directory advertising. The Director includes in his relevant market advertising in Tele-Direct's Yellow Pages directories and in telephone directories produced by independent (non-telco affiliated) publishers.

74 The respondents concede that advertising in independent directories is in the same relevant market as advertising in Yellow Pages directories. Their position is that both independent and Yellow Pages directories form part of a broader product market comprised of all local advertising media. The respondents define "local advertising" in this context as advertising designed to promote business at a particular location. They would include, for example, direct mail, outdoor signage, community newspapers, daily newspapers, catalogues, trade magazines, flyers, radio, television -- in fact advertising in any medium as long as the advertising is designed to promote a particular location.

75 It is important to keep in mind that our goal in defining the relevant market in this case is to determine whether other local advertising media provide competitive discipline for Tele-Direct in respect of its Yellow Pages pricing[32] and output decisions. The Director argues that they do not. The respondents argue that they do.

(1) Substitutability -- The Basic Test

76 The parties agree that the fundamental test or "touchstone" for determining the boundaries of the relevant product market is substitutability, as the Tribunal has consistently held in previous decisions, including three abuse of dominant position cases.[33] Products must be close substitutes in order to be placed in the same product market. The parties also agree that the appropriate approach to or framework for market definition is set out in the Federal Court of Appeal decision in *Director of Investigation and Research v. Southam Inc.*[34] Both parties quote the same passage from that decision:

> Products can be said to be in the same market if they are close substitutes. In turn, products are close substitutes if buyers are willing to switch from one product to another in response to a relative change in price, i.e. if there is buyer price sensitivity. Direct evidence of substitutability includes both statistical evidence of buyer price sensitivity and anecdotal evidence, such as the testimony of buyers on past or hypothetical responses to price changes. However, since direct evidence may be difficult to obtain, it is also possible to measure substitutability and thereby infer price sensitivity through indirect means. Such indirect evidence focusses on certain practical *indicia*, such as functional interchangeability and industry views/ behaviour, to show that products are close substitutes.[35] (reference omitted)

It is also common ground between the parties that this approach does not represent a radical departure from the approach used by the Tribunal in previous decisions.

(2) The Southam Decision

77 The *Southam* decision is the first Court of Appeal decision to deal in any depth with market definition under the Act.[36] That the parties differ considerably on how the general approach stated by the Court of Appeal in *Southam* is to be applied to the facts of the case before us is evident from the broad product market proposed by the respondents and the narrow product market proposed by the Director.

(a) Direct Evidence of Substitutability

78 There is no dispute that, first, we must consider any direct evidence of substitutability. In *Southam* the Court of Appeal states:

> To the extent that it is possible to adduce statistical evidence of high demand elasticity, such evidence is virtually conclusive that two products are in the same product market. Evidence of price sensitivity can also come in anecdotal form which is a less conclusive, although still a persuasive factor tending to show that products are close substitutes.[37]

79 The Director did not adduce any statistical evidence. The respondents mention the two "Elliott" reports, studies conducted for Tele-Direct in early 1993 for purposes other than this proceeding, as "statistical data" on advertisers' reaction to relative price increases.[38] The Elliott reports were general surveys of "customer satisfaction" which did not deal with price sensitivity of advertisers between different media.[39] Even if they had dealt with relative prices of various different media, in our view the Elliott reports would not qualify as the type of direct statistical evidence of demand cross-elasticity that was intended by the Court of Appeal. Such a study would have to be undertaken for the purpose of determining cross-elasticity between the products alleged to be in the market, be conducted in an appropriately rigorous fashion and meet tests of statistical significance. While the Elliott reports do not qualify as statistical evidence of demand cross-elasticity, they will be considered as part of the indirect evidence of substitutability.

80 Although the Director called a number of buyers or advertisers as witnesses in this case, he does not rely on their evidence as "anecdotal evidence" of price sensitivity, from his point of view, low price sensitivity. He refers to their evidence as indirect evidence under various rubrics. The respondents likewise treat the testimony of the advertisers as indirect evidence. We will therefore not address the question of whether that testimony provides any direct evidence of price sensitivity or a lack thereof.

81 In the absence of direct evidence regarding buyer price sensitivity, we must therefore proceed to examine the available indirect evidence or "practical indicia" to draw inferences about price sensitivity.

(b) Indirect Evidence of Substitutability

82 The Director has organized the evidence of product market definition using headings similar to those set out in the *Merger Enforcement Guidelines*:[40] end use, physical and technical characteristics, views, strategies, behaviour and identity of buyers, trade views, strategies and behaviour ("inter-industry competition"), price relationships and relative price levels and switching

costs. The respondents have also used the same headings to organize their evidence, although in a slightly different order. The *Merger Enforcement Guidelines* are not sacrosanct. But, as the parties are agreed that the evidence may be organized according to those guidelines, we accept that this is a practical and useful way in which to proceed.

83 The parties may use the same organizational structure but they do not agree on the respective roles to be accorded to the various practical indicia. In particular, they take different positions on the way in which the indicia of "functional interchangeability" and "inter-industry competition" should be employed in defining a product market based on the Court of Appeal decision in *Southam*. They also differ, of course, on the nature of the evidence and the conclusions to be drawn therefrom that should be considered under each heading. A detailed review of the evidence and the arguments under each heading will follow. We must first address, however, the arguments regarding the general approach to the practical indicia or indirect evidence of substitutability.

84 The Director submits that the Court of Appeal in *Southam* found that functional interchangeability is a "vital feature" and a "central part of the framework" of market definition, although it is not a sufficient condition for two products to be in the same market. The Director argues that the Court of Appeal did not state that functional interchangeability and inter-industry competition were the "sole" or "driving" factors in market definition but only found that *ignoring* those factors was an error of law.

85 The respondents in their written argument agree that the Tribunal must consider the evidence with respect to functional interchangeability and that it is central but alone does not conclusively demonstrate that two products belong in the same relevant market -- other factors must be considered. They point out that the additional factor that was "very important" to the Court of Appeal in *Southam* was inter-industry competition. During oral argument, counsel took the stricter position that the Court of Appeal held that if functional interchangeability and "broad" inter-industry competition are found, then it is an error not to place the products under consideration in the same market. If the two indicia mentioned are present, the Tribunal *must* infer price sensitivity and therefore a single product market.

86 The Tribunal must determine whether the Court of Appeal prescribed, as a matter of law, the role and importance of the factors or indicia of "functional interchangeability" and "inter-industry competition". With respect to functional interchangeability as one of the indirect indicia, the Court of Appeal stated that it was "not simply one of many criteria to be considered but a critical part of the framework." It also confirmed that functional interchangeability will generally be regarded as a "necessary but not sufficient condition to be met before products will be placed in the same market." With respect to inter-industry competition, the Court of Appeal found that evidence of "broad" competition, namely that the two types of newspapers were striving to reach many of the same advertisers with significant success by the community newspapers which, in turn, preoccupied Southam and generated responses by it, was sufficient to show competition "in fact". [41]

87 A finding that the products alleged to be in the same market serve the same relevant purpose is a necessary first step in the analysis. A finding of functional interchangeability, however, is not alone sufficient to place the products in the same market. As the Court stated:

> ... There are other factors which may tend to reinforce, or undermine, a finding that two products are functionally interchangeable. [42]

88 With respect to evidence of "broad" inter-industry competition, we do not understand the Court to be saying that the presence of such evidence, along with evidence of functional interchangeability, will, in every case, dictate that the products in question should be placed in the same product market. If the Court intended to confine the analysis to these two practical indicia and effectively negate consideration of other factors, like, for example, the views, strategies and behaviour of buyers, the Court would have done so explicitly. It did not do so. In *Southam*, the Court confined its conclusions to the matter before it:

> While evidence of substitutability through functional interchangeability and inter-industry competition was adduced, the Tribunal ultimately ignored such evidence. In doing so, the Tribunal adopted an overly narrow approach to substitutability as it dismissed "broad" conceptions of interchangeability and inter-industry competition. In doing so, the Tribunal erred

> in focusing predominantly on price sensitivity. *In this case, the similarity of use between Pacific Dailies and community newspapers, and the competitiveness which existed between them, is sufficient to place both in the same product market*. [43]
>
> (emphasis added)

89 We conclude that consideration of functional interchangeability is essential in assessing indirect evidence of whether two or more products are in the same market. But this does not exclude other relevant evidence which may reinforce or undermine what functional interchangeability implies.

90 In considering the whole of the evidence, the Tribunal will bear in mind the ultimate reason why the market is being defined. In this case, the goal is to determine if the respondents have market power (or are "major suppliers"), that is, if the alleged close substitutes, other local advertising media, provide competitive discipline for Tele-Direct in making price (or quality) and output decisions.

(3) Functional Interchangeability

91 The Director submits that two headings from the *Merger Enforcement Guidelines*, "end use" and "physical and technical characteristics", are both related to the question of functional interchangeability. Certain characteristics of directories are, he argues, key factors which dictate the end use of a directory as a directional reference tool and which thus limit the "functional interchangeability" of directory advertising with directional advertising in other media.

92 The respondents argue that all local advertising has the same end use: to increase business at a particular location. They submit that the characteristics of the various media should not be considered as part of the determination of functional interchangeability.

93 Regarding functional interchangeability, the Court of Appeal in *Southam* says:

> ... But the fact that community newspapers are more local in nature does not go to the question of functional interchangeability, but to the behaviour of buyers as to preference for geographical scope. This latter *subjective* factor should not be mingled with the purely *objective* factor of functional interchangeability which focusses on use or purpose. [44]
>
> (emphasis added)

The Court imposes the constraint that the views of buyers should not enter when functional interchangeability is being decided because they are "subjective". Only "objective" factors should enter at this point.

94 Under the criterion "end use", the *Merger Enforcement Guidelines* refer to the extent to which two products are "functionally interchangeable in end use". That is the way in which the term will be used in this decision. Physical and technical characteristics, along with other indicia, serve to determine whether the products found to be functionally interchangeable in end use are close substitutes. Rather than considering physical and technical characteristics as part of the determination of functional interchangeability, as the Director proposes, the Tribunal will treat them separately from functional interchangeability.

95 The Director and one of his economics expert witnesses, Richard Schwindt, [45] have defined the relevant end use of telephone directory advertising to be use as a "directional" medium. ("Directional" and "directive" were used interchangeably in the material before us.) Two elements are said to characterize a directional advertising medium: (a) consumers consult the medium when they are at a point in the buying cycle when they are ready to buy, and (b) the medium is used as a reference tool. Directional advertising is distinguished from creative advertising, which is widely acknowledged to be used for creating or stimulating demand. The Director admits that other advertising media besides Yellow Pages might be considered directional but names catalogues, direct mail and classified newspaper advertising as the only candidates.

96 The respondents and their economics expert witness, Robert Willig, [46] take the view that all "local" advertising [47] has the same end use, to attract customers to a particular establishment. Thus, they argue, advertising in the Yellow Pages and advertising

in other local media are functionally interchangeable. In response to the Director's argument, they argue that directionality is not generally regarded as encompassing the element of use as a reference tool. They further argue that the directional/creative dichotomy is not valid. They take the position that there is no such sharp distinction in the advertising done by local advertisers. In their submission, directional means only that the advertising directs consumers to a particular establishment - which can be done in any medium. Given the respondents' definition of "local" advertising, all advertising by a local advertiser necessarily has a directional component. Similarly, since they are of the view that all local advertising, including advertising in telephone directories, has as its goal the stimulation of demand at a location, all local advertising necessarily has a creative component.

97 Since the respondents have defined "local" advertising as advertising designed to promote business at a particular location, it follows that the purpose of all local advertising is to attract customers to a business. Such a definition is at a high level of generality. While we recognize that the "end use" indicia acts as a "filter" or a "first stage" in the analysis only, it should still cast some light on the ultimate question to be determined, i.e., whether all "local" media are *close* substitutes providing sufficient competitive discipline among themselves that they should be considered to be part of the same product market in this case. We find the words of Gibson J. in *R. v. J.W. Mills & Sons Ltd.*, which the Court of Appeal in *Southam* found "worthy of replication", to be instructive on this point:

> Defining the relevant market in any particular case, therefore, requires a balanced consideration of a number of characteristics or dimensions to meet the analytical needs of the specific matter under consideration.
>
> At one extremity, an ill-defined description of competition is that every service, article, or commodity, which competes for the consumer's dollar is in competition with every other service, article or commodity.
>
> At the other extremity, is the narrower scope definition, which confines the market to services, articles, or commodities which have uniform quality and service.
>
> In analyzing any individual case these extremes should be avoided and instead there should be weighed the various factors that determine the degrees of competition and the dimensions or boundaries of the competitive situation. For this purpose the dimensions or boundaries of a relevant market must be determined having in mind the purpose for what it is intended. For example, two products may be in the same market in one case and not in another. [48]

98 The criterion of functional interchangeability in end use should not be treated at such a high level of generality that it precludes objective yet contextual analysis. To say that, for example, automobiles and bicycles are in the same product market because they both provide a means of transportation would make the level of generality so high that no meaningful analysis could be performed as a result of it. Some consideration must be given to context.

99 To put functional interchangeability in end use in context in this case, it is important to look at the buying cycle and which types of media are generally regarded as directional and thus particularly effective in reaching consumers who are at the end of the buying cycle. These consumers are "ready to buy" but must decide which commercial establishment to patronize. The question is which types of media effectively bring the particular establishment to the consumer's attention in those circumstances.

100 The respondents referred us to a number of American cases which, they argue, support their broad conception of end use. We do not find these authorities particularly helpful. First, and most importantly, the product market that is arrived at in a particular case is very much dependent on the facts of that case and the context in which the case is brought, that is, the alleged anti-competitive wrong that the plaintiff is seeking to cure. As Gibson J. stated in the passage quoted above, "two products may be in the same market in one case and not in another." Therefore, the mere fact that another court did or did not find that directory advertising was in the same market as other local media is not in itself compelling. Some of the cases cited by the respondents were not antitrust cases. [49] Others did not deal with directory advertising. [50] In addition, counsel for the Director was able to bring to our attention a number of other American cases in which the courts, either explicitly or implicitly, used Yellow Pages advertising as a relevant market. [51] Further, while the reasoning with respect to market definition in another case might provide us with some insight, one would have to be reasonably certain that the court in question was applying the same

conceptual framework or "test" as we have adopted. These considerations all highlight the futility of looking for a simple, neat answer to market definition in the case law.

101 Based on the evidence, particularly materials created by the respondents themselves outside of the context of this proceeding, which we will review in more detail below, we accept the Director's position that the distinction between creative and directional media is a valid one for determining the end use of Yellow Pages and other local advertising. A fair consideration of the evidence, which will shortly be addressed, supports the position that creative advertising creates awareness of and demand for goods and services at the beginning of the buying cycle and that directional advertising refers to advertising to consumers who are at the end of the buying cycle which "directs" them where to buy a product or service. This effectively limits the number of media that can be considered to be directional.

102 Although the respondents argued that directional advertising simply means advertising (in any media including those traditionally considered creative) that contains a name, address or phone number to "direct" a consumer to particular establishment, [52] this was not Tele-Direct's view outside of this case. In the Multimedia Training Course created by Tele-Direct for its sales representatives, directional advertising is defined as:

> Media used by the advertiser to direct the buyer where to buy or use a product or service. Examples: Yellow Pages, catalogues, direct mail. Directive media complements and supports creative media. [53]

The three examples used suggest that directional media, in fact, have very specific characteristics beyond simply including a name, address or phone number. All are print media and in each case there is no editorial or entertainment content. The consumer has no reason to consult these media other than a reason related to making a purchase, i.e., at the end of the buying cycle.

103 The course material also discusses and sets out in chart form the role of the various media at the various stages of the buying cycle: awareness, interest, comprehension, trial, purchase and repurchase. The text explains:

> ... [S]uch traditional advertising media as TV, Radio and Magazines are by their nature designed to generate awareness for products and services. The impact or intrusion qualities of this advertising creates an interest for the products and services and has the ability to demonstrate the benefits to the consumer and is ultimately designed to create a need or desire in the mind of the consumer.
>
> . . .
>
> Although creative advertising is crucial at the awareness, interest and comprehension stage of the buying cycle, it loses impact at the actual purchase stage because of the time or distance between the initial awareness and the purchase. [54]

104 At the purchase stage, newspaper, direct mail, outdoor, radio and Yellow Pages are all considered to have some strengths. Television and magazines are not. Of those with strength at the purchase stage, only newspapers and direct mail (and Yellow Pages), however, are described as "directive". The strength of outdoor advertising at the purchase stage is as a "reminder message". The strength of radio at that stage is to offer price points and convey a "sense of urgency". Again, this course material supports the view that directionality imports something more than the ability to provide a consumer with a name and address. All of television, newspapers, direct mail, outdoor, radio and Yellow Pages are capable of including this information in advertising, yet Tele-Direct did not consider them all to be directional.

105 This interpretation is further supported by the letter sent to the Director by Tele-Direct during the course of the Director's investigation into the industry (referred to as the "Bourke letter"). The letter was intended to provide industry background. [55] It states that:

> The Yellow Pages traditionally is viewed as a "directional" or "considered purchase" advertising medium, which provides consumers with information on where they can purchase the goods and services they want.... Directional advertising is most attractive to local advertisers, particularly local retailers, who seek to motivate customers to visit their stores or to use

> their services. *Other directional media include direct marketing, catalogues, trade magazines, and specialty supplements to newspapers or magazines*.[56]
>
> (emphasis added)

There is no mention made of outdoor or television and radio as directional media. When Thomas Bourke, Tele-Direct's President, testified at the hearing he confirmed that the basic strength of Yellow Pages was to provide information on where to buy, as stated in the letter. In the list of directional media, he would, however, now include the classified sections of daily and community newspapers and specialty and other classified directories.

106 The letter continues:

> By contrast, the other major advertising media - outdoor, newspapers, radio, television and magazines - are classified as "creative" advertising media, which create awareness of and demand for products and services. Creative advertising assists advertisers who are either trying to sell a product or service, or promote their name. This service is attractive to major manufacturers or suppliers, who usually do not have a preference as to where the consumer buys its product or services.[57]

107 Since names, addresses and phone numbers could just as easily be included in advertising in the regular part of a newspaper and a magazine as in a special supplement or classified section, something more is involved in the way that the participants in the industry view directionality. As in the training material, all the examples of directional media are characterized by the absence of general editorial content. The characteristic that specialty supplements and classified sections in newspapers or magazines, other directories, catalogues and direct mail share with Yellow Pages is that the advertising in those media will be totally ineffective unless it is consulted by people who are "in the market" -- who are looking to make a purchase. As Mr. Bourke put it when describing how Yellow Pages complete the buying cycle, they must be in a "buying frame of mind". Consumers will not be involuntarily exposed to the advertising by virtue of going to the medium for entertainment or other reasons; they must voluntarily decide to consult the Yellow Pages or a catalogue, read the direct mail or an advertising supplement or classified section. These media are not picked up and browsed through idly in a spare moment.

108 The respondents argue that all directional advertising, even Yellow Pages advertising, has a "creative" component. Otherwise, they submit, no one would pay for a display advertisement in the Yellow Pages. The free business listing could provide a name, address and phone number. Clearly, there is "creativity" involved in designing an eye-catching Yellow Pages advertisement. This is not the same as creative ("creates" *demand*) as opposed to directional ("directs" consumers who are ready to buy) advertising as those terms are used in the industry, according to the evidence.

109 Mr. Bourke, echoing Raymond Greimel, Executive Director of YPPA, testified that the new attitude in the industry is that Yellow Pages are *both* directional and creative. He was unable, however, to explain how Yellow Pages advertising "creates awareness of and demand for products and services" in the words of the Bourke letter, as he recognized that people do not consult the Yellow Pages unless they already have a need for some product or service. He could only say that Yellow Pages advertising "reinforced" or "supported" the advertising in the creative media.

110 We are not satisfied from the paucity of evidence on the point that directional advertising means that the medium containing the advertising is a "reference tool", as the Director further submits. If this element were proven, virtually all media except directories would be excluded from potentially being part of the relevant product market at this point. We do not consider that the evidence supports narrowing the definition of "directional" in this respect.

111 Functional interchangeability is simply a preliminary filter to exclude those products which evidently do not have the same end use as Yellow Pages advertising. Nevertheless, certain conclusions can be stated. First, the respondents' position that local advertising in *all* media qualifies as directional is not tenable. In particular, television, radio and outdoor media are clearly not treated as directional in Tele-Direct's own materials. Television is seen as having little relevance to the latter stages in the buying cycle; it is strong in creating awareness and interest at the beginning of the cycle only. While radio and outdoor have a

role at the later stages, that role was not to present a directive message but rather to create "urgency" or serve as a "reminder" of other advertising.

112 This is not to say that these media *cannot* be used for directional advertising in any circumstances. It is a possibility, but in deciding whether various media serve the same end use, one must look to usual uses and not mere possibilities unsupported by the evidence. We are of the view that both the electronic and outdoor media can be excluded at this point as they are not directional media and thus do not have the same end use as Yellow Pages advertising. Since the electronic and outdoor media have not met this "necessary" condition for inclusion in the relevant product market, we will not deal with them further.

113 Second, there is some doubt as to whether "regular" advertising (as opposed to special supplements or classifieds) in newspapers and magazines is properly included as directional advertising. Based on the list in the Bourke letter, which was updated by Mr. Bourke in his testimony and is therefore, presumably, as comprehensive as Tele-Direct considers it should be, we could exclude "regular" newspaper and magazine advertising at this point. The Multimedia Training Course, however, does refer to "newspaper" advertising, without further details, as directive. Given the preliminary nature of the criteria of functional interchangeability and in light of the overall model used by the respondents to argue their case, we will not exclude newspapers from further consideration. Magazines will not be dealt with further, as they were largely ignored in the remainder of the evidence and argument of both parties.

(4) Other Relevant Indicia

114 Having determined that some, though not all, local advertising media pass the threshold test of functional interchangeability, we will now consider the evidence and argument on the remaining practical indicia to decide if those media are close substitutes and belong to the same product market as telephone directory advertising.

(a) Physical and Technical Characteristics

115 Telephone directories are issued annually, are comprehensive both with respect to including all suppliers and being delivered to all telephone subscribers, and they are governed by their own rules with respect to the content of advertising. The Director is of the view that these characteristics set Yellow Pages apart from other media.

116 The respondents argue that each advertising medium has different "strengths and weaknesses" and can claim to be unique. They submit that a "catalogue" of differences is not alone enough to place two products in separate markets. They state that the relevant question is whether the product is unique in some respect that significantly limits the extent to which *buyers* (here, advertisers) are willing to substitute other products for the product at issue. We agree that to deal with physical and technical characteristics separately from the views and behaviour of buyers is somewhat artificial. It is, however, the way in which the parties have chosen to organize their arguments and the evidence in this case. Therefore, in this portion of the judgment, we will restrict ourselves to the points raised by the parties in their respective arguments under that heading. We recognize that this factor is mainly important in the analysis as providing background for the next section on buyer views and behaviour.

(i) Time Insensitivity/Permanence

117 Advertisements in the Yellow Pages are finalized several months prior to publication and have to stand for the entire year between directories. This means that Yellow Pages advertising cannot be used to convey time-sensitive information. As noted by Professor Schwindt, for the Director, this sets Yellow Pages apart from other directional media, such as direct mail or supplements to magazines or newspapers, in which time-sensitive information such as prices tends to be featured. In fact, until recently Tele-Direct regulations prohibited the inclusion of prices in Yellow Page advertisements to avoid potential false advertising claims. This ban has now been lifted. It is doubtful whether, in a fast-changing world, price advertising can ever be an important part of telephone directory advertising while directories are a print medium that changes only every year.[58] The evidence of the advertiser witnesses amply supported the conclusion that Yellow Pages are *not* used for time-sensitive advertising.[59]

118 The fact that Yellow Pages cannot be used to convey time-sensitive information is characterized by the respondents as a "weakness", the "flip side" of which is "permanence", a "strength". Based on a statement by Professor Willig in his rebuttal affidavit, [60] they conclude that a weakness in Yellow Pages does not suggest that advertisers *would not* substitute other media for Yellow Pages; a weakness probably suggests that they *would* substitute other media. Thus, any identified weaknesses are seen as evidence of Yellow Pages vulnerability and not as evidence that the products against which Yellow Pages is being compared may not be close substitutes.

119 We do not accept that a "weakness" alone provides evidence of or even suggests substitutability. Substitution is not a one-way process. The conclusion on whether there are close substitutes for the firm's products is not based on asymmetrical substitution. We must certainly consider whether there is ready substitution *from* Yellow Pages *to* other media but we must also be satisfied of the reverse, ready substitution *to* Yellow Pages *from* other media.

120 For the very reason that telephone directories are not suited to time-sensitive information, they are the one source of directional advertising that advertisers can be virtually certain will be retained for a long period by consumers. Apart from catalogues, which often are valid for periods of up to six months, the information in other vehicles is quickly dated and will be discarded. Catalogues, however, generally provide information on a single seller and do not cover the wide range of goods and services found in the Yellow Pages. The relative permanence of directories supports the Director's position that Yellow Pages are unique among directional media in serving as a continuing reference of all available suppliers.

(ii) Comprehensiveness

121 It is conceded by the respondents that telephone directories are unique with respect to their comprehensive list of suppliers. They argue, however, that comprehensiveness comes from the free listings and that the directory would still be comprehensive even if it contained no display advertisements. That is true. The respondents go on to state that an advertiser values comprehensiveness *only* if the advertiser is targeting customers who contact *all* listed suppliers before making a purchase, in which case the advertiser would not need a display advertisement. The latter statement simply does not follow. The advertiser witnesses who appeared before us made it clear that they value the comprehensiveness of the Yellow Pages because that is a feature that leads consumers in general to use the Yellow Pages. (Since we are talking about a directional medium, we are speaking of consumers who are ready to purchase some good or service and are looking for a supplier.) Once a consumer decides to consult the Yellow Pages because of its comprehensiveness, an advertiser finds it profitable to advertise in the Yellow Pages to cause that consumer to choose its establishment as opposed to that of another supplier.

122 On the distribution side, the respondents do not dispute that there is no other medium that is so comprehensively distributed. All telephone subscribers, the vast majority of the population, receive a telephone directory. The respondents attempt to counter this fact by pointing out that persons who receive the Yellow Pages, and thus are the potential customers of businesses listed or advertising in the Yellow Pages, are also exposed to other media which do not depend on their active involvement, that is, on their deciding to consult the Yellow Pages. This argument, in effect, simply reiterates the respondents' position that all media have the same end use, since it ignores the fact that the voluntary nature of Yellow Pages (consumers must decide to consult the Yellow Pages to be exposed to the advertising) means that it is *not* used for the same purpose as are the creative media (consumers are involuntarily exposed to the advertising by virtue of using the medium for the entertainment or information value). We have found that Yellow Pages are a directional medium. Exposure to creative media is not relevant as they serve a different purpose.

123 The respondents also point out that the scope of a particular directory may be too broad for a particular advertiser. That advertiser may wish to reach only a limited geographic area and could do so more cost-effectively with flyers. This will be addressed in the next section when we consider buyer views on whether the unique characteristics of Yellow Pages are significant to them and thus limit their choices among media.

(iii) Other Restrictions

124 In addition to the restriction on price advertising there are Yellow Pages rules regulating comparative advertising, the use of coupons and the use of superlatives. There is no evidence on the effect of these restrictions. However, their existence does indicate that the publishers of telephone directories were and are willing to create an advertising environment that sets their vehicle apart from others. Clearly Tele-Direct is not concerned that these restrictions make Yellow Pages less attractive such that advertisers would substitute other media.

125 In summary, all media have strength and weaknesses. Contrary to the respondents' arguments, however, we are of the view that "weaknesses" of the Yellow Pages as a medium do not imply that advertisers will readily switch from it to other media. If pricing information is important to advertisers and they *cannot* use Yellow Pages to convey prices because of restrictive rules or time-insensitivity, then their choice to use newspaper advertising instead cannot be seen as a *substitution of newspapers for Yellow Pages*. Likewise, if advertisers *cannot* achieve their goal of being in a "reference" medium by advertising in newspapers, then their decision to advertise in the Yellow Pages cannot be seen as a *substitution of Yellow Pages for newspapers*. In other words, strengths and weaknesses in areas important to advertisers are really characteristics that tend *against* substitutability. The existence of significant (to advertisers) differences between Yellow Pages and other media would lead to the inference that other media are not close substitutes to the Yellow Pages.

(b) Views, Strategies, Behaviour and Identity of Buyers

126 Both sides recognize the importance of the identity, views and behaviour of buyers, in this case, Yellow Pages advertisers. Before turning to the more detailed evidence, we first set out the position of each of the Director and the respondents on the question of substitutability from the perspective of the advertisers.

127 The Director submits that advertisers do not consider that there are any close substitutes for Yellow Pages advertising. He bases this on the testimony of the advertiser and agency witnesses, who although not a representative sample, gave cogent reasons for their views on substitution despite the diverse businesses involved. He argues that the advertisers cannot easily move their advertising spending from Yellow Pages to other media because of the value that they place on certain unique characteristics of Yellow Pages as a medium. In support of this position, he also points to evidence that Yellow Pages spending is not even part of the "advertising" budget at large for many Yellow Pages advertisers.

128 The respondents conceive of all advertisers, including Yellow Pages advertisers, as operating on a fixed advertising budget which is allocated among various media (the "media mix") based on the highest returns that can be obtained from the advertising expenditures. Decisions about media mix are driven by perceptions of relative cost-effectiveness. Therefore, Yellow Pages spending is vulnerable to reduction (by means of smaller size, less colour) or cancellation in favour of expanded spending on other local media which are perceived as more cost-effective. The respondents' position emphasizes the possibility of significant substitution between media "at the margin".

129 The respondents argue that the evidence supports the following propositions (although they state them in a somewhat different order):

(1) the businesses that advertise in Tele-Direct's directories ("current Tele-Direct customers") also advertise in a variety of other media;

(2) current Tele-Direct customers perceive that other media provide as good or better value than Yellow Pages advertising and may be assigned as high or a higher priority in the advertiser's media mix;

(3) current Tele-Direct customers in the same line of business may each choose a different media mix, including a different emphasis on advertising in the Yellow Pages (bigger or smaller, black and white or colour Yellow Pages advertisement);

(4) many of the businesses that do not advertise in Yellow Pages ("Tele-Direct non-advertisers") advertise elsewhere;

(5) Yellow Pages advertisers who have cancelled their advertising in Yellow Pages ("former Tele-Direct customers") continue to advertise in other media; and

(6) former Tele-Direct customers are unenthusiastic about the value provided by Tele-Direct in relation to other suppliers.

They submit that these propositions support their theory that advertisers readily shift their spending between media and thus Yellow Pages advertising and advertising in all other local media are in the same product market. The respondents also point to some evidence which they say reflects *actual* switching behaviour by Yellow Pages advertisers to other media.

130 Two preliminary comments are in order. The first relates to the use of a term such as "at the margin" which, in effect, invites the Tribunal to ignore the cellophane fallacy because of its emphasis on current price levels rather than the competitive price. [61] Any firm or group of firms that have fully exploited their market power might see some substitution if the relative price of their product goes up further. Their inability to raise their prices without buyer switching "at the margin" is, in these circumstances, because they have already exercised their market power *not* because they have *no* market power because of the presence of close substitutes.

131 Secondly, with regard to the proposition that advertising budgets are fixed, there is some support in the evidence that this is true for large companies. The situation is not so clear for small companies. We recognize, however, that some percentage of Tele-Direct's revenue is likely derived from advertisers who have advertising budgets that include Yellow Pages. Therefore, we will proceed to address the critical question of whether these advertisers and others treat Yellow Pages and other media as close substitutes. It will be convenient, in this instance, to organize our review of the evidence put forward by the parties by focusing in turn on each of the customer groups mentioned in the respondents' propositions. We will look first at the evidence regarding former Tele-Direct customers, then turn to non-advertisers and finally, current Tele-Direct customers.

(i) Former Tele-Direct Customers

132 This group comprises Tele-Direct customers who have *completely* cancelled their Yellow Pages advertising. One would expect, therefore, that these advertisers would provide the most compelling affirmation of the respondents' theory of ready shifts in spending between media.

133 At the outset, we note, however, that whatever is learned about former Tele-Direct customers cannot be generalized to the population of Yellow Pages advertisers as a whole. From Tele-Direct's 1994 Corporate Post Canvass Analysis Report we know that former Tele-Direct customers are relatively unimportant in terms of total Tele-Direct revenue, and individually they were spending far less than average annual amounts in the Yellow Pages. The 1993 revenue from advertisers who cancelled their Yellow Pages advertising completely in 1994 represented only 1.3 percent of total 1993 revenue for Tele-Direct (Publications) Inc. The average annual expenditure in the Yellow Pages for these advertisers was about $700. [62]

134 The respondents rely on the information about former customers provided by the January 1993 Elliott report on customer satisfaction. [63] The report indicates that former customers view Tele-Direct's products and services as "poor value" and generally of fair to poor quality, both absolutely and relative to other suppliers.

135 Because the former Tele-Direct customers could answer questions about other media suppliers, the results do indicate that *some* Tele-Direct former customers use other media. The study does not reveal what percentage of former customers are, in fact, using other advertising vehicles or which ones they are using. We know from the 1994 Corporate Post Canvass Analysis Report that former advertisers were spending relatively small amounts in the Yellow Pages. This would tend to indicate their options for buying other media on an annual basis with the dollars thus freed up are limited, given the cost of some of the media (particularly newspapers, radio and television) alleged to be close substitutes. The survey also found, not surprisingly, a low level of satisfaction with Tele-Direct among former customers. The study does not provide convincing evidence that a significant portion of former customers transferred advertising spending *from* the Yellow Pages *to* other media or that Yellow Pages is vulnerable to competition from other media as opposed to losing advertisers by virtue of its own failings.

136 With respect to former Tele-Direct customers the Director refers to two Tele-Direct reports which set out the reasons which customers gave to Tele-Direct sales representatives for cancelling their advertising: the "P.A.R. (Potential Advertiser

Retrieval) Summary" report and the "Wipe Out Sampling Summary".[64] One can assume from the fact that the representatives were able to contact the customers that they remained in business and maintained a business listing.

137 Tele-Direct uses the P.A.R. form completed by cancelled customers to attempt to understand why advertising was cancelled. One of the choices on the form for reason for cancellation is "trying other media". Professor Willig found it "notable" that Tele-Direct listed "trying other media" as a choice on the P.A.R. form., i.e., that Tele-Direct was alive to the possibility of its advertisers switching to other media. However, the P.A.R. Summary report printed in September 1995 shows that only four out of 203 former customers (two percent) surveyed stated that they cancelled because they were "trying other media". Professor Willig conceded that this low number would have some significance and would suggest a low level of movement between media if the study were meant to be comprehensive.

138 To counter the low percentage, the respondents argue that the relevant denominator is actually smaller than 203. To the extent that 56 customers were probably going to go out of business, they should be excluded. If we remove these customers, only three percent of the former customers surveyed gave "trying other media" as their reason for cancelling their Yellow Pages advertising.

139 The respondents would also exclude a further 84 customers who gave a variety of reasons other than "trying other media" for their cancellation (e.g., "financial reasons", "restructuring", "wouldn't discuss", "clients are mostly from referrals") to bring the sample size to 63. They would also include in the numerator, with those advertisers who answered "trying other media", another 47 advertisers who gave various other responses[65] on the argument that these advertisers were probably already using other media and, therefore, would not say they were "trying" other media when they moved their dollars to what they considered a more effective medium. Thus restructured, they argue that the report yields an 81 percent response rate in favour of substitutability between all media.

140 There is nothing in the report which supports the changes advocated by the respondents. The inclusions and exclusions are based on speculation, at best. Beyond removing the customers who have gone out of business, the report must be taken as it stands. If it is significant, as Professor Willig maintained, that Tele-Direct wanted to know if former customers were "trying other media", and included it as a possible response for former customers to choose, then it is significant whether they did choose that response or not. Any of the customers who answered could have selected "trying other media" if that were indeed their primary motivation for leaving the Yellow Pages.

141 On the whole the P.A.R. Summary report demonstrates that only a handful of customers may have discontinued Yellow Page advertising in favour of other advertising vehicles. Even for these customers little can be concluded about substitutability. They said they were "trying other media". Without some follow-up as to whether they found other advertising vehicles more effective in boosting their sales, it is not possible to tell if the other media were close substitutes for them. Indeed, some of these customers may have returned to Yellow Pages because they did *not* find the other media adequate for their purposes.

142 Similarly, the "Wipe Out Sampling Summary" by Tele-Direct shows only two of 87 (about two percent) former customers "trying other methods of advertising". The respondents attempt to re-interpret these results in the same manner as with the P.A.R. Summary report, i.e., by reducing the denominator. Again, there is no support in the document itself for such re-interpretation. This report tends to support the conclusion from the P.A.R. Summary report that very few customers discontinued Yellow Pages advertising in favour of other advertising vehicles.

(ii) Tele-Direct Non-advertisers

143 Tele-Direct's overall penetration rate is about 50 percent. This means, as the respondents state, that some businesses do not buy any Yellow Pages advertising. It is probably also true that most businesses advertise in some way. What does the evidence reveal, if anything, about this class of Tele-Direct non-advertisers? Is their advertising spending likely to be easily switched from whatever vehicles they are currently using into Yellow Pages (and vice versa)?

144 Tele-Direct divides non-advertisers into two groups: poor prospects for Yellow Pages advertising (Market 6) [66] and current non-advertisers with some potential (Market 7). Market 6 accounts are not contacted during a sales canvass; about 85 percent of Market 7 accounts are contacted. Both Valerie McIlroy, Tele-Direct's Vice-president of Marketing until July 1994, and David Giddings, a Vice-president of Sales, described the manner in which Tele-Direct contacts these non-advertisers as a "blitz". During a canvass, one or two days at various times are designated as "non-ad blitz days" and the telephone sales representatives focus on calling as many non-advertisers as they can each day, up to 20 to 30 calls. Tele-Direct's success in converting these non-advertisers is at most five percent.

145 If all media are close substitutes and advertising dollars are as fluid as the respondents argue, then Tele-Direct would seem to have a reasonable prospect of luring customers away from those other media and into the Yellow Pages. Yet, Tele-Direct's success rate with non-advertisers is very low. In addition, the approach taken to non-advertisers, namely telephone sales "blitz" days, provides little indication that Tele-Direct considers these non-advertisers "good" prospects which merit spending a lot of time and money to convert. Former Yellow Pages advertisers who have cancelled would presumably be especially good candidates but Tele-Direct does not appear to direct any special effort even to this group. One of the studies referred to by the respondents that does include some specific information on non-advertisers is the 1990 study by Impact Research. [67] The study consisted of interviews with 36 business people in Montreal and Toronto, half of whom were Yellow Pages "non-advertisers". [68] There is some indication that the non-advertisers were probably using some other media but there is no data on how many advertisers or which media.

146 The results of the study do not, in any event, support the respondents' contention about the potential to shift advertising dollars between all local media in search of the most "cost-effective" alternative. Seventeen of the 18 non-advertisers did not advertise in the Yellow Pages "mainly because of the *perceived non-use of the Yellow Pages by their potential customers*." Sixteen of the non-advertisers were not going to advertise in the next Yellow Pages edition because they were convinced it was an "*inappropriate medium* for their advertising needs". [69] Two were undecided.

147 The views of non-advertisers do not support the contention that there is ready substitution between Yellow Pages and all other local media. If anything, the evidence that is available tends in the opposite direction.

(iii) Current Tele-Direct Customers

148 The respondents place considerable emphasis on the fact that existing Yellow Pages advertisers use a variety of media and that many believe that other media are as good or a better value than Yellow Pages. Because many firms advertise in a number of different advertising vehicles, the respondents argue, they are thus able to shift advertising dollars among them as the returns on them vary.

149 The evidence from the Director's advertiser witnesses, as well as from the Tele-Direct surveys, [70] confirms that Yellow Page advertisers tend not to be solely reliant on this one vehicle. Many advertisers use a variety of media. Even within a heading, some Yellow Pages advertisers have smaller advertisements, advertisements without colour or simply a free listing, thus potentially freeing advertising dollars to spend in other media. However, there is little that we can conclude from this fact alone. As acknowledged by Professor Willig, the use of more than one advertising vehicle tells us nothing about whether the vehicles in question are substitutes, complements, [71] or have no relationship whatsoever. To draw conclusions about substitutability there must be evidence that advertisers do *in fact* shift between the various media in response to competitive moves by those media.

150 The principal evidentiary source referred to by the respondents respecting current customers is the January 1993 Elliott report. As with cancelled customers, current customers were asked to rate Tele-Direct in terms of, among other items, value for money and overall quality. Many existing customers believe that other media provide as good value or better value and quality than Yellow Pages advertising. Thirty-five percent say that the relative value for the money of Yellow Pages is much or somewhat worse than other suppliers while the relative quality is about the same as other suppliers. Likewise, 38 percent of all customers believe that Yellow Pages are high or very high priced in relation to other suppliers. In the western region

(Ontario), 56 percent of large customers believe that Yellow Pages are high or very high priced while only five percent say that Yellow Pages are very low or low priced. The respondents say this evidence shows that Yellow Pages are vulnerable to advertisers switching to other media.

151 We are of the view that these results tend to contradict rather than support the respondents' premise that all media are close substitutes. It is difficult to conclude that customers who had good substitutes would choose to continue to purchase a product that they believed was too high priced and of poor value. One would expect that, if all media were close substitutes, the medium perceived as providing better value and price would be purchased in preference to the others. Yet, dissatisfied Tele-Direct customers apparently continue to advertise in the Yellow Pages despite their opinion that other media are as good or better value and lower priced. The Elliott report provides more support for the proposition that Tele-Direct has a comfortable cushion of market power that permits it to keep its customers in spite of the fact that significant numbers of them were not complimentary about its service and pricing than it does for the proposition that Tele-Direct competes with other suppliers providing easily substitutable products.

152 The respondents also refer to a 1994 study by Omnifacts Research in Newfoundland. [72] Four focus group sessions were conducted with a total of 31 Yellow Pages advertisers, two sessions with new advertisers and two sessions with established customers. [73] In-depth interviews were conducted with 16 customers, 10 of whom had reduced their Yellow Pages spending. Many of the customers also used other media, primarily print, in the form of local trade magazines, flyers and direct mail for new customers and flyers and direct mail for established customers.

153 There was a general view among the participants that they *had* to advertise in the Yellow Pages. They generally found it difficult to judge the effectiveness of the advertising they did, including Yellow Pages. In particular, they expressed considerable uncertainty about the value of larger size and coloured advertisements in Yellow Pages. Established customers "... tend to follow the competition when deciding on placement and size of Yellow Pages advertising. Most are clearly not sure whether the advertising in the Yellow Pages actually works, but the consensus is that they have to be there." [74] Some expressed displeasure at the number of headings since they felt compelled to advertise in several headings if their competitors did.

154 Particularly significant are the results of the interviews with customers who had reduced their Yellow Pages expenditures. The report states:

> Those companies who reported that their expenditures decreased fall into two main groupings: those who decreased as a cost cutting measure and those who decreased primarily because they do not perceive the Yellow Pages to be effective for reaching their target markets.
>
> Those that decreased their expenditures as a cost cutting measure essentially felt that the current economic conditions were affecting their business revenues....
>
> Clients who have decreased their Yellow Pages expenditures because they did not consider the Yellow Pages to be effective, reported that their markets are primarily industrial or business-to-business and given the nature of the products and services that they offer, the Yellow Pages are not therefore consistent with their target markets. [75]

There is no indication in either case that customers reduced their Yellow Pages advertising in order to shift dollars into other media. [76]

155 Turning to the Director's evidence, the viva voce evidence of advertisers and other market participants who represent advertisers strongly supports the position of the Director that advertisers do not regard Yellow Pages and other media as close substitutes. Although several advertisers were approximately average size in terms of spending on Yellow Pages, most were in the top two or three percent of Tele-Direct customers. That is, average expenditures ranged from about $2,000 annually to well in excess of $100,000. For the most part a large percentage of advertising dollars were spent by these advertisers on other advertising vehicles, although a small number of the advertiser witnesses devoted almost all their advertising to Yellow Pages.

Advertisers spending relatively large amounts in the Yellow Pages are, nevertheless, well placed to provide evidence on the opportunities for substituting between Yellow Pages and other advertising vehicles.

156 Although the circumstances of advertisers and the language used to describe their advertising strategies varied, none of the advertisers indicated that other media could be substituted for Yellow Pages. What they did say was that they use different media for different purposes. They use Yellow Pages advertising for purposes which take advantage of its unique characteristics. They advertise in the Yellow Pages because it is a reference of all available suppliers which is received and retained by most consumers and is consulted by them. They consider that Yellow Pages is cost-effective in this regard and generates a superior level of customer response.

157 Some, particularly large-budget, advertisers use other media to "create awareness". The witnesses use media other than Yellow Pages to advertise specials, include prices or to target a specific group or occasion. Steve Kantor of Tiremag Corp., who sells aluminum wheels and tires, uses other vehicles to convey a seasonal message, selling the "sporty" look in spring and "safety" in fall. Likewise, Kenneth Flinn, who operates a taxi and courier business (Lockerby Taxi Inc.) and relies almost exclusively on Yellow Pages, uses radio during the holiday season to convey the message "don't drink and drive". Yellow Pages cannot accommodate this time-sensitive advertising.

158 On this point, the respondents attempted to demonstrate the vulnerability of Yellow Pages to substitution by a review of advertisements in a number of newspapers from Toronto, Thornhill, London, Ottawa, Niagara, Sault Ste. Marie, St. Catharines and Montreal over a three-week period. The purpose was to show that some advertisers were using both Yellow Pages and newspapers and that they could substitute one for the other. [77] Professor Willig observes that a "limited number" of advertisers employed "much the same" advertisements in both the newspaper and the Yellow Pages. He puts forward only four examples, of which only two are identical. For the other two, "the newspaper ad includes some of the same information presented in the directory display ad, but ... the newspaper ad also includes some timely information of the kind that a directory ad could not contain, due to its permanence." [78]

159 The respondents provided three further examples of advertisements that were similar in both the Yellow Pages and a newspaper. [79] These types of advertisements evidently represent a very small percentage of Yellow Pages advertisements. Equally important is the conclusion that the respondents draw from Professor Willig's survey and the other examples, that the advertisements are only "essentially" the same and that where differences arise, they often stem from the *greater timeliness* of the newspaper. For example, the newspaper advertisement contains a price. They did not, however, provide us with any basis for concluding that prices and other time-sensitive information are trivial or unimportant to advertisers.

160 Time sensitivity for some advertisers cannot mean that those advertisers are likely to *switch from* Yellow Pages *to* newspapers and vice versa. Instead, they will use newspapers to convey time-sensitive information because that is what newspapers are good at doing. Likewise, they will use Yellow Pages to convey a message that is *not* time-sensitive but that takes advantage of other characteristics of Yellow Pages as a medium.

161 Agents specialized in selling Yellow Pages, general advertising agents, a witness with a large media buying agency and the former Vice-president of Marketing with Tele-Direct also testified that they did not consider other advertising vehicles a substitute for Yellow Pages and had not observed their customers to have ever done so.

162 Professor Schwindt's evidence supports the Director's argument that certain types of businesses use or do not use the Yellow Pages because Yellow Pages have particular characteristics that set them apart from other advertising vehicles. His evidence showed that businesses providing emergency services (glass repair, contractors, plumbers), infrequently consumed products (lawyers, moving and storage, exterminators), services used by travellers (automobile rental), products for which the use of the telephone is important (pizza), or any combination of these, tend to rely heavily on the Yellow Pages. Professor Schwindt also points out that there are types of businesses (grocers, department stores and theatres) that are known to advertise very heavily in other vehicles such as newspapers and flyers and spend virtually nothing on Yellow Pages.

163 On the other hand, Professor Willig, for the respondents, pointed out that whether Tele-Direct has market power, i.e., is vulnerable to ready substitution by advertisers to other media, depends on the combined demand of all advertisers, including those who are not necessarily very reliant on Yellow Pages. While he concedes some advertisers are more reliant than others on Yellow Pages advertising and that this affects the *average* elasticity of demand and the ability of Tele-Direct to exercise market power, he is of the view that the presence of advertisers who are willing to switch serves to discipline Tele-Direct's pricing. He acknowledges, however, that his position is subject to exception if Yellow Pages publishers could be shown to have the ability to price discriminate.

164 Price discrimination allows a firm with market power to secure higher profits (strictly, price less marginal cost) on sales to some customers than on sales to others. A firm without the ability to price discriminate may be disciplined by the ready ability of at least some of its customers to switch if prices are increased and, when considering a price increase, must weigh what it will lose against what it will gain from that action.

165 However, where a firm has found a way to price discriminate, no weighing need be considered. The prices for customers who might switch will be left at a level where they will continue to purchase. However, for those customers who are so reliant on the firm that they cannot switch, the firm may extract higher prices and therefore higher profits on sales to them. The ability to price discriminate therefore tends to demonstrate that a firm is not, at least in respect to the customers who are subject to the discrimination, vulnerable to those customers substituting other products for that of the firm.

166 On our assessment of the evidence, Tele-Direct does engage in price discrimination but not as between headings, i.e., it does not charge plumbers (a business likely to be heavily reliant on Yellow Pages) more for the same advertisement than it does grocery stores (likely to be less reliant). Rather, Tele-Direct price discriminates against those who tend to spend more in Yellow Pages by buying larger advertisements[80] or colour. Those customers are charged much more than can be explained by the additional costs associated with producing and servicing the enhanced advertisement. Thus, larger advertisers (by expenditure) under all headings contribute more to Tele-Direct's profits than smaller advertisers. Professor Willig agreed that if customers who use colour value Yellow Pages more than customers who do not, the pricing of colour is a way to price discriminate between customers who value Yellow Pages more and customers who value it less.

167 Tele-Direct does not have to target these firms; they in effect identify themselves. Firms that are heavily reliant on Yellow Pages are the ones that will buy a larger and more colourful advertisement in order to attract customers away from their competitors in the same Yellow Pages heading. This is indicated by the large average expenditures per subscriber and per advertiser under headings such as "moving and storage" and five other headings that stand out in the top 25 listed by Professor Schwindt in his report. The fact that there are advertisers under other headings who are less reliant on Yellow Pages can have no influence on the ability of Tele-Direct to extract higher returns from advertisers who compete heavily within headings.

168 Moreover, while headings provide an important first indicator of whether a business is likely to be a heavy advertiser, there may be important differences among advertisers within a heading. One advertiser in a heading may have a larger or more colourful advertisement than the advertising by its competition within that heading. This is illustrated by the evidence of Howard Kitchen of Lansing Buildall, whose firm of lumber supply outlets is a relatively large Yellow Pages advertiser in the Toronto area. When asked about the fact that a large new entrant in lumber supply was not advertising in the Yellow Pages, he pointed out that his firm encouraged telephone inquiries while his competitor did not. The pricing of Yellow Pages, therefore, is able to capture the greater need of particular customers within headings as well as between headings. Thus, Tele-Direct's ability to price discriminate causes us to conclude, at least in respect of those larger advertisers who are most reliant on Yellow Pages advertising and therefore purchase large size advertisements or colour, that there is no ready substitutability between Yellow Pages and other media.

(iv) Conclusion

169 There is little evidence supporting the respondents' position that all media are substitutes for local advertisers. Specifically, the evidence of switching behaviour between Yellow Pages and other media is extremely weak. There is almost no evidence

that advertisers regard Yellow Pages as serving the same purpose as other media nor that they regard its purpose in the broad manner put forward by the respondents. While there is evidence of changes in advertising expenditures, they are associated with changes in economic conditions or advertising strategy rather than switching between media in response to competitive moves by those media.

170 While it is true as a matter of arithmetic that when expenditures are shifted within a fixed budget there will be winners and losers among the media, this fact tells us nothing about the willingness of firms to reallocate expenditures within the budget *as a result of competitive moves by advertising vehicles*. Advertisers' goals, situations and advertising needs are subject to change. Specific physical and technical differences among media limit the way that they can be used to accomplish a specific objective, such as the announcement of a sale, the listing of prices or a promotion related to a change in season and raise doubt about the willingness of advertisers to treat advertising dollars as fluid or as easily substitutable between Yellow Pages and other media. The respondents' proposition that both former and current Yellow Pages advertisers use a variety of advertising vehicles is likely correct. It was also proven that relatively large percentages of former and current advertisers do not think very highly of Yellow Pages. This tells us nothing about whether there is a sufficiently large body of Yellow Pages advertisers who are willing to switch their advertising dollars in the event that Yellow Pages were priced above the competitive level. There must be evidence that advertisers reallocate dollars in reaction to competitive moves by different media. It is insufficient just to demonstrate a fixed budget and changes in allocation by advertisers between media. In other words, there must be evidence in one form or another that advertisers regard other advertising vehicles as close substitutes for Yellow Pages.

171 The testimony of the advertiser witnesses about why they use Yellow Pages and the importance of Yellow Pages advertising to them is supported by Tele-Direct's own studies of advertisers. Many advertisers believe they *have* to be in Yellow Pages to be in a comprehensive reference tool, particularly if their competition is there. They feel they have no choice. As stated in the Omnifacts study:

> ... There were numerous comments concerning the fact that the Yellow Pages, like the telco, operates in a monopoly situation where their customers are to some extent captive advertisers, who have really no choice but to place their advertising with Tele-Direct. [81]

If they do not use Yellow Pages it is because it does not suit their purpose, not because they can readily move dollars between Yellow Pages and other media. The views of buyers, therefore, strongly tend to support the view that Yellow Pages and other local media are not close substitutes.

(c) Trade Views, Strategies and Behaviour (Inter-industry Competition)

172 The Director argues that there is little evidence that Tele-Direct or other market participants consider Yellow Pages to be in competition with other media. Whatever steps Tele-Direct took in relation to other media, he submits, are to be contrasted with its reaction to other market participants that it clearly regarded as competition. The other competitors referred to by the Director are consultants, agencies which sell Yellow Pages advertising, and independent publishers of telephone directories.

173 The respondents argue that Tele-Direct does not compete, for various reasons, with either consultants or agencies in providing *services* to advertisers. They do, however, admit that independent publishers are in the relevant market with Tele-Direct, whether that market includes only directories or all local media. We will, therefore, compare Tele-Direct's reactions to other media to its reactions to independent directory publishers, about which there is no dispute between the parties.

174 The respondents argue that the evidence reveals "broad competition" or "competition in fact", as referred to by the Court of Appeal in *Southam*, between Tele-Direct and all other local media. They submit that Tele-Direct views other media as competitors and has taken various initiatives to compete with other media. They argue that other media, in turn, view Tele-Direct as a competitor.

175 The respondents submit that evidence of "broad competition" places all local media in the same product market. The respondents say that differences in the type or intensity of response to different "competitors" should not eliminate some

"competitors" from the relevant market. We cannot agree. The type and intensity of the alleged competitive response is an element for consideration in determining if the products argued to be in the same market are close substitutes. Substitutability, as pointed out in the *J.W. Mills* case quoted above, is always a question of degree. Differences in the intensity of the reaction to players admitted to be competitors by Tele-Direct and those alleged to be competitors by Tele-Direct can help us to determine where to draw the line in this case.

(i) Tele-Direct's Views and Behaviour

• General

176 The evidence is unequivocal that other directory publishers have been referred to as competitors by Tele-Direct and the respondents concede that they are. A number of independent publishers not affiliated with a telco produce directories in Tele-Direct's territory. Over the years, Tele-Direct has collected information on and copies of directories of independent publishers. As of 1994, the information was organized into a "competitive database" as part of the creation of a "Sensitive Market Intelligence System". The sales representatives gather information and the marketing department analyzes information on independent publishers as part of this system. Tele-Direct goes to considerable lengths to track and compile data on the revenues, prices, scoping, circulation and other features of independent directories. [82]

177 Further, it is not in dispute between the parties that when a broadly-scoped independent directory entered into Tele-Direct's territory in each of the Niagara region and in Sault Ste. Marie, Tele-Direct responded with zero price increases, advertiser incentive programs, promotional campaigns, and improvements to its own directories. [83]

178 While there are references within Tele-Direct documents to other media as "competitors" and to "competing for the advertising dollar", there was no effort on Tele-Direct's part to track revenues, prices, features or circulation in a comprehensive and detailed a fashion as there was with other directory publishers. When one compares the competition data base and sensitive markets material cited above to the documents put forward by the respondents as showing competition with other media, the difference in intensity is immediately apparent. They refer in their written argument, for example, to two speeches from 1984 and 1985 which refer to "competing with all other types of advertising media" and being in a "constant struggle for the customer's advertising dollar." Considerable emphasis is also placed on a 1993 document entitled "East Office Competition Analysis". The "east office" deals with only a portion of Tele-Direct's territory, namely the Peterborough, Orillia and Barrie areas. The document is a summary of a meeting regarding competition. It lists newspapers, flyers, consultants and television as competitors and canvasses various points of discussion. It does not identify particular competitors, give any detail on revenues likely lost, comparative pricing or features like circulation.

179 There was likewise no evidence of a Tele-Direct response to other media competition that bears any resemblance to the focused and intense response to the competing directory publishers. The respondents referred us to other initiatives by Tele-Direct that they submit are of particular significance and we will deal with them in further detail below.

• Educational Efforts

180 Educating employees to deal with the existence of competitors might be some evidence of concern by Tele-Direct about the potential for its advertisers to switch to other media. The evidence regarding Tele-Direct's educational efforts indicates, at best, a weak concern about the necessity to compete with other media. The respondents rely on the Multimedia Training Course as the principal Tele-Direct initiative to compete with other media. The only clear evidence we have, which comes from a written answer by the respondents to a question on discovery, is that the course was given once in 1992 for four days to all sales "employees". The oral evidence on the issue was vague, suggesting that the course was not an initiative that was considered significant by Tele-Direct. [84]

181 Based on the course having been given once in 1992 to all sales representatives, the investment by Tele-Direct was 1880 (470 × 4) person-days. Based on the average remuneration of a premise sales representative, the cost to Tele-Direct was *at most* $500,000. [85] This was a one-time cost relating to *all* of Tele-Direct's territory with benefits spread over a number of

years. By contrast, in reaction to the entry of DSP in Sault Ste. Marie, in one year (1993) in one relatively small market Tele-Direct spent over $215,000. Evidence of educational efforts does not suggest a great concern on Tele-Direct's part about other media competition.

• *Sales Aids*

182 The respondents point to a variety of "sales aids" produced by Tele-Direct which contain references to other media. They submit that the specific claims made in the documents with respect to other media in relation to Yellow Pages are unimportant. Rather, they say significance lies in the simple fact that Tele-Direct created material which refers to other media to provide to its sales force. They claim that if Yellow Pages were "unique", there would be no need for this type of promotional material.

183 We are of the view that in examining the documents prepared for use by Yellow Pages representatives, we should consider whether the content of those documents points to the treatment by Tele-Direct of Yellow Pages as a separate advertising medium (the Director's position) versus whether the content indicates signs of competitive activity with other media (the respondents' position). The mere existence of sales aids which mention other media in some context cannot be solely determinative of the issue.

184 Two memoranda dated 1983 and 1985, respectively, deal with direct mail (flyers) as an alternative to Yellow Pages and provide visual aids to salespeople. The first concludes:

> We all know that any form of advertising is beneficial in one way or another but direct mail should never be an alternative to Yellow Pages when considering the circulation, permanence, or economy of the two mediums, and these visuals prove that. [86]

The second states:

> Unbelievable.
>
> When comparing the economy of Yellow Pages with the cost of Direct Mail it is hard to imagine why someone would consider Direct Mail an alternative to Yellow Pages advertising. [87]

Despite the fact that Tele-Direct sales representatives may have had, to some extent, to provide arguments on the superiority of Yellow Pages in relation to flyers and, indeed, any other media, the words used suggest non-, or at least low, substitutability between Yellow Pages and the alternative media. The authors of the memoranda appear to express disbelief and incredulity that anyone would ever consider direct mail as an economical alternative to Yellow Pages advertising.

185 Tele-Direct's Strategic Business Plan for the time period 1983-88 states:

> Part of a large, profitable but slow growth industry, the directory advertising business operates from a privileged position in a captive market. [88]

Tele-Direct has characterized its own market as "captive" in this business plan. We infer that this high level document reflects the perception of Tele-Direct management as to competition from other media. It places in context the aforementioned memoranda.

186 The respondents also refer to a set of documents that was prepared for the 1992 sales canvass which includes comparisons between the cost of advertising in Yellow Pages and two dailies and three community newspapers in the Toronto area. Other documents give the same type of information for other cities and towns. Another similar package compares the cost of Yellow Pages to two Toronto dailies, and shows what could be purchased with the Yellow Pages dollars in television, radio, flyers, calendars, key chains and ball point pens.

187 When we examine the content of these documents, we find that, as with the direct mail examples, what is being emphasized is the *lack* of comparability between the cost of Yellow Pages and the other media. With respect to the comparisons

with newspaper advertising, one document (from 1992), for example, compares a 1/4 page advertisement for 30 days in the Toronto Yellow Pages (circulation over 1.3 million) at $677 with a 1/4 page single insertion in *The Globe and Mail* (circulation about 325,000) at over $7,000. Mr. Giddings described this type of sales pitch as making a comparison to point out that there is *no* comparison between Yellow Pages and newspapers. Newspapers are simply so much more expensive that there is no comparability. Another document has a similar tone; it focuses mainly on newspapers for comparisons but also highlights how *little* can be purchased with the Yellow Pages dollars if transferred to television ("2-60 second spots, non-prime time"), radio ("2-1 minute spots") and flyers, calendars, key chains and ball point pens (15,600 flyers, 709 calendars, 1,213 key chains and 1,365 pens while Yellow Pages circulation is over 900,000).

188 Tele-Direct, unlike other print media, does not use a "CPM" or cost per thousand measure in promoting its product to advertisers. A CPM is a calculation of the cost of the medium per thousand persons reached, which can be applied to the number of copies sold (assuming one reader per copy sold) or read (if that number is known) of, for example, a magazine or newspaper. The CPM allows comparisons between print media. Tele-Direct researched the possibility of developing a CPM for its directories in the late 1980s. Its survey of general and specialized advertising agencies revealed that the agencies thought such a measure

> ... entirely unnecessary since we [Tele-Direct] are the only ones in this field and there can be no similar comparison (they absolutely cannot imagine comparing us to the other "media").
>
> . . .
>
> In the event of serious competition, all agree that such a tool would be useful.
>
> However, two of the largest agencies already understand the usefulness and even suggest the development of this type of measure to better acquaint people with the Yellow Pages on a "national" level, and to establish ourselves as the unbeatable leader in the industry. [89]

Although a later study concluded that a CPM measure should be developed for Yellow Pages that would be, to some extent, comparable to other media in order to "contribute to developing a media image for Y.P. directories, and would create a barrier for potential competition", none was developed. Tele-Direct does use a CPM-type formula internally in its pricing to ensure that its directories of similar circulation are priced similarly but CPM is not used as a marketing tool.

189 Equally relevant to the question of how Tele-Direct views its product in relation to other media is the large volume of Tele-Direct promotional material selling advertisers on the advantages of being dominant *in* a Yellow Pages heading. The virtues of size and colour are extolled in testimonial letters and other promotional material. The "YPROI study", which the respondents argue is a primary tool of their sales force in selling the "value of the medium", starts with a comparison of which media influenced persons who had made a recent purchase, [90] but also includes a page trumpeting the importance of size, colour and "impact" within the Yellow Pages so as to influence the buyer's selection of a firm once he or she consults the Yellow Pages.

190 The advantage of "standing out" that is being sold to customers is with respect to competitors advertising *in the Yellow Pages*, and not with reference to advertisements in some other medium. As pointed out by one of the Director's economics expert witnesses, Margaret Slade, [91] the amount of advertising a firm does in the Yellow Pages is dependent on how much its competitors do. When a Yellow Pages sales representative convinces a customer to increase its expenditures on Yellow Pages advertising, this creates pressure on its competitors to do likewise (referred to as the "prisoner's dilemma"). This phenomenon came through in the comments received from the established customers participating in the Omnifacts study in Newfoundland, that they tend to follow the competition when deciding on placement and size of their Yellow Pages advertising. The pressure on advertisers to observe and to some extent follow what their competitors are doing in the Yellow Pages indicates that Yellow Pages are a distinct medium, a separate arena within which firms seek to stand out.

191 The respondents stress that competition for the advertising dollar is not so much a matter of whether firms advertise in the Yellow Pages but of how *much* they advertise, primarily whether they buy coloured advertisements and larger advertisements.

The number of headings would be an additional factor determining the expenditures of customers. It is noteworthy that the attempts by Tele-Direct to sell colour and size to its advertisers are based on comparisons with black and white advertisements or smaller advertisements *within* Yellow Pages.[92] Thus, the success or failure of Tele-Direct representatives in capturing more of the advertising dollar depends on the extent to which they can convince customers that they need to upgrade their advertisements *to be more effective vis-à-vis the customers' competitors* in the Yellow Pages. It is difficult to perceive of this as "inter-media" competition.

• *Pricing -- General Policy*

192 Another relevant area in inter-media views and conduct concerns how, if at all, the prices of other media influence Tele-Direct's pricing. Tele-Direct generally establishes its prices about a year and a half to two years in advance, with prices, for example, for the 1995 directories set in late 1993.

193 The Pricing Policy documents placed on the record reveal that Tele-Direct considers various inputs in setting prices. For example, in the 1993 Pricing Policy produced in October 1991,[93] these included rate/circulation alignment policy,[94] recent Tele-Direct price-ups (1988-92), the consumer price index ("CPI") (1991-93), the paper and allied industry price index (1990-92), the percentage change year-to-year in the number of directory copies printed by Tele-Direct (1991-93), estimated price-ups in other media for 1992 and Tele-Direct's internal rate of inflation (1991-93). Given the timing, much of the information is estimated. The 1994 Pricing Policy is a two-page document only as all 1994 issues had a zero percent price-up. In the brief text, the following are mentioned: relationship with customers, impact on profitability, prevailing economic factors, cost containment including a recent, more favourable printing contract and the rate of inflation or CPI. In the 1995 Pricing Policy, the only change from the 1993 Pricing Policy is to replace the "paper and allied industry price index" heading with "junked directories".[95] The 1996 Pricing Policy adds two additional items, gross domestic product and personal disposable income and reverts to using an indicator of paper cost increase, as for 1993.

194 In all cases, the information regarding the forecasted price-ups of other media that is contained in the policies was obtained from general advertising agencies, usually two or three different ones, and is stated as a range. The media included are television, dailies, magazines, outdoor and radio. "Business papers" also appeared in one year and "transit" in one other year.

195 To obtain insight on how the information with respect to other media entered into pricing decisions, we look to the testimony of Ms. McIlroy, who was intimately involved in the pricing decisions. According to her, the "key drivers" of pricing were, in order of importance: relationship to cost, rate/circulation re-alignment, revenue stream for the sales force and local considerations, both economic and the presence or feared entry of a competitive directory. She stated that there was no direct relationship between the prices of other media and Tele-Direct's pricing. Her view was based on her own experience and a review of all relevant pricing documents on the record, dating from the early 1980s to the 1995 Pricing Policy. Ms. McIlroy did not alter her position regarding the relative unimportance of other media in setting Yellow Pages prices when responding to questions on cross-examination.

196 Douglas Renwicke was the Senior Vice-president to whom Ms. McIlroy reported from 1991-94 and was involved in sales or marketing from 1988. He expressed general agreement with Ms. McIlroy's description of the price setting process. He disagreed over certain details that are not germane to the present discussion. However, more importantly, he also disagreed with Ms. McIlroy concerning the relevancy of other media prices in Tele-Direct price setting.

197 Mr. Renwicke stated that the three "primary" key drivers for pricing in the 1990s are CPI, other media price-ups and local market knowledge. A group of "secondary" key drivers include growth and circulation, gross domestic product and Tele-Direct's internal rate of inflation (costs). He distinguished price setting in the 1980s when the key drivers were circulation, internal costs and, from 1987 to 1990, circulation alignment.

198 At least for the 1980s, during which Tele-Direct enjoyed exceptional growth, Mr. Renwicke agrees with Ms. McIlroy that factors such as the internal rate of inflation at Tele-Direct and circulation growth were primary determinants of Tele-Direct's prices. He also recognizes that towards the end of the 1980s discrepancies in rates per thousand in different directories became

another important concern that entered at the local market level. The attempt to get prices in line across markets was abandoned for a couple of years following the recession but appears to be reemerging as an ongoing factor. Considering Ms. McIlroy's and Mr. Renwicke's evidence together, we conclude that other media prices were not a "key driver" during the 1980s.

199 Mr. Renwicke explicitly distinguishes the 1990s and it is here that he appears to take issue with Ms. McIlroy. We will, therefore, look in more detail at the information available to the officers engaged in price setting in 1991, 1993 and 1994 (for 1993, 1995 and 1996). [96]

200 The 1993 Pricing Policy document sets out the following predicted increases in various items for 1993:

Increase in CPI for Ontario: 3.6%

Increase in CPI for Quebec: 3.7%

Tele-Direct internal rate of inflation: 5%

Increase in cost of printing: 4.7%

Increase in copies to be printed: 2.9%

(proxy for circulation increase)

201 The ranges of predicted percentage price-ups for other media set out in the document were obtained by Claude Phaneuf, Manager of Marketing Research, from two general advertising agencies and a media buying firm. [97] Notably, these predicted increases are for *1992 only*:

Television: 0% - 10%

Dailies: 3% - 7%

Business Papers: 5% - 8%

Magazines: 3% - 7%

Outdoor: 3% - 5%

Radio: 4% - 7%

According to Messrs. Phaneuf and Renwicke the predicted price changes for 1992 were considered relevant even though Tele-Direct was considering price changes for 1993 because the canvass of customers for the 1993 directories was done during 1992. However, Mr. Phaneuf could not explain why predicted changes for other factors such as the CPI were obtained for 1993.

202 Two notes accompany the information on other media price increases. They state: "Demand Driven Market" and "Anybody's Crystal Ball". According to Mr. Phaneuf, the second note is a warning about the discrepancy in the information received from different sources (as indicated by the wide range of predicted price changes, such as for television). Taking the first note at its face value, it means that the prices that would actually prevail in 1992 would depend on the state of demand at that time.

203 The average Tele-Direct price increase established in October 1991 for 1993 was five percent, with a minimum of 3.5 percent and a maximum of 5.9 percent for specific directories. The average price increase of five percent for 1993 falls within the range of other media price-ups (not difficult since the range is so large) but the same average increase could just as easily have been arrived at without any reference to other media prices. This observation also applies to the pricing documents for 1995 and 1996 that were used in setting prices in 1993 and 1994.

204 Several other points emerge from a review of the information available to Mr. Renwicke and other officers. Although Mr. Renwicke stated that he would be concerned about the prices of community and daily newspapers, only the price-up of dailies was collected. While the general agencies that provided the information to Mr. Phaneuf were much more likely to be familiar with dailies than with community newspapers, it is instructive that there is no evidence of any effort by Tele-Direct to obtain pricing information about its other alleged competitors, community newspapers.

205 Further, no information on flyers or direct mail is included. Other Tele-Direct documents group flyers with Yellow Pages as directional media, indicating that prices for flyers would clearly be relevant, and perhaps more relevant than predicted prices for the electronic media, business papers and magazines. We also note that the information provided by Mr. Phaneuf for television does not reveal whether the prices in question relate to local television, network television or both. When questioned about this Mr. Renwicke was not sure but thought that the predicted price changes related to local television.

206 We conclude that Ms. McIlroy's view that the prices of other media had little or no influence on Tele-Direct's pricing policy in the 1990s is borne out. Mr. Renwicke's use of the term "key driver" when referring to the prices of other media is disingenuous. The documentary evidence does not support this characterization. Nor, in fact, does the remainder of Mr. Renwicke's own testimony. By a "key driver", he apparently meant a very tenuous relationship between Tele-Direct's price increases and the price increases of other media. He testified that other media prices enter into Tele-Direct's price setting as follows:

> ... [W]e wouldn't focus this closely on network TV as we would on community or daily newspapers, but we focus on that because we don't want to be way out of line with what newspapers are pricing up at or other comparable media that we feel our advertisers use amongst their choices of how to promote their business.
>
> ... We feel if the gap was too large and we didn't pay attention to that over time, there could be at least substitution on the margin that could take place.
>
> I think that's a real concern throughout the recession.
>
> . . .
>
> > Q. You said you would be concerned if the prices were way out of line. What do you mean by "way out of line"?
> >
> > A. Frankly, particularly with newspapers, I would consider anything, five percent or greater, to be too much out of line. [98]

A fear of losing *some* advertising dollars to other media if a *relatively large* difference in price *increases* persists over time (and during a recession) confirms only that newspaper or other media pricing provides little or no competitive discipline for Tele-Direct's pricing. Tele-Direct did not ignore the prices of other media; they were a part of the general economic environment. But given the types of media covered and the tentative conclusions that it could derive from the information we cannot conclude that it had the concern of a firm worried about close substitutes.

• Pricing -- Revision of 1993 Prices in 1992

207 The respondents place considerable emphasis on the fact that in February 1992 Tele-Direct, for the first time ever, revised its 1993 prices during the canvass for the 1993 directories as it ran into advertiser resistance due to the difficult economic times. For the remaining directories not yet canvassed the average price increase was reduced from five percent to 3.2 percent.

208 The respondents point to a brief statement in the minutes of a sales and marketing executive meeting held in February 1992 which they say reflects the reasons why prices were revised:

> The rates that were implemented for 1993 have been revised to lower levels given the reaction of our customers to our 1992 prices, *the pricing of other media* and the expected rate of inflation in Ontario and Quebec. [99]

(emphasis added)

They also rely on the revised Standby Statement for 1993 Pricing which was presented at the meeting and apparently accepted by all concerned. The Statement reads:

> Our pricing policy for 1993 issues of Yellow Pages and White Pages directories has been revised downward to take into consideration the economic conditions prevailing in 1992.
>
> This policy reflects the fact that most prices are on a downward trend for 1992. It is also in step with the advertising industry where media rates for 1992 are expected to be in the 3% to 5% range for daily newspapers, magazines and out-of-home (billboards, etc.). Radio and T.V. are expected to be in the 0% to 5% range with peaks of 10% for T.V. due to high demand for last-minute buying.
>
> All media are expected to increase their rates towards the end of 1992 as the economy picks up. Forecasts for 1993 and 1994 are for prices increases of 10% or more. Based on these forecasts, it is evident that Yellow Pages directory advertising will be one of the media with the lowest price-ups during that period.
>
> Finally, our pricing structure must also reflect our own internal cost increases which have been kept to a minimum for 1992 thus allowing us to keep price-ups at their very low levels. [100]

209 Both Mr. Renwicke and Ms. McIlroy attended the meeting at which the prices were revised. Ms. McIlroy attributed no importance to the Standby Statement as a price setting document, regarding it purely as a document prepared for public relations purposes. Nor did Mr. Renwicke mention other media prices when describing the motivation for the revision in 1993 prices. He emphasized general economic conditions:

> In 1991 we clearly did not project the decrease that would take place in CPI or the recession ... [I]n February '92, we actually re-did prices for '93 for the books we could still catch and I am thinking of the border markets in particular that were being decimated with cross-border shopping, Niagara Falls, Sarnia, Windsor.
>
> We reduced those all by a percentage point. So, we did our best to try and get back down to a point where we were near CPI because our customers were reading in the paper every day that inflation in Toronto was approaching zero and why were our rates up at four per cent, five per cent, six per cent. Partly it was a function of the lag we had in setting those prices initially and not foreseeing the downturn that did take place in the economy. [101]

Taking into account both the documents and the views of two of the officers involved in the exercise, the 1993 price revision does not change our view that other media prices are not "key drivers" in Tele-Direct's pricing.

• New Products

210 The respondents list four new product initiatives which they say show competition between Tele-Direct and the other media by the fact of their having been tried. These four products were coupons in directories, AdSpot and BrandSell (creative-type directory advertisements), colour and participation in the "Marketing the Medium" program which is designed to prove the value of Yellow Pages.

211 There was little evidence about the nature and cost of these programs and why they were launched, which media were considered important competitors in triggering them, what success they achieved in terms of revenue gain or loss for Tele-Direct and if they were discontinued and why. Contrary to the respondents' submissions, we cannot accept that the mere existence of these alleged new products is instructive. Their mere existence is not indicative of substitutability between Yellow Pages and any other advertising medium.

(ii) Newspapers

• *Newspaper Consultants*

212 The respondents rely on the evidence of the activities of newspaper consultants as proof both of Tele-Direct's response to a "competitor" (daily newspapers) and of an initiative by another medium to compete against Yellow Pages. Newspaper consultants attempt to convince Yellow Pages advertisers that they are spending too much on their Yellow Pages advertising. Once the newspaper consultants have succeeded in persuading the advertiser to cut back on Yellow Pages spending, they then try to convince the advertiser to place some of the dollars "saved" in newspaper advertising.

213 Newspaper consultants first became active in Canada in 1987, having previously operated in the United States. One method used by the consultants was to hold seminars, sponsored by the newspaper that hired the consultants, to which Yellow Page advertisers were invited. A second method, apparently employed to a greater extent in recent years, is to locate good "prospects" among Yellow Pages advertisers (those with large or coloured Yellow Pages advertisements) and then visit them.

214 Newspaper consultant activity is not convincing evidence that newspapers and Yellow Pages are close substitutes. If Yellow Pages and newspapers were close substitutes, the newspaper's sales representatives would be fully familiar with Yellow Pages as part of the competitive environment. If the two media were close substitutes it would not be necessary for newspapers to hire outside "consultants" on a one-shot or periodic basis. Further, it would be expected that price discounting by the newspapers would be a more potent weapon than the rather circuitous approach of the use of consultants in regaining or capturing revenue from the Yellow Pages. The success of newspaper consultants depends on finding customers who are unhappy with Tele-Direct. An unmistakable implication is that such customers do not perceive other media as close substitutes for Yellow Pages, otherwise they would already have stopped or reduced their use of Yellow Pages.

215 Further, a successful newspaper consultant must convince the advertiser that a different, less costly Yellow Pages advertisement or set of advertisements will work *as well* as the existing Yellow Pages advertising. In other words, the question is how much does that advertiser really need to spend to have an effective advertisement *in the Yellow Pages*? This is borne out by the fact that a consultant's methodology involves two distinct steps. First, the Yellow Pages advertiser must be convinced that he or she can reduce Yellow Pages expenditures without prejudicing the results from the Yellow Pages advertising. Then, the newspaper consultant must try and sell the advertiser on spending the dollars saved elsewhere. But, this is clearly a second step. This is recognized even by Tele-Direct in a document referring to newspaper consultants:

> newspaper reps are recommending down-size YP and don't talk about newspapers (probably will go in later to make pitch). [102]

The advertiser, of course, may simply decide to pocket the savings. This process is not indicative of shifting of spending from one competing media to another. The restriction of the context to the Yellow Pages as the first step taken by newspaper consultants is a critical point in defining the relevant market. It indicates that what is occurring is not the allocation of the advertisers' overall advertising budget between newspapers and Yellow Pages but rather focusing on whether money can be saved in Yellow Pages advertising without regard to other media.

216 On the whole, the presence of newspaper consultants has been sporadic, sometimes in one local market and sometimes in another. In no case have they been continuously active in any local market. With respect to the actual success of the newspaper consultants, Ms. McIlroy testified that "they were never successful in doing any damage really of any kind, at least that we monitored. I never noticed any significant damage." [103] Mr. Giddings also testified that he could not quantify their impact. [104] This is telling evidence regarding Tele-Direct's response to the alleged "competition". The success of newspaper consultants could be easily tracked. They visit advertisers individually and try to convince them to adopt a specific advertising plan. In these cases it is perfectly clear to the Tele-Direct sales representatives why the customer is making changes in his or her program. No data was gathered by Tele-Direct on the impact of newspaper consultants, which would have been expected had Tele-Direct considered the effort worthwhile. It apparently did not.

• *Community Newspapers*

217 The respondents called one witness who represented community newspapers. Ginette Allard-Villeneuve of Quebecor testified that, in her opinion, community newspapers and Yellow Pages compete for the advertising budget and that the advertisements placed in each are "somewhat interchangeable". Since Ms. Allard-Villeneuve appeared to have very little familiarity with or knowledge about the Yellow Pages, it is evident that she is referring to a very attenuated form of "competition" between the two. The respondents do not, in fact, seem to be claiming anything more than that.

(iii) Conclusion

218 The evidence on inter-industry views and conduct indicates that there was some limited competition between Yellow Pages and other media, principally newspapers. When the form of this competition and Tele-Direct's response to it are contrasted with the kind of head-to-head competition that occurred in Sault Ste. Marie and Niagara Falls, where there was entry of competing broadly-scoped telephone directories, there are pronounced differences in the intensity of Tele-Direct response. [105] The same difference in intensity is found in Tele-Direct's failure to track its successes and failures relative to other media and its assiduous efforts to track the sales volumes of independent publishers that it had identified as competitors. Tele-Direct did collect anticipated prices of other media in setting its prices. However, these were broad estimates and the prices for electronic media, for which there is virtually no evidence of direct competition with Yellow Pages, are included. On the other hand, media which are closer (as opposed to "close") substitutes such as community newspapers and flyers are excluded. It is difficult to see the predicted price changes of other media as an important ingredient in Tele-Direct's pricing. In short, the evidence of inter-media competition supports the Director's position that Yellow Pages and other media are not close substitutes.

(d) Price Relationships and Relative Price Levels

219 There is little evidence that can properly be considered under this heading. Telephone directories and other media do not have a common standard of measurement that would allow valid price comparisons. While price comparisons were prepared for the use of Tele-Direct sales representatives, they were designed to show that Yellow Pages advertising was virtually non-comparable to other media (primarily newspapers). In any event, no common standard of measurement was used.

220 The respondents refer to two documents which purport to track a weighted average of annual price increases of other media and those of Tele-Direct over approximately a decade, along with the overall rate of inflation. [106] There is no rigorous analysis either in the internal documents of Tele-Direct or by the experts that would allow any conclusion to be drawn from these documents alone. Given that there are common economic forces driving prices even in very disparate industries, one would expect to see some correlation in overall price movement. An attenuated correlation in price movement does not indicate close substitutes. Even a high correlation between two sets of prices is only a *necessary* condition for the two products to be considered to be in the same market. But, it is not a *sufficient* condition to prove they are in the same market because other factors than substitutability may be responsible for the correlation.

(e) Switching Costs

221 There is no dispute that the costs of switching from one medium to another are relatively low.

(5) Conclusions Regarding Substitutability

222 Each of the indicia points in the same direction. We have little difficulty in concluding that telephone directory advertising is a distinct advertising medium without close substitutes. Directory advertising is a directional medium with a function distinct from that of creative media. Within the group of media considered to be directional, a review of the evidence regarding physical and technical characteristics, advertiser perceptions and behaviour, inter-industry competition and price relationships leads us to conclude that telephone directory advertising is a relevant product market.

B. Geographic Market

223 There is no dispute between the parties that the geographic market is local in nature, corresponding roughly to the scope of each of Tele-Direct's directories.

VII. Control: Market Power

224 The exercise of defining a relevant market is only a step towards answering the critical question of whether Tele-Direct has "control" or market power in that market. As the Tribunal has said on previous occasions, market power is generally considered to mean an ability to set prices above competitive levels and to maintain them at that level for a significant period of time without erosion by new entry or expansion of existing firms. In those cases, the Tribunal also recognized that where the available evidence does not allow the definition of market power to be applied directly, it is necessary to look to indicators of market power, such as market share and barriers to entry. [107]

225 The Tribunal has never ruled out the possibility, however, that direct indicators of market power might be available as evidence in an appropriate case. Direct indicators of market power relate to the performance of the firm or firms in question or to their behaviour. The broad question that is posed is whether the observed performance results (e.g., profits) or observed patterns of conduct (e.g., pricing policy) are more likely to be associated with a firm or firms that are competitive or with those that have market power. While there are difficulties in applying direct indicators of market power, if the evidence is available this avenue should not be excluded. In this case, the parties addressed both the indirect or structural approach to market power (market share and barriers to entry) and "other evidence" of market power of a more direct nature. The Tribunal will likewise address both avenues in that order.

A. Indirect Approach: Market Structure

226 Having determined that telephone directory advertising in local areas constitute relevant markets, it remains to determine Tele-Direct's market share and the conditions of entry into those markets. A large market share can support an initial determination that a firm likely has market power, absent other extenuating circumstances, in general, ease of entry. [108]

227 We will deal with the question of market power in the supply of telephone directory advertising, which includes both publishing and advertising services. The issues relating to the possible "subdivision" of the market into two (or perhaps more) component parts will be canvassed later in these reasons.

(1) Market Share

228 Based on Tele-Direct's November 1995 revenue estimates for independent publishers operating in its markets and the data on the record regarding its own published revenues for Ontario and Quebec for 1994, Tele-Direct (Publications) Inc. has approximately 96 percent share of telephone directory revenues in Ontario and Quebec. [109] It is instructive to note that, in 1992, a Tele-Direct document estimated the total *potential* sales of independent directories in Ontario and Quebec at $32 million. [110] That would indicate an upper limit on the potential growth of the independents of well under 10 percent of Tele-Direct revenues. The same year, Tele-Direct estimated the *actual* sales of independents at less than one-third of the "potential" amount set out.

229 The November 1995 estimates place the total revenues of the independents at slightly over one-half of what was described as their potential business in 1992. Even in Tele-Direct's worst case scenario regarding growth of independents, it would still be left with a market share of 90 percent.

230 Although there was no significant disagreement between the parties that the geographic markets are local in nature, largely corresponding to the scope of the relevant Tele-Direct directory, Tele-Direct's information on other publishers was presented for sales throughout the territory of Tele-Direct (Publications) Inc., namely Ontario and Quebec. No local market information was placed on the record except for the revenues of White and DSP in the Niagara and Sault Ste. Marie areas. White publishes a directory in each of Niagara Falls, St. Catharines and Fort Erie, as does Tele-Direct. DSP publishes one directory covering the area bounded by Sault Ste. Marie, Elliot Lake and Wawa in Canada. Tele-Direct publishes three separate directories for that

area. On the basis that in each of those two local markets the large independent and Tele-Direct are the only significant players, in the Niagara region based on 1994 revenues, Tele-Direct has a market share of about 85 percent, while in the Sault Ste. Marie region its market share is about 80 percent. [111]

231 Thus, even in the two markets in which Tele-Direct faces the most significant competition, its market share is still over 80 percent. In the absence of further detailed information on local market shares, which apparently even Tele-Direct does not compile, this fact, allied with Tele-Direct's overwhelming share of sales over its territory as a whole, leads us to conclude that Tele-Direct dominates telephone directory advertising in markets in Ontario and Quebec. *Prima facie*, we are of the view that Tele-Direct has market power based on its large share of the relevant market, absent compelling evidence of easy entry into the supply of telephone directory advertising.

(2) Barriers to Entry

232 In the absence of barriers to entry, even a single seller cannot exercise market power. Any attempt by the incumbent to price above the competitive level will attract immediate entry by competing sellers. We have concluded that Tele-Direct has a large share of the relevant market. Proof of easy entry would overcome the initial determination that Tele-Direct has market power in the supply of telephone directory advertising.

233 The parties have organized their arguments regarding barriers to entry under three headings, (a) observed entry and exit, (b) sunk costs and (c) incumbent advantages. We will use the same headings.

(a) Observed Entry and Exit

234 Observed entry into a market can provide some indication of the existence or non-existence and the nature of any barriers to entry. There is no dispute that entry into publishing a "niche" directory appears to be relatively easy. The Director has admitted as much, based on the large number of niche directories and the high level of observed entry and exit.

235 The Director argues that the smaller directories have captured only a "minuscule" portion of the market and that fact, combined with Tele-Direct's lack of competitive reaction to their presence, confirms that they are of little importance in constraining Tele-Direct's market power. Further, the experience of White and DSP confirms the existence of significant barriers to entry by a broadly-scoped directory.

236 The respondents submit that entry need not be on a large scale and that many independent publishers have entered on a small scale and then grown slowly, thus avoiding drawing a response from Tele-Direct. Although not directly stated, the implication is that the publishers that chose this strategy have become a competitive force in the market. They also point to White and DSP as proof that broadly-scoped directories have successfully entered, remain in the market and are even profitable.

(i) Niche/Smaller Directories

237 Relative ease of entry by niche directories is not particularly relevant to an assessment of Tele-Direct's market power as it is clear from the evidence that the presence of these directories has had and can have little competitive impact on Tele-Direct. There is no evidence of any response by Tele-Direct to the presence or entry of a niche directory. There is certainly no evidence that they currently limit Tele-Direct's pricing or encourage better service by their presence.

238 With the exception of directories published by White and DSP, virtually all of the independent directories cover smaller geographic areas than the directories produced by Tele-Direct. The Director is correct that these smaller directories account for only a small portion of the overall market (less than three percent by revenue). Further, level of activity of each of the smaller independent directories indicates why individually they are not a serious threat to Tele-Direct. If the directories of DSP and White are excluded, there are 279 other independent directories with estimated average annual sales of just over $51,000 each. Of these, the 30 Locator directories had by far the largest estimated average annual sales, of the order of $200,000 per directory. Mr. Renwicke thought that the largest Locator directory "could" be close to $1 million in revenue, which would make the remaining directories even smaller on average. The remaining 249 directories had estimated average annual sales of

approximately $33,000 each. In contrast, in 1995, the broadly-scoped DSP directory had estimated annual revenues of over $1 million while each of White's three broadly-scoped directories averaged over $500,000 in revenues.

239 The respondents spent some time with their witness, Mr. Renwicke, reviewing examples of directories of three independent publishers in support of their position that, instead of going "head-to-head" with Tele-Direct, an independent could enter small and gradually expand and still be a competitive force in local markets. The respondents referred specifically to the Easy to Read directory, the Locator directories and the Other Book. There are Easy to Read directories in about a dozen, mainly small, Ontario communities. Locator publishes some 30 directories in various small to medium-sized Ontario towns. The Other Book published ten directories, all in the Ottawa area, but is not published anymore. [112]

240 The argument focuses on the Easy to Read directory in Stratford, Ontario. It is described in the argument as an "impressive" directory. The fact remains, however, that it is of negligible size. The total revenues of all the Easy to Read directories are not even stated separately on the Overview of Other Publishers in Tele-Direct Markets. Presumably they are included in the group of "Other Publishers in Ontario (geographic)" which have average total annual sales of only about $31,000. Tele-Direct's 1994 revenues in Stratford were over 40 times that amount. [113]

241 Mr. Renwicke pointed out and made favourable comments about the features of the Locator directory entered in evidence, which included postal codes, audiotext [114] and community pages. He also described the Other Book, which had postal codes, amortization tables and a babysitter's guide as some of its features, as a "good-looking book".

242 Yet, despite the apparent quality of these directories, some of which contain features not offered by Tele-Direct in its directories, the respondents did not refer us to any evidence of Tele-Direct reacting to their presence in a way that would indicate that they were actually a competitive concern, in the sense of providing some discipline on Tele-Direct's quality and pricing. It is indisputable that Tele-Direct is aware of the presence of these independents and to some extent monitors their progress. That is not, in our view, evidence that these directories are a competitive force in the market. There is no indication on the record before us of any positive reaction of the type that occurred when DSP and White entered. Other than the existence of the competitive database and Mr. Renwicke's opinions, the respondents referred only to a 1993 presentation by Mr. Renwicke to the Tele-Direct board which provided information on independents and named White, DSP and Locator.

243 Moreover, even if there was evidence of some competitive response by Tele-Direct to niche directories this by itself would hardly be sufficient to conclude that Tele-Direct did not have market power given its overwhelming market share. The smaller or niche directories are, by their very nature, limited in scope and influence. Thus, although entry on this scale is easy, up to a point (since each new entrant must find a new "niche" and there is a limited number), entry by smaller directories does not limit Tele-Direct's market power.

(ii) Broadly-Scoped Independent Directories

244 The conditions of entry by a broadly-scoped independent directory covering an area similar to the corresponding Tele-Direct directory, which will compete head-to-head with Tele-Direct, are highly relevant to the question of market power. Tele-Direct's responses to the entry of broadly-scoped directories in the Niagara and Sault Ste. Marie areas indicate that only such head-to-head competition has the potential to produce the benefits to consumers that one looks to competition for, namely lower prices and better products and services.

245 Can entry by publishers of broadly-scoped directories be considered sufficiently easy so that Tele-Direct is unable to take advantage of its large market share? Additionally, assuming that entry of a single competing publisher were to occur, would this assure that Tele-Direct would no longer have market power because of either the intensity of competition or easy entry conditions for additional publishers? The respondents urge us to conclude that because White and DSP managed to enter in particular markets and have remained in business, entry barriers are low enough that Tele-Direct has no market power. We decline to place so much emphasis on two isolated instances of entry in answering these questions. To answer both questions properly, we must review the arguments on entry conditions for broadly-scoped independent directories in some detail.

(b) Sunk Costs

246 The Director argues that sunk costs are a barrier to entry as they are perceived by potential entrants as unrecoverable if entry is unsuccessful. The respondents submit that, based on the Tribunal's decision in *Southam*, sunk costs alone are not enough. In *Southam*, the Tribunal held that neither sunk costs nor economies of scale were themselves sufficient to create an entry barrier but that together they were.[115] The respondents contend that the other source of a barrier to entry identified by the Director in this case, namely incumbent advantages, is not like economies of scale and does not operate with whatever sunk costs are present to create entry barriers in the sense required by *Southam*.

247 We agree that *Southam* held that sunk costs or economies of scale individually are not sufficient. That decision, however, should not be taken to mean that the combination of sunk costs and economies of scale is the only way in which sunk costs can form part of a barrier to entry. What is important is whether the market in question is one in which the potential entrant faces the risk that the post-entry conditions will be less favourable than pre-entry conditions because of the likely response of the incumbent. Thus, in *Southam*, the presence of sunk costs and economies of scale meant that there was a credible threat that the incumbent would maintain output in the face of new entry even if doing so drove prices down towards cost.[116] This acted as a deterrent to entry.

248 In this case, therefore, it will be necessary to ask, first, whether there are in fact significant sunk costs associated with directory publishing. Then, we must determine whether the nature of the market is such that prospective entrants face a credible threat that the incumbent will respond in a manner that will make entry unprofitable given the existence of the sunk costs.

249 Sunk costs are defined as the part of the investment required for entry that cannot be recovered in the event that the attempt fails. Assets that are of value only to a specific enterprise are sunk and those that are of value to other firms are not sunk, or only partially sunk. The Director submits that entry into the directory business requires substantial sunk costs: acquiring and compiling subscriber listing information, assembling advertising enhancements), training the sales force and promoting the directory. The respondents admit that there is no doubt that there are "some" sunk costs associated with publishing a directory for the first time but submit that the Director has overstated the sunk costs. They say the sunk costs are not, in fact, significant. However, the evidence of the witnesses from White and DSP, which was not contradicted, amply supports the premise that the activities listed must be carried out in order to produce a directory and that the costs incurred are substantial.

250 DSP and White both entered by publishing a "prototype" directory. With a prototype directory, the publisher offers advertising in the directory at no charge. The prototype is distributed to consumers and the publisher then has a history of usage to give it credibility in selling advertising in its next directory. The respondents argue that the sunk costs are substantially increased when an independent publisher chooses to enter by publishing a prototype because there are no advertising revenues to offset the costs. They say that the extent of the sunk costs is within the control of the entrant and a different entry strategy would generate lower sunk costs.

251 Establishing usage and selling advertising are inextricably linked for a directory publisher. As stated in the 1993 Simba/ Communications Trends study, achieving credibility among local advertisers is one of the biggest hurdles that a publisher must overcome.[117] It was precisely in order to overcome the credibility concerns of advertisers that both DSP and White chose initially to publish a prototype directory. Entering with a paid directory does not eliminate the credibility problem and achieving credibility, by whatever means chosen, involves costs. We have no basis on which to conclude, as urged by the respondents, that it would have been less costly overall for White and DSP to enter first with a paid directory.

252 The respondents also submit that if the entrant chose to enter with an initial paid directory, it could avoid the cost of publishing entirely if a sufficient volume of business was not confirmed during the canvass and it then abandoned its plans to enter. While we agree that the only way to avoid the costs of producing a directory is to abandon the project, we do not agree that this is a strategy that could be used with impunity by would-be entrants. The mere possibility that such a strategy could be employed exacerbates the credibility problems facing a would-be entrant, and in the event it were employed, would detrimentally affect any prospects for the same firm or other firms to attempt entry in another market.

253 Recognizing that there are sunk costs involved in entry into directory publishing, do those sunk costs amount to a significant barrier to entry? We are of the opinion that those sunk costs do create a barrier to entry when a broadly-scoped directory is introduced because the entrant publisher is going "head-to-head" with the telco's directory. In those circumstances, the incumbent will respond and post-entry conditions will be less favourable for a would-be entrant than pre-entry conditions. As the Simba/Communications Trends study noted, under the heading "Disadvantages of Large, Head-to-Head Directories", "[u]tilities are willing to 'pull out the big guns' to protect large bread-and-butter markets."[118] It is not disputed that when White and DSP entered into Tele-Direct's markets with broadly-scoped directories, Tele-Direct responded with price freezes, incentive programs, enhancements and promotional campaigns. Thus, the combination of sunk costs and likely response by the incumbent create a significant entry barrier and entry would not necessarily occur even though Tele-Direct was pricing above competitive levels.

(c) Incumbent Advantages

(i) Subscriber Listing Information

254 Would-be entrants into the directory business do not have access to subscriber listing information from the telcos on the same terms as Tele-Direct. Access to subscriber listing information by independent publishers has been the subject of some controversy and has been dealt with on several occasions by the CRTC. In 1992, the CRTC ordered greater access to the subscriber listing information in the hands of Bell Canada. Because of the price of the information, and other conditions imposed on its distribution, this decision did not result in commercially viable access to the information. Both White and DSP witnesses testified that they were forced to wait until the Tele-Direct directory was published and then re-key, verify and update the listings to use in their own directories, a costly and time-consuming process.

255 In March 1995, the CRTC revisited the matter at the request of White and liberalized the availability of listing information, including reducing the price that could be charged by Bell Canada. There was no indication from the White or DSP witnesses who appeared before us of any problem with the 1995 resolution by the CRTC of the price and availability issues. Richard Lewis, the Executive Vice-president and Chief Executive Officer of White, stated, in fact, that White was very satisfied with that aspect of the decision.

256 The CRTC added an important proviso, however, when it ruled that consumers who wanted to opt out of having their listings sold to a "third party" could do so. From the point of view of the independent directory publishers, this caused a problem because the CRTC did not distinguish between types of "third parties". Thus, the independent publishers were grouped in with, for example, telemarketers, to whom many consumers would not want their information to be released. The 1995 decision was stayed pending an appeal to Cabinet which, in late June 1996, overturned that portion of the CRTC ruling.

257 In light of the Cabinet decision, which was rendered after the close of the hearing in this matter, the Tribunal invited further submissions from the parties regarding the impact of that decision on their respective positions. The respondents submit that the Cabinet decision has removed the only barrier to entry into publishing. The respondents point to Mr. Lewis's statement that after a favourable decision from Cabinet, White will proceed with additional directories in the Toronto/Niagara area. The Director agrees that the Cabinet decision will likely reduce *one of* the barriers to entry into directory publishing but maintains that there are still other, significant barriers into the market. The Director refers to the United States situation where, despite access to subscriber listing information for several years, independents have less than seven percent of total industry revenues.

258 The only evidence before us is that the issues of importance to the independents, availability, price and opting out, have been dealt with satisfactorily to them. We conclude that, at present, subscriber listing information cannot be considered to be a significant barrier to entry.

(ii) Reputation/Affiliation with Telco

259 An entrant into directory publishing has the related tasks of convincing users of the value of its directory and of convincing advertisers that it is a worthwhile vehicle in which to advertise. The directory will only be widely used if it has

a critical mass of advertising in it. If the directory is not widely used, few businesses will advertise in it and, in the absence of advertising by its competitors in a new directory, there is no pressure on a potential customer to advertise itself in the new directory. This is not a problem that Tele-Direct ever had to face because of its (or Bell Canada's) longstanding presence in the market as the only available directory. In addition, Tele-Direct benefits from its affiliation with a large and established telco which lends a certain authenticity.

260 To overcome the preference of advertisers for the incumbent directory requires enhanced expenditures on advertising and promotion and lower prices by the entrant. There is numerical evidence on the disadvantage of entrants *vis-à-vis* the incumbent only with respect to lower prices. The Simba/Communications Trends study of the directory industry in the United States revealed that in the top 10 competitive markets, the average telco (utility) rate for a double-half column was 53 percent higher than for independent publishers competing head-to-head in those markets. The average cost of advertising, per thousand of circulation, for the utility directories was 46 percent higher than for the independents. [119]

261 Mr. Lewis of White stated that his company usually plans on pricing about 40 percent lower than the telco directory in a market they are considering entering. Gary Campbell, the General Manager of DSP, testified that on average their prices were 30 percent less than those of Tele-Direct. A comparison of published prices between Tele-Direct and the initial White and DSP directories confirms these general statements although price differences vary considerably between types of advertisements. [120]

262 In both markets, the entrants had invested in introducing new features (enhancements) into their directories that Tele-Direct had not hitherto introduced. For example, White's Niagara region directories included the following features not previously offered by Tele-Direct: free smaller size copy in addition to the regular size directory (a "mini"), audiotext, extensive community pages which provide information of regional or local interest, [121] larger size print, three column format instead of four, postal codes included in the white pages, additional colour in the advertisements. DSP also included many of the same enhancements in its directories plus other, unique, features. [122] Thus, any advantage enjoyed by Tele-Direct clearly stemmed from its incumbency and its affiliation with Bell Canada and not from the superiority of its product.

263 Based on White's experience in the United States, it appears that the rate differential between the independent and the telco does narrow over time but still remains significant. Mr. Lewis testified that in Buffalo, New York, where White has published for 27 years, its prices are still 25 to 33 percent less than those of the telco directory.

264 As part of the survey resulting in the January 1993 Elliott report, customers of Tele-Direct were asked if they would advertise in a competing directory if it offered 15 percent lower prices. Only 36 percent said that they would advertise in the new directory and a mere eight percent that they would discontinue advertising in Tele-Direct's directory. [123] As indicated by the United States data and the experience of White and DSP, to attract a significant number of advertisers the entrant would likely have to offer discounts closer to 50 percent than to 15 percent.

265 Based on both the particular experiences of White and DSP in entering Tele-Direct's markets and the more general evidence relating to the United States experience, it is our conclusion that an incumbent directory publisher's "reputation" or affiliation with a telco constitutes a significant barrier to entry into publishing a competing broadly-scoped directory. An important part of this barrier is the advantage that the incumbent directory has because it already contains the advertisements of a business's competitors. A new entrant must overcome that fact in seeking to persuade the business to advertise in its new directory. New entrants must offer substantial price discounts, even when they are publishing a product with features not included in the incumbent's directory.

(iii) "Yellow Pages" Trade-mark

266 The words "Yellow Pages" and "Pages Jaunes" and the "walking fingers" logo are both registered trade-marks of Tele-Direct in Canada. Tele-Direct only licenses those marks to publishers which are affiliated with other telcos. The same words and the logo are in the public domain in the United States.

267 As attested to by Mr. Lewis, it probably would have been easier for White (and DSP or any other entrant) to explain the nature of the product it was seeking to introduce in the Canadian market if it had been permitted to use the marks, which have a high level of public recognition, as it can and does in the United States. In fact, Mr. Lewis would have paid a "substantial" fee to use the marks in Canada. The trade-mark situation appears to confer some marketing advantage on Tele-Direct and reinforces the other barriers already discussed.

(iv) Strategic Behaviour

268 Under this heading, the Director first refers to the anti-competitive acts being alleged in a later portion of the argument regarding other publishers. Paragraph 120 states that

> ... It was Tele-Direct's objective to "make competition expensive" and "raising the bar" to entry and it succeeded.

The only way in which we could determine if the strategic behaviour referred to constitutes an entry barrier would be to assess the effects of that behaviour on the market. The Director did not deal with evidence of effects in relation to the issue of market power. The alleged anti-competitive acts regarding publishers will, of course, be dealt with in due course.

269 The Director also argues that the alleged anti-competitive acts in respect of services are relevant to entry conditions into publishing. It is submitted that one of Tele-Direct's objectives was to reduce the power of the specialized agencies in order to make it harder for new entrants into publishing to gain market share. If it had been proven that some Tele-Direct policy or initiative against agents did indeed have a deleterious effect on new publishing entrants, this would be relevant to our assessment of entry barriers. We are of the view, however, that the limited evidence provided on this point does not prove that there were such effects.

(3) Conclusion

270 We are of the view that even with subscriber listings available to independent publishers on reasonable terms, significant entry barriers in the form of the reputation effects and sunk costs reviewed above will remain. The condition of easy entry required to overcome the presumption of market power arising from Tele-Direct's extremely large market share is not satisfied.

B. Direct Approach: Other Evidence of Market Power

271 As other evidence of market power the Director relies on the high profits earned by Tele-Direct, its lack of responsiveness to customer needs, and an allegation that it has lagged behind other media in supporting agents, in promoting the product and in using technology to process advertisements received from agents. We are of the view that there is insufficient evidence on the record, and that the question was not explored in sufficient depth, for us to draw a conclusion one way or the other regarding the allegation of lagging behind other media. The evidence regarding profitability and customer dissatisfaction, however, is extensive.

(1) Profits

272 The respondents acknowledge at paragraph 41 of their response that Tele-Direct earns very large accounting profits. It is also undisputed that Tele-Direct pays 40 percent of its collected revenues directly to Bell Canada and a similar percentage to the other telcos with which it contracts to publish a directory. This payment is said to be in return for access to subscriber lists and for services. The evidence revealed that the only service provided by the telcos is billing.

273 Where the respondents and their expert, Professor Willig, differ from the Director is with respect to the significance of Tele-Direct's admitted profitability as an indicator of market power. The respondents' argument first points out the well-known concerns about trying to convert accounting to economic profit. While we recognize the validity of those concerns in general, we do not consider that they apply with much force to the most compelling evidence of profitability, the payment by Tele-Direct to Bell Canada. That payment is a set percentage of collected revenues. It is not an accounting "profit" figure or a "bottom line" amount produced by the application of accounting conventions. Therefore, we are of the view that an examination of the

payment to Bell Canada and its possible implications for market power is not clouded by accounting conventions at the outset. The presence of such a payment indicates that Tele-Direct has revenues of at least 40 percent over its recorded costs.

274 Professor Willig took the position that the profits which allow Tele-Direct to make the payment to Bell Canada reflect a return on intangible capital which is a necessary investment in the creation of the profits. In his rebuttal affidavit he stated:

> 46. ... 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 trade-marks, 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.... [124]

275 In other words, Tele-Direct is only earning the requisite return on its intangible assets to remain in business and not any kind of economic rents. Professor Willig returned in his oral testimony to the example of a magazine and its intangible assets which create a loyal readership. We have some difficulty seeing the same effect at work with a directory which has no editorial content, unlike a magazine. There may be creativity in the way the directory is assembled so it is of maximum utility to consumers but the evidence was that Tele-Direct lagged behind new entrants like White and DSP in this respect.

276 When asked specifically about the intangible assets or activities of Tele-Direct, Professor Willig responded:

> Evidently ... there is some value to having, and having had, the "utility" franchise in a given area. If one tries to translate that into what it means today or next year, the operative word really is "reputation", and the reputation is of significance both to advertisers and also to consumers who have to decide whether to pick the book up or not and, if so, which book to pick up. Somehow that reputation attaches to that book because of its heritage, its history, evidently, and also to its identification with the current telco.
>
> . . .
>
> I agree ... that it is hard to reach out and grab that reputation. But if we think about the character of the directory business ... the notion that, if you are an advertiser and you are being asked to pay for an ad in advance of the completion of the book and in advance of evidence about what consumers are going to do in terms of using it, then you have to reach, as an advertiser, an expectation, an anticipation of how good the book is going to be.
>
> You have to form an image in your mind before you commit yourself to your advertising expenditure: Is everybody going to use this and will the other advertisers take ads in it? If they don't, then consumers won't use the book and, if consumers don't use the book, then my ad which I am being asked to pay for today won't have its exposure.

> The key to the underlying value proposition of the advertiser is the anticipation that 18 months later or 12 months later the book is going to be out and it is going to be a really good book and people are really going to use it.
>
> It is unusual that you can't really tell the value of what it is you are buying until it is done and many months have passed.... [125]

277 There are several difficulties with this hypothesis. First, on a factual level, there is evidence that Tele-Direct's advertisers (except the small group using agencies) do not pay for their advertising 12 to 18 months in advance. Monthly billing commences once the directory is published. Advertisers pay in instalments (interest free) after publication.

278 Second, Professor Willig emphasized that the key to the value of Tele-Direct's reputation asset was the anticipation that advertisers have that the directory is going to come out and will be a "good" directory that people are actually going to use. Surely all local media, which the respondents postulate are close substitutes for telephone directory advertising, face the same challenge in selling time or space to advertisers. Rather than paying Tele-Direct at a level that allows Tele-Direct to earn a 40 percent premium, would not advertisers simply switch to one of the other alleged close substitutes? Tele-Direct's premium would soon disappear in that scenario.

279 If, on the other hand, telephone directory advertising is somehow unique because of the close link between a critical mass of advertising in the directory and use of the directory by consumers, then this uniqueness argues against other media being close enough substitutes to provide competitive discipline. Tele-Direct's ability to exploit its association with the telco to earn returns well above its costs would then indicate market power in the market for telephone directory advertising. This latter scenario is more in accordance with the other evidence on the record which reveals that as between the telco directory and other *directory* publishers, the fact of association makes a significant difference. As was already discussed above, one cannot attribute the premium to Tele-Direct having a "superior product" to other telephone directory publishers in terms of the features of the directory. If it had a superior product, Tele-Direct would not concern itself with competing directories, which it does, and the only evidence before us was that the entrants like White and DSP were initially the superior product, until Tele-Direct responded to their enhancements.

280 Further, Professor Willig's theory of profits as a return on intangible assets cannot co-exist with the respondents' pleading that Tele-Direct's profits go to cross-subsidize Bell Canada's local telephone service as set out in their second amended response:

> 20. ... What was initially conceived as an essential but costly feature of telephone service has become a lucrative revenue source for the telcos....
>
> 21. In Ontario, for example, T-D Pubs pays each of the independent telcos with which it contracts 43% of the gross revenue collected from subscribers of the telco who advertise in the telephone directories. In the case of T-D Pubs, this revenue source, as well as the entire net income of T-D Pubs, are included by the CRTC in Bell Canada's revenues to reduce the cost of local service. Each residential telco subscriber in Ontario and Quebec receives a subsidy of over $2 per month as a result of the revenues captured through telephone directory advertising.

281 Bernard Courtois, Vice-president, Law and Regulatory Matters for Bell Canada, explained:

> ... So, both the commission revenues from Tele-Direct [the 40 percent] and all the net income of Tele-Direct, that is equivalent to adding $284 million to the revenues of Bell Canada in 1994 for regulatory purposes. Divide that by the number of residential subscribers and it amounts to $3.38 per month on the average residence telephone bill.
>
> I should say that the average residence basic telephone bill in Bell Canada with Touchtone is about $12.75. So, if you didn't have the Tele-Direct activities going on, that bill would have to be more than $16.00. Of course, if Tele-Direct were a completely arm's length company, we would still get some of that commission revenue.
>
> . . .

> Q. I think you did point out that in any telco basically they always collect some of this profit through the 40 percent. I mean every telco seems to collect that so they all get subsidized in that way by publishers. Is that what you were saying?
>
> A. That's correct, and I should point out that it's a very large part. I guess the commission revenues might be two-thirds and the net income one-third of that subsidy.... [126]

282 George Anderson, who was previously with NYNEX, described a similar situation in the United States. He testified that the utility directory publisher has to "impute" a substantial portion of its income, over and above the cost for subscriber listing information which has been widely available for some time in that country, back to the telco to help defer the cost of telephone service. In his words:

> The [AT & T] consent decrees ... took an unregulated business, which was Yellow Pages, and at the ninety-ninth hour put it in with the regulated segment of the business to serve as a cash cow, not my words, to serve as a funding business that would help defray, defer, hold down the rate of return and hold down the cost of telephone service. [127]

James Logan, currently President of YPPA and formerly with US West, confirmed this view.

283 We observe that if all Tele-Direct and other telco directory publishers were earning was a competitive return on all assets, including intangibles, the telcos would not have "profits" available to use for a completely different purpose, namely cross-subsidization of local telephone service. Unless intangibles are to be treated as a *deus ex machina* to explain away high economic profits, they must be identifiable, as must be the activities resulting in their creation. Otherwise, simply asserting "intangibles" would always preclude high profits from demonstrating market power. We cannot accept an approach leading to such a conclusion. Intangibles that can account for *apparent* high economic profit are the result of activities that are extraordinarily successful, such as those creating new products or ways of doing things better than others. In contrast to the example of successful magazines cited by Professor Willig, there is no evidence of this in the case of Tele-Direct or the other Yellow Pages publishers. Moreover, the fact that there is such widespread subsidization of telephone services by Yellow Pages publishers associated with telcos strongly suggests that the source of the subsidies is not any outstanding effort on the part of individual publishers.

284 The Director also argues that the fact that new entrants view the market as potentially profitable, even given the large price discounts off Tele-Direct's prices that they must offer and the other expenses they must incur to establish their own credibility or reputation, is an objective measure of Tele-Direct's profitability. We agree that market participants are responding to economic profit rather than to accounting profit.

285 We conclude, therefore, that the payment to the telcos by Tele-Direct is a form of "economic rent" whose value depends on the surplus that can be earned from publishing a directory associated with a telco. The cost to the telcos of providing the subscriber listings and doing the billing is minimal. The listings are a by-product of supplying telephone service and the billing for advertising is incorporated into the subscriber's monthly telephone bill. While it is true that it would be more costly for Tele-Direct to do the billing itself, it is unlikely that it would cost, at most, more than a few percent of revenue. [128]

286 In the face of competition from other media the amount that Tele-Direct could afford to pay, and that the telcos could demand, would be considerably less. With sufficient competition the payments to the telcos would disappear entirely. Even if Tele-Direct earns no economic profit on its operations beyond what it pays out to Bell Canada, its price to average cost margin is extraordinarily high. While no benchmark was placed in evidence, merger guidelines, both in the United States and Canada, place products in separate markets if their existence would not prevent a hypothetical monopolist, post-merger, from increasing prices by five percent. Even allowing as much as two percent for mailing costs, one is left with a margin of 38 percent. We are of the view that the evidence of economic rents provides a direct indication of Tele-Direct's market power.

(2) Dissatisfied Customers

287 The Director submits that the respondents' actions towards the advertisers, their customers, display market power. Reference is made to Tele-Direct's requirement that advertisers give up copyright in their advertisement, its restrictions on group advertising and evidence of low customer satisfaction in general. There is evidence, in the form of studies like the Elliott reports and the presence of consultants, that a significant percentage of Tele-Direct customers are less than happy with the service provided by Tele-Direct. We reviewed the evidence to this effect in the section on Market Definition when dealing with the arguments of the respondents which emphasized the low degree of customer satisfaction. As a direct indicator of market power, however, we are reluctant to rely on customer dissatisfaction because of the practical difficulties in applying such a subjective test.

(3) Other: Pricing Policies

288 In addition to the evidence of profitability advanced by the Director, the Tribunal is of the view that Tele-Direct's approach to setting prices supports the conclusion that Tele-Direct is behaving more like a firm with a comfortable margin of market power than a firm facing close substitutes. We note Professor Willig's point that evidence of price discrimination, in isolation, would not reliably indicate market power. In combination with the other evidence it is, however, compelling. Two aspects of Tele-Direct's price-setting policy are important: the premiums charged for colour and larger size (price discrimination) and the effort to equalize price per thousand across geographic markets (circulation alignment).

(a) Price Discrimination

289 As we reviewed in the section on market definition, colour and increased size are more valuable to advertisers who rely more heavily on the Yellow Pages. In broad terms, these are advertisers whose business involves infrequently purchased or emergency services (e.g., plumber, exterminator, mover, auto repairs, lawyer), infrequently purchased, expensive durables where comparison shopping is likely (e.g., cars, major appliances), services used by travellers (e.g., car rental) or which encourage orders by telephone (e.g., pizza, lumber yard with telephone order business). They need to attract attention in the Yellow Pages so that a consumer is drawn to their Yellow Pages advertisement as opposed to the Yellow Pages advertisement of their competitor. In our view, Tele-Direct systematically price discriminates against advertisers who are heavily reliant on the Yellow Pages through its pricing of colour and size and its ability to do so is direct evidence of market power.

290 Tele-Direct charges a 50 percent premium to add red to an advertisement. This premium is unrelated to costs of production. The representative of one of the independent publishers testified that at a 50 percent premium, a publisher would be realizing a very high profit margin. In other words, the additional printing and production costs are well below the price charged.

291 Ms. McIlroy explained that the object of Tele-Direct's pricing of colour at a premium is to control its penetration to ensure that it will be sufficiently uncommon so that the coloured advertisements "stand out" on the page. The price is set high enough that everyone will not buy it. In the same vein, Tele-Direct introduced multi-colour in those markets where there was already a lot of red in the directories as an alternative way of allowing advertisers to "stand out". This is not the kind of pricing policy that can be pursued by a firm under competitive pressure because its competitors would simply charge a lower price to take advantage of the profit opportunity and compete away the premium.

292 Further, the premium for red is largely invariant across local markets. It is difficult to see how there could be such uniform pricing in the face of "competition" from other local media, which would vary from market to market. Tele-Direct's pricing of red can hardly be seen as a response to these prices but is much more consistent with a company concerned only about its own, unique environment.

293 Based on the evidence before us, there is similar uniformity and lack of relationship to cost in Tele-Direct's pricing of larger advertisements. A comprehensive Tele-Direct rate card was not placed in evidence. In the 33 local markets included on the excerpt from the YPPA rates that was tendered as an exhibit, the price increases by about 90 percent for each doubling of advertisement size from a quarter column (1/16 page) to a double quarter column (1/8 page) and from a double quarter column to a double half column (1/4 page).[129] As in the case of colour, the evidence revealed that the additional costs of producing

larger advertisements do not appear to justify the increase in price. Based on cost, one would expect a discount greater than ten percent for an advertisement twice as large.

294 The respondents do not dispute that Tele-Direct's premiums for red and for size cannot be explained by additional costs. Counsel conceded in argument that those were the facts but argued that Tele-Direct was engaging in "value pricing". He hypothesized that an advertiser buying a larger advertisement might get ten times the results that would have been obtained with a smaller advertisement and, therefore, paying almost twice as much for the larger advertisement is actually a bargain. The larger advertiser, the argument goes, is getting more value out of the medium. Value pricing is not a phenomenon readily associated with a competitive market, the hallmark of which is pricing which is ultimately cost-driven. [130] Value pricing is more likely to be associated with a regulated monopolist and is more an indication of the presence of market power than of its absence.

295 The ability of Tele-Direct to discriminate against customers who spend *more* on advertising by way of larger or coloured advertisements is of particular importance in assessing whether Tele-Direct lacks market power *because* other local media provide close substitutes for Yellow Pages, as argued by the respondents. Larger Yellow Pages advertisers have greater choice among the allegedly competitive media since, by definition, they have more dollars in Yellow Pages that they can switch to any other media. Smaller advertisers are less likely to be able to afford the full range of other media. While it may be true, as Professor Willig pointed out, that certain vehicles, such as community newspapers or church calendars might be more acceptable to smaller advertisers, there is no denying that, from a budget point of view, larger advertisers have more options. Thus, larger Yellow Pages advertisers should have the more elastic demand if there are, as the respondents argue, close substitutes to Yellow Pages. The fact that Tele-Direct's margin over cost increases with enhanced expenditures on colour and size indicates the opposite. The anomaly of Tele-Direct being able to price discriminate against advertisers who at first blush have the greatest range of options underscores its market power.

296 The two broadly-scoped independent publishers, White and DSP, also charge some premiums for colour or size, although neither charges a premium as high or as consistent across the board as Tele-Direct's. [131] Certainly, no one has suggested that either White or DSP has market power. Yet, Mr. Campbell provided the same explanation of DSP's pricing of red, for example, as Ms. McIlroy did -- that it is priced above incremental costs to ensure its scarcity. Does the independents' use of some premiums for colour or size imply that Tele-Direct has no market power? We think not. The presence of two publishers in Sault Ste. Marie and Niagara certainly does not indicate a "competitive" market.

297 The evidence regarding the independent publishers does not detract from our view that Tele-Direct's ability to price discriminate is evidence of market power. Although the independents can, to a much more limited extent, implement some of the same pricing policies, this is not surprising. Tele-Direct prices in each local market create an "umbrella" beneath which the new entrants can shelter which underlines that Tele-Direct has market power sufficient to create the umbrella.

(b) Circulation Alignment

298 Since 1987 (or for 1989 prices onwards), Tele-Direct has actively pursued a policy of "circulation alignment" in calculating its annual price increases. The only exception was in 1992 (for 1994 prices) when poor economic conditions resulted in a zero price increase across the board. The objective of this policy was to bring about consistency in cost per thousand or CPM between directories. Some directories had experienced rapid growth in circulation but since they were subject to the same general price increases as other directories which had not grown as much in circulation, their CPM or price relative to circulation was substantially lower. Ms. McIlroy referred to the Mississauga directory as one in which the rates were seen as too low given the circulation of the directory. A program was therefore instituted to bring the CPMs in all markets into line over a number of years by imposing additional price increases (but not price decreases) in particular local markets.

299 In applying the alignment policy absolutely no allowance was made, or is made, for differentials in the intensity of competition from other media in each local market. The entire process can be described as a very bureaucratic one and certainly not what one would expect if Tele-Direct was forced to respond to varying degrees of competitive pressure in the numerous (approximately 100) local markets where it operates.

300 Professor Willig conceded that this "bureaucratic" approach to pricing and apparent indifference to local market conditions was puzzling but theorized that it could result from Tele-Direct's connection to a utility company. Utilities come from a culture of regulation where pricing flexibility is frowned upon. Further, if individual sales people were given latitude to discount to individual customers, the result for a large organization like Tele-Direct would be chaos.

301 Pricing individually by customer goes well beyond responding to the supposedly competitive media in a local market and thus does not directly address the point. The regulatory "culture" of utilities, is, of course, undeniable. What is more pertinent is how Tele-Direct could maintain such a culture in the form of its approach to pricing in the presence of the alleged close substitutes. If its bureaucratic price-setting led Tele-Direct to set a price too high in a particular market, surely it would see a dramatic revenue loss to other media and would quickly change its approach. There is no evidence that this has happened.

(4) Conclusion

302 The other direct evidence of market power advanced by the Director along with Tele-Direct's pricing policies affirm our previous conclusion based on the indirect approach that Tele-Direct has market power in telephone directory advertising.

VIII. Tied Selling

A. Introduction

303 Tying or "tied selling" is dealt with in section 77 of the *Competition Act*. The relevant parts of section 77 are:

> (1) ... "tied selling" means
>
> > (a) any practice whereby a supplier of a product, as a condition of supplying the product (the "tying" product) to a customer, requires that customer to
> >
> > > (i) acquire any other product from the supplier or the supplier's nominee, or
> > >
> > > (ii) refrain from using or distributing, in conjunction with the tying product, another product that is not of a brand or manufacture designated by the supplier or the nominee, and
> >
> > (b) any practice whereby a supplier of a product induces a customer to meet a condition set out in subparagraph (*a*)(i) or (ii) by offering to supply the tying product to the customer on more favourable terms or conditions if the customer agrees to meet the condition set out in either of those subparagraphs.
>
> (2) Where, on application by the Director, the Tribunal finds that ... tied selling, because it is engaged in by a major supplier of a product in a market or because it is widespread in a market, is likely to
>
> > (a) impede entry into or expansion of a firm in the market,
> >
> > (b) impede introduction of a product into or expansion of sales of a product in the market, or
> >
> > (c) have any other exclusionary effect in the market,
>
> with the result that competition is or is likely to be lessened substantially, the Tribunal may make an order directed to all or any of the suppliers against whom an order is sought prohibiting them from continuing to engage in ... tied selling and containing any other requirement that, in its opinion, is necessary to overcome the effects thereof in the market or to restore or stimulate competition in the market.

304 A tie is the supply of one product *on the condition that* the buyer takes a second product as well *or* on terms that *induce* the buyer to take the second product as well. Such an arrangement may be prohibited by the Tribunal under section 77 if it meets all the other requirements of that section, namely that the tying is a practice engaged in by a major supplier and results in a

substantial lessening of competition. The requirement that Tele-Direct must be a major supplier is satisfied by our earlier finding of market power in the telephone directory advertising market. The other requirements of the section are still to be resolved.

305 The Director alleges that the respondents have engaged in a practice of requiring or inducing customers for advertising space in telephone directories (the tying product) to acquire another product, telephone directory advertising services (the tied product), from the respondents. The Director further alleges that the practice of tied selling has impeded entry into or expansion of firms in the market resulting in a substantial lessening of competition.

306 The advertising space or publishing business is described at paragraph 9 of the application as including:

> ... all matters relevant to the provision of advertising space in a directory, including access to a subscriber data base (including information relating to new subscribers) upon which the books are based, compilation, physical creation of hard copy, printing, promotion and distribution.

The advertising services business refers to:

> ... the provision of services relating to the sale of advertising space in a telephone directory, including establishing new customers, calling on customers, and providing advice, information and other services relating to the design, cost, content, location, creation and placing of the advertisements.

The Director further states that the purchaser of an advertisement in a telephone directory obtains two products related to the two businesses: advertising space and advertising services.

B. Facts

307 Before we proceed further, it is necessary to review some facts relevant to the supply of advertising services to Yellow Pages advertisers.

(1) Tele-Direct's Internal Sales Force

308 Tele-Direct sells telephone directory advertising through its internal sales force. This group is sub-divided into those representatives who deal with customers over the telephone ("tel-sell") and those who attend at the customers' places of business ("premise"), together called the general sales force or "GSF". The premise sales representatives travel from place to place during the year to canvass advertisers for a particular area or directory within a confined time frame. In 1994, premise sales accounted for about 60 percent of the revenues generated by Tele-Direct's internal sales force, while tel-sell generated less than 30 percent of revenues.

309 A further category of sales representatives, sometimes included as part of the GSF and sometimes considered apart from it by Tele-Direct, is that which services so-called "national accounts". These representatives are called national account managers ("NAMs") or national account representatives ("NARs"). This group accounts for the remaining approximately 10 percent of revenues.

310 There are no hard and fast rules governing which accounts are handled by the NAM/NAR group as opposed to the remainder of the GSF. Some large accounts are serviced by the GSF. The Tele-Direct witnesses indicated that, in general, accounts that require a great deal of servicing, for example, multiple visits over a year, are likely to be assigned to the NAM/NAR unit. Because of the canvass-based sales approach used by the GSF, often the GSF is involved in a canvass in another area and is unavailable to service a particular account repeatedly. The NAMs and NARs are located in certain centres all year long and can service these accounts more easily. A further factor is the account's complexity, including number of headings, the number of markets, and the amount of change required each year. If the account requires a lot of attention to ensure accuracy (for example, that no directories are missed) and perhaps clerical-type support, it will end up in the national group. There was also evidence that accounts which had little future growth potential or which had simply proven to be problem accounts in the past are handled by the NAM/NAR unit.

311 Tele-Direct (Publications) Inc. is divided into two geographic regions, eastern and western. The eastern region is comprised of the province of Quebec, with parts of Ontario such as Ottawa, Kingston, Sault Ste. Marie and Sudbury. The western region covers the remainder of Ontario. The structure and organization of the company in both regions is broadly similar, although the eastern region is smaller both in terms of revenue serviced and number of sales representatives.

312 The facts regarding (a) remuneration, (b) evaluation and (c) account assignment and continuity for Tele-Direct's internal sales force are relevant because one of the Director's arguments regarding Tele-Direct's motivation to engage in the alleged tied selling is that its internal sales force can be more effectively motivated to sell more Yellow Pages advertising than agents.

(a) Remuneration

313 The remuneration of the Tele-Direct representatives is highly dependent on the revenues generated by each individual as they are paid through a combination of salary and commission. Both the tel-sell and premise representatives earn a base salary (which is higher for premise) and in addition are eligible for a number of commissions and incentives.

314 The amount of commission paid to a sales representative is determined by the nature of the advertising which is sold. If the sales representative manages to generate new business (an increase over the previous year's advertising expenditure), an annual commission of 13 percent is paid on the total new business. If the advertiser is renewing the advertising which was purchased in the previous year, the sales representative is paid a 2.4 percent commission on the renewal amount. Renewal commission is paid on any portion of an account which is renewed, even if the total amount of advertising purchased is less than the previous year. The renewal commission was first introduced in the early 1980s, prior to which the representatives were paid only salary and new business commission. The final basis upon which a commission is paid to a sales representative reflects rate increases. This applies in a situation where an advertiser renews exactly the same advertising program as it had in the previous year but there has been a rate increase which is applicable to that advertising program. The sales representative receives renewal commission on the amount spent the previous year and rate increase commission on the difference between the two account totals because of the rate increase. The rate increase commission is six percent.

315 Since 1993, a premise representative also has the potential of earning a yearly bonus in the amount of $2,000. The bonus is based on factors such as the number of complaints made against the representative by advertisers, the representative's score in Tele-Direct's internal evaluation, the number of "lates" (advertising submitted after a directory closing date) and mistakes and the representative's overall work flow. Apart from the bonus, there are a number of other incentives offered to premise sales representatives, for example, awards and trips.

316 The NAM/NAR group also earn base salary plus commission but with a much larger proportion of their income accounted for by salary. Their new business commission is nine percent, with a renewal commission of 0.5 percent and a rate increase commission of 1.2 percent. They may qualify for a bonus equal to seven percent of their income for maximizing net sales or a bonus of three percent for maximizing retained revenue. An average NAM earns less than an average premise representative.

317 Sales representatives are supervised by salaried sales managers. Sales managers also qualify for various incentives and bonuses, which may vary in nature from year to year, based on the results of the sales representatives that they supervise.

(b) Evaluation

318 In the western region Tele-Direct has a formal assessment program for its sales representatives called Total Performance Assessment ("TPA"). Each representative is assessed using the TPA every six months.

319 The TPA is comprised of three categories: sales results (worth 60 percent), customer satisfaction (worth 20 percent) and job administration (worth 20 percent). The sales results score is largely based on the representative's incremental revenues in relation to other representatives (25 points of 60). Customer satisfaction is broken down into customer disputes and an overall customer survey. Customer disputes refer to the number of times customers of the representative have called in with a complaint or a concern. The customer survey component is a Gallup survey. [132] The final aspect is job administration which includes

work flow (success in meeting benchmark requirements for servicing a certain percentage of revenue during a canvass by a certain date), number of internal queries and lates.

320 The TPA is not used in the eastern region which has not had a formal evaluation program since 1994 because of union disputes. Currently, sales representatives in the eastern region are evaluated by an internal management review in which their supervisors conduct follow-up interviews with clients. It is Tele-Direct's intention to replace this less formal evaluation process in the future.

(c) Account Assignment and Continuity

321 Tele-Direct uses a canvass approach to sell advertising. Each directory has a canvass period, the length of which depends on the size of the directory, during which the GSF focuses its attention on selling advertising for the next issue of that directory. The GSF is under time constraints to complete its sales and solicitations prior to the deadline, or the closing date, for the directory. Once one canvass is complete, the GSF moves on to the next one.

322 For each canvass, Tele-Direct canvass coordinators assign accounts to the sales representatives to ensure as much as possible that each salesperson ends up with a bundle of accounts which is balanced in revenue and in growth potential. Accounts are assigned based on a complex system of "markets" and "grades". For example, "Market 1" accounts are dealt with by premise representatives while "Market 2" accounts are dealt with by tel-sell. As well as being divided by market, accounts are also graded; the lower the grade assigned to an account the higher the potential that type of business will buy Yellow Pages. Grades are based on the type of business as represented by the heading under which it would appear in the directory.

323 For each canvass the grades and markets for the accounts are analyzed to determine whether, based on factors like time, the size of the cities or towns included and the number of sales representatives available, the premise representatives will cover all of the grades in Market 1, or whether, perhaps, some of the higher grades in that market should be assigned to tel-sell. For the same reasons, for a given canvass, not all accounts are assigned; those with lower potential or that are inactive may be dropped.

324 For both the premise and the tel-sell group, account assignment has traditionally been random. With a few minor exceptions, accounts were divided up at the beginning of each canvass with no intention of returning individual accounts to the same representative who serviced them in the previous year. In 1993, a test was conducted in a northern market whereby there was 100 percent continuity of tel-sell accounts. Ms. McIlroy's impression of the results was that they were positive in general; however, we have no information about whether tel-sell continuity has been adopted more generally. For premise sales, Tele-Direct adopted the Very Important Advertiser ("VIA") program in the late 1980s which provided a form of continuity: advertisers spending a certain amount per month were assigned the same representative every year. By 1992-93, there was a more general continuity policy in place whereby 30 percent of all premise accounts were assigned back to the sales representative for three years if $500 or more was being spent or a pricing incentive was involved. Currently, about 55 percent of the accounts of a typical premise representative (about 85 percent of revenue) are subject to continuity.

(2) Tele-Direct's Commissionability Rules

325 Prior to 1958, a 15 percent commission was available on "national" advertising. The definition of "national" was, however, unclear. In 1958, Bell Canada adopted a new policy, developed in consultation with and endorsed by the Canadian Association of Advertising Agencies. To be commissionable at 15 percent, the advertising had to appear in two or more directories serving two or more "calling areas" with no more than 80 percent of the total advertising in one directory. No particular association membership was required of the agency; if the agency's ability to pay was in doubt, its credit was investigated.

326 Tele-Direct's definition of a commissionable account underwent a further change effective January 1, 1976. The amended definition of commissionability became known as the "eight-market rule". To qualify as a commissionable account under this rule, the advertiser had to purchase advertising with a minimum value of a trade-mark in eight "markets", as defined by Tele-Direct. Canada was divided into 19 markets, with six in Quebec and seven in Ontario. The entire United States constituted a single 20th market. If the account qualified and the agency provided completed artwork, Tele-Direct would pay a 15 percent commission on the account. Again, no particular membership in an industry association was required.

327 The commissionability rule was next changed effective July 1, 1993 to create the so-called "national definition" which is the current rule. Under this rule, to be commissionable an account must advertise, at a minimum, in directories in two provinces. Advertising must be placed in at least 20 directories and in each directory the value of the advertising must be a minimum of a trade-mark. Finally, 20 percent of the total value of the advertising must be placed in directories outside Tele-Direct's territory.

328 In order to receive 25 percent commission on "national accounts" the agency has to be a CMR and a member of YPPA. In addition, to be eligible for the 25 percent commission, the CMR must transmit its order to Tele-Direct via the Value-Added Network ("VAN") run by the YPPA. This facility provides for electronic transmission of account data and other information to a publisher. In order to access VAN, the CMR must be a member of the YPPA and must acquire the necessary computer hardware and software.

329 All accounts which met the eight-market rule as of July 1993 have been "grandfathered"; Tele-Direct still pays 15 percent commission on those accounts. Once an account ceases to qualify under the eight-market rule, it cannot be re-qualified. New accounts, those which reached eight-market status after July 1993, cannot be "grandfathered". Tele-Direct has made no commitment to how long the "grandfathering" of eight-market accounts will remain in place. It could be discontinued at any time.

C. Alternate Theories of the Case

330 As elaborated in the opening statement, the Director's theory of the case for tying is that the respondents, as a condition of supplying space, have required or induced customers to acquire the tied product, services, from them. We have already reviewed the structure of the market. The respondents offer a commission on accounts meeting their "national" definition and on grandfathered eight-market accounts. They service the remainder of the accounts themselves and do not offer a commission, or price space and services separately, for those "local" accounts, amounting to over 90 percent of Tele-Direct's revenue.

331 In accordance with his theory, the Director alleges that the respondents by refusing to sell either the space or the services in an unbundled fashion have violated section 77. Counsel for the Director described the Director's case in opening in alternative terms by referring to the respondents' refusal to pay commission except to the limited extent that they now do as a violation of section 77 because commission would be a means of recognizing or effecting an unbundling for the services that non-commissionable customers seek. The Director says that as matters now stand, non-commissionable customers have a choice of either obtaining services from respondents as part of the "package" price that they pay for their advertising or paying twice for the services -- once as part of the package price charged by the respondents and once directly to the service provider.

332 The respondents say that the Director's concept of tying is misconceived. They submit that there is no product known as "advertising services" separate from a product known as "advertising space". They focus on the *selling* portion of the services referred to by the Director and argue that the sales advice provided by Tele-Direct's internal sales force forms an inseparable package with the space which Tele-Direct supplies in its directories. Indeed, they emphasize, there is no advertising space without a sale. They argue that how advertisements in their directories are sold is a business decision to be made solely by Tele-Direct and is not justiciable. Tele-Direct determines when it is more appropriate to sell its product through its internal sales force and when it will "employ" and pay a commission to agents to sell its product.

333 In other words, the respondents argue that they have chosen a "hybrid" system. As their primary sales channel, they maintain an internal sales force. They have also chosen to employ agents to sell to a limited group of large advertisers who have distinct needs. Among the reasons given for primary use of the internal sales force were: efficiency, that the average cost of revenues serviced internally was lower than for revenues serviced by outside agents; revenue growth, that the internal sales force is more effective in growing revenue; and servicing, to ensure attention to small advertisers and non-advertisers that Tele-Direct considers important but external agents might not.

334 The respondents take the position that the Director's application regarding tied selling is an attack on vertical integration. They characterize Tele-Direct's decision regarding commissionability as a choice in some instances to buy services from agents

and in others to make the services in-house. They refer to the words of Posner J. in *Jack Walters & Sons Corp. v. Morton Buildings, Inc.* for guidance:

> The end that Walters [a terminated dealer] alleges is that Morton [the manufacturer] wanted to take over the retail function; in the terminology of industrial organization, it wanted to integrate forward. But vertical integration is not an unlawful or even a suspect category under the antitrust laws: "Firms constantly face 'make-or-buy' decisions -- that is, decisions whether to purchase a good or service in the market or to produce it internally -- and ordinarily the decision, whichever way it goes, raises no antitrust question." ... Vertical integration is a universal feature of economic life and it would be absurd to make it a suspect category under the antitrust laws just because it may hurt suppliers of the service that has been brought within the firm.
>
> A common type of vertical integration is for a manufacturer to take over the distribution of his product....
>
> We just said that vertical integration is not an improper objective. But this puts the matter too tepidly; vertical integration usually is procompetitive. If there are cost savings from bringing into the firm a function formerly performed outside it, the firm will be made a more effective competitor. [133] (references omitted)

The respondents urge us to take from the words of Posner J. that their narrowing of the commissionability criteria is simply taking over the distribution function internally and Tele-Direct's decision about how to run its business, which it does not have to "justify" to anyone.

335 The Director underlines that he is not opposed to vertical integration in principle. He cautions, however, that if the method chosen for the vertical integration violates a section of the Act, with particular reference to sections 75, 77 and 79, then it is subject to challenge and the respondents cannot achieve immunity by "waving the flag of vertical integration". We agree that simply affixing the label of "vertical integration" does not conclusively decide anything. It does not preclude the Director from attempting to convince the Tribunal that what is going on in the case before it meets the requirements of a section of the Act. This view is not inconsistent with the *dicta* of Posner J. in the *Jack Walters* case, who indicates that the presence of market power may cast vertical integration in a different light and points out that market power was not present on the facts before him:

> ... some economists believe that monopolistic firms might integrate vertically in order to deny supplies or outlets to competitors, or to make it more costly for new firms to enter the market (because they would have to enter at more than one level of production or distribution), or to facilitate price fixing with their competitors. But nothing of this kind is suggested here. Walters does allege that Morton has a big name in the prefabricated farm buildings market, but there is no indication that this is a meaningful economic market that might be worth monopolizing, or that Morton's purpose in integrating into retail distribution was to make life harder for *its* competitors. Its object was to make more money by reducing the cost of retail distribution, not by coercing or excluding (or for that matter colluding with) its own competitors, whoever they may be, or discouraging potential competitors. *Indeed Walters' tie-in claim is premised on the ready availability, from other manufacturers, of the building parts that Morton sells in kits from which Morton Buildings are put together. This shows that Morton has no monopoly*. [134]
>
> (emphasis added; references omitted)

336 The recognition that vertical integration is generally pro-competitive on efficiency grounds raises another issue. The Director says there is no provision in section 77 for an efficiency "defence". We agree that there is no such explicit reference to an efficiency defence. However, many forced "package sales" are the product of efficiency and even a supplier with market power may sell items in combination for efficiency reasons.

337 A fundamental requirement of tying is the existence of two products, the tied product and the tying product. It is implicit in the determination of whether there are one or two products that efficiency considerations must be taken into account. We consider that demand for separate products and efficiency of bundling are the two "flip sides" of the question of separate products. Assuming demand for separate products, if efficiency is proven to be the reason for bundling, there is one product.

If not, there are two products. As we will review below, this approach is consistent with the American jurisprudence regarding the test for separate products relied on by the Director.

338 The Director is of the view that, assuming that the necessary elements of the section have been met -- major supplier, two products, tying, and the exclusion of competitors resulting in a substantial lessening of competition -- it is not necessary for him to provide a plausible explanation of *why* or *how* the firm benefits from the tie. This is a valid position. The Tribunal would not impose such a requirement on the Director. It cannot be denied, however, that there is always more comfort in drawing conclusions the greater the depth of understanding.

339 In this case, the Director has in fact provided explanations as to why Tele-Direct might be engaged in tied selling. The Director submits that Tele-Direct is leveraging its market power in the sale of space into the market for advertising services through tying. One explanation of this is that Tele-Direct's policy of bundling advertising space and services allows Tele-Direct to exploit better an alleged information asymmetry it enjoys *vis-à-vis* its customers, the advertisers. As with any advertising medium, it is not possible to evaluate effectiveness of Yellow Pages advertising with any degree of precision. To the extent that data on effectiveness of the medium is available, it is in the control of Tele-Direct not the advertisers. In light of this, the Director argues that Tele-Direct prefers to keep advertising services in-house as much as possible because its representatives can be more effectively motivated to "oversell" than independent service providers. We will deal with this reasoning in due course.

340 The Director also says that the "usual" assumption of profit maximization used in determining whether a firm stands to gain from a tie does not apply in the instant case and the economic literature on the subject that relies on this assumption to analyze the possible effects of a tie is not a useful source. He says it is futile to seek a "rational" or "profit-maximizing" explanation for Tele-Direct's behaviour since Tele-Direct, because of its unique situation and relationship to Bell Canada, is not subject to the constraints of profit-maximization and its corollary, cost-minimization.

341 In support of the premise that Tele-Direct is not profit-maximizing, Thomas Wilson, [135] an economist expert witness for the Director, draws on the fact that the profits of Tele-Direct are included for regulatory purposes when decisions are made about Bell Canada's prices. He is of the view that the pressure to minimize costs is reduced and that there may also be systematic distortions such as the use of more capital than an unregulated firm would use in order to boost the capital base of the regulated firm (the "Averch-Johnson effect"). However, this particular hypothesis is not supported by the evidence which, in fact, points in the other direction insofar as Tele-Direct has chosen to subcontract capital intensive operations such as printing.

342 Professors Wilson and Slade, for the Director, are also of the view that management's decisions with respect to the commissionability of various accounts are motivated by a concern to maximize *sales* rather than to minimize *costs*. Professor Wilson sees the reduced pressure on regulated firms to minimize costs as allowing Tele-Direct's management to pursue personal interests, such as operating a larger enterprise, thereby garnering personal satisfaction and monetary rewards. Professor Slade is of the view that the ownership structure of Tele-Direct, whereby there is no threat of a takeover, contributes to allow management to pursue its hypothesized desire for larger size.

343 Even though there are several occasions when we have difficulty understanding the decisions of Tele-Direct's management if they really are pursuing cost-minimization, we are far from convinced that Tele-Direct's management is not generally constrained to follow a profit-maximizing course. The fact that Tele-Direct is a wholly-owned subsidiary should be sufficient to ensure that there is adequate ownership control. It is obvious from the evidence of Mr. Courtois, the Bell Canada representative on Tele-Direct's Board of Directors, that Bell does not practice micro-management. The main instrument of control appears to be the requirement that Tele-Direct pay Bell the same percentage of revenues as Tele-Direct is required to pay other telcos when it contracts to perform their directory functions. This requirement was introduced precisely to impose market discipline on Tele-Direct. In addition to the forty percent of revenue that Tele-Direct remits to Bell, it also makes a substantial contribution to Bell's profits in the form of dividends. The evidence does not support the conclusion that Bell has been cavalier about allowing Tele-Direct's management to pursue other than profit-maximizing goals. Moreover, in recent years Bell's earnings have been well below its regulated allowed rate of return, a situation not conducive to permissiveness. Even when Bell earnings were not below the allowed rate of return, higher profits from Tele-Direct would still benefit Bell between applications for rate increases.

344 While we do not rule out that Tele-Direct's management may be under less than the usual amount of pressure to perform, we are reluctant to discard the usual working assumption of profit-maximization in the absence of some compelling evidence that is consistent with the assumption that Tele-Direct is pursuing other goals. The only specific evidence cited in support of the premise that Tele-Direct's management pushes revenue growth beyond the point of profit-maximization is the stress that they place on canvassing businesses that do not advertise in the Yellow Pages, the non-advertisers. The success rate from this effort is low and Professor Slade concludes that the fact that the effort is made can be explained by management's greater concern with growth of revenue than with profits. On the whole, however, the evidence on the canvass of non-advertisers is that moderate resources are devoted to this task. We are not convinced that the canvass of non-advertisers is not profit-maximizing.

345 We note here that there is another possible theory of the case. For reasons of clarity and coherence, however, it is more convenient to deal with it at a much later point in these reasons. We return to it below as an "Addendum" to our conclusion regarding the separate products issue.

346 We therefore do not accept that we should approach this case with a view to treating Tele-Direct as other than a profit-maximizing firm, albeit a firm with market power. Nor do we accept that efficiency considerations are not relevant to our section 77 analysis. Efficiency and demand, together, form the basis of the consideration of one or two products, to which we now proceed.

D. Separate Products

(1) Approach to Determining Separate Products or Single Product

347 The first element of section 77 to be considered is whether advertising space and advertising services are separate products. The Director takes the position that advertising services constitute a distinct product separate from advertising space. The respondents argue that advertising services are in fact an "input" into Yellow Pages advertising, not a separate product.

348 Merely labelling advertising services and advertising space as either two "products" or as "inputs" into a single product does not assist. As Areeda, Hovenkamp and Elhauge state:

> ... just about any product could be described as a tie of its components. And just about any two products could be described as mere parts in a more encompassing single product.... [136]

There must be some rationale for distinguishing between situations where there are two products involved, and thus at least the possibility of an illegal tie that should be prohibited, and those where there is a single product and no question of tying.

349 The parties are in agreement that the Canadian jurisprudence does not provide much guidance on the test to be applied. Both parties referred to the 1984 decision of the Supreme Court of the United States in *Jefferson Parish Hospital District No. 2 v. Hyde* [137] for guidance, although they emphasize different portions of the decision.

350 In *Jefferson Parish* the Court provided its most extensive discussion of the "single product" test. At issue in the case was the validity of an exclusive contract between the hospital and a firm of anaesthesiologists. Any patient who chose to have an operation performed at that hospital was required to use an anaesthesiologist employed by the firm in question (Roux & Associates). The Court had to decide if this constituted an illegal tying arrangement. In making that inquiry, the Court considered two questions, whether the hospital was selling two separate products that might be tied together and, if so, whether the hospital used market power to force its patients to accept the tying arrangement. The majority answered the first question in the affirmative but the second question in the negative (the hospital was found not to have market power), so in the result it found no illegal tying arrangement. The minority found only one product and concluded for that reason that there was no illegal tying arrangement. [138]

351 In discussing the question of separate products, the majority noted that the answer to the question of one or two products turns not on the functional relationship between them but rather on the character of the demand for the two items. The majority then stated:

> ... Thus, in this case no tying arrangement can exist unless there is a sufficient demand for the purchase of anesthesiological services separate from hospital services to identify a distinct product market in which it is efficient to offer anesthesiological services separately from hospital services. [139] (reference omitted)

352 We adopt this statement of the majority as the applicable test for separate products. We believe that this test effectively captures both the demand and the efficiency elements necessary for us to distinguish between cases when a tie that is injurious to consumer welfare is possible and those in which the tie, although imposed by a major supplier, is efficient and should not be condemned. Demand is, of course, critical. If there is no demand, it would be pointless to require that the two products be offered separately. Efficiency is also critical as the existence of separate demand should not govern if providing the products separately would result in higher costs that would outweigh the benefits to those who want them separately.

353 Our approach will be to examine first the evidence pertaining to the demand side of the equation, to determine whether the Director has proven buyer, in this case advertiser, interest in acquiring space and service separately. By this we mean an answer to the question: "Is there a significant set of advertisers who actually want the items separated?" If this question is answered in the affirmative, then we will turn to the evidence relating to whether it is efficient to separate the products.

354 The respondents rely on a portion of the minority judgment in *Jefferson Parish*. The minority wrote:

> ... there is no sound economic reason for treating surgery and anesthesia as separate services. Patients are interested in purchasing anesthesia only in conjunction with hospital services, so the hospital can acquire no *additional* market power by selling the two services together.... In these circumstances, anesthesia and surgical services should probably not be characterized as distinct products for tying purposes. [140]

In conclusion, they reiterated:

> ... Since anesthesia is a service useful to consumers only when purchased in conjunction with hospital services, the arrangement is not properly characterized as a tie between distinct products. It threatens no additional economic harm to consumers beyond that already made possible by any market power that the hospital may possess. *The fact that anesthesia is used only together with other hospital services is sufficient, standing alone, to insulate from attack the hospital's decision to tie the two types of services*. [141]
>
> (emphasis added)

355 The respondents did not provide us with any reason to adopt the minority judgment over the majority. In fact, the majority opinion explicitly rejected tests based on functional relationships, including the "useless without" test. In a footnote the majority noted:

> The fact that anesthesiological services are functionally linked to the other services provided by the hospital is not in itself sufficient to remove the Roux contract from the realm of tying arrangements. We have often found arrangements involving functionally linked products at least one of which is useless without the other to be prohibited tying devices.... [142]

There are also sound economic reasons to reject such a test. As pointed out in the Areeda text, it may perversely save the most dangerous ties and call for review when there is little likelihood of adverse effects. The authors of that text use the example of a manufacturer with a monopoly over can-closing machinery who requires all purchasers of the machinery to buy cans from it to point out that:

... [s]uch a tie would bring the [manufacturer] a complete monopoly over cans, for presumably no one would buy empty cans without the machinery to close them. Yet the useless-without test would immunize this tying arrangement. Moreover, while short-run profit maximization is *generally* not enhanced when the tied product has no other use, monopoly in the tied market can impair competition severely in the long-run.... [143]

(2) Other Case Law

356 The respondents have also advanced a plethora of other American cases with respect to the question of separate products. In general, the respondents rely on these cases to urge us to view the facts before us solely from the supplier's (Tele-Direct's) perspective and to ignore demand considerations. Their fundamental premise appears to be that Tele-Direct's choice to "market" its product in a certain fashion is determinative and negates the possibility of any tying claim. We did not accept the Director's argument that considerations of demand govern; likewise we reject the respondents' argument that a supplier's choice is paramount. Both elements of demand and efficiency will be taken into account, as set out above. In any event, it is clear that the case before us is unique and does not "fit" exactly into any of the precedents cited to us. A more detailed treatment of the case law follows.

(a) Single Product

357 One tying case was referred to, *Souza v. Estate of Bishop*, [144] a case against a lessor of land in Hawaii based on the refusal of the lessor, like most other landowners in Hawaii, to sell the land. The tying product was argued to be the residences plaintiffs owned on the land while the tied product was the leasehold. The claim was dismissed on a motion for summary judgment, affirmed by the Court of Appeal.

358 From this decision, the respondents ask us to conclude that if a supplier presents two products as a package or, in other words, if they are being marketed together, that is the end of the matter and the Tribunal must conclude that there is a single product. The Court found that the plaintiffs' argument defied reason because the product being marketed was a house plus leased land and not a house purchasable separately from the land on which it stood. The Court also found that the plaintiffs presented no evidence that the house and the leased land constituted separate products. We have already set out the test we intend to apply, which takes into account both demand and supply. We do not accept that simply because a producer or a supplier bundles products together that they are, *ipso facto*, one product.

359 Four cases are relied on by the respondents because they involve the Yellow Pages industry or an analogous industry. The respondents argue that these cases indicate that the United States courts have uniformly rejected any concept of an antitrust violation because of a publisher's refusal to pay commission or its decision to change the accounts on which it will pay commission. Thus, they conclude that the courts "in effect" have treated directory advertising as one product. They make this argument despite the fact that none of these cases was based on a claim of tied selling and therefore the issue of separate products in the sense with which we are dealing here was not before the court. The respondents claim, however, that these cases indicate that there is only one product *because* the tying argument was not raised in any of them.

360 We do not accept that the absence of a tying claim makes the cases dispositive of the issues before us in a tying case. In general, we do not see how the results in these cases can be directly transferred to the case before us. We will, however, review the decisions in order to see what, if any, assistance we can draw from the findings in resolving the issue of separate products on the facts before us.

361 In *Selten Agency, Inc. v. Pacific Telephone and Telegraph Co.*, [145] a specialized advertising agency brought an antitrust action involving numerous allegations against a number of telcos and telephone directory publishers that were members of the National Yellow Pages Service Association ("NYPSA") (the predecessor to YPPA). All of the allegations involved joint action by the NYPSA members. The only issue with any possible, although remote, relevance to this case was the claim by the agency that the NYPSA members *agreed* not to pay commissions on local advertising to agencies, constituting an illegal horizontal division of markets.

362 The Court concluded there was no evidence of an illegal agreement. The evidence was that the NYPSA agreement covered only national advertising; there was no prohibition on commissions for local advertising. Publishers were free to offer commission on local accounts and, the Court notes, some, in fact, did so. The Court also noted that those who did not offer commission on local accounts had their own sales force and therefore did not require the services of advertising agencies. The respondents rely heavily on the next sentence of the judgment, that "[i]t is not a violation of the antitrust laws for a publisher to refuse to buy a service that is not worth buying" [146] to argue that publishers do not have to buy services from agents or, in other words, provide a commission for any accounts they do not want to. As we have already stated, we do not accept that the supplier's choice is the sole governing factor in a tying case. Due consideration must be given to the supply side of the equation but we cannot ignore demand considerations.

363 In *O'Connor Agency v. General Telephone Co.*, [147] an advertising agency alleged that a Yellow Pages publisher conspired with other publishers to change the definition of local or "B" accounts so that commission would no longer be paid on those accounts. The defendants brought a motion for summary judgment which was granted.

364 In granting the motion, the Court found an "agreement" to change the criteria based on adherence to the YPPA guidelines. Using a rule of reason approach, the Court then proceeded to consider and weigh both the anti- and pro-competitive effects of the change in the relevant market. The Court found that the plaintiff had provided no admissible evidence that the relevant product market was Yellow Pages and also provided insufficient admissible evidence of actual anti-competitive effect arising from the change. The Court also found that the publisher had a legitimate business reason for adhering to YPPA standards, namely the uncontroverted evidence that the defendant changed the commission criteria to increase its national Yellow Pages advertising which was not performing up to expectation.

365 The respondents rely on this case for the very broad proposition that "the U.S. jurisprudence directly involving Yellow Pages has rejected any concept of any antitrust violation because of the refusal of a publisher to pay commission to a CMR or as a result of the publisher changing the accounts on which it will pay a CMR" and that "[i]n effect the courts have said there is only one product that we're selling and we can sell it through whatever channel we want". [148] The case certainly does not support those broad generalizations. It was a conspiracy case resolved on a motion for summary judgment because of failure to prove either a relevant market or actual anti-competitive effect.

366 The respondents submit that the case of *Thompson Everett, Inc. v. National Cable Advertising, L.P.* [149] is analogous to the case at bar. In that case an independent cable television advertiser representative brought action against exclusive contracts between the cable company and their spot advertising sales agents on the basis that the "traditional" cable representatives or sales agents were engaged in a concerted effort to exclude the independent from the business. The Court of Appeal affirmed the decision of the lower court to grant summary judgment.

367 The Court found that the exclusive contracts were not being enforced through an illegal conspiracy. It also found that the independent did not have access to the exclusive contracts because it was not willing to compete with the exclusive agents for them and was simply seeking to substitute its own method of serving the cable company for that selected by the cable company. The Court also found that there was no unlawful monopoly in the cable representative market because cable companies are part of a larger market.

368 Once again, the respondents rely on this case to argue that the Court endorsed the cable company's choice of using exclusive representatives simply because that was the way the cable company chose to do it. We have already indicated that the supplier's choice will not be the only consideration in a tying case. Indeed, the case itself does not go that far.

369 The most interesting decision referred to by the respondents is *Ad-Vantage Telephone Directory Consultants, Inc. v. GTE Directories Corp.* [150] The case involved a claim by an "authorized selling representative" ("ASR") for the placement of national advertising in telephone directories that the publisher had monopolized or attempted to monopolize the sale of Yellow Pages advertising. Because of problems in collecting payment for advertising placed by the ASR, the publisher started billing

the advertisers directly. The ASR claimed that the publisher's direct contact with its customers resulted in a loss of accounts to it and its eventual failure.

370 The monopolization case failed because the ASR could not define any relevant market in which it and the publisher competed. The ASR had originally based its claim on the national advertising market where the publisher competed for the sale of national advertising as an ASR itself but could not show any market power on the part of the publisher in that market. The claim was then amended to allege that the relevant market was the sale of advertising space in a specific directory, shifting the focus to local advertising. Based on evidence that the ASR had received commission for the placement of advertisements for two local advertisers, apparently by accident, the ASR argued that it competed with the publisher's sales force for local advertising. The argument of the ASR was that the lawful power to publish the exclusive directory for a specific geographic area did not give the publisher the right to be the exclusive seller of advertising space within that directory as publication and sale were separate activities.

371 The Court commented that the ASR's market theory had a certain "superficial" appeal based on its similarity to a typical wholesale/retail monopolization case where a vertically integrated manufacturer uses its dominant position at one level of activity (manufacturing) to eliminate competition at another level (retailing). The Court noted that for the ASR's theory to work, the publisher must be viewed as a wholesaler or manufacturer of advertising space and the ASR as a retailer of this space. If not a retailer, the ASR could not be considered a competitor of the publisher at the retail level.

372 The Court concluded that, to the extent that the sale of Yellow Pages advertising is an activity separable from the publishing of the advertising, the sales made by independent ASRs were in the nature of an agency and not retail sales. Agents, the Court noted, do not compete with those whom they represent. The wholesale/retail analogy failed, in part, because there *could* be no "resale" of Yellow Pages:

> ... Yellow pages is not a product that is produced and distributed. The blank yellow pages do not exist prior to the sale of an advertisement, somehow awaiting distribution on a resale market. Each advertisement, that is, the space of the ad, is "created" when the advertisement is sold to the advertiser.... ASRs do not maintain an inventory of ad space to be sold. An ASR cannot purchase a page in the yellow pages and then distribute it to advertisers as it sees fit. [151]

373 The agency characterization was preferred, in part, because the Court considered the relationship between the publisher and the ASR in the case before it to be analogous to the relationship between an airline and a travel agent:

> ... The publisher lawfully establishes the price for its advertising and announces it to the public. It determines when it is going to publish directories, and has the ultimate say on how many advertisements it will accept. An advertiser may deal directly with the publisher, or may use an Authorized Sales Representative. However, should it use an ASR, the ASR must submit a request for advertising to the publisher, analogous to a reservation in the forthcoming publication. The ASR does not purchase an inventory of yellow pages space. The service which the advertiser has paid for is performed by the publisher, not the ASR. Further, should the advertisement fail to appear as requested in the appropriate directory, the publisher is under an obligation to refund the advertiser's money. Finally, should a publisher not receive enough advertisements to make a directory profitable, it must still publish the directory; the publisher retains the "risk" that not enough yellow pages advertisements will be "distributed" -- not the ASRs. [152]

The Court found ample evidence in the record that the ASR functioned as an agent, including the NYPSA guidelines which provided that ASRs represented the publisher "when selling National Yellow Pages advertising to national advertisers or their advertising agencies, or when negotiating disputes with such national advertisers or their advertising agencies". [153] The Court noted that there was also evidence that the ASR acted as an agent of the advertiser, including liability to the publisher for payment, but concluded that "[e]ither way, an ASR functions as an agent, not an 'independent contractor,' and not, in any case, as a retailer of yellow pages advertising space." [154] Thus, the leveraging argument failed as there was no "second activity" to be monopolized by using the publisher's market power to publish directories as leverage.

374 One element of this decision is the Court's insistence that the ASRs had to be considered retailers in order to be in competition with the publisher. A finding that the ASRs were merely agents of the publishers or, perhaps, agents of the customers, in the sense of having no independent existence from either or both of those two entities seems to preclude competition between the ASRs and the publisher. We do not believe, however, that the inapplicability of a strict retail model is conclusive. The Court did mention in passing, for example, independent contractors. The fundamental question is whether the publisher is in competition with the ASR or other person alleged to be excluded by the activity in question, which we agree is a question that should also be addressed in the context of a tying claim.

375 A second important element of the Court's conclusion concerned the functions performed by ASRs, that were apparently viewed as simple "order takers" insofar as the commission from the publisher was concerned. The Court indicated its assumption that the ASR was paid separately by the advertiser for other services such as layout [155] when it distinguished the case before it from a successful monopolization claim by an advertising agency against a television station. The television station had expanded its in-house advertising agency services by starting to produce commercials (for a fee) as well as selling air time. In *Ad-Vantage*, the Court stated:

> Thus, in *Six Twenty-Nine Productions*, a leveraging argument was possible. The production of [Yellow Pages] advertisements is a related activity separate from the sale of advertising space. Each is a separate source of revenue. In the context of this case, no evidence was presented indicating that ASRs receive no separate compensation from their clients when the ASRs engage in the production -- the lay out -- of the advertisements. In fact, testimony of a former NYPSA official indicated that *most* of the national yellow pages advertising is purchased through ASRs by advertising agencies on behalf of national advertisers, supporting the notion that ad agencies perform a separate function. Thus, the leveraging argument made in *Six Twenty-Nine Productions* is not available here. [156]

376 What we take from this case is that it is important to examine the actual services performed by the agents for advertisers and the relationship between Tele-Direct and the agents, with a view to determining if they do, in fact, "compete" with Tele-Direct in any relevant sense.

(b) Relationship between Agents, Advertisers and Tele-Direct

377 The respondents say that, as in the *Ad-Vantage* case, agents in the case before us function as either representatives of Tele-Direct or, on occasion, as agents of the advertisers. In the first case, Tele-Direct does not compete with itself or its own representatives and in the second, it cannot be considered to compete with its customers. Based on the evidence of Charles Mitchell, Tele-Direct's Director of Marketing Sales Support, they submit that, in fact, Tele-Direct has not competed for agency accounts since 1992. The Director argues that, unlike in *Ad-Vantage*, the Canadian CMRs are not agents of Tele-Direct. The Director submits that the evidence supports the proposition that Tele-Direct has consistently considered, and still does consider, the agencies as its competitors.

378 The initial point at issue is the exact contractual relationship between agents and Tele-Direct. In 1988, Tele-Direct required the agencies to sign new contracts with it. Under those contracts, the agent warrants that it is duly authorized to enter into the agreement on behalf of the advertiser. Further, the agency agrees that "it is not acting and does not purport to act as agent for Tele-Direct." [157] This is exemplified by the provisions that the agent agrees to pay for the advertising; to indemnify and hold harmless Tele-Direct from claims by the advertiser; and to warrant on behalf of the advertiser the truth of all assertions in the advertising. Tele-Direct's Corporate Secretary and legal counsel, Patrick Crawford, confirmed that these contracts have not been revoked and that the agencies were not agents for or of Tele-Direct.

379 The respondents argue that the 1993 YPPA agreements entered into by the agencies in order to be accredited as CMRs supersede the earlier contracts although no steps have been taken to repudiate or amend the earlier contracts. In the application to be accredited as a CMR, the agency agrees to "represent" the publisher in the same terms as quoted in *Ad-Vantage* from the NYPSA guidelines. [158] The YPPA guidelines, however, describe a CMR as a member of YPPA which:

a. Represents to the users the Publishers' product, services and policies, while representing to the Publishers the customers' needs, desires and concerns.

b. Develops a comprehensive national Yellow Pages advertising program for prospects and/or advertisers.

c. Compiles and provides current information pertaining to all Publishers' practices affecting an advertiser's national Yellow Pages program.

d. Develops market research and cost studies for the advertiser or its agency as a basis for making advertising proposals.

e. Provides Publishers on a timely basis with the authorized list of dealers for solicitation under Advertiser's Trade Item.

f. Pays Publishers' invoices without recourse within the time period set forth in the individual Publishers' credit terms, notwithstanding its own collection status with that advertiser or its agency, unless any individual Publisher provides otherwise.

g. Absorbs all adjustment amounts incurred as a result of its own acts, errors, or omissions which including (*sic*) among other things, failure to notify Publishers of cancellations of orders, unless any individual Publisher provides otherwise. [159]

380 What comes out of this somewhat contradictory documentation of the relationship is that agents are not agents or representatives of Tele-Direct in any sense that would preclude a finding that the two are in competition. The agents are not so allied with Tele-Direct as a publisher that they have no independent existence. Their relationship has elements of both co-operation and competition.

381 The agents rely on the Yellow Pages industry, as represented by YPPA, and Tele-Direct specifically, to provide information on the effectiveness of Yellow Pages advertising. They are accredited based on industry standards. With respect to accreditation and the promotion of the medium, the relationship between Tele-Direct and the agents is undoubtedly cooperative.

382 However, the thrust of the Tele-Direct internal documentary evidence is that Tele-Direct treated the agents as competitors of its internal sales force. Prior to the 1990s, Tele-Direct sought to protect its client base from the agents by selling advertisers on using its services instead, stressing the advantages that dealing directly with Tele-Direct offered, including monthly billing and later closing dates, as well as considering more positive initiatives like assigning representatives to large accounts for a longer period of time. During the early 1990s, when Mr. Mitchell was head of the national accounts group, Tele-Direct actively competed for agents' clients. Mr. Mitchell testified that as of 1992, the approach changed to one of protecting internal accounts and revenue only but the documentation does not bear this out. Certainly, one of the reasons for the creation of Tele-Direct (Media) Inc. in 1994 was to combat the loss by Tele-Direct of national accounts to CMRs. The only "contradictory" evidence on this point is a somewhat unclear statement by Wayne Fulcher of DAC that prior to the formation of its CMR, Tele-Direct did not "normally" try to take away agency "headquartered" accounts. However, Mr. Fulcher does think that Tele-Direct's CMR is in competition with his agency.

383 Perhaps the most telling point is that Tele-Direct requires that agencies pay at the time of issue of a directory for advertising placed on behalf of their clients. If agents were only agents of Tele-Direct, they would not be financially responsible for the obligation of third parties -- the advertisers. This is compelling evidence that the agencies do not act as agents of Tele-Direct. The evidence is that Tele-Direct has always considered agents to be, and has reacted to them, as competitors.

384 Nor can the agents be considered to have no independent existence apart from the advertisers themselves that they also "represent" in the sense of placing orders for advertising on their behalf. Yellow Pages advertising is not a simple product to buy and advertisers desire assistance in making the purchase. Agents, however, are not *mere* "order placers" for advertisers or other advertising agencies employed by advertisers. The evidence before us, which is reviewed in more detail below, is that agents provide a range of services, including advice, layout, design and administration, for which they do not receive additional compensation beyond the commission paid by Tele-Direct. [160] Further, we have no evidence that much of the agents' business

consists of simply placing orders for another advertising agency employed by the customer to do the remaining work involved in producing the advertising. Advertisers want these other services in relation to their Yellow Pages advertising from agents. Thus, for advertisers, agents have a separate existence from Tele-Direct.

385 The relationship between Tele-Direct and agents is complex. Tele-Direct treats the agents as independent businesses with which they cooperate to advance their own objectives but with which they also compete. While Tele-Direct apparently recognizes that agents can service certain accounts better than its internal sales force, by reason of its creation of a class of commissionable accounts, it is also its goal, or at least the goal of certain groups within the corporation such as the national accounts group, to keep as much revenue as possible in-house and reduce its dependence on agencies to the absolute minimum possible. We conclude that the business relationship between Tele-Direct and agents is not inconsistent with Tele-Direct and agents treating each other as competitors.

(c) Additional Economic Benefit

386 The respondents argue that there is an "exception" to tying recognized in the American jurisprudence where the seller of the alleged tying product does not receive an "additional economic benefit" from the sale of the tied product. They say that Tele-Direct gets no additional economic benefit from the sale of services in this case because there is no "separate charge" for services.

387 The respondents cite two cases on this point. The first is *Directory Sales Management Corp. v. Ohio Bell*,[161] a decision affirming summary judgment granted against the plaintiff in an antitrust suit by an independent directory publisher against the telco and its directory publisher. The two defendants were wholly-owned subsidiaries of the same parent. One of the allegations was that the defendants tied business telephone service (tying product) to a free Yellow Pages listing (tied product) by refusing to reduce the price of the telephone service if the subscriber chose not to be listed.

388 The Court noted that an illegal tying arrangement might exist if the telco in some way charged for the "free" listing indirectly in the bill for telephone service, even though it did not charge for the listing directly. The evidence was that there was no hidden charge for the listing as the telco did not pay the publisher for the expenses incurred in publishing the listing. The Court stated that if the telco did not receive a "financial benefit" from the tied product, there could be no tying arrangement.

389 The second case is *Beard v. Parkview Hospital*.[162] Dr. Beard, an osteopathic radiologist, was employed by a group of doctors that was the exclusive provider of radiological services to Parkview Hospital. Dr. Beard resigned from the group with the intention of providing radiological services on his own to patients at Parkview Hospital. The hospital did not permit him to do so and Dr. Beard sued, alleging that the exclusive contract for radiological services was an illegal tie of radiological services to other hospital services. Under the terms of the contract between the hospital and the group providing the radiological services, the group billed patients directly for its services and the hospital did not share in the fee. The lower court granted summary judgment for the hospital.

390 In affirming the dismissal, the appeal court approved the lower court's reliance on the requirement that the seller of the tying product must benefit directly from the sale of the tied product. The Court held that the requirement was also consistent with *Jefferson Parish*, which stated that an illegal tying arrangement is one where a firm with market power attempts to impose restraints on competition in the market for the tied product, because the seller who "derives no economic benefit from sales of an alleged tied product or service is not attempting to invade the alleged tied product or service market in a manner proscribed by section 1 of the Sherman Act."[163]

391 Areeda explains the purpose of this rule in American case law and its relationship to tying as a *per se* offence:

> ... a tie-in, though affecting a substantial volume of commerce in the tied product, is not per se unlawful when it does not foreclose any rival supplier or, perhaps, when any such foreclosure is inherently minor....
>
> One convenient and frequent way to capture the concept of a relevant foreclosure is to ask whether the defendant has a financial interest in the tied product. In most courts, ties do not cross the threshold of potential power or effect when

> the defendant lacks an economic interest in the tied product, primarily because such a tie does not ordinarily enhance the defendant's power in the tied market or bring about any other consequences of the kind that the per se rule against tying seeks to prevent. "Foreclosure" there may be but not a relevant one. [164] (reference omitted)

Further, using the example of a defendant firm accused of providing its product *A* only to buyers who purchase *B* from a second, separate firm *T*, thus "foreclosing" other suppliers of product *B*, he explains:

> The defendant who gains not a penny, directly or indirectly, from firm *T*'s sales of product *B* is no "competitor" in the market for the tied product *B*. This much is clear, although there are difficulties ahead in deciding what type and magnitude of financial connection with firm *T* makes the defendant a "competitor" of those foreclosed suppliers. [165]

Therefore, where there is no financial interest in sales of the tied product or in the tied market, the alleged tie-in does not cross the threshold for *per se* illegality, although the alleged tie does remain subject to review under the rule of reason. [166]

392 There are three points to be made regarding this argument of the respondents. First, the test of lack of any financial interest in the tied market or economic benefit from the sale of the tied product, however worded, is closely linked in American law to the *per se* nature of tying, which makes us reluctant to adopt it directly because Canadian law is based on a different standard, that of "substantial lessening of competition".

393 Second, there is some validity to the Director's argument that the question of economic benefit from the tied product, or of participation by the firm with market power in the tied market, only arises when two separate corporate entities are involved in the supply of the tying and the tied products. That was the case in both decisions cited and is not the case on our facts.

394 Further, in the *Beard* case it was abundantly clear that the hospital itself, the supplier of the alleged tying product, was not a participant in the radiological services, or tied product, market in any way as it did not receive any part of the fee for those services, which went directly from the patient to the unrelated doctors' group. In *Ohio Bell*, the situation was less clear as the two corporate entities were related but, in any event, the Court was definitive that there was no evidence of a "hidden" or "indirect" charge for the Yellow Pages listing in the telco's bill for telephone service. The telco, the firm with market power, was not attempting to, in the words from *Beard*, "invade" the market for the supply of directory listings.

395 In contrast, on the facts before us, Tele-Direct itself supplies both space and services to all advertisers, both commissionable and non-commissionable. We also have evidence that it considers both consultants (detailed elsewhere) and agencies, the alternate service suppliers, to be its competitors. Since Tele-Direct provides services, it must be compensated for them. As a rational firm it would not provide something for nothing. Therefore, it cannot be concluded that it receives "no additional benefit" from its own sales of the alleged tied product. The precise form of that compensation or "benefit" is not at issue here. [167] Whether Tele-Direct has succeeded in foreclosing any alternate suppliers in the services market is evidently a relevant question but that is not what this argument of the respondents focuses on. This argument is that Tele-Direct gets no additional economic benefit from the provision of services and that, therefore, any exclusionary effects in that market are irrelevant because of the lack of linkage to the firm with market power over the tying product. The facts do not support this hypothesis.

(d) Separate Billing/Separate Payment

396 The respondents argue that if a producer pays for the "components" of a "product" directly and then sells the "product" complete with "necessary inputs" at a specified price, there is no tying. They state that the concept of tying *only* applies where the customer pays *separately* for the alleged tied and tying products. In oral argument, this was expressed as the proposition that it is not a tie to bundle something because as long as there is only one "cost" to the buyer, what is being sold is the supplier's single "product".

397 A distinction was drawn between the case at bar and the facts in *Jefferson Parish*, in which the respondents submit the items found by the Court to be separate products were not "bundled" but were in "two pieces" because there were two bills. They

argue that the patient in *Jefferson Parish* paid for both "parts", presumably hospital services and anaesthesiological services, and that if a buyer pays for two different things on two bills, there cannot be one product. Reference was also made to the case of *Collins v. Associated Pathologists, Ltd.* [168]

398 Turning to *Jefferson Parish*, the distinction drawn by the respondents between that case and the instant case on the facts relating to billing is not as apparent as argued. In *Jefferson Parish*, the hospital and Roux & Associates had a contract which provided that all anaesthesiological services required by the hospital's patients would be performed by Roux. The hospital agreed with Roux to provide an anaesthesia department, including space, equipment, maintenance and other services, drugs and supplies, and nursing personnel (subject to approval by Roux). The use of the anaesthesia department was restricted to physicians employed by Roux. As the Court said:

> The hospital has provided its patients with a package that includes the range of facilities and services required for a variety of surgical operations. At East Jefferson Hospital the package includes the services of the anesthesiologist. [169] (reference omitted)

399 The Court describes the billing arrangement as follows:

> ... The fees for *anesthesiological services* are billed separately to the patients by the hospital. They cover the hospital's costs *and* the professional services provided by Roux. After a deduction of eight percent to provide a reserve for uncollectible accounts, the fees are divided equally between Roux and the hospital. [170]
>
> (emphasis added)

400 The majority of the Supreme Court did consider the "separate billing" of "anesthesiological services" as a factor that entered into its determination of whether there were separate products. Yet, the actual billing arrangement, as described by the Court, looks very much like a combined bill for the tied product (professional anaesthesiological services) and part of the tying product (hospital services), much like Tele-Direct's bills for Yellow Pages advertising. Specifically, the amount billed included both a professional services portion for anaesthesiological services and a hospital-supplied anaesthesia equipment, facilities, support personnel and drugs portion. The fee is simply divided equally between the two, irrespective of the actual extent of professional services required in the particular case. It is not explicit separate billing of professional services.

401 In any event, there is no indication in the Court's decision that the factor of "separate billing" is essential or even critical. The most that can be said is that it is one factor to examine. We agree with the Director that if the entire resolution of the one or two products issue could be determined simply by the pricing or billing arrangements, this would allow suppliers to immunize all activity from tying claims simply by refusing to quote separate prices for items provided as a package.

402 Further, the Director submits that the mechanism or the route by which the money ends up in the hands of the separate service supplier is not relevant. In the commissionable market, the separate service supplier is paid by commission. A payment by commission may be somewhat more circuitous than, for example, direct billing by the hour by agents for their services (allied with a discounted price for space provided by Tele-Direct to persons who did not use its services) but the end result is the same -- the advertiser pays for the services, the advertiser receives the services of an agent, the agency receives payment for the services provided. Payment to agencies by way of commission was historically, and to a large degree still is, a fact of life in all advertising media.

403 The significance of the reference to *Collins* in this context escapes us. The Court in that case found that there was no distinct demand for pathology services as a product separate from hospital services. The Court did not refer to billing arrangements at all in making its findings. It based its conclusion solely on the lack of consumer or patient requests for specific pathologists or perception of pathology services as separate from other hospital services.

404 In summary, none of the cases referred to convinces us that the approach we have adopted to the separate product question is inappropriate. Several were largely irrelevant because they dealt with completely different facts or different, non-

tying, antitrust issues. To the extent issues were raised which we considered relevant, particularly in the other Yellow Pages cases, we dealt with them in that context. We will now proceed with the basic approach we outlined at the outset and consider the evidence and arguments relating to demand and efficiency.

(3) Demand by Advertisers

405 Are advertisers that fall in that portion of the market which Tele-Direct currently defines as non-commissionable interested in purchasing the services associated with creating and placing a Yellow Pages advertisement from a source other than Tele-Direct? In other words, does Tele-Direct's practice of bundling space and services for a single price "force" them to buy a product that they would rather not buy from Tele-Direct? Or, do they regard the two components as a package that they would rather not acquire separately in any event?

406 The Director called 19 advertiser witnesses; the respondents called two. All of the witnesses except the two called by the respondents expressed a desire to obtain the services associated with developing and placing Yellow Pages advertising from someone other than Tele-Direct. Seven of the 19 advertisers called by the Director are current agency clients; [171] the remainder of the advertisers are serviced directly by Tele-Direct representatives. Of those, eight use or have used a consultant. Three would like to use an agent but cannot qualify for commission.

407 Fourteen witnesses represent multi-outlet (whether franchised, licensed or corporate-owned), multi-directory advertisers. The geographic dispersion of the outlets ranges from a metropolitan area to country-wide. Three are single outlet but multi-directory advertisers because of the wide territory from which they draw business. The remaining four advertisers are single outlet, single directory advertisers. All of the witnesses called are spending above-average amounts in the Yellow Pages. Two were spending close to the average of $1,700 (at about $2,000 annually each); the remainder ranged from $7,000 to $300,000.

408 The respondents have not attempted to rebut the specific evidence of the advertisers who indicate that they would prefer to obtain advertising services from someone other than Tele-Direct. They called two witnesses to show that some advertisers prefer Tele-Direct's services, although one of those witnesses stated that advertisers should have the choice of dealing with Tele-Direct or using an agent. Counsel admitted in oral argument that in the "top end" of the market, some advertisers find the bundling of services and space by Tele-Direct problematic. He argues, however, that these advertisers constitute a "statistically insubstantial sample" and that there will always be a number of people "who would like to get something for nothing" and "as long as they aren't paying for it".

409 It is true that the customers called to give evidence constitute a very small proportion of total advertisers. They were not randomly selected and we do not treat them as a statistically significant sample. However, coupled with their anecdotal evidence of why they prefer to use agents is the evidence that in the current commissionable market, which includes grandfathered eight-market accounts, agents enjoy the lion's share of the business. When advertisers have the choice, the vast majority choose an agent, rather than Tele-Direct, for services. There is clearly separate demand beyond what Tele-Direct considers a "national" account (the 1993 definition) with respect to eight-market accounts, currently grandfathered. Moreover, there is no reason to believe that the line drawn by Tele-Direct between commissionable and non-commissionable accounts accurately reflects the boundary of demand; that those accounts that are commissionable prefer to use an alternate service provider while those who are not commissionable do not. Given the strength of demand for agents' services in the current commissionable market, we think it is reasonable to infer that the preference shown by the large majority of commissionable accounts for the use of agents extends down into the current non-commissionable market, at least to some extent. We are satisfied there is sufficient evidence before us to conclude that there is demand for separate advertising services below the existing commissionable market and that the advertisers called by the Director can tell us something about the nature of that demand.

410 Common amongst the Director's witnesses, whether single or multi-directory advertisers, was a preference for the advice or consultative services provided by an agent or a consultant over those of Tele-Direct. A recurring theme was that the agent or consultant provides an "overall" picture, reviewing all of the client's Yellow Pages advertising, including white pages listings, which headings were being used and which should be used, all the directories involved, what the client's competitors are doing and the nature of the business's markets. These service providers help plan the Yellow Pages advertising,

including recommending headings and, in some cases where the level of expenditure is higher, budgeting. In the case of agents, a representative is assigned to the account for a long period of time and the clients have the perception that the agency "understands" its particular business. That these service providers tend to pay attention to the overall picture is suggested by the testimony of two advertisers, one the client of an agent and one of a consultant, that the agency or the consultant was the one to bring to its attention duplicative advertisements in its Yellow Pages program.

411 The advertisers using agents also mentioned creative services as one of the elements of the service provided. For the clients of consultants, creative services are at least equally important since by re-designing an advertisement and by substituting other design techniques, like, for example, screening, for the more expensive size and colour, the consultants are able to reduce the cost of advertising.

412 In the case of both agents and consultants, advertisers generally perceive that these "independent" service providers are more interested in helping them get more out of their Yellow Pages advertising dollar than is the typical Tele-Direct representative. Frequently, according to the advertisers, the Tele-Direct representative does not have time to sit down and consult with the advertiser. The advertiser has to accommodate itself to the schedule of the representative faced with a full schedule and deadlines in a particular canvass. Another recurring complaint is that the Tele-Direct representative is more interested in selling more colour or a larger size than in arriving at the level and type of advertising that is right for that client; representatives are perceived as quite aggressive and prone to "upsell". Most of the advertisers also recognize that these problems result from the way in which Tele-Direct operates its canvasses and compensates its representatives; their comments were not directed at the representatives as individuals. While the agencies are also paid commission, individual representatives are paid straight salary for servicing the agency's existing client base. [172]

413 The multi-directory advertisers also prefer the services of third parties because they provide "co-ordination" or "administrative" services. These multi-directory advertisers are primarily the clients of agents rather than consultants. [173] They testified extensively about the advantages of using an agency which will keep track of publication dates for the various directories, control the uniformity of the advertisements, company image and message across directories and, where applicable, organize the contact between head office and franchisees or licensees for approval of advertisements and billing. Promoting a uniform message and image is particularly important to franchisers whose franchisees may be quite independent of head office and also to those which had enrolled businesses to their network which operate the franchised business as only a part of their overall business. [174]

414 It might be argued that the administrative services provided by agents are not supplied at all by Tele-Direct. [175] On that reasoning, administrative services would not be a component of the advertising services at issue in the tying case. The argument would be that since Tele-Direct does not supply administrative services, it is not in competition with agents because it is supplying different services and customers who want administrative services are free to purchase them separately.

415 It appears that, in fact, Tele-Direct has made some effort to provide the administrative services emphasized by the advertiser witnesses who appeared before us (uniformity and coordination) through its national accounts group and with its efforts regarding continuity. Further, while it is possible that such administrative services could *conceivably* be purchased separately, there is no reason to believe that it would be efficient to do so. There is no evidence of agents providing these services to advertisers who use Tele-Direct for the remaining services, even though there is clearly a demand for them. The fact that Tele-Direct provides administrative services in some cases but not in others simply means that Tele-Direct and the agents are not providing precisely the same product. Indeed, one would not expect to find homogeneous packages of services. Otherwise, there would be no reason for customers to choose one service provider over the other. Therefore, we are satisfied that administrative services are a relevant and important aspect of advertiser demand for advertising services.

416 We now turn to the respondents' argument that advertisers only prefer agents because they are getting something for nothing or they are not paying for the agents. We do not accept this argument. The advertiser is paying for the advertising services whether provided by Tele-Direct or, if the account is commissionable, by an agent. With respect to the use of consultants, advertisers pay to use consultants as Tele-Direct's price remains the same but the consultant charges the advertiser a portion of

the amount the advertiser saves by use of the consultant. Those savings would otherwise be for the advertiser to either spend on more Yellow Pages advertising or to pocket.

417 Even if we were to accept that the cost to advertisers of obtaining services is the same whether they choose Tele-Direct or an agent, we think it is still evidence of separate demand that where advertisers have the choice, the advertisers prefer to use agents. However, the evidence is, as will be explained, that when advertisers use agents, they bear costs additional to what they would have to bear if they placed their advertising through the Tele-Direct representative. Thus, it is apparent that customers prefer agents even if it is more costly to use an agent than to deal directly with Tele-Direct. This is strong evidence of demand for the services of agents by advertisers when they have the possibility of using them.

418 One source of higher cost derives from the billing practices of Tele-Direct. When advertising is placed through Tele-Direct's representative, the cost of advertising is divided into twelve equal parts and included in the Bell Canada telephone bill commencing upon issue of the directory. Advertisers who use agents are required to pay for their advertising on an issue basis, that is, to pay the full amount upon issue of the directory. When this occurs the advertisers' additional cost of using an agent is roughly one-half the annual cost of funds or, in other words, one-half of the commercial interest rate. [176] Given interest rates over the past 20 years, this has, depending upon the time, constituted approximately three to six percent of the advertising bill, a cost the advertiser does not pay if it uses Tele-Direct's services. In the words of Mr. Kitchen of Lansing Buildall, these advertisers are "paying a premium in terms of the payment schedule." While it is true that some advertisers that used agencies have arranged for periodic payments, no arrangement disclosed in the evidence is as favourable to them as the Tele-Direct monthly billing practice.

419 Another cost borne by some advertisers in order to use an agent is the placing of "extra" advertising in directories outside the areas from which the advertiser draws its customers so that the criteria for the eight-market rule (grandfathered accounts) are met. Five advertiser witnesses buy "extra" advertising. In one case, the cost of the additional advertisements is paid by the agent; in another the agent pays 15 percent of the cost of the additional advertisements. The other advertisers bear the full cost of the "extra" advertising.

420 How far down does the demand for separate services extend? We have evidence from a number of advertisers, both agency clients and clients of consultants, probably best described as large local or regional advertisers. Despite the amounts they are spending in Yellow Pages, these advertisers would not qualify even under the eight-market rule if they only advertised in the areas where they have locations or from where they draw business. [177] Since there are only seven market areas in Ontario and six in Quebec, that rule requires advertising outside the boundaries of each province. [178]

421 However, we did not hear from any truly "small" advertisers. Although two of the advertiser witnesses spend about average amounts in the Yellow Pages, they are the outlying examples. Most of the remaining witnesses, even those using consultants, spend at least $10,000 and most spend considerably more than that. Advertisers spending more than $10,000 annually represent only two percent of Tele-Direct's total advertisers by number and about one-third of its advertising revenues. There are, therefore, a vast number of advertisers representing a significant amount of revenue about which we know little regarding the character of their demand for separate advertising services.

422 The Director refers us to documentary evidence dating from 1975 when Tele-Direct changed to the eight-market commission rule to show that approximately 20 percent of the pre-1976 agency customers purchased less than $1,000 per year of Yellow Pages advertising. Many purchased as little as $500 worth of advertising annually. We have no reason to doubt the accuracy of these statements. We are reluctant, however, to reach conclusions about "small" advertisers based only on documentary evidence that is some 20 years old.

423 On the other hand, we have the views of Michael Trebilcock, the respondents' economist expert witness, [179] regarding "smaller" advertisers, which imply that these advertisers do not demand advertising services from a source other than the publisher. Based on the data provided in the report of the Office of Fair Trading, [180] he notes that for smaller advertisers, the cost of providing advertising services overwhelmingly comprises space and selling effort rather than advisory services. The

reasoning behind these statements is sound and there has not been any evidence or argument to the contrary. It is certainly plausible that the lowest-cost "advertisements", for example a bold listing, do not contain much, if any, creative content. We therefore accept that the general thrust of this argument is valid and that, for "smaller" advertisers, it is highly doubtful that a separate demand for advertising services exists. [181]

424 The evidence supports the view that there is buyer interest in obtaining advertising services from suppliers other than Tele-Direct over at least part of the spectrum of advertisers. While it is difficult to know where exactly to draw the line, we can conclude at this point that there is no evidence that would satisfy this threshold test of separate demand from "smaller", including new, advertisers. It is apparent that the larger advertisers would have the greater need for the services of agents or consultants based on the complexity of their advertising. Smaller, including new, advertisers whose advertising is relatively more simple likely would not have such need.

425 However, based on the evidence before us, we are not prepared to draw a firm line below which we could confidently say there is no evidence of buyer demand for services of independent advertising service providers. Therefore, at this point, we only conclude that there is evidence of buyer demand for advertising services for suppliers other than Tele-Direct for "larger" advertisers.

(4) Respondents' "Efficiency" Arguments

426 Given the evidence of demand for services from suppliers other than Tele-Direct, is there evidence that efficiency considerations would dictate a single product? Based on the historical practices of Tele-Direct, the Director has ample evidence that the products can and were, in fact, sold separately. Pre-1975, a large percentage of advertisers could acquire services from a source other than Tele-Direct. Under the eight-market rule and the 1993 rule, any advertiser that qualifies or can make itself qualify by some extra advertising can acquire services separately from an agent. The respondents have put forward a number of efficiency arguments which, if valid, they say would lead to the conclusion that there is a single product and therefore, no tie. These arguments are largely based on the analysis and evidence of Professor Trebilcock, their expert witness. There were also profitability studies entered in evidence by the respondents and they will be dealt with in the next section.

(a) Impossibility of Leveraging: Fixed Proportions

427 Professor Trebilcock, for the respondents, is of the view that the Director's theory that Tele-Direct is attempting to leverage its market power (assuming it has market power) over space into the services market by bundling space and services is not valid. He states that such leveraging cannot occur because advertising space and advertising services are complements which are consumed in fixed proportions. There is agreement between the experts on both sides that complementary goods used in fixed proportions imply that the only profit-maximizing motive to bundle the two products is in order to minimize costs; all opportunities to exploit market power could be accomplished with control over either product. This implies that the bundling is socially efficient and it should be concluded that there is only one product. [182]

428 Professor Slade, for the Director, argues that space and services are at least partially substitutable. Professor Slade is of the view that:

> ... it is possible to achieve the same impact by using a large ad or one that is cleverly designed. In addition, astute targeting of the "right" directories can substitute for purchasing space in a larger group of directories. More generally, an agency that provides service can often advise on ways to cut expenditure on space while maintaining the same level of advertising impact. In addition, it might even suggest ways of obtaining a higher impact from lower expenditure by, for example, substituting white knockout for colour. [183]

Because of the failure of the assumption of complementarity, she argues, leveraging is possible. Certainly the possibility of an extension of market power over a substitute, even if only a partial substitute, is one which causes concern and should be examined further.

429 The evidence supports variable rather than fixed proportions. To the extent that agents tend, compared to Tele-Direct representatives, to be less likely to promote increased expenditures on space, the additional expenditures on advertising services by agency clients (through the purchase of extra advertising, foregoing monthly billing) lead to the substitution of advertising services for advertising space. Furthermore, once it is recognized that there is an issue of the quality and content of advertising services, as indicated by the evidence of advertisers and their willingness to pay more for agents than it would cost them to use Tele-Direct's representatives, even assuming the same expenditure on space using an agent or Tele-Direct, it is difficult to see how advertising services are being consumed in fixed proportions with advertising space.

430 The evidence regarding the activities of consultants also suggests that advertising services and advertising space are not used in fixed proportions, and that they are partial substitutes. The purchase of services from a supplier other than Tele-Direct results in reduced expenditures on space. An example provided by a consultant concerned a very large and apparently inappropriate existing advertisement for a taxi company in the Hamilton area. The existing full page advertisement included a large picture of an airplane and reference to airport service. The consultant (Serge Brouillet of Ad-Vice Communications) determined from his marketing needs analysis for the client that he actually did very little airport business. The changes proposed by the consultant were both less costly and appeared to be more effective.

431 We conclude that advertising space and service are not consumed in fixed proportions and it cannot therefore be assumed, as argued by the respondents, that only efficiency explains why they are bundled by Tele-Direct.

(b) Widespread Industry Reliance on Internal Sales Force

432 As part of his expert evidence on behalf of the respondents, Professor Trebilcock stated that any theory of the tying allegations in this case must explain four central facts. One of those facts is stated as:

> Almost all yellow pages directory publishers organize their selling functions in a similar way to TD i.e. by heavy reliance on an internal sales force. [184]

It is not in dispute that all North American publishers, whether telco-affiliated or independent, rely heavily on their internal sales force. The Director has, however, brought forward evidence indicating that where the line is drawn between accounts that are open to agency competition because they qualify for commission and those which are exclusive to the internal sales force differs from publisher to publisher. The Director further argues that Tele-Direct's current commissionability rule is one of the strictest in North America.

433 The respondents submit that Tele-Direct's national account definition simply represents the transposition of the YPPA national account definition (also referred to as the YPPA "A" account definition) into the Canadian context. The YPPA by-laws provide that, as a minimum standard, an advertising program involving two or more publishers, 20 or more directories, and at least three states with 30 percent of the advertising revenue outside the primary state is considered national Yellow Pages advertising. Publisher members must accept advertising meeting those criteria as national. They are not precluded from accepting advertising meeting less stringent criteria as national. Each publisher decides on the level of compensation for advertising it defines as national.

434 While the *terms* of the YPPA definition are similar to those used by Tele-Direct in its definition, the evidence was that the effect of applying the definition in Canada is very different. Where there are about 6,000 directories in the United States, there are only about 350 in Canada. Tele-Direct is one of only seven or eight publishers in Canada and controls 70 percent of Canadian Yellow Pages publishing revenue. Tele-Direct's definition incorporates a minimum of two provinces instead of three states. Tele-Direct requires 20 percent of the published revenue outside the primary *publisher's territory*; the YPPA definition requires 30 percent of the revenue but outside the primary *state*. Under the YPPA definition, as long as two publishers are involved, there could be minimum revenue in the second publisher's territory. According to the agency witnesses, the 20 percent requirement is especially onerous given that Tele-Direct's territory includes the two most populous provinces. Overall, commission is currently

paid on 13 to 14 percent of total directory advertising revenues in the United States as opposed to seven to eight percent of total revenues in Canada.

435 Although it is true that an account wholly within a large state such as California (with a larger population than all of Canada) might not be commissionable under the "A" account definition, according to the President of the YPPA, most publishers, including telco affiliates (RBOCs) pay commission on regional accounts, called "B" accounts. For example, the evidence was that Pacific Bell has a commissionable account which could include accounts wholly within the state of California.

436 In Canada, with one exception, all the telco publishers require advertising to be placed in two publishers' territories to qualify for commission at 25 percent, [185] usually with a minimum of 20 percent of revenues required outside the dominant publisher's territory. Effectively, this generally means that two provinces will also be required. [186] Since the other publishers have much smaller territories than Tele-Direct, their "two publishers" requirement is easier to meet.

437 Professor Trebilcock places great stress on the fact that independent publishers also rely heavily on an internal sales force because "many of these directories do not remotely possess any market power (however measured) in many of the directory markets in which they operate." [187] Therefore, he concludes

> *The stark and enormously significant implication of this fact is that the decision to vertically integrate advertising selling functions clearly has nothing to do with market power*. It must be explained entirely by the kind of efficiency considerations ... outlined earlier in this opinion. [188]

438 Based on the evidence from White and DSP, we know that, in Canada at least, despite the fact that they offer commission on all accounts brought to them by CMRs, [189] the independents rely heavily on their internal sales force. The evidence that we have is that an internal sales force is a *necessity* for their survival rather than a choice based on efficiency considerations. Despite the liberal commission rules, they receive a small proportion of their overall revenues from agents and must rely on their own sales force for the bulk of their revenues. [190] In fact, recruiting an effective sales force is one of the hurdles a new publisher has to overcome.

439 While we agree that the independent publishers are unlikely to have market power, we are reluctant to conclude solely on the basis of the fact that they rely on an internal sales force that the "bundling" of sales and service by a publisher with market power is competitively benign. [191] We would likely be willing to draw that conclusion if we had evidence that the markets in which independents are operating, particularly in the United States, are competitive. If they were, yet most sales by publishers were on a bundled basis, that would be a very strong indication that efficiency was dictating the bundling and that there was only one product at issue. The only evidence we have, however, is that those markets, like Tele-Direct's market, are dominated by the telco publisher. It was pointed out to us by the respondents that most RBOCs' prices are even higher than Tele-Direct's. We also referred in the section dealing with Tele-Direct's market power to testimony that indicates that American telco publishers also have sufficient profits to subsidize local telephone service. We are, therefore, not satisfied that widespread reliance on an internal sales force across publishers, including independents, dictates a single product on efficiency grounds because it may be a function of telco dominance in all markets.

(c) Agents' Views

440 The implication of finding and prohibiting the tied selling alleged by the Director is that agents would, one way or another, be permitted to offer their services to a wider range of accounts below the level of "national" accounts currently considered by Tele-Direct as commissionable. Professor Trebilcock is of the view that agents are not interested in servicing smaller accounts.

441 In interviews with agents that the Director's staff undertook in investigations prior to filing the application, the agents stated that they were not interested in the smaller accounts. As reported by Professor Trebilcock, who had access to the summary of the interviews prepared by the Director's counsel, the smallest accounts that any of the agents expressed an interest in ranged from those spending from $10,000 to $50,000 per year on Yellow Pages. A lower limit of $10,000 excludes almost 98 percent

of all customers and approximately 70 percent of total revenue but would represent a substantial increase over the amount of revenue currently commissionable.

442 When giving evidence the agents took a different position and stated that they would be interested in all customers but would handle the business differently. The only reasonable interpretation is that the early answers reflected the agents views given their current method of operation. Their answers when giving evidence, in contrast, reflected the willingness of businesspeople to consider any reasonable opportunity to turn a profit, including considering the possibilities of paddling into uncharted waters. On the whole, we regard their views during the interviews as the more reliable. Because the agents apparently have little or no interest in servicing smaller accounts, we infer that they regard themselves, at least in their current setup, as at a cost disadvantage *vis-à-vis* Tele-Direct in dealing with these smaller customers.

443 Therefore, we agree with Professor Trebilcock that agents are not interested in servicing smaller accounts, although neither he in his evidence nor the Tribunal at this stage can be more explicit than having regard to the $10,000 to $50,000 range about what constitutes "smaller" accounts.

(d) Justification for Tele-Direct's Practice of Bundling

444 Professor Trebilcock attempted the most complete explanation and justification of Tele-Direct's practice of bundling space and services over most advertiser accounts. Initially, he divides what the Director has alleged to be advertising services into selling effort and consulting advice regarding the advertisement (artwork, placement, etc.). He states that selling effort cannot be priced on its own as customers will not pay for a "sales pitch"; it must be bundled with either space or consulting advice. The overall problem facing Tele-Direct (and other publishers) is to exercise control over those selling its product and to motivate agents or internal staff, as the case may be, to provide an optimal mix of selling effort and consulting advice *from Tele-Direct's viewpoint*. The Tribunal agrees that there is what is known as a "principal/agent" problem at work here. The issue is the nature of the problem and whether Tele-Direct's viewpoint is the only relevant one or should be the operative one.

445 Professor Trebilcock divides his explanation concerning Tele-Direct's approach to commissionability into three categories: small advertisers, larger local advertisers (which presumably includes regional advertisers) and currently commissionable advertisers (larger national or regional accounts involving multiple publishers). We have accepted that it is likely that small advertisers have no separate demand for advertising services. New advertisers, with few exceptions, coincide with small advertisers. For the sake of completeness we continue with the "efficiency" or cost-side evidence for all advertisers including small advertisers.

446 Professor Trebilcock's primary explanation of why Tele-Direct prefers to rely on its own resources for servicing small customers is that it is highly likely that it is cheaper for Tele-Direct to service small customers internally. His view is that the most effective method of selling advertising to these customers, probably because of significant economies of scale, appears to entail "'blanketing' directory territories in concentrated time blocks on a sequential basis" as Tele-Direct currently does. It is, however, not self-evident that this approach results in lower per unit costs than using smaller numbers of representatives who take a longer time to do a canvass. There is simply no evidence.

447 Another factor cited by Professor Trebilcock that is likely to lead to attenuated efforts by CMRs regarding small advertisers is the possibility that advertisers would engage in opportunistic conduct. The difficulty Professor Trebilcock foresees is that once the successful selling effort has been made, which the customer is unwilling to pay for, the customer is in a position to ask for, and other sellers are in a position to offer, a discount because they need only provide the consulting advice and not the selling effort, for which the first seller will be uncompensated. He believes that this problem is most acute for small advertisers, including first-time buyers. For large advertisers, selling effort constitutes a smaller percentage of overall advertising services. In addition, larger customers might have more difficulty engaging in opportunistic conduct because they are more likely to become known to agents. Tele-Direct can avoid this "free riding" by small advertisers by bundling space and selling effort. This is a version of the free riding argument often made in defence of vertical arrangements such as resale price maintenance which may be valid in some circumstances. There is, however, absolutely no evidence that it applies on the facts in the instant case.

448 Professor Trebilcock also points to a divergence of interest between Tele-Direct and agents which leads to an incentive compatibility problem should Tele-Direct use agents to service small advertisers, otherwise referred to as the "completeness externality". This externality, compounded by advertiser opportunism as explained above, is also the principal explanation advanced for why Tele-Direct prefers to provide services internally for "larger local" advertisers. As Professor Trebilcock recognizes, a simple cost difference cannot explain the reluctance of Tele-Direct to offer a commission on these accounts as the agents would not service them, even if commission were offered, if they were at a cost disadvantage to Tele-Direct.

449 According to Professor Trebilcock, there is a positive correlation between the "completeness" of a directory and the value that users place on it. Advertisers are willing to spend on a directory to the extent that the users find it valuable. But since each individual advertiser benefits only minimally from their own contribution to completeness, they are unwilling to pay for this effect. Tele-Direct, as the publisher, is able to internalize this externality over the longer term (the more "complete" and useful the directory, the more valuable the advertising space and the higher rates it can charge).

450 While there is no doubt that publishers value "completeness" for the reasons stated, it is largely an undefined term. There is no explanation in Professor Trebilcock's evidence, for example, of why a directory is in any sense more complete when there are paid bold listings rather than unpaid listings in ordinary type. Nor is there any adequate explanation of why users would value more advertisements in colour or larger advertisements unless they provide more information. There were also indications from the evidence that there can be *too much* advertising from the viewpoint of users. In large centres such as Montreal and Toronto, it has been necessary to split directories because of their size. Thus, while it is indisputable that directories must have sufficient representation by advertisers so that the directory is considered to be a useful reference, it is far from clear that *all* increases in advertising contribute to this objective. This point is critical because if Tele-Direct is encouraging increased selling effort beyond the range where further advertising contributes to completeness in any meaningful positive way, then the ability of Tele-Direct to sell additional advertising through its own sales force cannot be assumed to be socially beneficial in providing users with additional value.

451 Professor Trebilcock is of the view that the completeness externality leads to two results. First, Tele-Direct has a stronger incentive than CMRs to recruit new accounts; CMRs will focus most of their efforts on attracting existing advertisers from Tele-Direct or other CMRs. Second, while Tele-Direct is interested in retaining customers over the long term in order to enhance completeness, CMRs will be more concerned with immediate returns. Thus, when Tele-Direct recommends the, in Professor Trebilcock's words, "optimal" advertising package, the CMR will have an incentive to convince the advertiser that a less expensive or "sub-optimal" package is equally useful in order to recruit the customer. The risk of dissatisfaction on the part of the customer is increased; the customer may stop using Yellow Pages because of informational imperfections which make it difficult to distinguish between weakness in the medium and bad advice.

452 Further, Professor Trebilcock is of the view that it would be difficult for Tele-Direct to structure incentives to CMRs to induce them to sell a "socially optimal" quantity and quality of advertising by way of contract because of significant transactions costs. On the other hand, Tele-Direct can and does motivate its internal sales force "to sell and advise clients to purchase optimal packages by offering training, encouragement, screening of advertising sales by managers, internal promotions, awards, a team ethic, etc." [192]

453 The Tribunal is inclined to agree with Professor Trebilcock that it is probably easier for Tele-Direct to create incentives that motivate its own representatives to sell more than agents. The more important question is whether leaving Tele-Direct the unfettered choice of when to use agents and when to service internally leads to a truly "socially optimal" result. We have already indicated some doubts that the unrestricted pursuit of completeness, while it may be in Tele-Direct's interest, is wholly in the public interest or "socially optimal".

454 The Director argues that Tele-Direct chooses to retain services in-house because this allows it to motivate its sales force to exploit better the "information asymmetry" it enjoys *vis-à-vis* its customers or, in other words, to "oversell". He submits that Tele-Direct's incentive structure results in its sales representatives convincing advertisers to buy more than they would if they were provided with balanced information or the possibility of obtaining an alternative viewpoint from another service supplier.

Witnesses stated that they did not regard the advice from Tele-Direct's representatives as objective. We have acknowledged that, as a general matter, the effectiveness of marginal dollars spent on advertising is difficult to determine. This leaves customers somewhat vulnerable to the advice they receive. The incentive structure for Tele-Direct's representatives makes the Director's argument that they are motivated to "oversell" at least plausible. To the extent that the Tele-Direct representatives succeed in selling "too much" advertising to one advertiser, the effect would multiply throughout a heading, since, as the evidence revealed, many firms base their Yellow Pages expenditures on that of their competitors (the "prisoner's dilemma"). We, therefore, cannot accept Professor Trebilcock's critical assumption that the advertising a Tele-Direct representative sells is necessarily socially optimal.

455 With regard to recruiting new customers, we accept that a publisher would want to ensure that there was a thorough and efficient canvass of potential new customers, in the sense that all were approached and there was no duplication of effort. Since the prospective new Yellow Pages advertisers are easily identifiable from business telephone subscriber information in the hands of the publisher, it makes sense to assign them to specific persons rather than creating a "free for all". This can be done on an individual basis, by territory, or any other method that avoids multiple contact of the same prospect by different persons. The assignment is key; if customers are assigned it makes little difference whether the persons making the contact are employees or outside agents.

456 Professor Trebilcock also believes that a reason why Tele-Direct does not make larger local customers commissionable is that agents would curry favour with customers by recommending less than the "optimal" amount of advertising (or the amount that a Tele-Direct representative would recommend), with long-term detrimental effects, because they are primarily interested in immediate returns. While Tele-Direct may worry about the advice being given by agents, it is far from clear that the quality of their advice is a cause for concern with respect to satisfying the needs of consumers. The facts before us do not support Professor Trebilcock's view that agents tend to take a short-term view. When the actual relationships between customers and agents and customers and the internal sales force are considered, it is the former who have the long-term relationship. Until recently most Tele-Direct representatives, *unlike* agents, predominantly had a short-run relationship with customers. Professor Trebilcock also acknowledged that agents might be reluctant to be perceived as pushing current sales because customers might be inclined to switch agents. Tele-Direct's representatives do not have this concern because customers do not have freedom of choice. Much of the representatives' livelihood depends on increased sales to existing customers whereas the employees of the agents are on salary and receive no additional compensation for increased sales to existing clients.[193] Moreover, there is no evidence that agents' clients have tended to cancel advertising for any reason.

457 In Professor Trebilcock's view, the fact that Tele-Direct chooses to pay commission on multiple publisher accounts is evidence that Tele-Direct is motivated by efficiency considerations with respect to all its decisions regarding commissionability. Otherwise why would Tele-Direct choose to make any part of its sales commissionable? Professor Trebilcock interprets the fact that Tele-Direct pays commission on national accounts and that the bulk of sales to this segment is made by agents as proof that agents can more efficiently service this segment. While Professor Trebilcock believes that the tendency of agents to undersell and focus on existing advertisers and the possibility of opportunism are still present, the cost advantages of agents compensate for these weaknesses. These sophisticated advertisers are also better able to monitor whether they are being sold the "optimal" amount of advertising and the possibility of losing such a client effectively polices the agent. While the Director accepts that the agents are more efficient in servicing the commissionable segment, he disputes, as noted above, that agents in any circumstances sell "sub-optimal" amounts of advertising as defined by Tele-Direct's perspective. The Director takes issue with the view that Tele-Direct is more efficient in dealing with the rest of its customers. Detailed evidence on relative efficiency was placed before us and is the focus of the next section.

458 In summary, as indicated in the section on advertiser demand, we have accepted Professor Trebilcock's view that there is no separate demand for advertising services for "small" customers. With respect to those advertisers for which separate demand has been proven, called "larger local" advertisers by Professor Trebilcock, the Tribunal does not accept that either the completeness externality or the possibility of advertiser opportunism is supported on the evidence before us and, therefore, does not dictate that space and services are a single product with respect to those customers. The question of relative efficiency or cost advantages on the part of Tele-Direct with respect to servicing those advertisers will be addressed in detail in the next section.

(5) Comparative Profitability Studies: Agents/Internal Sales Force

459 The respondents have introduced evidence bearing on the comparative efficiency of Tele-Direct's representatives and agents to argue that the commissionability rules are, and always have been, efficiency based. The primary evidence is a comparative cost study dated 1995 created for these proceedings and entered through Michel Beauséjour, Tele-Direct's Vice-president of Finance. In addition, there are two other internal contribution-to-profit studies from 1974 and 1985, along with the descriptive evidence of Donald Richmond, Director of Manufacturing and Contract Administration for Tele-Direct, and Jan Rogers, Director of Corporate Methods and Support.

460 Before turning to a detailed discussion of the evidence it is necessary to consider its import with respect to the respondents' claim that its policies with respect to the payment of commission and the utilization of agents are dictated by efficiency considerations. While the studies referred to are relevant to the respondents' position, there are very important caveats that seriously weaken the conclusions that can be drawn from the evidence. Firstly, in an ordinary "make or buy" decision what is being compared is only the *cost* of producing a particular product in-house or buying it. This basic requirement (of looking only at cost) is violated when a comparison is made between the *contribution to Tele-Direct's profit* by the internal sales force and agents, i.e., revenue considerations enter.

461 More importantly, the products (i.e., the provision of services to commissionable and non-commissionable accounts) being compared in the Raheja study from 1974 and the 1995 study are very different. In fact, these studies are well described by the comparison of "apples and bananas". It is difficult to see what can be derived from the exercise of comparing the contribution to profit of agents and Tele-Direct's representatives who each deal with an entirely different set of customers. A significant percentage of the non-commissionable accounts are dealt with entirely over the telephone. Where representatives meet with customers, the customers' needs, for the most part, cannot be compared with the large multi-directory customers who rely on agents. What is the point of comparing the contribution to profit of agents, who are acknowledged to be relatively effective in serving complex "national" customers, with the contribution to profit of Tele-Direct's representatives in serving customers, many of whose requirements are relatively simple? While the comparison in 1985 between NAMs/NARs and agents might be considered to be a close, although not an exact comparison, the data are not current and not particularly detailed.

462 Overall, we have found these profitability studies not to be supportive of the respondents' position. The early studies are out-of-date (and Raheja is of limited relevance because of the difference in products being compared and an error in it), a critical point when considering current efficiency. At numerous points in the 1995 study, the differences in costs can be traced to differences in the characteristics of the customers being served rather than to any possible difference in the relative costs of agents and Tele-Direct's personnel. It also suffers from bias in favour of Tele-Direct because of its time frame and from methodological weaknesses.

463 For completeness, we will comment on the studies to further explain why, in our opinion, they are not reliable for the purpose advanced by the respondents, that is, to demonstrate that Tele-Direct's internal sales force is more efficient than agents.

(a) Raheja Study (1974) [194]

464 This study was prepared as part of a review of Tele-Direct's policy towards advertising agencies, including agencies specializing in Yellow Pages, which were a relatively recent phenomenon at the time, with a view to determining a commission payment. The study itself notes that the system of classifying accounts at Tele-Direct made it difficult to calculate profitability of the various components. Nevertheless, Mr. Bourke was of the view that management at the time placed sufficient confidence in the results of the study to make decisions on the basis of it. The study showed that in the "local market", defined as all sales within Tele-Direct's own directories, agency sales were less profitable. Although there is no evidence of the weight that the study played in the decision, in 1976 Tele-Direct sharply restricted the commissionable market by moving to the eight-market rule.

465 The odd thing about the exercise is that, taken on its own terms, there is an obvious error in the study: the commission to agents is counted both as a reduction from revenue *and* as an expense. When the error is corrected the comparative ratio

is somewhat better for the agents than it is for Tele-Direct's own representatives. The respondents take the position that the existence of the error is irrelevant; management acted on the information, proving that Tele-Direct was motivated by efficiency considerations and not by any other motive. While the study may suggest that Tele-Direct was at least *interested* in efficiency at the time, it is peculiar that so simple an error was not easily immediately detected by those supposedly basing decisions on it. In the circumstances, and having regard to the many qualifications in the study, the existence and results of the study are not of assistance.

(b) Profitability Study: National Accounts - Selling (1985) [195]

466 This study deals with the contribution to profit of national accounts serviced by agencies and NAMs in 1983 and 1984. Agencies included specialized and regular agencies while the NAMs included one Tele-Direct sales representative who dealt with high revenue potential customers and another who dealt with low revenue potential customers.

467 The study was entered in the record during the cross-examination of Mr. Beauséjour. Although the bottom line contributions to profit were noted, there was no examination of the study with the witness other than to establish that the then prevailing methodology regarding the payment to Bell Canada was employed. Based on the description in the document the only costs that were specifically attributed to the agents and NAMs were agency commissions and so-called sales expenses. The latter included the salaries of sales personnel in the national accounts group but also the personnel who processed orders submitted by agents. [196] All other costs were allocated on the basis of the net revenues generated by each of the two channels.

468 For the combined eastern and western regions, the contribution to profit as a percentage of total revenues generated for the agents and NAMs in 1983 was 18.7 percent and 17 percent respectively. In 1984 the contribution was 20 percent for both. While there are caveats, [197] the important point that emerges from the study is that Tele-Direct had no reason to believe at that time that it was less costly to rely on its own representatives who dealt with customers with the same or similar characteristics as those served by agents. The respondents did not bring to our attention any further study or any evidence whatsoever of internal consideration of relative efficiency leading up to the 1993 change in the commissionability rules. The only documentation on the record, and the evidence of Mr. Mitchell who was intimately involved in the preparation leading up to the change, focuses on effects on number of accounts and revenues that would be available to agents or the internal sales force under various scenarios.

(c) Profitability Study (1995) [198]

469 Towards the end of the hearing counsel for the respondents introduced through Mr. Beauséjour a document comparing the relative contribution to profit in 1994 of agents and the internal sales force, including the national accounts group. The document was admitted over the strenuous objections of counsel for the Director. During discovery, Tele-Direct provided a cost of sales figure for its internal sales force of 12.3 percent of revenue. The basis for that figure was explored through detailed follow-up questions and further explanation. There was no indication from the respondents that a second study was being undertaken by Tele-Direct, and that it contained results that were different from those that had been given on oral discovery and in follow-up answers. On December 4, 1995, counsel for the respondents produced the second study to counsel for the Director.

470 While we found the timing of the production and, in fact, counsel for the respondents' conduct of this whole matter of the new study to be, to say the least, unfortunate, we admitted the document while allowing the Director further discovery and preparation time. Despite the inappropriate timing, we were of the view that the Tribunal should not forego receiving information that could have an important bearing on the case and which apparently went to the heart of the respondents' position that the bundling of space and services by Tele-Direct was dictated by efficiency considerations.

(i) Unrepresentative Timing of Study

471 Apart from the general difficulty, already highlighted, of comparisons being made between the servicing of very different types of accounts, there is another serious defect in the recent study. The period for which the study is done almost certainly creates a bias in favour of the internal sales force *vis-à-vis* the agents because of the state of progress of certain improvements Tele-Direct was making to its process. The study fails to take account of the fact that the application of technology is in a period

of transition. While improvements favouring the internal sales force have been put in place, those favouring agents are on the immediate horizon. Despite this, the latter have been ignored in the study.

472 The system that Tele-Direct was putting in place in 1994 with respect to the publishing process was much more efficient for the internal sales force than the system that it replaced. More specifically, a computer system was introduced that allowed the electronic storage of advertisements, including finished artwork. This means that advertisements that renew without change, about 70 percent of all advertisements, are already in the computer. This is contrasted by Mr. Richmond with the previous system:

> ... In the old system, when we used an outside supplier [for pre-press functions, e.g., layout, paste-up], if we got an ad from last year, we may or may not have found that artwork because it was kept in a filing cabinet somewhere. It meant that the next year we had to have an artist redraw the artwork to match what was in the book before. This was very inefficient. We had to store logos all over the place so that everybody could get hold of it. [199]

There are also savings when there are changes to the advertisement. Under the new system, minor changes can easily be made on the electronic version of the advertisement.

473 Although agents submit their advertisements "camera ready" (as "veloxes"), they must be scanned into its system by Tele-Direct. If there is no change in an advertisement from the previous year then it follows that it should be possible to avoid re-scanning the advertisement, as it is already in the system, so some savings should be possible. Mr. Richmond did not know the percentage of agents' advertisements that are repeated without change but he did state that *all* CMR advertisements are scanned, implying they are scanned even if there is no change. It is not clear why Tele-Direct does this.

474 Thus, until recently and certainly when commission was further restricted in 1993, the costs that Tele-Direct would have experienced for the internal sales force were those that existed prior to the introduction of the new system. Under the old system the fact that agents were submitting complete advertisements meant that the cost comparison in the publishing part of creating a directory was far more favourable to agents than is presently the case. According to Mr. Richmond the cost of implementing the new system is $26 million and the annual savings are of the order of $12 million, which would have made previous publishing costs for internally-generated advertisements almost twice as high as they were in 1994.

475 Using current data disadvantages the agents with respect to the near future. There would be no need to scan agents' advertisements if the advertisements could be transmitted electronically. Currently, newspapers and magazines have systems in place for this purpose. The Yellow Pages publishers are moving in this direction, according to Mr. Logan, the President of the YPPA. He foresees this capability on the VAN system, the electronic YPPA order system, in two to three years. The pay-off would be a smoother flow with lower costs for publishers and CMRs and a reduction in errors.

476 The other area within publishing where change can be anticipated is in how Tele-Direct receives orders over the VAN. Currently a clerk in Montreal and one in Toronto take the information off the VAN as hard copy. After the order has been dealt with in this form, it is eventually re-entered into Tele-Direct's system. Ms. Rogers stated that Tele-Direct had hoped to be able to transfer all orders received through VAN directly into the contract data base without re-keying but this did not happen. According to Mr. Logan of the YPPA, "[t]he bigger publishers, both independents and utilities, now are developing and I think probably most of them -- not everybody, most of them -- can take the information directly off the VAN and run it into their systems without re-keying". [200] For some reason Tele-Direct is lagging behind other North American publishers in taking advantage of the VAN, the system for which agents made significant investments and for which, in part, Tele-Direct agreed to raise commission rates from 15 to 25 percent over a two-year period. While there have been reductions in cost in processing agents' orders since the movement to VAN, according to Ms. Rogers these appear to be less related to the VAN than to internal reorganization and, therefore, this confirms that Tele-Direct has not taken full advantage of the VAN.

477 For all these reasons, we conclude that the study does not recognize the technological transition in publishing Yellow Pages and that failure to do so favours the internal sales force over the agents.

(ii) Methodological Weaknesses

478 There are significant methodological problems with this study. The study is based on a "causal model". Costs were analyzed by Tele-Direct personnel to determine whether particular costs would be experienced in the absence of either agents or the internal sales force. If the answer was in the affirmative those costs were assigned to the group that caused the costs in question. Costs that could not be identified as caused by one or the other channel were treated as common costs and allocated to the two channels on the basis of relative revenue. This overall methodology was submitted to Tele-Direct's auditing firm for confirmation that the approach was sound. All cost assignments and allocations were performed by Tele-Direct personnel and the results were not audited by an outside firm. The testing of the results was done only through discovery and cross-examination during the hearing.

479 In the final result, the internal sales force's contribution to profit is shown to be approximately 13.5 percentage points higher than that of the agents. If we ignore for the moment the complications created by the difference in types of accounts serviced by each, this result would mean that in order for the agents to be competitive with the internal sales force the commission rate paid to them would have to be nine percent rather than the average of 22.5 percent that in fact is paid to them (22.5 less 13.5).

480 We turn first to the method used to allocate common costs. It is, in our view, valid to allocate these costs on the basis of revenue where the common costs can be considered to be related to the level of sales. This is true for an area such as manufacturing the directories, where the costs depend on the volume of advertisements and it may make little difference whether the advertisements are generated by the internal sales force or agents. This approach to allocating common costs is far less justifiable when the costs in question relate to personnel, e.g., the personnel department itself. This is important because sales representatives and all their support personnel are internal to Tele-Direct while the agents and their support personnel are not. In areas like these it would be more appropriate to allocate costs based on the relative proportion of employees identified as devoted to servicing the internal sales force and agents. Mr. Beauséjour admitted that this was an equally valid approach as using relative sales and that either method could have been used.

481 An analysis of each of the common cost areas to see whether it was more appropriate to use one or the other weighting procedure would have produced a more objective and defensible result. We note that Tele-Direct did depart from its approach to allocating common costs on the basis of revenue in at least one instance, which also happened to work in its favour.[201]

482 In the study Tele-Direct has violated its own methodology for attributing costs on a causal basis in a way that increases the costs of dealing with agents. As noted earlier, the current system of storing advertisements in a computer is in the process of being introduced. The cost of duplication between the old and new systems which would, on the stated approach, be attributed to the internal sales force, was treated in the study as a "transition" cost and was subtracted from the total internal costs. Similar costs related to moving to the VAN system were, however, attributed to the agents. To be even-handed, they too should have been considered "transition" costs and subtracted from the agents' costs. Further, it is questionable that the large investment in the new system for dealing with internal orders should simply be ignored, as was done in the study, rather than amortized over several years. The effect of not doing so is also to understate internal costs.

483 Counsel for the Director questioned the validity of the cost attribution in the study in several areas where a relatively small percentage of costs was taken to be caused by internal sales force even though the internal sales force and its direct support account for 61 percent of total employees. With respect to the costs of the Personnel and Benefits department, Tele-Direct concluded that there would only be a saving of about 16 percent from eliminating the internal sales force and thus only 16 percent of the total cost was attributed to the internal sales force. Similarly, in the Labour Relations department the saving assumed was only 30 percent. In defence of these decisions, Mr. Beauséjour explained that there were certain basic requirements that would have to be maintained to service the remaining personnel even if 61 percent of the personnel were eliminated. In effect, this approach treats the present organizational chart as inviolate. We question whether Tele-Direct would approach such a massive change on an "avoidable cost" basis.

484 The Director's principal challenge to this study relates to the method of dealing with the "cost of customer service" ("CCS"), the 40 percent of net sales revenue that is paid to Bell Canada. In all past studies of profitability, CCS was treated as a cost. It was also so treated throughout the many months when there were successive drafts and refinements of the

1995 study, almost until the moment that the study was entered in these proceedings. As a result of the penultimate amendment to the figure for CCS, the contribution to profit of the agents changed from being slightly less than the internal sales force to almost five percent *more* than the internal sales force. [202] Subsequent to that, Mr. Beauséjour decided that there was no reason to treat CCS as a cost since Tele-Direct and Bell were part of the same corporate entity and it makes little difference whether Tele-Direct made payments to Bell in the form of CCS or as dividends. Despite the apparently fortuitous timing of this realization, we accept that the point is valid. It is one thing for Bell to insist that CCS be included as a cost in order to impose market discipline on Tele-Direct but it is another matter when a study of the relative costs of using agents and internal staff is being performed. It then makes better sense to treat Bell and Tele-Direct on a consolidated basis. This in itself is not a methodological weakness.

485 However, the same reasoning means that the Tele-Direct study should have taken into account the benefits accruing to Tele-Direct/Bell from the fact that agents pay up-front for advertisements whereas customers of the internal sales force pay monthly. Mr. Beauséjour recognized this benefit in cross-examination but it does not appear in the study. As discussed earlier, the difference in timing of payment amounts to interest for about half a year, an appreciable difference of three to six percent per year.

(iii) Particular Examples of Problems Arising from the Difference in Products

486 The respondents advance this study as evidence which they say proves the different, and greater, "interface" costs that they incur when processing orders originating with external agents as compared to the costs of processing orders originating internally. As we indicated at the outset, it is extremely difficult, in conducting a study of this nature, to distinguish the genuine interface costs, costs that arise because Tele-Direct is dealing with agents rather than the internal sales force, from costs that arise from the nature of the advertising, and thus are not clearly related to the channel submitting the order and are not true interface costs. This problem permeates the study and, thus, it cannot prove relative interface costs in its present form as the respondents maintain it can.

487 That is not to say that we think the problems arising from the difference in the products, unlike the unrepresentative timing and methodological weaknesses already identified, consistently operate in the respondents' favour by lowering internal costs and raising agents' costs. As detailed below, this is sometimes the case; sometimes the reverse is true.

488 We turn to some examples. One relates to the interpretation and treatment of credits to customers as a result of Tele-Direct's errors. Customers using the internal sales force were reimbursed 1.3 percent of gross revenues as a result of errors made by sales representatives or during the publishing process. The rate of reimbursement to agents as a result of publishing error was 3.5 percent. This difference in the rate of Tele-Direct's errors is a factor in the overall lower contribution to profit of agents.

489 In the notes to the study it is stated that the difference is due to the fact that orders from agents are handled by more people, that is, CMR personnel and the national accounts publishing group of Tele-Direct. It is, however, irrelevant how many people in the CMR handle orders because only errors attributable *to Tele-Direct* are reimbursed. One possibility that may explain part of the difference in error rates is the greater knowledge and, perhaps, incentive that agents have to discover and complain about errors compared with the customers of the internal sales force. Mr. Beauséjour admitted this was a possibility. While this explanation would probably not change Tele-Direct's view that the higher reimbursement is a "cost", it would hardly be a reflection of lower efficiency in the use of agents compared to the internal sales force.

490 On the other hand, Ms. Rogers stated that the higher error rate in processing agents' orders was due to the larger, more complex advertising programmes submitted by agents. This suggests that the error rates are related to the nature of the advertising programmes rather than the channel through which they flow. To the extent that the principal reason for the difference is the difference in the type of accounts serviced by each channel, it cannot be concluded that the difference in error rate is a cost of dealing with agents.

491 The comparatively large error rate in dealing with agents' advertisements also shows up in other costs attributed to dealing with agents. A Tele-Direct employee checks the advertisements after the directories have been printed, a duplication

of effort since the agents also verify their advertisements. In addition, there are the resources expended in error negotiations with the agents.

492 Apart from the difference in the size of advertising programmes mentioned by Ms. Rogers, we also know about one other respect in which there is a significant difference in the content of advertisements submitted by the internal sales force and agents. Approximately 80 percent of "trade-mark" advertisements are handled by agents. Three Tele-Direct clerks within the department which processes agents' orders are assigned to checking a proposed trade-mark advertisement to ensure it has been authorized by the owner of the trade-mark. This is a cost assigned totally to agents that depends on the nature of the advertisement rather than on the channel dealing with the advertisement.

493 In a related area, that of bad debts, the study may, in fact, underestimate the comparative cost of dealing with agents as opposed to the internal sales force. Over the years there is a regular, although fluctuating, percentage of unpaid bills to customers serviced internally. Until recently Tele-Direct has not had the same experience with agents. Mr. Beauséjour noted that Tele-Direct is currently owed money by an agent but no figure for non-collection from agents was included in the study. The area of "melt", bad debts along with discontinuance of phone service, which negatively affect the internal sales force contribution to profit, are probably due to the character of the clients served by the internal sales force rather than having anything to do with who is servicing them. This is consistent with the more "volatile" nature of smaller accounts commented on in internal Tele-Direct documents.

(d) Conclusion

494 The numerous points on which the various studies are subject to challenge confirm that they cannot be used for the purpose of comparing the relative efficiency of Tele-Direct's internal sales force and agents.

(6) Conclusion on Separate Products

495 The Director has alleged that tying is present over the entire demand spectrum, although counsel for the Director has, in effect, recognized that there may not be tying for "small" customers. [203] According to the respondents, there is no tying for any of their customers. The parties' positions represent the two extremes. The Director would have us order the respondents to offer space and services separately (whether by separate prices or expanded commission) to all their customers. The respondents would have us make no order, thus allowing them to offer the two separately only to those customers that they choose.

496 We are of the view that neither extreme is supported by the evidence. What we see is that customers or advertisers are not homogeneous in terms of their need for services, or demand, or in terms of the costs involved in servicing them, or efficiency considerations. On the contrary, they are very heterogeneous, ranging from an individual running a small business from home and spending a minimal amount on a simple advertisement in the Yellow Pages to large corporations advertising in a multitude of directories. Our view is that we cannot decide whether there is one product or two products for all these different customers in a blanket fashion. We must engage in an exercise of "line drawing".

497 We are of the view that the evidence on demand for separately supplied advertising services and the evidence and arguments relating to efficiency of supply indicate that advertising space and advertising services are separate products with respect to "large local" and regional advertisers. They are a single product for "small" advertisers. The difficulty is in knowing how reasonably or workably to distinguish regional and, more problematic "large local", advertisers from "small" advertisers, whether in terms of number of markets (as in the eight-market rule) or dollars spent on Yellow Pages. In approaching this task we have been mindful that the Director bears a burden in this regard of justifying any remedy granted. To the extent that the evidence and argument have left the matter unresolved, it behooves us to be cautious in our conclusions.

498 We know that in the current commissionable market, including grandfathered accounts, where advertisers have a choice, they overwhelmingly choose agents. We have found that demand extends well below the 1993 "national" definition and below the eight-market definition of commissionability.

499 The differences in the constituents of demand between the relatively smaller advertisers that employ the services of a consultant and those of larger, multi-directory advertisers that use agents or would use them if their accounts were commissionable are notable. The needs of the latter are more complex. In addition to advice and creative services, most require help in administration and in assuring uniformity of message. We infer that the intensity of demand, as measured by their willingness to pay, year after year, for these services by way of extra advertising or issue billing, is greater for larger customers that have multi-dimensional needs.

500 We turn to cost considerations to focus further on the appropriate dividing line. We have concluded that agents' interest, presumably driven by their view of their comparative efficiency *vis-àvis* Tele-Direct, is primarily in customers with a minimum size ranging from $10,000 to $50,000 in annual expenditures on Yellow Pages advertising. This alone would dictate raising the bar for any unbundling of space and services to a minimum of $10,000.[204]

501 While the evidence that at least some independent publishers are willing to pay commission on any business brought in by agents could be interpreted to mean that it would be efficient to unbundle across the entire demand spectrum, we are not comfortable going that far. It is far from clear that these publishers are guided by the relative efficiency of agents and in-house staff in servicing customers since for the most part their market position requires them to rely heavily on in-house staff despite their liberal commission rules. Their policy on commission could as easily be reflective of their desire to attract additional demand as of the relative efficiency of agents and in-house staff.

502 The approach of the large American publishers associated with telcos is to bundle space and services for all accounts smaller than those classified as national accounts or, for those who use a "B" account definition, for accounts smaller than regional accounts. We are not satisfied, however, that the publishers in question operate in competitive markets and that their choice of a dividing line is necessarily efficiency driven. As a result, we conclude that while unbundling of national and "B" accounts by them is probably efficiency driven, we cannot say that bundling for the balance of their accounts is motivated by efficiency and is conclusive on the dividing line for one versus two products.

503 Tele-Direct's studies are not helpful in drawing conclusions with respect to relative efficiencies of agents and Tele-Direct's employees along the demand spectrum. What we do know is that the eight-market rule was created by Tele-Direct primarily to capture more accurately "national" accounts than did the original 1958 definition and, at the time, Tele-Direct apparently considered this rule to be in its interest. Further, it is also clear had no internal discussion of relative efficiencies when it further restricted commissionability in 1993. In doing so it ignored demand from existing eight-market customers (including those that were forced to buy unneeded advertising to qualify for eight-market status). Given that agents had served these types of customers over many years, that other publishers have "B" accounts, and that Tele-Direct at no time addressed the comparative efficiency of agents and the internal sales force for these accounts, there is no evidence of any efficiency offset which would lead us to conclude that space and services were not separate products for all the accounts within reach of the eight-market rule.

504 The eight-market rule was not specifically designed to deal with the needs of regional advertisers. This is obvious from the fact that there are seven markets in Ontario and six in Quebec. By almost any definition an advertiser covering all the markets in a province would be considered "regional" although such an advertiser would not be commissionable under the eight-market rule. Many of them likely managed to bring themselves within the rule with extra advertising. At a minimum, a firm that covers an entire province the size of Quebec or Ontario should qualify without more. We have no reason to doubt that the strong demand for advertising services from agents displayed by currently grandfathered eight-market accounts extends to advertisers that cover six markets, which would mean, for example, the entire province of Quebec. It is difficult to see that the efficiency implications for separately supplied advertising services at the six-market level are significantly different than for eight markets.

505 There is a rough relationship between the number of markets served and the amounts spent on Yellow Pages advertising. According to Tele-Direct's internal studies, the average amount spent on Yellow Pages advertising among customers served by Tele-Direct representatives but that were in the commissionable category under the eight-market rule was $54,000.[205] The comparable figures for accounts that would qualify under a seven-market and six-market rule, respectively, are $44,000 and

$26,000. While some agents might find six-market accounts below their threshold of interest, the evidence is that they are within the range that some agents are willing to service, perhaps in anticipation of future growth.

506 We are cognizant that looking only on the demand side a case might be made for unbundling well below the six-market level. The evidence with regard to efficiency, principally the agents' views on accounts that they would like to service, does not support this conclusion. The Director suggests that there is no harm in unbundling across the board -- the market can be allowed to decide. If agents are more efficient, they will end up servicing the accounts. If Tele-Direct's internal sales force is more efficient, especially for smaller accounts, it will end up servicing those accounts. This implies a simple solution to a complex problem. In large measure, Tele-Direct is "the market" since the pricing of advertising services is inevitably its responsibility, whether it chooses to set commission rates for various types of accounts or to charge separately for the services of its internal sales force. Given widespread unbundling, Tele-Direct might well decide to set several different prices (or commission rates) for advertising services depending on the relative costs of servicing various categories of accounts. As the study on relative profitability showed, this would likely be a difficult task. It is not one that should be imposed without some greater certainty that there will be a significant overall benefit from the change. Therefore, we find that space and services constitute two products down to the six-market level and a single product below that level.

Addendum on Tying

507 At the outset of our discussion on tying, we indicated that another theory of the tying case was possible and we address that now. While some of the respondents' arguments and evidence are related, they did not adopt the precise approach which we outline hereunder.

508 One interpretation of the evidence is that advertising space and services are not demanded nor provided separately even in the existing commissionable market. Rather, larger advertisers either wish to purchase the bundle of space and services from Tele-Direct or from agents, in either case they are purchasing bundled space and services. Tele-Direct insists that the agents it deals with be accredited. The Director acknowledges that the placing of advertising in telephone directories is complex and accepts accreditation of agents by Tele-Direct. Indeed we do not necessarily envision advertisers purchasing space from Tele-Direct and providing their own services (except perhaps in the case of advertisers with accredited in-house advertising departments).

509 Following from the fact that accreditation means that only accredited services providers (including Tele-Direct's internal sales force) can place orders for space and they do so along with providing other services, it could be concluded that space and services must be bundled to be sold and that, therefore, they constitute a single product. Another way of viewing the matter would be that advertising space and services could be considered a single finished product on the basis that the real complaint respecting tying is not that advertisers are precluded from purchasing space and services separately, but that Tele-Direct has simply refused to supply unbundled space (i.e., at a discount) to agents which prevents them from selling to advertisers the same bundle of advertising space and services that is sold by Tele-Direct.

510 The evidence does not support this interpretation for the following reasons. First, we are satisfied that agents are not resellers of Tele-Direct's advertising space such that advertisers are purchasing the space *from agents* along with services. Agents do not carry an inventory of advertising space which they purchase from Tele-Direct for resale to advertisers. They assume no risks with respect to advertising space. Rather, when the agent's customer decides to purchase Yellow Pages advertising, the agent submits an order to Tele-Direct together with all other necessary information and Tele-Direct processes the order. The fact that Tele-Direct contracts with and bills the agents for the space, and treats the agents as the "buyer" in that sense, is not determinative of the relationship between the agent and the advertiser. We think that the fact that the agent does not have an inventory of space for resale is more consistent with the agent acting as an agent for the advertiser for the acquisition of space from Tele-Direct.[206] On this view of the evidence, the purchaser is not purchasing a bundle of space and services from the agent.

511 Second, the evidence does not indicate that advertisers wish to purchase advertising space from an agent as opposed to Tele-Direct. We think, all other things being equal, they are probably indifferent. However, there was evidence that they would prefer to pay Tele-Direct for space through monthly billing on their telephone bill rather than purchasing the space through

agents on an issue billing basis. It is Tele-Direct that requires the latter arrangement, not the customer who demands it. This is not evidence that advertisers demand Yellow Pages space from agents as part of a service and space bundle. Nor have we been presented with evidence suggesting that efficiency would be adversely affected if Tele-Direct was to contract with and bill advertisers directly for space.

512 Finally, a purpose of the *Competition Act* is to encourage competition in order to provide consumers with competitive prices and product choice. There is evidence of demand for services from agents as opposed to Tele-Direct and efficiency considerations at the six-market level and above do not preclude facilitating such choice. For these reasons we have rejected this alternative interpretation of the evidence and have accepted that advertising space and advertising services constitute separate products.

E. Tying Condition

513 Having determined that there are separate products over at least part of the spectrum of Yellow Pages advertisers, we must now determine if those advertisers falling within that range were somehow "forced" to buy the products together rather than from separate sources. Since we have not found separate products below six markets, any references to the "local" market in this section refer only to that portion of the market from the current "national" definition down to six markets. In that range, where we have found separate products, we must establish that the two products were "tied" together as set out in subsection 77(1).

514 Paragraph 77(1)(a) provides one definition of tied selling. In essence, it is described as a practice whereby a supplier, as a "condition of" supplying the tying product to a customer, requires that customer to acquire another product from the supplier. Paragraph 77(1)(b) provides an alternative definition, the operative portion of which is that tied selling is a practice whereby a supplier "induces" a customer to meet the condition of acquiring another product from the supplier by offering to supply the tying product on more favourable terms and conditions if the customer agrees to acquire the second product.

515 The Director pleaded both the "requirement" or "condition" and the "inducement" in the application. The Director submits that, on non-commissionable accounts, the respondents require the customer to acquire their advertising services as a condition of supplying the space at a bundled price "and/or" the respondents induce customers to acquire their services by offering to supply space at no additional cost for the additional value if the customer also acquires their services.

516 It is undisputed that Tele-Direct does not segregate the charges for space and services in the non-commissionable market segment and that those "local" customers who get their services elsewhere than from Tele-Direct (for example, by using a consultant) or do not need any or some of the services, do not pay less or get a discount off the total price of their advertising. The Director submits that the effect of this is that "local" customers must buy space and services together from Tele-Direct; it is only economically viable to purchase services separately from an independent provider in the commissionable market. To do so in the non-commissionable market would require the customer to pay twice for services, once to Tele-Direct as part of the bundled price and once to the independent service provider that would actually provide the services. The Director argues that the effect of this is that it is either a "requirement" that both space and services be acquired from Tele-Direct or, perhaps the better fit on the facts, a compelling "inducement" to do so.

517 The Director points to evidence of the advertisers that recognize that if they use an independent service provider when commission is not available they will, in effect, be paying twice for services and this is why they stay with Tele-Direct despite dissatisfaction with the quality of service. Further, the Director emphasizes that Tele-Direct itself knew the value of this economic inducement and used claims that its services were "free" or included in the cost of the space to convince customers to choose its services.

518 The respondents advance a number of arguments relevant to the question of whether space and services are indeed tied together on the facts of this case. They argue that there is no "condition" involved because there is no contractual obligation to purchase services from Tele-Direct as local customers are free to acquire services from a CMR; however, Tele-Direct will not pay a commission on the account. They rely on the case of *Ortho Diagnostic Systems, Inc. v. Abbott Laboratories, Inc.*[207] for the proposition that it is not an antitrust violation to sell components as a package where the same items can be purchased

separately but at greater cost. They argue that there are no *more favourable* terms and conditions offered to customers that take Tele-Direct's services over those that do not because there is only one set of terms and conditions in the local market -- the bundle.

519 We see no reason to conclude that the references in the section to "conditions" or even "terms and conditions" require that these be embodied in an explicit contractual document. As we understand this requirement, it is to determine that customers are effectively forced or coerced to take the two products, which have been determined to be separate products, from the supplier of the tying product rather than acquiring only the tying product from that source and getting the tied product from someone else. This obviously can occur where there is an explicit contractual requirement to that effect. It may, however, also be equally present where there is a discount or other advantage that constitutes an inducement to acquire the two from the same source. The "conditions" or coercion referred to in the section mean more than contractual terms; they may be economic conditions which have the effect of precluding choice of supplier. Whether customers actually do have an effective choice or not is a question of fact to be determined on the evidence before us, not of the legal nature of the purchase arrangement.

520 The *Ortho* case is of no assistance to the respondents. The case involved an application for a preliminary injunction by Ortho to prevent the implementation of a contract between the Council of Community Blood Centers and Abbott for a number of blood tests. Ortho alleged both monopoly leveraging and tying based on the theory that Abbott's pricing of various "packages" of blood tests forced any rational buyer to purchase all five tests from Abbott rather than buying one or more tests from competing suppliers like Ortho. The preliminary injunction was denied on the basis that Ortho had shown no irreparable harm.

521 The passages quoted to us by the respondents were simply the Court's summary of Abbott's arguments and authorities on the monopoly leveraging point. [208] The Court stated that Abbott's arguments gave it "pause" but all that it concluded in the end was that Ortho had shown that there were sufficiently serious questions on the merits to warrant litigation. On the tying claim, the Court, in fact, noted:

> There is some case law to support the position that a tie does not have to be explicit but can instead be inferred from the pricing structure of two products and the market power which the party has....
>
> Absent an explicit condition in the contract, there is a question of fact for the fact-finder regarding the existence of the tie, and we are unable on this state of the record to determine if plaintiff is likely to prevail on the merits of the tying claims. What is evident however is that there are sufficiently serious questions going to the merits of the tying claim to make them a fair ground for litigation. [209]

522 Therefore, the relevant question for us is whether, on the facts before us, the customers of Tele-Direct were "forced" to acquire services from it or did they have the option of acquiring space alone from Tele-Direct. We conclude that the evidence of the advertiser witnesses and Tele-Direct's own behaviour amply support the position of the Director that the lack of commission in the "local" market operated as a powerful inducement to acquire both space and services from Tele-Direct.

F. Substantial Lessening of Competition

523 Has the extent of the exclusion resulting from Tele-Direct's limitation of commission to "national accounts" as defined in the 1993 rule resulted in, or is it likely to result in, a substantial lessening of competition? It is first necessary to establish the relevant comparator that should be employed in evaluating the magnitude of the lessening involved. There is no purpose in comparing the six to eight-market accounts with all other accounts that are currently bundled and that we have decided may remain that way because demand characteristics and likely efficiency comparisons dictate a single product. The most relevant comparator is the size of the existing commissionable market under the 1993 definition because we are considering expanding that market. Eight-market accounts are currently commissionable but this could be discontinued at any moment without an order of the Tribunal so we include eight-market accounts as part of the tied portion of the market to evaluate substantiality. Further, grandfathering currently prevents accounts from "growing into" eight-market status.

524 In a word, it is clear that six to eight-market accounts constitute an appreciable volume of business that, without the tying practice, would be available for agents to service. The largest constituent is currently grandfathered eight-market accounts.

In addition, there are the six and seven-market accounts now serviced exclusively by Tele-Direct. Based on the Tele-Direct documentation prepared in anticipation of the 1993 rule change and the evidence of Mr. Mitchell, both of which are far from being completely clear, we find that a fair approximation of the value of accounts which are now commissionable under the 1993 definition (thus, excluding grandfathered accounts and including "national" accounts serviced both by Tele-Direct and agents) is about $30 million. Our best estimate of the accounts which have been found to be tied, namely six, seven and eight-market accounts, and would be added to the commissionable market is about $19 million. Thus, the combined total of the accounts found to be tied adds up to well in excess of 50 percent of the current commissionable market. Both in relative and absolute dollar terms, the amount of revenue affected by the tie is undoubtedly sufficient to conclude that there is a substantial lessening of competition.

525 A final issue arises with respect to substantial lessening. The respondents advance in their written argument a "technical" argument based on the use of definite and indefinite articles in subsection 77(2). They submit that the substantial lessening of competition must be assessed in the market for the tying product, here the market for the supply of advertising space: has the tying of space and services impeded entry into or expansion of a firm or had any other exclusionary effect in the space market? This argument was not referred to orally.

526 While the definite and indefinite articles can be read in different ways, the section should be read in a way that makes sense. Since tying generally, and certainly in this case, involves "leveraging" from the tying product market to the tied product market, it is only sensible to assess the effects of the practice, or the substantial lessening of competition, in the target or tied product market.

G. Remedy

527 Section 77 of the Act provides that upon a finding by the Tribunal of tied selling by the supplier of the tying product (Tele-Direct), the Tribunal may make an order "prohibiting [the supplier] from continuing to engage in ... tied selling...."

528 Prohibiting Tele-Direct from continuing to engage in tied selling means that the tying product, advertising space, and the tied product, advertising services for six, seven and eight-market accounts, must be unbundled by Tele-Direct. The "unbundling" may take the form of separate prices: Tele-Direct could quote separate rates for space and services. It may also take the form of an expanded definition of commissionable accounts to allow six, seven and eight-market customers to use the services of an agent, who would earn commission at an appropriate rate.

529 While we do not rule out the possibility of advertisers acquiring space from Tele-Direct (at the separately quoted space price) and then paying a separate fee for services to Tele-Direct or to an agent, we think this scenario is unlikely. There are practical implications arising from Tele-Direct's predominance in the publishing market and the accreditation of agents that suggest that the marketplace in an "unbundled" environment after our order will work largely the same as it does today except that the commissionable market will be expanded to cover six, seven and eight-market accounts. Advertisers that wish to utilize Tele-Direct's services would continue to buy space and services from Tele-Direct at one price.

530 Because of the specialized nature of the Yellow Pages industry, the respondents regard accreditation as important and the Director and his witnesses, for example, Ms. McIlroy and Professor Slade, support it. Thus, Tele-Direct would be justified in requiring that services, including the placement of orders, be provided by accredited service providers only. Unbundling does not require that advertisers be given the opportunity to interface directly with Tele-Direct to place their orders, if they do not wish to utilize Tele-Direct's services. Advertisers would either deal with Tele-Direct for space and services or with an agent for services and, through an agent, with Tele-Direct for space. This contributes to our view that in all likelihood, the structural arrangement that exists today would likely continue, changed only to permit agents to compete with Tele-Direct to provide services to six, seven and eight-market accounts.

531 The prohibition on tying, however, does not carry with it a requirement that Tele-Direct pay a specified commission to agents. It will be up to Tele-Direct to pay such commission as it chooses. Commission rates could be identical for all accounts or might be variable. However, the prohibition on tying implies that the price charged by Tele-Direct for its space and services

together cannot, in relation to the price at which it offers space to customers using agents (i.e., its price for both space and services together less the commission to the agent) be an inducement to customers' using Tele-Direct's services rather than agents, thus continuing the tie. In other words, the price for space to customers of agents cannot be artificially inflated (or the commission paid to agents artificially reduced) so that space is not realistically available separately. Tele-Direct cannot make it economically non-viable for customers to purchase space from Tele-Direct and use an agent's services because in those circumstances the space effectively costs more than if the customer were to use Tele-Direct's services.

532 The intervenor agents (and the Director in the alternative) submit that the Tribunal should order Tele-Direct to pay a minimum 15 percent commission to agents. Although this proposition was advanced in the context of the Tribunal finding a tie across the entire market for Yellow Pages advertising in Tele-Direct's directories, in the context of our finding that there is only tying down to the six-market level, the minimum 15 percent commission would apply in respect of six, seven or eight-market customers serviced by agents. We have no difficulty with Tele-Direct voluntarily complying with our order prohibiting tying by paying a minimum 15 percent commission. A 15 percent commission rate has historical precedent and is well accepted in the advertising industry. It appears to be a workable "average" that would be simpler to administer than variable commission rates for each of the six, seven and eight-market accounts, should Tele-Direct choose to use it.

533 However, the setting of a commission rate by the Tribunal is not, in our opinion, envisioned in the powers given to it under section 77 of the Act regarding tying or in the general jurisdiction given to the Tribunal under section 8 of the *Competition Tribunal Act*.[210] The Tribunal is not a rate-setting body. The implication of rate-setting is an ongoing regulatory oversight which is the antithesis of the objectives of competition policy. To grant this remedy, the Tribunal would be required to hold itself open to revision to the 15 percent rate. We could not saddle Tele-Direct or the agents with a rate cast in stone forever and the alternative of ongoing rate regulation is, in our view, simply not part of the mandate of the Tribunal. It is true that the Tribunal issued the Consent Order providing for a 25 percent commission on national accounts, but that order was for a limited time and was on consent. It provides no justification for a gearing up of a general regulatory process implied by setting a rate for an indefinite period in this contested proceeding.

534 The Tribunal's order will therefore provide that Tele-Direct is prohibited from tying its advertising services to advertising space for six, seven and eight-market accounts. Should Tele-Direct choose to comply with the order by a commission arrangement with accredited agents at a minimum rate of 15 percent, the Tribunal would find such an arrangement acceptable compliance. Otherwise, Tele-Direct can price space and services separately or implement a commission arrangement for six, seven and eight-market accounts at an appropriate level or levels. The price Tele-Direct charges for its bundle of space and services, if it continues to offer them as a package, in relation to the price that it charges for space separately cannot be such that it continues to tie space to services by way of an inducement offered to customers that take Tele-Direct's services. The order will specify that the parties may apply to the Tribunal for interpretation of the order or directions if they consider it necessary to ensure compliance.

IX. Abuse of Dominant Position

A. Introduction

535 For ease of reference, we set out again subsection 79 (1) of the Act, which deals with abuse of dominant position:

> Where, on application by the Director, the Tribunal finds that
>
> > (a) one or more persons substantially or completely control, throughout Canada or any area thereof, a class or species of business,
> >
> > (b) that person or those persons have engaged in or are engaging in a practice of anti-competitive acts, and
> >
> > (c) the practice has had, is having or is likely to have the effect of preventing or lessening competition substantially in a market,

the Tribunal may make an order prohibiting all or any of those persons from engaging in that practice.

536 Unlike previous abuse of dominance applications that have come before the Tribunal, where only one market was at issue, the Director here is putting forward two abuse of dominance cases, one involving the alleged market for the supply of advertising space and the second, the alleged market for the supply of advertising services.

537 One case is that the respondents have market power in the market for the supply of telephone directory advertising space, or publishing, and have engaged in a practice of anti-competitive acts which has resulted in a substantial lessening of competition in that market. This case involves the responses of the respondents to the instances of new entry by competing broadly-scoped publishers in local markets, most significantly the entry of White in the Niagara region and the entry of DSP in Sault Ste. Marie.

538 The second case is that the respondents have market power in the market for the supply of telephone directory advertising services or, in the alternative, that they are leveraging their market power in the space market into the services market, and have engaged in a practice of anti-competitive acts which have resulted in a substantial lessening of competition in the services market. Among the anti-competitive acts alleged to form a practice affecting this market are both acts directed at agents and acts directed at consultants. For example, one of the alleged anti-competitive acts is the bundling of space and services (restricted commissionability rules for agents) which forms the basis of the tying portion of the Director's application. Another is the alleged refusal by Tele-Direct to deal with consultants.

B. Approach to Section 79 Analysis

539 In dealing with the particular allegations in this case, the purpose of section 79 must be kept in mind. Neither party disputed that section 79 is not intended to condemn a firm merely for having market power. Instead, it is directed at ensuring that dominant firms compete with other firms on merit and not through abusing their market power. [211] Such abuse includes, as pointed out by the Director, entrenchment and extension of market power. [212] It would not be in the public interest to prevent or hamper even dominant firms in an effort to compete on the merits. Competition, even "tough" competition, is not to be enjoined by the Tribunal but rather only anti-competitive conduct. Unfortunately, distinguishing between competition on the merits and anti-competitive conduct, as the Tribunal has noted in the past, is not an easy task. [213]

540 The Tribunal established in *NutraSweet* that the list of anti-competitive acts set out in section 78 is not exhaustive. The Tribunal held that the common feature of the acts included in section 78 is that they are all performed for a "purpose", namely "an intended negative effect on a competitor that is predatory, exclusionary or disciplinary." [214] The Tribunal's approach to assessing whether acts are anti-competitive was set out most recently in *D & B*:

> ... in evaluating whether allegedly anti-competitive acts fall within section 78, the Tribunal must determine the "nature and purpose of the acts which are alleged to be anti-competitive and the effect that they have or may have on the relevant market". The required analysis will take into account the commercial interests of both parties to the conduct in question and the resulting restriction on competition. The decision in *Laidlaw* makes it clear that, although such proof may be possible in a particular case, it is not necessary for the Director to prove subjective intent to restrict competition in the relevant market on the part of a respondent. The respondent will be deemed to intend the effects of its actions. [215] (references omitted)

541 The Tribunal must determine the "purpose" of the act that is alleged to be anti-competitive. "Purpose" is used in this context in a broader sense than merely subjective intent on the part of the respondent. As counsel for the Director pointed out, it might be more apt to speak of the overall character of the act in question.

542 What the Tribunal must decide is whether, once all relevant factors have been taken into account and weighed, the act in question is, on balance, "exclusionary, predatory or disciplinary". Relevant factors include evidence of the effects of the act, of any business justification and of subjective intent which, while not necessary, may be informative in assessing the totality of the evidence. A "business justification" must be a "credible efficiency or pro-competitive" business justification for the act in

issue.[216] Further, the business justification must be weighed "in light of any anti-competitive effects to establish the overriding purpose"[217] of the challenged act:

> ... The mere proof of *some* legitimate business purpose would be, however, hardly sufficient to support a finding that there is no anti-competitive act. All known factors must be taken into account in assessing the nature and purpose of the acts alleged to be anti-competitive.[218]

543 In their argument, the respondents advance several propositions regarding the nature of an anti-competitive act that they submit the Tribunal must determine as a matter of law in this case. One of these propositions is particularly relevant to the case relating to the publishing market. They state that certain acts constitute "competition on the merits" and cannot ever be anti-competitive acts. In another formulation, they state that objectively competitive conduct cannot constitute an anti-competitive act. They would define "objectively competitive" conduct as conduct which a non-dominant firm would have undertaken in similar circumstances.[219] Applying this argument to the specific case of the allegations involving the publishing market, the respondents say that the Director cannot allege, for example, that "zero price increases" are an anti-competitive act because competitive firms sometimes use zero price increases or even price decreases to compete.

544 We do not take issue with the proposition that section 79 is not intended to prevent dominant firms from competing on the merits. We do, however, doubt that it is possible to define, in the abstract, a list of acts that are "objectively competitive" and that could never, therefore, engage section 79. Competition on price is surely one of the hallmarks of a competitive market. Yet even the act of "price cutting" cannot be given absolute immunity from review under section 79 because of the possibility of predation. In our view, a case-by-case, factual analysis will always be necessary to determine if, in the particular circumstances, an act is anti-competitive. All the relevant factors must be weighed in deciding whether a particular act is, in the circumstances, competition on the merits or an anti-competitive act. That question cannot be answered as a matter of law in a vacuum.

C. Market for Advertising Space - Publishing

(1) Facts

545 The independent publishers DSP and White have already been discussed at various places in these reasons, largely in chapter "VII. Control: Market Power". We summarize here and add some further relevant facts.

546 Since 1993, DSP has produced a white pages and classified directory covering Sault Ste. Marie, Elliot Lake and Wawa in northwestern Ontario. Since January 1994, it has been a division of Southam Inc. but is still operated largely independently from the Southam newspapers in the area in question. Tele-Direct publishes three separate directories for the areas covered by the DSP directory.

547 The DSP Canadian directory is combined with a corresponding directory for the Sault Ste. Marie, Michigan area. The American portion is published by Noverr Publishing Inc. ("Noverr") which publishes several directories in the state of Michigan.

548 White publishes competing directories (Niagara Falls, St. Catharines and Fort Erie) to Tele-Direct's in the Niagara region in Canada. White also entered Canada in 1993. White is a wholly-owned subsidiary of the American company White Directory Publishers, Inc. which is a private company controlled by the Lewis family. The American company began operations in 1968 with a classified directory (yellow pages only) in the Buffalo area. A white pages directory was later added and then in the second half of the 1980s and early 1990s additional directories containing both classified and white pages were started in other areas of New York state and Pennsylvania. White's entry into Canada was followed by further expansion in the United States in 1994 and 1995, into Florida and North Carolina.

549 Both DSP and White first published "prototype" directories in Canada, DSP in January 1993 and White in November and December 1993.[220] DSP published its first revenue directory in November 1993. White began its canvass for its first revenue directory in late 1993 and continued in 1994. Its first revenue directory was published in late 1994.

550 In order to produce their directories, White and DSP had to generate subscriber listings for their white and yellow pages. As discussed earlier, despite the 1992 ruling of the CRTC, at the time of their entry DSP and White did not have commercially viable direct access to subscriber listings. They had to use the most recent Tele-Direct directories, re-key the data, verify and update each listing.

551 Included in the directories of White and DSP were features which were not present in the existing directories of Tele-Direct in either region, including audiotext, community pages, larger size print, three-column format, postal codes and additional colour plus a free smaller size copy in addition to the regular size directory (a "mini").[221]

552 Less detail was provided on the other two competitive markets referred to by the Director. In October 1994, a competing directory was published in Joliette, Quebec by Les Pages Soleil, a joint venture involving the company which publishes the Locator directories in Ontario. Les Pages Soleil also feature enhancements like community pages, postal codes and only three columns per page.

553 In Newfoundland, a company called Unifone Files Inc. ("Unifone") intended to publish a province-wide directory called "The Big Phone Book", apparently some time in 1993 or 1994. Tele-Direct (Services) Inc. publishes seven directories in Newfoundland for Newfoundland Tel (St. John's, eastern Newfoundland (four), western Newfoundland and central Newfoundland). In addition to its broader scope, the Unifone directory was to feature larger print, community pages and a "mini" directory. As of February 1994, however, Unifone was no longer in existence and it never did publish a directory.

554 The two entrants for which we had evidence on this point (White and DSP) priced advertising in their directories 30 to 40 percent below Tele-Direct's rates.

555 Tele-Direct responded to these various entrants using a number of initiatives, including price freezes, advertiser incentive programs, advertising and promotional expenditures, and directory enhancements. Tele-Direct was also involved in litigation or threatened litigation against the entrants in Sault Ste. Marie and Niagara. Further details on these responses follow.

556 Tele-Direct adopted a zero percent price increase or price freeze in Sault Ste. Marie in 1993. Except for 1994, when there was a general price freeze across all of Tele-Direct's territory, prices were increased annually in the vast majority of Tele-Direct's directories outside of the competitive markets.[222] In 1995, there were zero price increases in Sault Ste. Marie, Joliette and the Niagara region. The information on the record regarding 1996 prices is that all markets were subject to a price increase, including the competitive markets.

557 Tele-Direct has offered advertiser incentive programs of various kinds throughout its territory at different times. The critical distinction between the programs offered in the competitive markets and those offered in other markets is that in the competitive markets the incentives were available to advertisers who *renewed or increased* their advertising whereas in the other markets only those advertisers who *increased* their level of spending were eligible.

558 The advertiser incentive program in Sault Ste. Marie was first offered in 1993. While originally intended as a one-year program it was extended to three years, ending in 1995.[223] In Niagara, a program similar to the Sault Ste. Marie advertiser incentive program was offered in 1994 and 1995. As of the hearing, no decision had been taken about proceeding to offer the program in Niagara for a third year. In Joliette, a program was offered in 1995 which provided that advertisers renewing or purchasing advertising would receive the next largest size advertisement or colour if applicable. In Newfoundland, the same program was offered in four directories in 1994. Mr. Beauséjour, Tele-Direct's Vice-president of Finance, confirmed that the program was instituted in response to the presence of Unifone.[224]

559 In each competitive market, Tele-Direct added a number of features to its directories that were introduced first by the entrant. Most of these features tend to be fairly standard in many American markets. For example, the enhancements used by White in its Canadian prototype are almost all standard features for it in its American markets. The features added by Tele-Direct in response are not generally used by it in its directories in other markets.

560 We have limited information about the Joliette and Newfoundland situations in this respect. Tele-Direct did add a community pages section to its Joliette directory. Mr. Renwicke thought that postal codes had also been added. A memorandum dated October 1993 records a recommendation by Tele-Direct (Services) Inc. that the Newfoundland directories contain "some enhancements starting with the central Newfoundland 1994 directory." [225]

561 In Sault Ste. Marie, Tele-Direct added enhancements to its directories similar to those offered by DSP, including four-colour format, postal codes, community pages and its own audiotext system (Talking Yellow Pages or "TYP"). Likewise, in Niagara Tele-Direct reacted to the entrance of White by adding enhancements similar to those of White to the Tele-Direct directories in that area. Tele-Direct did not introduce all of the enhancements included by the entrants. For example, it did not adopt larger type or distribute "mini" directories.

562 Some further detail is required about the audiotext system or TYP in order to understand the allegations advanced by the Director in this respect. Audiotext is an electronic technology which allows consumers with Touch-Tone phones to obtain access to audio messages which are stored on a computer. The directory publisher provides in its directory codes which can be used by consumers to gain access to the messages on topics of interest to the consumer. The provision of an audiotext service is comprised of both hardware components, the computer and satellite dish, for example, and the information lines which are fed to the satellite dish from a supplier. Depending on the information being offered, the lines are updated at regular intervals during the day, on a daily basis or on a monthly basis.

563 Tele-Direct introduced its first TYP in Kitchener in 1988 followed by Toronto and Quebec City that same year. Unlike the audiotext involving the provision of general information on various topics to consumers, the Kitchener and Quebec City services involved advertiser-specific information. The code was provided in the advertisement; the interested consumer could call for more detailed information regarding that supplier, for example, prices. These services were later abandoned for lack of advertiser interest; the Toronto service, which is of the general information type, is still offered. Since it first offered TYP, Tele-Direct's supplier of the information lines required has been a company called Perception Electronic Publishing ("Perception"). [226] As of November 1993, Perception is owned by Brite Voice Systems.

564 When it entered the Sault Ste. Marie market with its prototype directory in January 1993, DSP provided an audiotext service. This was the first time such a service was offered in Sault Ste. Marie. The information supplier for DSP was Perception. During the first two months that it was offered, the DSP audiotext service was heavily used.

565 Tele-Direct introduced its TYP in Sault Ste. Marie in April 1993 in advance of its June 1993 directory, some three months after DSP published its prototype directory, also using Perception for its information feed. Tele-Direct used flyers to distribute the relevant codes to consumers. It was roughly at the same time as the Tele-Direct TYP were introduced that DSP began to experience deterioration in its audiotext service because the information was no longer being updated in a timely manner. DSP was in constant contact with Perception in order to get the lines updated within an acceptable time frame, but with no success. The quality of DSP information feed from Perception remained poor until November 1993, which was essentially the same time that Perception was acquired by Brite Voice Systems.

566 Tele-Direct also engaged in large advertising campaigns in Sault Ste. Marie and Niagara. No detailed information was provided in this respect regarding the other two competitive markets. Compared with pre-entry levels virtually all of the advertising and promotional expenditures were new. In Sault Ste. Marie, Tele-Direct spent only about $50,000 on advertising in 1992 as compared to $215,000 in 1993. By 1994, expenditures had dropped back to $22,000. In Niagara, Tele-Direct spent $43,000 in 1992, $71,000 in 1993 and $28,000 in 1994. [227] In 1993, advertising expenditures in Sault Ste. Marie constituted approximately 11 percent of published revenues for that city; in 1993 in the Niagara area, advertising expenses amounted to less than one percent of published revenues.

567 Another circumstance relevant to the Director's allegations respecting publishers is that Tele-Direct initiated a suit against DSP in May 1993 for infringing the "walking fingers" trade-mark and Tele-Direct's copyright in the advertisements in the Tele-Direct directory with its prototype directory. In the spring of 1995, Tele-Direct notified DSP that it would also be challenging

the 1994 and 1995 DSP directories. At the time of the hearing, the lawsuit had reached the stage of discoveries. A representative for Tele-Direct had been discovered and the discovery of the representative for DSP was scheduled for November 1995.

568 Although no suit has been launched in relation to White, Tele-Direct made it abundantly clear to White early in 1993 that it would vigorously defend its trade-marks and its interpretation of its copyright interests arising from the advertisements in the Tele-Direct directories. In particular, Tele-Direct informed White that it could not make use of an advertiser's copy, layout or graphics as they existed in the current Tele-Direct directory in creating the first White directory.

(2) Control of a Class or Species of Business in Canada

569 The Tribunal has already found that the supply of telephone directory advertising constitutes a relevant product market and that the relevant geographic markets are local in nature. We have also found that Tele-Direct possesses market power in those markets. We are satisfied, therefore, that Tele-Direct has market power in the market for the supply of advertising space or the telephone directory publishing market and therefore controls the business in the relevant geographic markets.

(3) Practice of Anti-competitive Acts

(a) Allegations - Pleadings

570 The Director's application, as amended, says at paragraph 65 that the following acts together constitute a practice of anti-competitive acts affecting the market for advertising space, or the publishing market, which leads to a substantial lessening of competition in that market:

. . .

> (g) targeting price reductions and other discounts to those markets in which entry by competing publishers has occurred or is occurring; and
>
> (h) causing, directly or indirectly, advertising agencies to refuse to place advertising in telephone directories published by competing publishers or otherwise discriminating against or causing independent advertising agencies to discriminate against competing publishers; and
>
> (i) making disparaging statements in regard to new market entrants.

571 In argument, the Director did not refer to the act set out in (i). Under the heading in the written argument, "Otherwise Discriminating between Publishers", the Director gathers evidence relating to the respondents' policy of not allowing the directories of competing publishers to count towards the 20 directory requirement of Tele-Direct's national account definition. Under the heading in the written argument, "Targeting/Raising Rivals' Costs", the Director refers to various actions by the respondents in response to entry by competing publishers in the local markets of Joliette (Quebec), Newfoundland, Niagara and Sault Ste. Marie which are alleged to constitute anti-competitive acts because of their targeted nature and intent and the degree or intensity of the response. The particular responses listed are zero price increases, incentive programs, advertising and promotional spending, directory enhancements, interfering with the DSP audiotext feed and litigation or threats of litigation.

572 The respondents say that the allegations involving directory enhancements, promotional spending and litigation or threats of litigation are not encompassed by the pleadings and cannot be relied on by the Director.

573 It is not in dispute that the evidence and the argument put forward by the Director on this issue must be supported by the pleadings, either by the specific words in the application or by reasonable inference therefrom. It is trite to say that the pleadings are intended to define the issues in dispute between the parties, to give fair notice to each party as to the case that it will have to meet and to assist the decision maker in considering and deciding the allegations that have been made. Where, as here, an argument about the scope of the application is only raised at the stage of final argument, we agree with the Director that regard may be had to interlocutory proceedings, discovery and the conduct of the hearing itself to determine what the *parties* considered were the issues raised by those pleadings. We need not restrict ourselves to the pleadings in a vacuum.

(i) Enhancements

574 Directory enhancements were not explicitly mentioned in the application. However, in its request for leave to intervene, White specified, in paragraph 9 of the request, those matters in issue which affected it. Item (e) reads:

> offering directory enhancements (community pages, an audio text system and postal codes) targeted to areas where competition or the threat of competition exists....

575 As stated in the reasons of the Tribunal for granting leave to intervene, the respondents did not oppose the intervention. The respondents only objected to White being given leave to make representations with respect to certain issues which, the respondents argued, were outside the scope of the Director's application. The respondents submitted that the representations of an intervenor must be relevant to the proceedings and that relevance is defined by the parties' pleadings. The Tribunal agreed. The issues in White's intervention challenged by the respondents as being outside the scope of the application did not include item (e) "enhancements" but rather focused on six other items. The Tribunal accepted that four of the disputed six items were not supported by the application and excluded them from the purview of White's intervention.

576 If the respondents were genuinely of the view that the question of directory enhancements was outside the scope of the application as defined by the pleadings, then they would have challenged that part of White's intervention request. The question of what was and what was not supported by the pleadings regarding the alleged anti-competitive acts in relation to independent publishers was squarely in issue at the intervention hearing. The clear implication of the respondents' failure to challenge item (e) is that they considered that enhancements were within the pleadings.

577 Nothing occurred after the intervention hearing that would have led to any other conclusion. The Director requested the production of documents and conducted discovery on the question of enhancements. Eventually the relevant documents were produced, without objection.[228] The Director submits that Tele-Direct has taken this "about face" on the question of enhancements in order to provide an after-the-fact explanation for its belated production of a boxful of relevant documents relating to its responses in competitive markets. The Director called evidence at the hearing on enhancements, without objection. The respondents themselves led evidence on the question of enhancements. Tele-Direct cannot now change a position that it took on an interlocutory proceeding and maintained throughout discovery, the hearing and up until the commencement of its final argument. The entire case has been conducted on the basis that directory enhancements are fairly in issue. Enhancements are properly before the Tribunal.

(ii) Advertising and Promotional Expenditures

578 Unlike directory enhancements, advertising and promotional expenditures were not specifically addressed at White's intervention hearing. If we looked only at the words of the pleadings, it might be arguable whether those words would support the allegation. Again, however, we have a course of conduct that sheds considerable light on whether the parties themselves thought promotional expenditures were at issue as part of the allegation of anti-competitive acts. It is clear that they did. Oral and documentary discovery was conducted by the Director on this issue. Counsel for the Director referred to it in his opening address. The Director called evidence in chief on the issue and the respondents called responding evidence. Advertising and promotional expenditures are properly before the Tribunal.

(iii) Litigation and Threatened Litigation

579 Counsel for the respondents pointed out that the Director was not seeking any remedy specifically relating to litigation. Counsel for the Director did not address the respondents' argument that litigation or threatened litigation falls outside the pleadings. In argument on the merits, however, the Director took the position that litigation or threats of litigation contribute to the anti-competitive act of "targeting" or "raising rivals' costs".

580 The words of the pleadings do not obviously incorporate such a concept. The original application, at paragraph 65(h), contained a specific allegation of an anti-competitive act of "threatening or taking legal action to restrict competing suppliers of

advertising space from gaining access to, or from utilizing, subscriber listing information". This allegation was later withdrawn. However, as with promotional expenditures, litigation was dealt with in the evidence and argument. In view of the specific withdrawal by the Director of the reference in the pleadings to litigation or threatened litigation, the respondents' position is somewhat stronger on this point than on the others. But, it is not necessary to decide the issue on procedural grounds. As will become apparent, we are not satisfied on the merits of the argument that litigation or threatened litigation constitute anti-competitive conduct in this case.

(b) Alleged Anti-competitive Acts

(i) Causing Agencies to Refuse to Place Advertising with Independents

581 The independent publishers' directories do not count towards the 20-directory requirement that forms part of the 1993 definition of a Tele-Direct commissionable account. The Director argues that the effect of the Tele-Direct policy in this regard is that CMRs do not recommend independent directories to advertisers when they would do so if those directories counted towards qualification as a commissionable account. Thus, it is submitted, this excludes independents from revenues that they would otherwise obtain.

582 The Director relies on the evidence of Mr. Lewis of White comparing the situation in Canada with respect to advertising placed in his directories by CMRs to that in the United States. In distinction to Tele-Direct's policy, in the United States publishers include the directory of any other YPPA member in determining whether an account qualifies for commission. White is a YPPA member and therefore its directories count towards the minimum directory requirement in the United States. Mr. Lewis testified that in that country eight percent of White's advertising revenues are placed by CMRs while in Canada less than one-half of one percent comes from CMRs.

583 The respondents respond that this testimony alone does not constitute proof of the requisite exclusionary effect. Because White has been operating in the United States for a lot longer, and is therefore more established than it is in Canada, they question the validity of the comparison being made. Further, they rely on the evidence of Stephanie Crammond of Media Nexus, a specialized Yellow Pages advertising agency, that if she had confidence in the distribution figures cited by the various independents, she would consider them. Likewise, Richard Clark of DAC stated that his position on independent directories was to "wait and see" if they were going to stay around and then base a decision on which directory had greater usage. He did point out that typically the telco directory has the greater usage and, therefore, if a competing directory is used, generally it is on a secondary basis, with the primary advertising dollars allocated to the telco directory.

584 On balance, we are not persuaded by the Director's argument. While we recognize that monetary incentives are bound to enter into an agency's recommendation to a client, the Director's argument implies that agencies are entirely driven by earning commission and will compromise the quality of the advice they give by omitting to recommend a good, independent directory merely because it would not help the account qualify for a Tele-Direct commission. The burden of the remainder of the Director's case, as it involves agencies, is that they are, among other things, independent suppliers of advice to advertisers and therefore provide a valuable alternative to Tele-Direct's captive salesforce. For the Director to suggest now that agencies would not provide good advice seems to be somewhat inconsistent with that position. But apart from this, the independents, of course, pay their own commission on advertising placed in their directories.

585 There are factors at play other than Tele-Direct's criteria in agents' decisions when recommending directories to their clients. As Mr. Clark's testimony indicates, an important reason why independent publishers in Canada may not receive a high volume of business from agencies is that, because Tele-Direct is the established publisher, it is rarely a choice *between* Tele-Direct's directory and the independent directory for a particular area. Rather, the agency will generally recommend the Tele-Direct directory as the primary directory for advertising because of widespread usage and then, if additional money is available, recommend the independent *also*.

586 In summary, we do not accept that Tele-Direct's policy regarding the 20-directory requirement discourages agency recommendations of independent directories.

587 One final observation in this area arises from the respondents' written argument at paragraph 590, that as a matter of law "[i]t cannot be an anti-competitive act for a dominant firm to decline to assist or give aid to a competitor." We agree with the general proposition that a firm is not, and should not be, required to "assist" its competitors. The respondents, however, add an additional element to the proposition when they submit that:

> Each of the anti-competitive acts listed in section 78 require the dominant firm to *actively initiate* some action.... None of the listed acts are triggered simply by the dominant firm *not doing something or refusing to assist*....
>
> (emphasis added)

588 While the respondents did not advance this argument in relation to the specific allegation we are dealing with here (or, in fact, in relation to any specific allegation), it certainly seems relevant to the question of whether Tele-Direct should be obliged to recognize advertising in independent directories as counting towards Tele-Direct's commissionability requirement of a minimum of 20 directories. As stated above, as a general proposition, competitors should not be required to assist one another. But, this general proposition may be shown to be inapplicable in a given section 79 case by the Director proving that the "act" of the respondent meets the elements of that section and is an anti-competitive act leading to a substantial lessening of competition. Then, any order of the Tribunal which may issue is, by definition, not an order to "assist" a competitor but rather, in the case of subsection 79(1), an order to cease and desist from anti-competitive conduct.

589 It is, therefore, not sufficient, in circumstances such as these, to argue the general proposition. Nothing can be determined by simply labelling the alleged anti-competitive "act" as "doing something" (active) or "not doing something" (passive). The anti-competitive effect of the conduct of the respondents, whether "active" or "passive", must be weighed against any business justification in order to conclude whether there has or has not been a substantial lessening of competition. That can only be done by reference to the evidence. On this point, Tele-Direct only argued the general proposition.

(ii) Targeting/Raising Rivals' Costs

• Reaction of Tele-Direct

590 Before turning to the evidence it is necessary to consider what the Director means when he alleges that "targeting/raising rivals' costs" is an anti-competitive act. There is a growing body of literature dealing with "raising rivals' costs" ("RRC"). The theory was proposed as a similar but more credible route to market power than predatory pricing because it does not depend on short-term price cutting beyond what is profit-maximizing followed by later recoupment. With RRC, it is not necessary to cause the rivals to exit, no "deep pockets" are necessary and the additional profits are gained immediately.[229] Typically, an RRC strategy involves increasing rivals' costs by raising the price of some scarce input which in turn results in the rival reducing its output.[230] In other words, there is a relatively immediate output reduction in the market concerned. Only two elements of the act alleged by the Director seem to bear any resemblance to this conception of RRC -- the audiotext affair and litigation and threats of litigation. As we shall see, the remaining actions of Tele-Direct relating to pricing, incentives and advertising did not result in output reduction in the markets in question. The considerations involved in RRC can provide little assistance in evaluating the allegations relating to those reactions of Tele-Direct in competitive markets or the "targeting" aspect of this act.

591 The Director has not attempted to explain what is meant by targeting in any detail, perhaps regarding the term as largely self-explanatory. It is, however, far from being a household word in competition law. While we have no reason to discourage novel approaches to discerning potentially anti-competitive conduct that might fall within section 79, we do see considerable difficulty in applying the targeting concept. It is always difficult to distinguish between anti-competitive practices and normal competition. The conduct in question may be generally benign and it is only in certain contexts that it is anti-competitive. The difficulty is even more pronounced in this case, given the actions on the part of Tele-Direct that the Director would have the Tribunal, if not prohibit completely, certainly restrict.

592 In argument counsel for the Director described the nature of targeting as follows:

> The reason that acts of predation or near-predation can be anti-competitive is because the firm is dominant in a larger market. The danger is that, rather than bringing the public the benefit of competition in a limited area, what is happening is that in the long-term analysis the dominant firm is leveraging its market power from its broadly-dominated market into specific targeted areas where competition enters, with a view to either eliminate that competition entirely or, as in the situation here where the expressed intent fell a bit short of that, to ensure that the competition didn't move into any other markets and to raise their costs so that those companies would know that it was not going to be a profitable enterprise to continue their expansion.
>
> What we are suggesting is that this is really a test of degree, that we have in at least one of the markets evidence which is very close to predation. What we have is such a tightly focused and overwhelming marshalling of the dominant resources of the company to these targeted areas that there is a need for a remedy.
>
> . . .
>
> ... While one may formulate various tests that would have different requirements in terms of the super-normal targeted response, this is probably the clearest case imaginable in terms of the absolutely overwhelmingly aggressive nature of the response to these targeted markets. [231]

Counsel clarified that "leveraging" in this context means the use of monopoly rents from other markets to subsidize near-predatory behaviour in the markets in question. [232]

593 One of the ordinary meanings of the word "target" is

> anything that is fired at or made an objective of warlike operations ... [233]

In one obvious sense, therefore, "targeting" simply refers to focused or aimed rather than general responses. The facts show that Tele-Direct behaved differently in the competitive markets. If the Director is arguing that the actions of Tele-Direct constitute the anti-competitive act of targeting merely because its actions in markets in which broadly-scoped entry was occurring were different from those in markets where no such entry had occurred, we do not accept the argument. Targeting cannot be distinguished as an anti-competitive act merely by the fact that there is a differentiated response. Targeting, in the sense of a differentiated response to competitors, is a decidedly normal competitive reaction. An incumbent can be expected to behave differently where it faces entry than where it does not. One competes where there is competition. Similarly there may be gradations of reaction depending on the nature of the competitive threats.

594 The earlier discussion regarding market power established that, whereas the broadly-scoped directories published by entrants in the "targeted" markets were considered by Tele-Direct as competition for its own directories, the same was not true of other publishers who sought market niches defined by geography or other specific characteristics of their intended audience (e.g., ethnic, religious, easy to read directories). Furthermore, both White and DSP introduced features into their directories such as postal codes, information about cultural events, coupons, etc., that provide value to users that could affect whether the Tele-Direct directories would be retained by telephone subscribers in those markets if Tele-Direct did nothing.

595 If "targeting" does not depend solely on differentiated responses, how is it to be distinguished from competition on the merits? We do not take the Director to be proposing that an incumbent, even one with a dominant market position, is precluded from responding to entry. Entry would obviously be *encouraged* if the incumbent accommodated the entrant. It is, however, doubtful that anyone would suggest that this is a desirable competitive outcome. Anything short of accommodation is likely to make the post-entry prospects of an entrant less attractive than the pre-entry benefits enjoyed by the incumbent. It is, therefore, not enough for us to find that Tele-Direct's responses made entry less attractive.

596 Indeed, the Director's position seems to be that a firm is free to act to discourage entry but that there is a limit to what it may do. This is reflected in the Director's proposed remedy, which would allow Tele-Direct to use two out of three of price

reductions or discounts, enhancements and an advertising campaign in individual markets.[234] Once the incumbent passes this critical threshold, it is submitted that it has moved into the realm of anti-competitive conduct. The reasoning behind this, as we understand it, is that while what has been done in the particular markets may not be particularly harmful, the long-term harm caused by discouraging future entry outweighs any immediate benefit. In other words, the response in the markets where entry occurs is part of an effort to discourage entry into other markets by behaving in a fashion which is nearly, but not necessarily, predatory in the strict sense in which that word is usually used.

597 In support of the position that Tele-Direct's response went beyond what is "normal", the Director relies on its expressions of corporate intent, the number, variety and degree of its responses and the intensity of those responses. As a standard for assessing how far Tele-Direct went the Director submits that we can look to the evidence that its response in Sault Ste. Marie caused Tele-Direct to incur losses, a comparison to the experience of independent entrants in American markets, and the difference between White's and DSP's expectations and their actual results and their future plans.

598 Counsel for the Director also suggests that Tele-Direct is using its monopoly rents from other markets to cross-subsidize its responses in competitive markets. This possible meaning of targeting would only apply, however, where the dominant firm is incurring losses in the targeted market. However, the Director does not appear to be suggesting that this is a necessary condition for the Tribunal to find that "targeting" is an anti-competitive act in this case.

599 First, we will examine the question whether what Tele-Direct did in the competitive markets was generally of benefit to consumers (advertisers) in those markets, largely neutral or, in fact, harmful. While Tele-Direct's actions clearly made it more expensive for the entrants than if it had accommodated them, seizing market share from a rival by offering a better product or lower prices is not, in general, exclusionary since consumers in the markets concerned are made better off. The Director has not attempted to argue that Tele-Direct's responses caused harm to advertisers in the particular markets in which entry occurred. The Director did, however, submit that at least some of Tele-Direct's actions were of negligible or temporary benefit to those advertisers.

600 With respect to the zero price increases, there is no question that advertisers benefitted from this initiative. The evidence indicates that the advertiser incentive program in competitive markets was carefully designed to absorb customers' directory advertising budgets so that little would be left for the new entrants when they canvassed for paid advertising. Yet, it is difficult to conclude that these programs did not benefit advertisers, particularly when rebates were involved. Making its directories more attractive by adding enhancements and increased advertising by Tele-Direct would both tend to increase usage of telephone directories and, thus, benefit advertisers in those markets. There was evidence that some of the enhancements to Tele-Direct's directories were viewed by the company as temporary expedients. For example, the postal code feature in Niagara was designed to be easily removable.[235] Nevertheless, as no evidence was brought to our attention indicating actual removal of the postal code section, we can only conclude it has been maintained by Tele-Direct. Further, although the Director argued that much of Tele-Direct's advertising was "negative" advertising which only disparaged its competitors, we do not have enough information on the advertising campaign to be in a position to identify which portions were "negative" and if the negative outweighed the positive. Overall, the inescapable conclusion is that Tele-Direct's responses to entry resulted in an improvement for advertisers in the "targeted" markets.

601 What, then, about the likelihood of harm in Tele-Direct's territory as a whole because of the effect of these responses on future entry or expansion? There is evidence that Tele-Direct was not solely concerned with "meeting" competition in Sault Ste. Marie and Niagara. Tele-Direct also feared further entry into other areas, particularly from DSP which was associated with Southam and had the advantage of having local connections and organization through the publisher's newspapers. This is clear from the evidence of Ms. McIlroy, who was in a key position as Vice-president of Marketing at that time.

602 Ms. McIlroy testified that Tele-Direct designed its strategies first around the Sault Ste. Marie situation and then replicated them in Niagara when White appeared. She confirmed that one of her objectives in Sault Ste. Marie, as set out in document recording her notes for a presentation, was to "limit Southam motivation to continue Yellow Pages roll-out in Ontario".[236] She further explained that as a "counter-strategy", if Southam's intention to enter directory publishing was a long-term, well-

funded strategy, then her second objective was to "make the cost of carrying on business against [Tele-Direct] market-by-market exceptionally high." [237]

603 But those were not the sole objectives. Ms. McIlroy also described Tele-Direct's strategy in the following terms:

> ... the basic premise was to make it expensive for the competitor to compete with us and to focus on doing everything and doing it right in the Sault, putting whatever investments or resources that was necessary to avoid unnecessary market share [loss] and to protect our interest in that market. [238]

Similarly, in a presentation that she made to her fellow officers she set out the following points as constituting Tele-Direct's "challenge":

- Protect usage and awareness - promotion
- Add value to advertiser - incentive
- Add value to user - product enhancements
  - size and colour
- Sustain leadership profile
- Compete on value vs. cost
- *Make competition an expensive proposition*{239} (emphasis added)

Notes: 239 Confidential exhibit CJ-33 (black vol. 12), tab 88 at 133316.

Mr. Renwicke disputed whether the last point was ever accepted as corporate policy, but in matters of dispute between Ms. McIlroy and her fellow officers we accept her evidence. She left Tele-Direct on good terms and she has no discernible reason for colouring her evidence, particularly as she was the officer responsible for preparing tactics that the Director would have us label as anti-competitive.

604 It is only the reference to making competition "expensive" as part of Tele-Direct's strategy that raises any question of anti-competitive motivation. It is doubtful that Tele-Direct could make competition expensive without negatively affecting its own profitability. According to Ms. McIlroy the participants at the officers' meeting were taken aback at the cost to the company of making it expensive for the competition. They agreed to "spend what it took" with the proviso that the expenditures would be selective and the officers would be kept current on what was transpiring, even as frequently as on a weekly basis. The fact that Ms. McIlroy convinced her fellow officers to adopt a policy of making competition expensive even when doing so would be detrimental to current profits provides some indication that Tele-Direct was trying to influence its competitors' future conduct to some extent.

605 There is as well another consideration. The documents relating to Tele-Direct's responses in Sault Ste. Marie and Niagara were not provided during documentary discovery within the time frame ordered. They did not make their appearance until after Tele-Direct apparently learned that the Director had contacted Ms. McIlroy and that she would appear as a witness in these proceedings for the Director. Counsel for Tele-Direct attempted to blame the delay in the production of these documents on inadvertence. He said that the relevant box of documents got lost but that no one seemed to know where or why. If the documents were lost, a detailed explanation is in order especially given the controversial issue to which they pertain and that the content of some of the documents is clearly adverse to Tele-Direct's position. A vague explanation carries little weight. The belated production and inadequate explanation cause the Tribunal to make an adverse inference with respect to Tele-Direct's intentions on this issue. Tele-Direct apparently considered that it might have "gone too far" in its responses in those markets. This, along

with the statements of corporate policy, provides support for the view that Tele-Direct intended, in a subjective sense, to convey a warning about future entry as well as protecting its position in the individual markets subject to entry.

606 Nonetheless, the critical question is whether there is a reasonable likelihood that future entry will be discouraged by Tele-Direct's actions. If so, is that possible negative effect more compelling than the proven benefits in the individual markets from Tele-Direct's improving its product, freezing prices and increasing advertising expenditures, all of which contributed in some measure to increasing usage of telephone directories, which is generally seen as pro-competitive. A reasonable likelihood of significant long-run detriment must exist if these tactics are to be discouraged.

607 The Director relies to some extent on the evidence given by White and DSP, which will be canvassed below, regarding their intentions about future expansion, which he says shows that future entry and expansion *have been* deterred by Tele-Direct's behaviour. That evidence is, however, a small portion of the evidence put forward by the Director in support of his case. In effect, the Director asks us to *infer* from the "overwhelming intensity" of Tele-Direct's response in the markets where it faced entry that potential entry into other markets *will* be deterred.

608 Before we proceed to consider the more detailed arguments, we should indicate at the outset that we have serious reservations with respect to the overwhelming intensity approach adopted by the Director. The Director has not advanced any "objective" criteria by which the Tribunal is to assess whether Tele-Direct's responses in the competitive markets have the overall anti-competitive character or "purpose" required for section 79.

609 Although the Director is not arguing that Tele-Direct's conduct was predatory, predation is certainly the closest analogy to what is put forward here. The essence of an allegation of predatory pricing is that the firm foregoes short-run revenues by cutting prices, driving out rivals and thus providing itself with the opportunity to recoup more than its short-term losses through higher profits earned in the longer term in the absence of competition. A predatory pricing allegation is difficult because, at least in the short-run, consumers apparently benefit from lower prices. In addition, predation can only succeed if the predator has greater staying power than its rivals and a reasonable prospect of recouping its losses. In order to distinguish competitive pricing action from predation, therefore, the "Areeda-Turner test" for predatory pricing [239] was developed and has been adopted by the courts.

610 Our difficulty here is that, unlike the predatory pricing case, no "test" or criteria of any kind were even proposed by the Director or his experts. Indeed, we acknowledge that the likelihood of being able to establish objective criteria to distinguish between harmful and beneficial conduct of the type in issue is remote. In effect, because of the absence of any criteria, the Tribunal is being asked by the Director to place itself in the shoes of a potential entrant with a view to assessing the credibility of the alleged "threat" being issued by Tele-Direct by its responses to entry. The Tribunal must determine whether the response in the initial markets in which entry occurred was so "overwhelmingly intense" that an entrant would be intimidated and future entry or expansion deterred. [240] What may seem to be a response of "overwhelming intensity" to one person may not to another. It is inevitably a highly subjective exercise. Decisions by the Tribunal restricting competitive action on the grounds that the action is of overwhelming intensity would send a chilling message about competition that is, in our view, not consistent with the purpose of the Act, as set forth in section 1.1. We are concerned that, in the absence of some objective test, firms can have no idea what constitutes a "competitive" versus an "anti-competitive" response when responses like those used by Tele-Direct in this case are involved (e.g., price freezing or cutting, incentives, product improvements, increased advertising).

611 While Tele-Direct certainly made very strong responses to entry in Niagara and Sault Ste. Marie, there is no certain way for the Tribunal to judge what magnitude of response Tele-Direct would have employed had it not been concerned, among other things, with discouraging further entry. To say that the response was greater than it otherwise would have been assumes that we can judge how much Tele-Direct would have done had it been acting competitively and that, therefore, we can determine, with reasonable assurance, to what degree the observed responses went beyond that and became anti-competitive. In trying to make this comparison urged upon us by the Director, it must be recognized that Tele-Direct was facing pretty stiff competition from the new entrants. The entrants' publications were initially superior with respect to features and they were priced up to 40 percent below Tele-Direct. While Tele-Direct's expenditures on advertising and promotion constituted a sea change from its

previous expenditures, DSP spent more over the three years from 1992 to 1994 than Tele-Direct did, including large amounts in the local Southam newspaper.

612 The Director makes two broad arguments in support of the position that Tele-Direct's actions went beyond "normal" competition and, taken together, constitute anti-competitive acts. The first is that Tele-Direct's "bottom line" results in Sault Ste. Marie in 1993 reveal that Tele-Direct barely broke even in that market when the cost of introducing the improvements to the directory and the advertising and promotional expenditures are taken into account. This conclusion was not disputed by Mr. Beauséjour who agreed that the results shown were "very close to breakeven".

613 The analysis presented to the witness, however, included the payment to Bell Canada (CCS) as an "expense" deducted from revenue. When Bell and Tele-Direct are treated on an integrated basis, as we earlier found in the tying context to be appropriate when considering Tele-Direct's profitability study, it would be inaccurate to refer to Tele-Direct's results in Sault Ste. Marie as a "marginal profit" or "loss" situation. The pro-rated share of the payment to Bell would have to be added back to the Tele-Direct's results in Sault Ste. Marie. Given that the Bell payment is mostly contribution to profit and it is a substantial amount, this would move the Sault Ste. Marie results well above the breakeven point, even with the extra expenditures on enhancements and advertising. Indeed, it would appear that the payment to Bell constitutes the largest portion of the "profit" that attracts independent publishers to attempt to enter Tele-Direct's markets and which allows them to contemplate profitably pricing 30 or 40 percent below Tele-Direct. In the Niagara region, Tele-Direct earned a profit in 1993 even when the payment to Bell is treated as an expense.

614 The Director's second argument is that experience in the industry also demonstrates that Tele-Direct went beyond "normal" competitive responses. This includes the evidence regarding expectations of White and DSP versus their experience and their future intentions as well as evidence about how American telco publishers have responded to entry in their markets.

615 With respect to the experience of an American telco publisher responding to entry, Mr. Anderson, who was with NYNEX, testified in chief that when NYNEX perceived independent directory publishers as significant competition, it would make its sales force aware of their presence, possibly do more advertising, and consider the scoping of its directories and their features. He also pointed out that it had not been his experience that features would be introduced only in a competitive market. After a trial run, if the feature proved successful, it would be implemented "across the product line." In cross-examination, he admitted that NYNEX had never, at least to his knowledge, offered an incentive program similar to that used by Tele-Direct in its competitive markets in response to entry of a competing publisher. He gave the same response when asked about a specific market where, in response to entry, NYNEX might have frozen prices in specific markets in response to entry for two years, without rescoping. With respect to the remaining possibilities put to him by counsel for the Director, Mr. Anderson either had no knowledge (e.g., advertising as a separate budget item) or commented on the lack of applicability in the American context (e.g., telco publishers cannot offer audiotext, no trade-mark to protect through legal action). Without any knowledge about the marketplace in which NYNEX operates, we are unable to draw any conclusions about this evidence.

616 With respect to White, Mr. Lewis stated that his experience in entering markets in the United States had led him to believe that White would have larger sales in Niagara than turned out to be the case. In its first revenue year, White expected to capture between 30 and 40 percent of Tele-Direct's revenue.[241] In fact, White's revenue for its second directory (the first revenue-generating directory), published in 1994, was 17 percent of Tele-Direct's revenue. Revenue for the third directory (the 1995 directory) represented a nine percent increase from the previous year for a total of about 19 percent of Tele-Direct's revenue.

617 Mr. Lewis stated that his initial plans for expansion beyond the Niagara region in Canada had been put on hold indefinitely due to Tele-Direct's conduct *and* the inability to obtain complete subscriber listing information. At the time of the hearing, this matter of subscriber listings was on appeal to the federal Cabinet. Mr. Lewis also said that upon a favourable Cabinet decision on the privacy issue, he would anticipate starting a number of additional directories in the Toronto and Niagara region. Any conclusion that White was deterred from future expansion by Tele-Direct's conduct and that, therefore, that conduct passes an anti-competitive threshold would be difficult in light of this evidence and the subsequent Cabinet decision overruling the

CRTC decision that was to the effect that consumers should be able to opt out of having their listing information released to independent publishers.[242]

618 In formulating its entry strategy, DSP factored into its business plan both the risk of legal action by Tele-Direct and the possibility of a Tele-Direct competitive reaction. DSP, erroneously as it turns out, anticipated little response from Tele-Direct based on that company virtually ignoring the entry of the Locator directories in a large number of communities. As we have discussed, the Locator directories are simply not close substitutes for Tele-Direct's directories. DSP's expectation for its first revenue-generating directory was to capture about 50 percent of Tele-Direct's revenue. In developing this estimate, DSP reviewed the American experience and consulted extensively with its joint venture partner, Noverr. Instead, the directory generated about half of the expected revenue in dollar terms. The revenues for the second revenue-generating directory, published in 1994, were once again considerably lower than expected. It was, however, anticipated that the revenues for the 1995 directory would be higher and marginally profitable.

619 DSP has also decided not to expand in Ontario even though that was the original plan. While Tele-Direct's conduct was said to have been the reason for that decision, the evidence suggests that there were other reasons as well. In particular, it would appear that DSP's expectations were quite aggressive for a new business and, to some extent (in relying on the Locator experience), in error. The Director says that the Sault Ste. Marie, Michigan part of the DSP joint directory, which did not experience a response like Tele-Direct's, had been far more successful than its Ontario counterpart. However, that side of the publication also fell well short of what had been anticipated as a "normal" first year revenue, further suggesting that the DSP's expectations may not have been realistic.

620 We do not have enough evidence to arrive at any conclusion about the effect of Tele-Direct's actions on deterring entry or expansion in the Newfoundland and Joliette situations.

621 The remedy suggested by the Director changed from the application to final argument. In our view, the remedy, as currently formulated, illustrates the difficulty of dealing with "targeting" as an anti-competitive act. The notice of application, at paragraph 1(b)(xiii), requested that:

> the Respondents be prohibited from targeting price reductions and other discounts for advertising space to those markets in which entry by competing publishers has occurred or is occurring.

In oral argument, counsel for the Director explained that the remedy ultimately being requested by the Director would read as follows:

> that the respondents be prohibited for a period of five years from: (i) targeting a price, a price reduction, or other discount including any advertiser incentive program offering free colour, free size up, or a first time placement discount where there is no annual increase in advertiser spending; *and* (ii) targeting any directory enhancement, including audio-text service; *and* (iii) targeting any advertising campaign; to a market where entry by a competing directory publisher has occurred, is occurring, or is reasonably anticipated to occur unless such listed item is offered or applied uniformly and simultaneously by the respondents in the majority of their directory markets.

The "and" between the listed items is critical. The Director proposes that Tele-Direct be permitted to do any *one* or *two* of the three enumerated actions in any market where entry has occurred. However, if all three should be undertaken then they would have to be followed in a majority of Tele-Direct's local markets.

622 We recognize that the Director is likely attempting, by this compromise remedy, to recognize that Tele-Direct's responses are of benefit to consumers in the market in which they occur. This effectively highlights the difficulty of the "targeting" allegation. First, the number of competitive responses (one or two) that Tele-Direct is allowed is completely arbitrary. The Director has not provided the Tribunal with any rationale as to why one or two (but not three) responses would not be anti-competitive. Further, there is no suggestion that the Tribunal should limit the extent to which Tele-Direct could invoke the

competitive responses to which it would be entitled. Yet, the Director alleges that Tele-Direct's responses in the competitive markets were anti-competitive in part *because of* their intensity and ferocity.

623 Considering the difficulty in circumscribing "targeting" so that it does not result in discouraging desirable competitive activity, we do not find that Tele-Direct's conduct with regard to pricing, promotion and changes to its directories in the competitive markets, in particular in the Sault Ste. Marie and Niagara areas, is anti-competitive.

• *Litigation or Threatened Litigation*

624 Finally, we turn to the Director's argument that litigation or threatened litigation by Tele-Direct, when taken together with the other actions of Tele-Direct, contribute to targeting/raising rivals' costs.

625 The Director argues that Tele-Direct's use of litigation or threatened litigation "goes into the mix" to show intent and the excessive degree of the overall response to entry in the competitive markets. The Director does not rely on the nature of the litigation on its own. The Director does not argue, for instance, that the litigation was a "sham". "Sham" litigation, or litigation which the plaintiff knows is without foundation but uses to stifle or impair competition, can be a technique of predation. [243] In the words of Robert Bork: "As a technique for predation, sham litigation is theoretically one of the most promising." [244]

626 Since no argument is being made that the litigation started by Tele-Direct against DSP was "without foundation", [245] we need some other means to determine whether the litigation in question crossed the line to anti-competitive conduct. We do not consider that it is sufficient to look at the litigation only in combination with the other responses. There must be some evidence specific to the bringing or the conduct of the litigation itself that would lead us to conclude that the purpose was to contribute to the impairment of competition over the protection of property rights.

627 The Director points out that while Mr. Crawford, Tele-Direct's Corporate Secretary and legal counsel, originally testified that Tele-Direct defended any unauthorized use of its trade-marks and copyrights, it became apparent on cross-examination that this was not true. Tele-Direct overlooked unauthorized use on a number of occasions. Perhaps the difficulty with this witness's credibility on this issue and the fact that litigation seems only to be taken against specific competitors do lead to the view that Tele-Direct focused on those competitors. However, that alone is not enough if the litigation is not a sham.

628 On the facts of this case, we cannot conclude that Tele-Direct brought, conducted or gave warnings regarding otherwise apparently valid litigation in such a manner that its purpose was clearly to contribute to the impairment of competition in those markets where entry occurred rather than the protection of its intellectual property rights. There is no evidence, for instance, of undue delay. As of the date of the hearing, DSP had not yet been discovered but a major factor in this delay was the illness of Mr. McCarthy, the intended representative for DSP. Discovery of DSP was, however, scheduled for November 1995 with Mr. Campbell for DSP. Discoveries of Tele-Direct had been completed by the date of the hearing. There is no evidence that the litigation is following any other than the "normal" course. Unlike the *Laidlaw* case, there is no evidence of responding to an apparently minor matter in a "wildly overly aggressive manner" with multiple claims or of pointed threats to put a competitor "out of business" using, in part, the pursuit of legal action for which, as the Laidlaw representative informed the competitor, a large sum of money had been reserved. [246] While Tele-Direct did not proceed against White after its warning regarding possible litigation, it is certainly plausible that it did not do so because of the similarity of the issues to the DSP case. That litigation would seem likely to settle at least the copyright question once and for all, by establishing a precedent for Tele-Direct's dealings with other publishers.

629 The Tribunal, therefore, cannot accept the Director's submission that litigation or threatened litigation in this case can contribute to a finding of anti-competitive acts by Tele-Direct.

• *Audiotext in Sault Ste. Marie*

630 The Director alleges that Tele-Direct used its power as a major buyer to influence the supplier of audiotext information in Sault Ste. Marie, Perception, resulting in a degradation of the feed to DSP. The respondents acknowledge in their written

argument that the allegation could be an anti-competitive act, if proven, but dispute that it is supported by the evidence. The critical questions are whether Tele-Direct was merely asserting its contractual rights and what responsibility, if any, can be assigned to Tele-Direct for the quality of service delivered by Perception to DSP.

Did Tele-Direct have a contractual right to exclusivity?

631 The respondents state in their written argument, at paragraph 930, that "Perception recognized that Tele-Direct was entitled to the exclusive right to its only feed ...." This statement is not supported by the evidence. Up until January 1994, the only contract between Tele-Direct and Perception was for the Toronto area and it provided Tele-Direct with exclusive access to Perception's feed in the Toronto local calling area only. Perception had in fact refused to grant Tele-Direct exclusivity for other areas because of the limitation on its ability to market its service.

632 In the fall of 1992, when Tele-Direct became aware of the proposed entry into Sault Ste. Marie by DSP, including offering audiotext, Tele-Direct entered into negotiations with Perception to supply its TYP in that market. One of Tele-Direct's concerns was that the feed in Sault Ste. Marie be exclusive to it, that DSP not have access to the same feed. The evidence reveals that the parties did not, in fact, come to an agreement on exclusivity until much later. While exclusivity is mentioned in a letter in March 1993,[247] the draft contract sent by Perception to Tele-Direct in May 1993 is instructive. The letter enclosing the contract states that with "all the excitement of getting 'the Soo' up and talking" Perception had neglected to send Tele-Direct the contract for Sault Ste. Marie. The contract clearly states that it is a "non-exclusive" licence to receive and store information.[248]

633 The contract was never signed by Tele-Direct but nonetheless provides proof that Perception, at least, did not consider at that time that Tele-Direct had exclusive rights to its feed. They were certainly not *ad idem* in that respect. The final contract covering Sault Ste. Marie, which does provide for exclusivity, was not signed until January 1994.[249] A letter in September 1993 provides that upon acceptance of a new agreement by Tele-Direct, the "BDR Audio Network will be made available to only directory publishers in Canada and exclusively to Tele-Direct within Ontario and Quebec."[250] Peter Dolan, Director of Sales at Tele-Direct (Services) Inc., admitted, however, that Tele-Direct had to go "back and forth" with Perception a couple of times in order to get the wording regarding exclusivity re-inserted into the final contract. Tele-Direct does not appear to have had, until November 1993 at the earliest, a right to exclusivity with Perception and, therefore, had no right to insist or attempt to insist on exclusive service from Perception prior to that date.

Did Tele-Direct influence the delivery of service by Perception to DSP?

634 Upon becoming aware in late 1992 that Perception was supplying an information feed to DSP and that it had the same content as Tele-Direct's feed, Tele-Direct, through Mr. Dolan, expressed its displeasure to Perception. Perception agreed to remedy the situation prior to publication of the DSP directory. Mr. Dolan said that he thought Perception would acquire an alternate feed for DSP as a remedy. At the same time, Tele-Direct was pushing for exclusivity with Perception.

635 Tele-Direct's TYP were launched in mid-February 1993. Tele-Direct was not satisfied with Perception's response to its complaint regarding the feed to DSP, including an effort in early February whereby Perception started sending slightly re-arranged or reworded content to DSP. In cross-examination, Mr. Dolan indicated that Tele-Direct wanted a "superior feed" to that provided to DSP.[251]

636 A meeting was scheduled for February 23, 1993 with Perception. The agenda, which was provided to Perception, states that what Perception was doing with respect to the DSP feed was "not satisfactory" to Tele-Direct. Mr. Dolan explained that Perception was simply re-voicing the network and again stated that Tele-Direct was not satisfied because it wanted a "superior" feed. This concern was communicated to Perception at the meeting.

637 In re-examination, taking Mr. Dolan to clause 8 of the January 1994 contract with Perception which uses the word "superior", counsel for the respondents elicited a response that "superior" meant "of high quality" and that was the way in which Mr. Dolan had used the word in his cross-examination. Clause 8 of the contract reads:

> ... Brite does commit that the BDR Audio Network will continue to be of the same exceptional quality as the affiliate has enjoyed. BDR will continue to be of superior quality and utilize its own personnel for the creation and dissemination of information. [252]

Clause 11.6, which was later brought to the witness's attention, is instructive:

> ... Brite will continue to supply the superior level of programming that the Affiliate has come to expect. Other audio networks offered by Brite Voice Systems or any Brite subsidiary or related company, will not exceed the BDR Audio Network in measurable deliverables including, but not limited to, frequency of reports, quantity of content, program choice and diversity as well as voice quality. Brite will make every effort to avoid American colloquialism.... [253]

Even in the contract, therefore, it is apparent that the word "superior" is used in a comparative, rather than an absolute, sense. [254] When questioned by the panel about clause 11.6 of the contract, Mr. Dolan agreed that what the clause was meant to ensure was that nobody had anything *better* than Tele-Direct. We conclude, therefore, that, despite the later attempt at qualification, Mr. Dolan was using the word "superior" in its comparative sense throughout his testimony. Tele-Direct was pressing Perception for a better feed than Perception was giving DSP.

638 Of most significance, on January 25, 1993, Tele-Direct held out what can only be regarded as a major "carrot" to Perception. Mr. Dolan, on behalf of Tele-Direct, wrote asking Perception for its "advice and recommendations" on the most efficient way to provide a TYP service throughout Tele-Direct's territory. [255] There is evidence that by March of 1993, consequent upon a February 25, 1993 officers' meeting, these plans were scaled down dramatically. TYP installation was to begin only in markets currently or potentially threatened by a competitor, some ten markets. TYP were treated as a strategic tool against competition rather than a widespread innovation. In fact, after Sault Ste. Marie TYP were introduced only in Niagara Falls, in response to White, and in Windsor, where Tele-Direct was concerned both about potential entry by White and the fact that the Windsor Star is owned by Southam. It is difficult to escape the conclusion that Tele-Direct was using the promise of the roll-out of TYP service throughout its territory in order to gain the cooperation of Perception when it introduced its TYP service in Sault Ste. Marie in February 1993.

639 That the promised roll-out of the TYP service was a factor in the relationship between Tele-Direct and Perception is clear from the letter Perception wrote Tele-Direct on March 1, 1993, following the February meeting. In it Perception informed Tele-Direct that an "alternative audio source" for DSP would be provided by March 29, 1993. The letter concludes "... you are a very important client to us and we want to work with you as you roll out audiotex *(sic)* through out your territory." [256]

640 The deterioration to DSP feed was coincident with its first revenue canvass in the spring and summer of 1993. (Its first revenue directory was published in November 1993.) Because of the poor quality of the feed, the audiotext lines were not used to nearly the same extent as in the first two months of operation. Because of the reduced volume, DSP could not use the record of the number of calls to its audiotext service as evidence of widespread use of its directory by consumers. As a result, the audiotext service was not as positive a factor as it might have been in selling its directory to advertisers.

641 Mr. Campbell said that it would have been virtually impossible for DSP to change its information supplier when it experienced problems. Despite what Mr. Dolan said, there was little reason for Tele-Direct to think that Perception was able, even if willing, to produce an alternative high quality feed for DSP. As matters turned out, the feed to DSP only became acceptable again once the merger of Perception and Brite resulted in another source of feed becoming available in about November 1993.

642 We are of the view that Tele-Direct used its bargaining power, stemming from its dominant position in the market for the supply of telephone directory advertising, to pressure Perception to, in effect, withhold supply from DSP for the purpose of frustrating or, at least, negatively impacting, the DSP attempt at entry in Sault Ste. Marie. [257] Unlike the other responses used by Tele-Direct in the competitive markets, the only perceptible effect on consumers and advertisers was a negative one.

It would appear to us that the kind of conduct engaged in by Tele-Direct regarding audiotext in Sault Ste. Marie unequivocally falls within the class of anti-competitive acts against which sections 79 is meant to guard.

643 Did Tele-Direct engage in a practice of anti-competitive acts in relation to audiotext in Sault Ste. Marie? Based on the standard set out in *Nutrasweet*,[258] an "isolated act" does not constitute a practice. In the instant case the deterioration in the audiotext feed to DSP resulted from intensive and repeated efforts on the part of Tele-Direct that hardly qualify as an "isolated act". Nor do we find that the reasonably anticipated duration and seriousness of the consequences of the efforts by Tele-Direct suggest that they should be treated as "isolated" and thus outside the reach of section 79. We therefore consider that Tele-Direct's actions regarding the DSP feed for its audiotext service in Sault Ste. Marie constitute a practice of anti-competitive acts.

644 Further, we find no difficulty in concluding that the effects of the deterioration in the quality of the audiotext feed resulted in a substantial lessening of competition in the Sault Ste Marie market. In conducting its first revenue canvass, DSP was denied the anticipated marketing advantage of using its audiotext call volumes to prove usage of its directory to potential advertisers because the feed deteriorated just as the canvass started. Achieving credibility with advertisers is one of the biggest hurdles that an entrant publisher must overcome.[259] The audiotext problem was a serious setback for DSP in its initial effort to attract paid advertising. However, as the Director has not requested a remedy specific to the audiotext problem or, more generally, governing Tele-Direct's relationship with the suppliers, no remedy follows from this finding.

D. Market for Advertising Services

(1) Class or Species of Business in Canada (Relevant Market): Agents

645 The Director alleges a number of anti-competitive acts which form a practice resulting in a substantial prevention or lessening of competition in the market for the supply of advertising services. These alleged anti-competitive acts affect agents and consultants or, in some cases, one or the other. The Director takes the position that when determining whether there is a substantial prevention or lessening of competition the effects of all of the listed acts found to be anti-competitive should be combined because they all affect the advertising services market. Further, one of the alleged anti-competitive acts is the tying of the provision of advertising services to advertising space, the same allegation we have already dealt with in the tying portion of this decision. Another alleged anti-competitive act which bears a striking resemblance to an allegation of tying is also included under the heading "Squeezing", namely, "further restricting the availability of commission [to other service providers] over time".

646 The respondents submit that, to the extent a separate "services" market exists, consultants and agents are in different services markets and acts affecting more than one market cannot be combined to form a practice and, thus, to determine whether there has been a substantial prevention or lessening of competition. A prevention or lessening of competition must take place *in a market* in the words of section 79. They also argue that Tele-Direct does not have market power in either services market.

647 As we have found that there is an anti-competitive tie covering only part of the alleged advertising services market, we cannot agree with the Director that there is one advertising services market in which both agents and consultants operate that encompasses *all* of Tele-Direct's customers. Customers meeting the 1993 commissionability rule are evidently included in the services market. The customer segment that we have determined is anti-competitively tied under section 77 -- namely regional customers -- is also included. (We will return below to the question of whether the tying practice should also form part of the section 79 case.) Agents are operating in this services market. And, Tele-Direct competes with the agents in providing services to those customers. Consultants do not.

648 It is difficult to see how acts taking place in different markets could be logically combined to determine if competition is substantially lessened or prevented in a particular market. Thus, only the acts affecting agents can be combined for the purpose of determining whether there has been a substantial lessening of competition in the services market.

649 Correspondingly, only acts affecting consultants can be combined to determine whether there has been a substantial lessening of competition in the relevant market in which they operate. It is a separate section 79 case. The details of the allegations against consultants will be dealt with below under the heading "Consultants".

650 Further, not all the alleged practices of anti-competitive acts respecting agents are of a sufficiently similar character so that they can be combined when assessing whether there has been a substantial prevention or lessening of competition in the services market. In particular, tying (and its restatement "restricting commission over time") differs significantly from the other alleged anti-competitive acts. The Director has brought the allegation of tying under both sections 77 and 79. The analysis and result are the same under both sections. Having found that tying results in a substantial lessening of competition by impeding entry of or expansion of agents into or excluding them from the part of the demand spectrum between six and eight markets, should this substantial lessening of competition be combined with the effects resulting from any other practice of anti-competitive acts that the Director succeeds in proving? If so, all anti-competitive acts so found would automatically lead to a finding of substantial prevention or lessening of competition by reason of our finding respecting tying.

651 In our view, it is not appropriate to combine the effects of tying with the effects of the practice of other anti-competitive acts. The other alleged anti-competitive acts (save for group advertising) relate to a specific historical market, the commissionable market including the eight-market grandfathered accounts. It is possible to evaluate the effects of the alleged anti-competitive acts in this well-defined context. The issue is whether there has been a substantial lessening of competition where agents have historically been competing. In the case of tying, the allegation is that the extent of the market itself has been limited.

652 In this case, there is a distinct difference between the nature and effect of tying and the other alleged anti-competitive acts, save for group advertising which we return to below. We note that this might not be true in other cases where there might be some interaction or a less distinct dividing line between the section 77 and section 79 claims. A finding that the respondents have engaged in tying does not act as a spring-board for a finding of substantial lessening in the market segment where the agents have been competing. Prohibiting tying should permit the agents to compete in the enlarged market as they have in the historically commissionable market. A finding of substantial lessening of competition in the historically commissionable market should therefore be based on a practice of acts with respect to that market.

653 Therefore, we need not deal with tying further under section 79. We will now turn to the allegations relating to the commissionable market and then the allegation regarding the prohibition on group advertising which is distinct.

(2) Control of the Existing Commissionable Market

654 It is evident that, despite the Director's submission to this effect, Tele-Direct does not have *direct* control or market power in the currently commissionable advertising services market. It has a modest market share of approximately 25 percent in that market.[260] The Director also advances an alternative position that is not based on direct control by Tele-Direct but rather on the hypothesis that it is leveraging its control in the publishing market into the services market. We have found that Tele-Direct has control in the telephone directory advertising market which gives it market power in the publishing of advertising space. The Director argues that Tele-Direct is using this market power as a lever to obtain market power in advertising services through its alleged anti-competitive acts. We agree that this is an arguable theory that could, if proven, fall within the parameters of section 79. Whether Tele-Direct has, in fact, leveraged its existing market power must now be determined.

(3) Analysis Respecting the Existing Commissionable Market

655 The alleged anti-competitive acts are set out in full at paragraph 65 of the application. We paraphrase them here (not necessarily in the order set out in paragraph 65) as they relate to agents and alleged abuse of dominance only:

> (1) "squeezing" the return available to agents by transferring functions to, withholding services from and making terms of supply to agents more onerous;

(2) discriminating against agents by providing space to them on less favourable terms than available to Tele-Direct's internal sales force, including:

> • *group advertising* - prohibiting advertisements containing the name of more than one local advertiser, e.g., franchisees;
>
> • *issue billing* - requiring agents to pay for advertising on behalf of their clients at the time of issue as opposed to payment on a monthly basis which is the payment method employed when sales of advertising are made through Tele-Direct's own sales personnel;
>
> • *closing dates* - requiring that agents submit advertising for publication earlier than the date applicable to Tele-Direct's sales personnel;
>
> • *tear sheets, etc.* - refusing or delaying to provide tear sheets and other information and material to agents; and
>
> • *promotional programs* - delaying to inform agents of or refusing to make certain promotional programs available to agents' clients, including:
>
> > • a program whereby an advertiser using Tele-Direct's sales personnel could obtain a subsidy towards the cost of Yellow Pages advertising if Yellow Pages are mentioned in advertising in other media;
> >
> > • cooperative advertising programmes whereby a supplier contributes to the cost of advertising of its customer or distributor;
> >
> > • keyed advertising in which a new advertisement with a new telephone number is placed in the Yellow Pages and the calls to that number are monitored to assess the effectiveness of the advertisement; and
> >
> > • other trial and test programs.

656 The Director submits that these acts have had adverse effects on agents and that there is no business justification that would exempt the acts from being found to be anti-competitive. The Tribunal would observe that some of these acts appear to have created some difficulty for agents and, in some cases, there does not seem to be an acceptable business justification. However, it is not necessary to embark upon a detailed act-by-act analysis to weigh their effects on agents against their business justification because of our conclusion that the Director has not demonstrated that the acts have or are likely to prevent or lessen competition substantially in the relevant advertising services market.

657 Both parties referred us to the statement set out in the Tribunal's decision in *NutraSweet* that:

> [i]n essence, the question to be decided is whether the anti-competitive acts engaged in ... preserve or add to ... market power. [261]

The Director's operative theory is that Tele-Direct is extending its market power from the space market to the services market through the alleged practice of anti-competitive acts. This means that the Director must demonstrate that Tele-Direct has or is establishing, or is likely to achieve, market power in the services market.

658 In order to assess whether Tele-Direct now controls the services market, we first look to market shares in the currently commissionable market. There is disagreement between the Director and Tele-Direct on the respective market shares of Tele-Direct and the agents. The parties rely on a variety of data that most supports their positions. Market share estimates range from 65 to 87 percent for agents and from 13 to 35 percent for Tele-Direct. We reject the extreme numbers put forward by the Director and Tele-Direct as not supportable on the evidence and, indeed, they were not seriously advanced by either side. While there are weaknesses in the data, we are satisfied that a market share of about 75 percent for agents and 25 percent for Tele-Direct is reasonably accurate. [262]

659 A high market share for agents and a correspondingly low market share for Tele-Direct would suggest that, even if Tele-Direct has engaged in anti-competitive acts, it has not been successful in obtaining market power in the advertising services market. Indeed, the fact that Tele-Direct's market share is as high as it is may well be attributable to factors unique to Tele-Direct but which are not anti-competitive, such as the desire of some advertisers to deal directly with the publisher. From the available data, it is apparent that, even on an individual basis, Tele-Direct does not have as high a market share as DAC/NDAP, which has about a 40 percent share. Based on all these considerations, we are satisfied that Tele-Direct's 25 percent share falls well short of a level that might be considered to indicate market power.

660 We must also consider whether there is any evidence of a trend towards a material increase in Tele-Direct's market share, which might indicate that it is in the process or is likely in the future to acquire market power as a result of the acts which the Director alleges to be anti-competitive. Certainly, there is anecdotal evidence of individual advertisers switching from an agent to Tele-Direct for some of the reasons which constitute acts which the Director submits are anti-competitive, for example, issue billing. We have no evidence, however, of any declining trend in market share for agents or increasing trend in market share for Tele-Direct over any period of time. Further, it would not seem that the agency business is unattractive or that agents are in any way systematically going out of business. On the contrary, we have had evidence of additional agents being accredited in recent years and others who are still seeking accreditation.

661 Is there any reason to believe that in the future the alleged anti-competitive acts will have any *greater* deleterious effect on the agents than they may have had in the past? We recognize that a new element has been added to the interactions in the marketplace by the relatively recent creation of Tele-Direct's CMR. Could it be that, in combination with Tele-Direct (Media) Inc. which provides an additional vehicle for Tele-Direct to use practices like the alleged anti-competitive acts, the alleged anti-competitive acts will likely cause competition to be prevented or lessened substantially in the future?

662 We are unable to arrive at such a conclusion. We have no evidence of the competitive impact of the advent of Tele-Direct's CMR into the market. It has been competing since 1994 but we were provided with no evidence whatsoever from which to infer that the combination of its presence and Tele-Direct's alleged anti-competitive acts have resulted or will result in a materially lower market share to agents and a correspondingly higher share for Tele-Direct. One would have expected that if this was an important factor, we would have seen some significant movement of accounts from the independent agents to Tele-Direct's CMR. There was no such evidence. It is true that Tele-Direct's CMR is in its early years and it may not be as effective now as it will be later. To be valid, however, inferences about the future must be based on evidence. Given the record before us, any conclusion about the future effect of Tele-Direct's CMR in combination with the alleged anti-competitive acts would be speculative.

663 The Director has the burden of proving a substantial lessening of competition. We conclude that while some of the disadvantages which form part of the Director's abuse of dominance case and were imposed on agents by Tele-Direct may have had some adverse effect on them, that effect could not have been and is not likely to be substantial or the agents would not hold 75 percent of the market or there would be evidence of a decline over time in the share held by agents.

(4) Group Advertising

664 Group advertising is display advertising consisting of the individual business names of a number of franchisees or distributors under a common logo or trade-mark.[263] This type of advertisement is now prohibited by Tele-Direct and to all intents and purposes is not sold by agents or Tele-Direct.[264] The revenues that might potentially be converted into group advertising are currently non-commissionable and are serviced by the internal sales force as local or individual business accounts.

665 The effect of the alleged practice of anti-competitive acts regarding group advertising is to prevent competition by limiting the size of the commissionable market available to agents, rather than limiting their ability to compete for existing commissionable accounts. Because of the difference in the nature of the allegations, whether there is a likely substantial

prevention of competition as a result of Tele-Direct's practice regarding group advertising must be evaluated separately from the alleged practices of anti-competitive acts respecting the existing commissionable market.

666 We believe that Tele-Direct's policy on group advertising is dictated by its concern with a net revenue loss should advertisers abandon or reduce individual advertising in favour of group advertising. The incidental effect is to deny a type of advertising that would primarily be of interest to larger advertisers, for example, franchisers, some of whose accounts are likely targets for agencies. Although we heard anecdotal evidence of how certain advertisers would prefer to participate in group advertising, we were not presented with evidence as to the magnitude of the effect of this restriction. In the circumstances relating to agents we are of the opinion that such information should have been provided. Without such evidence, we cannot conclude that the prohibition against group advertising constitutes a substantial prevention of competition.

(5) Conclusion

667 We are unable to conclude that the evidence demonstrates that the acts alleged to be anti-competitive in the existing commissionable market and in respect of group advertising have had, are having or are likely to have the effect of preventing or lessening competition substantially. As a result, the Tribunal is without jurisdiction to grant a remedy under section 79 of the Act. It is, therefore, not necessary to consider in detail whether the individual acts complained of are anti-competitive and whether separately or in combination they amount to a practice.

668 We are not unmindful that some of Tele-Direct's actions in respect of agents seemed wilful and senseless. However, the Competition Tribunal does not exist to regulate industry practices generally. Rather, it has jurisdiction only to remedy the substantial prevention or lessening of competition and where this has not been proved, no remedy can be ordered.

E. Consultants

(1) Introduction

669 At paragraph 65(b) of the application, the Director alleges that Tele-Direct engaged in anti-competitive acts by refusing to deal directly with consultants as agents for advertisers purchasing space from Tele-Direct. The paragraph continues:

> The Respondents have issued guidelines to their advertising space sales staff which provide that the customer must deal with the Respondent's salespersons and no consultant can deal with the salespersons as a customer's agent.

The following, more specific, aspects of refusing to deal directly with consultants were provided in the written argument at paragraph 297:

> **[I.]**
>
> > (a) written instructions: refusal to act upon written instructions received from consultants on behalf of advertisers;
> >
> > (b) oral instructions: refusal to act upon oral instructions received from consultants on behalf of advertisers or meet consultants or the advertiser in the presence of consultants to receive same;
> >
> > (c) follow-up: refusal to deal with consultants on subsequent errors or problems.

670 In paragraph 65(c)(v) of the application, the Director alleges that Tele-Direct also engaged in anti-competitive acts by providing advertising space to consultants on less favourable terms than to its own sales staff, including rejecting or delaying orders based on alleged errors or other problems which would not result in delay or rejection of orders from Tele-Direct's own sales representatives. As set out in paragraph 296 of the written argument, the specific aspects of these acts are:

> **[II.]**

(a) delivery and processing problems: refusal to acknowledge or accept delivery of orders involving consultants or denial of delivery resulting in the delay or rejection of same, refusal to process such orders or the return of such orders to the advertiser or consultant;

(b) alleged errors: the identification of errors or problems in such orders which would not result in the delay or rejection of orders handled by the Respondents' own sales staff;

(c) oral instructions: refusal to meet with the advertiser to take instructions originating in advice from consultants;

(d) consequential acts: rejecting or delaying the processing of consultant orders, permitting or facilitating the following consequential actions:

(i) informing advertisers that their orders may or may not be processed if prepared by consultants or that consultants are "scam artists", have committed errors or similar threats or derogatory comments;

(ii) inducing breach of the contract between advertisers and consultants.

671 The final alleged anti-competitive acts of relevance to consultants are found at paragraph 65(e) of the application. The Director maintains that Tele-Direct is engaging in anti-competitive acts by refusing to supply specifications to consultants for the placing of advertisements in its directories.

672 We will deal with the alleged anti-competitive acts under the headings (a) refusal to deal directly with consultants, (b) discriminatory acts and (c) specifications, starting in "(5) Anti-competitive Acts", below.

(2) Allegations - Pleadings

673 The respondents argue that the "consequential acts" listed under II. (d) above do not fall within paragraph 65(c)(v) of the application and should not, therefore, be considered by the Tribunal. They also submit that one of the remedies requested by the Director, pertaining to copyright in advertisements, was not pleaded. The Director conceded that the case for including the remedy is not strong and we will not deal with it further.

674 On the question of the construction of the pleadings and what may be considered as fairly within them, once we have reached the stage of final argument we have indicated that what is determinative is what the parties considered to be in issue, looking at the proceeding as a whole. We will use the same general approach to the arguments here.

675 Counsel for the respondents admitted that aspects II.(a) and II.(b) were clearly in the application and II.(c) might be reasonably inferred from the application but II.(d) was outside the pleadings. The elements of (d) which were emphasized in oral argument by the respondents regarding their objection related to the question of inducing breach of contract and what was termed the "bad mouthing" claim or the making of disparaging remarks about consultants. In reply, counsel for the Director stated that the Director was not seeking a remedy with respect to the consequential acts and that there was little point in addressing whether they were part of the case. We have some difficulty with this position. The Director is clearly seeking a remedy for the alleged anti-competitive acts of providing advertising space to consultants on less favourable terms than to its own sales staff, including rejecting or delaying orders based on alleged errors or other problems, of which II.(d)(i), at least, is a subset. The Director also accepted, however, and we agree that any issue of counselling breach of contract is a matter for the civil courts so we will not deal with it further. The remaining acts listed in II.(d) were addressed by *both* parties through evidence and argument. Based on their conduct of the proceedings, the respondents were aware that these acts were in issue and there is, therefore, no prejudice to them by the Tribunal dealing with them on the merits.

(3) Competition Between Consultants and Tele-Direct

676 For the Director to succeed in any of the allegations, it must first be shown that Tele-Direct and the consultants are competitors. The respondents submit that consultants do not "sell" anything; they merely "unsell". They describe consultants

as being in the business of providing independent (or non-partisan) advice to disgruntled, local Yellow Pages advertisers. They say that Tele-Direct does not operate in this market since advertisers recognize that Tele-Direct's advice is partisan and not independent.

677 The Tribunal accepts that while the relationship between Tele-Direct and the consultants is not that seen in the more usual competitive context, they are nonetheless competitors. It is true that consultants exist by downselling, while it is highly unlikely that Tele-Direct representatives would offer the same type of advice. It is also true that consultants' advice is independent while Tele-Direct representatives are, by definition, partisan. Further, consultants normally do not have an ongoing relationship with an advertiser and their remuneration arrangement takes a different form than that for Tele-Direct. There may be other differences of detail.

678 At bottom, however, both consultants and Tele-Direct representatives provide services which a customer can use to achieve the final result of an advertisement in the Yellow Pages. As we have seen from the evidence put forward in this case, a customer may choose to use either a consultant or the Tele-Direct representative to obtain these services. In this sense, they are substitutes for one another and compete to serve the advertising customers. There was substantial evidence put before us that Tele-Direct, in fact, views consultants as significant competitors, monitors their progress and takes action to attempt to limit their inroads on its revenues.

679 This is not to say that consultants (and Tele-Direct) operate in the "separate" services market, an argument which we have already rejected. Both consultants and Tele-Direct are participants in the broad telephone directory advertising market. Tele-Direct controls that market, as set out in the chapter entitled "VII. Control: Market Power", above.

(4) Facts

(a) Consultants and their Method of Operation

680 Three directory advertising consultants testified before the Tribunal. Jim Harrison of Tel-Ad Advisors Ltd. ("Tel-Ad") has serviced the Ontario market from an office in the Toronto area since June 1984. Prior to that time, Mr. Harrison was an employee of Dominion Directory. Serge Brouillet, previously in sales and also training and promotion with Tele-Direct, started Ad-Vice Communications ("Ad-Vice") in mid-1989 in Sudbury to service northern Ontario. In the fall of 1990, he sold the northern Ontario operation to Charles Blais to be run as Ad-Vice North and moved into the Toronto market. Mr. Blais also appeared as a witness. Mr. Blais operated the Ad-Vice franchise in Sudbury from November 1990 to December 1992 when he sold it back to Mr. Brouillet who ran it in 1993.

681 A summary of the *modus operandi* of consultants in general will provide context for the relations between consultants and Tele-Direct and for the Director's allegations. Consultants operate on the basis that many Yellow Pages advertisers can reduce their Yellow Pages spending without reducing the effectiveness of the advertising. In other words, they target customers who are dissatisfied with the amount that they are spending with Tele-Direct and are willing to pay a fee to lower it. Consultants recruit customers by going through the Yellow Pages and identifying likely candidates for their services, those for whom they can save money. Two of the major factors are the size of the advertisement and the use of colour; number of headings and number of directories are also reviewed.

682 After contacting the client by telephone to determine interest, the consultant or an employee of the consultant meets with the client and makes a presentation showing the client various options for changing the advertising. The potential for conflict with Tele-Direct and its commissioned sales representatives is obvious from the outset. The consultants' income depends on reducing customers' expenditures on Yellow Pages. Thus, they attempt to convince the customer that the extra amount spent for options like larger size and colour is not worth paying. To do this, they might bring to the attention of the customer how much more those options cost and question their effectiveness for the customer. Tele-Direct's representatives, of course, emphasize the value and effectiveness of colour, size and the like by drawing on arguments and evidence put together by Tele-Direct to show that they are worth the cost.

683 With respect to submitting customers' orders to Tele-Direct for processing, when it first commenced operations Tel-Ad sent orders to Tele-Direct on behalf of customers. These were rejected by Tele-Direct. Then Tel-Ad sent in the orders on a generic order form with no identifiers; these were also rejected and returned either to Tel-Ad or the customer. Attempts to submit orders with a letter of power of attorney from the customer also failed. Eventually, Tel-Ad simply left the orders with the customers to be submitted to Tele-Direct. In July 1984, Tel-Ad started legal action against Tele-Direct for refusing to accept advertising orders directly from Tel-Ad. Tel-Ad also sought an interlocutory injunction requiring Tele-Direct to accept orders submitted by Tel-Ad on behalf of advertisers. The injunction application was denied on the basis of no irreparable harm and the action was later abandoned. Tel-Ad's activities led to the first version of Tele-Direct's guidelines for dealing with consultants, drafted in 1986. Tele-Direct's guidelines are reviewed in some detail below.

(b) Tele-Direct Reaction - General

684 The existence and activity of consultants strike at the trustworthiness of advice provided by Tele-Direct's sales representatives and place highly profitable revenues in jeopardy. Tele-Direct does all within its power to eliminate any possibility of consultants gaining the ear of its customers. It has taken out advertisements warning customers to beware of consultants. The same message is conveyed by the representatives and by letters to customers telling them to call Tele-Direct if contacted by consultants.

685 According to the 1986 Tele-Direct guidelines for dealing with consultants, the "official" line on consultants to be conveyed by representatives is that their objective is to reduce Yellow Pages advertising which will reduce the effectiveness of the advertising and likely adversely affect the customer's business, based on studies conducted by Tele-Direct. Emphasis is placed on the fact that consultants are only paid if the customer reduces Yellow Pages spending, implying that consultants are likely to give biased advice, and that Tele-Direct will perform the "same" service as the consultant (advice and artwork) and "not charge a fee".[265] Tele-Direct also encouraged its representatives to point out to the customer that while Tele-Direct was concerned with the long-term, consultants do not have a continuing relationship with the customer and therefore have no incentive to take into account the possible negative repercussions on the customer's business if their advice is followed.

686 There is evidence that at least some sales representatives went considerably further in their efforts to discredit consultants, calling them "scam" artists and other epithets, saying they were unfamiliar with Tele-Direct's specifications and showing poor photocopies of artwork done by consultants to customers in an attempt to cast doubt on the ethics and professionalism of the consultants.

687 Tele-Direct has also taken other, positive steps to combat consultants by improving elements of its service to its customers. For example, Tele-Direct has attempted to create a better working relationship with customers through "consultative" selling and by assigning representatives to customers for up to three years rather than changing each year. While the changes made by Tele-Direct were not in response to consultants alone, they were rooted in customer dissatisfaction with Tele-Direct's service.

(c) Tele-Direct's Consultant Guidelines

688 The guidelines set out Tele-Direct's procedures and directives to its sales force for dealing with orders for advertising originating with consultants and for handling customer contact once involvement of a consultant has been detected or suspected. This stage of the relationship between consultants, customers and Tele-Direct forms the focus of the Director's allegations of anti-competitive conduct. While the application of the various guidelines has been somewhat erratic and interpretation of their terms varied, it is clear that Tele-Direct has at no time dealt directly with a consultant acting *on behalf of* or in a representative capacity for an advertiser. Tele-Direct has always insisted on visiting a customer suspected of using a consultant even after an order was received from the customer and obtaining the customer's signature on its own documents. The package provided by Mr. Brouillet of Ad-Vice to his clients, following futile attempts on his part to avert the visit of the Tele-Direct representative by providing Tele-Direct's contract or a similar document to his clients himself,[266] advises the client that the Tele-Direct representative will be in contact to transfer the advertising program onto the Tele-Direct forms.

(i) 1986 Guidelines and Their Application

689 As general rules, the 1986 guidelines provided that:

> (c) Tele-Direct will not accept insertion orders directly from directory consultants who have not been granted accredited agency status by Tele-Direct.
>
> (d) Tele-Direct sales representatives should continue to contact their customers directly and request that the customers actually sign the Tele-Direct contracts and layout sheets so as to ensure the accuracy of the Yellow Pages advertising proposal prepared by a directory consultant. [267]

690 While the Tele-Direct policy of refusing to accept orders directly from consultants may have been followed in Tele-Direct's western region, it was not followed in the eastern region, in particular in Montreal, Sudbury and Ottawa. Letters sent in 1989 by Tele-Direct to Consultant en publicité annuaire et communication (CEPAC 2000) Inc. ("CEPAC 2000") in Montreal and Ad-Vice in Sudbury and in 1990 to Steven White of Tel-Ad in Ottawa [268] outlined for the consultants in question the procedure to follow in submitting orders to Tele-Direct. [269] The orders had to be delivered to named Tele-Direct managers in the relevant offices, accompanied by proper authorization by the advertiser on the advertiser's company letterhead.

691 Paul de Sève, Tele-Direct's Vice-president of Sales for the eastern region, confirmed that, although Tele-Direct's policy was not to deal directly with the consultant on the advertiser's behalf, in the eastern region at least, it was accepting orders from consultants. Orders were not automatically rejected and returned to the consultant even though Tele-Direct was aware of consultant involvement. The orders were taken as an indication that the customer wanted to change its advertising and a Tele-Direct representative would visit the advertiser and deal with him or her directly. In Tele-Direct's own words,

> ... Regardless of whether the "cut agent" or the customer was directing insertion/change/cancellation of Yellow Pages advertising through letter or order form, we would accept this information as notification that the customer wished to renegotiate his Yellow Pages advertising. The Tele-Direct representative would deal directly with our customer, using our forms and contracts in the setting up of Yellow Pages advertising. [270]

(ii) 1990 Policy and Application

692 Tele-Direct implemented new consultant guidelines in December 1990. The opening words of the revised guidelines state that:

> We changed our operating procedures on dealing with "cut agents" effective December, 1990, to further strengthen and reinforce our direct servicing philosophy with our customers.
>
> These changes were made to ensure that we did not act on "cut agent" instructions, for the insertion/change/cancellation of our customers' Yellow Pages advertising. Furthermore, these changes were intended to leave no doubt in the minds of our customers that we do not do business with "cut agents". [271]

The "general procedures" established by these guidelines were as follows:

> • we will always accept letters/packages sent or given to us by customers and act in accordance with their wishes.
>
> • to the best of our knowledge, we will not accept, nor act upon, information sent or given to us by "cut agents" on behalf of our customers, nor accept or act upon information sent or given to us by customers containing directives from "cut agents."
>
> • Instead, our procedure will be to not accept packages from "cut agents" or from customers for "cut agents" and in the event that a package is accepted in error, its contents will be returned to the "cut agent" with a covering letter designed for this purpose. [272]

693 The guidelines then provide more detail on the procedure to be followed in particular situations. The gist is that if, upon external examination of a letter or package, it became apparent that it was from a consultant or from a customer working with a consultant, the letter or package would be returned to the consultant. If the letter or package was apparently from a customer, with no external indication of consultant involvement, the letter or package would be opened but if further examination of the contents revealed the involvement of or a directive from a consultant, the letter or package would be returned to the consultant. Even when the letter or package appeared to come from or was, in fact, dropped off by the customer, if it was rejected because of consultant involvement, the customer would not be informed that the order had been returned to the consultant.

694 Mr. de Sève admitted that the procedures set out above represented a dramatic change from the 1986 guidelines, at least with respect to how the Montreal, Sudbury and Ottawa offices had been operating. [273] It is also clear from his testimony that the principal reason for the change was that Tele-Direct was having second thoughts about having "legitimized" the consultants to the extent they had by writing the letters referred to above in 1989 and 1990. The 1990 strike by Tele-Direct's sales representatives meant that the consultants were particularly active in the fall of that year.

695 The 1990 guidelines were adhered to strictly in one respect. At no time did Tele-Direct accept orders that were not submitted on the customer's letterhead. Other aspects of the guidelines appear to have been unevenly applied. Despite the statement that Tele-Direct would *always* accept orders from its customers and "act in accordance with their wishes", there was evidently considerable uncertainty within Tele-Direct as to how the guidelines were to be applied with respect to rejecting customers' orders for consultant involvement. Some orders containing indications of consultant involvement or where a consultant was known to be involved were accepted without incident or accepted after an initial rejection. Yet, Mr. de Sève's evidence, which as Vice-president of Sales for the eastern region we take to be an "official" application of the guidelines, was that where there was doubt, it was *assumed* that the documents came from a consultant and they were returned to the consultant without advising the customer.

696 This is what happened in the summer of 1991 in the case of a package containing 23 orders under customers' signatures which were, in fact, prepared by Ad-Vice North (Mr. Blais). An internal Tele-Direct document dealing with how it should respond to a complaint by Mr. Blais about this incident indicates that packages were being returned to Ad-Vice North by the Sudbury office *even though* Ad-Vice North was not mentioned in any of the correspondence and *regardless of* the fact that the letter of direction was from the customer because the employees recognized the Ad-Vice "format". Mr. de Sève stated that consultant involvement was probably assumed because of the number of orders in one envelope.

697 Mr. de Sève also confirmed that in 1991 Tele-Direct adopted a further policy of not processing orders received at the closing date according to the customer's instructions if they originated with a consultant even though it would do so for orders coming from its own sales force. Tele-Direct would instead rely on its last year's contract with the customer or the latest contract signed by the customer.

(iii) 1992 Policy and Application

698 The difficulties with and the inconsistency in application of the 1990 guidelines led to the most recent Tele-Direct guidelines for dealing with consultants, dated February 1992. These guidelines are currently in force. The operating procedures in those guidelines state that they are designed to "formalize our existing policy of dealing directly with customers." Two important aspects of that policy are:

> ... Tele-Direct will not accept a customer's appointment of a consultant to act on his/her behalf in dealings with Tele-Direct; and, Tele-Direct will not knowingly take instructions from a consultant acting on behalf of a customer. [274]

699 The detailed procedures provide that when correspondence is received from a consultant, whether by mail, courier, delivery, etc., it is opened and the contents examined to determine what action (from a list of A to D) should be taken. According to the procedures, any correspondence from a customer appointing a consultant to act on his/her behalf is to be returned to the customer with a form letter indicating that Tele-Direct will only deal with its customers directly (B). Any "directive" from a

consultant is to be returned to the consultant with a form letter which simply states that the material was received "in error" (C). A second form letter is to be sent to the customer explaining that the material has been returned to the consultant without being processed and stating Tele-Direct's policy of only dealing with the customer directly. The guidelines also state that any correspondence from a consultant regarding problems with or errors in published advertising are to be ignored altogether and the matter resolved directly with the customer (D).

700 Most importantly, if the correspondence contains instructions from a customer regarding his/her advertising, the procedures provide that the instructions should be accepted and handled "in the normal fashion, i.e., deal directly with the customer" (A). The evidence of Messrs. Renwicke and de Sève regarding when correspondence will be considered by Tele-Direct to contain instructions "from a customer" and will be accepted and handled in the "normal fashion" reveals that the guidelines are still open to interpretation. Mr. de Sève testified that even if the instructions are from the customer, on the customer's letterhead, if they include any reference to consultant involvement, the order will not be accepted. He was of the view that such a case fell within B or C set out above. Mr. Renwicke, on the other hand, first stated that such an order would be accepted. He then qualified this by saying that it depended on the "tonal quality" of the letter and of any references to a consultant. According to him, the defining criteria is whether it was perceived that the consultant "is going to be seen to or is actually playing a leadership role for that account". [275]

701 Assuming that the order is accepted, the guidelines also set out a "protocol" for customer contact by sales representatives when dealing "directly" with customers which reveals that little weight is given to the order already received from the customer. The representatives are to conduct themselves throughout in a "business-like and professional manner" but are expected to "only provide Yellow Pages selling services *directly to a customer*." While Tele-Direct's representatives are permitted (but not required) to meet with a customer when a consultant is present, they must decline to take *any* instructions from a consultant even if the customer insists. The protocol provides that all instructions must come directly from the customer. If the customer refuses to deal with the Tele-Direct representative directly, the representative is to review with the customer the customer's legal obligations under the existing Tele-Direct contract, i.e., that the previous year's advertising will simply be renewed. If this approach fails, the sales representatives are advised to try again later to re-convene the meeting but if the customer still refuses to deal directly, then advise the customer that the contract will remain in force in accordance with its terms.

702 Mr. de Sève admitted that under this protocol, where a customer handed the Tele-Direct representative a package containing instructions prepared by a consultant and asked the representative to follow them, that would lead to a termination of the interview and the instructions would not be followed. He also admitted that, in fact, Tele-Direct representatives would refuse to meet with the customer in the presence of the consultant because they would not be able to discuss with the client "one-on-one" the merits of the change in the advertising program.

(d) Specific Incidents

703 The Director relies on numerous specific incidents involving consultants and their customers as evidence in support of his allegations. The respondents dispute that some of those occurrences took place or if they took place, took place as related by the Director's witnesses.

704 We accept that there were times when Tele-Direct went beyond simply rejecting or returning orders from customers where consultant involvement was suspected and treated these in an extremely cavalier fashion. On one occasion in 1989, a package of customer orders prepared by Mr. Brouillet, including one from Ad-Vice's law firm, was left with a secretary who threw it out of the Tele-Direct office and into the hallway. The lawyer was able to confirm after a number of phone calls that his order had been retrieved and was processed. He inquired about the remaining orders but Tele-Direct refused to inform him of the fate of the other orders in the package.

705 On another occasion in 1990, when the manager designated to receive orders from Ad-Vice in Sudbury was not in the office, the process server left the package on the counter and the receptionist threw it in the garbage. Apparently the order was not processed in accordance with those instructions, according to the respondents, because the advice was delivered late. The only evidence brought to our attention on this point was a recently written note by the Tele-Direct representative that

stated "delivered past deadline - did not use their material".[276] The affidavit of service sworn contemporaneously, however, indicates that the package was delivered on August 16, 1990. Mr. de Sève's evidence was that the closing date for Sudbury was in November. We therefore do not accept that the package was delivered late.

706 We accept the evidence of incidents in which orders from customers who had used a consultant were subject to "errors" in processing by Tele-Direct. In three cases Tele-Direct acknowledged to the customers that errors had been made and provided a credit. These included Todd Optical Ltd. (mistake in telephone number and location), Adler Moving Systems (advertisement in the Elliot Lake directory omitted), Forest Products and Builders (advertisement did not appear), all customers of Mr. Brouillet. The owner of Todd Optical Ltd. had written a letter of support for Ad-Vice. We note that these errors all had potentially serious adverse consequences for the businesses involved.

707 Another customer of Ad-Vice, Lockerby Taxi Inc., whose owner appeared as a witness, experienced an odd error when an unpaid "filler" advertisement was published featuring Lockerby's name with the query "Sales Down?" in the background. Mr. Flinn was never provided an explanation or apology for the error. His attempt to obtain compensation was denied by Tele-Direct because he could not prove damage to his business.

708 The Director also called evidence that Tele-Direct informed customers that advertising prepared by a consultant did not comply with its specifications on the slimmest of pretexts.[277] Several of the examples related to clients of Mr. Brouillet, who testified that to his knowledge the advertisements were in accordance with existing specifications. The respondents called no evidence that the advertising did not meet specifications. In one case, the respondents admitted that the advertisement prepared by CEPAC 2000 did, in fact, comply with specifications.[278] We conclude that Tele-Direct would not have objected to these advertisements had it not been for the involvement of a consultant in each case.

709 As noted above, Tele-Direct's admitted practice is not to act on a customer's order, where a consultant is believed to be involved, until the customer has been visited by a Tele-Direct representative. Instead, Tele-Direct treats the order from the customer merely as an "indication" that the customer wants to change his or her advertising. Thus, in every case of suspected consultant involvement, the customer will be visited by a Tele-Direct representative. At the point of a meeting between the Tele-Direct representative and the customer, usually the customer would have already signed a contract with the consultant approving the changes recommended by the consultant and agreeing to pay the consultant's fee. The respondents deny that there was any tendency within Tele-Direct to delay visiting a customer who was known or suspected to have used a consultant until the last minute and to use the visit as the occasion to make disparaging remarks implying that the customer had been "taken advantage of" by the consultant or to use other tactics to pressure the customer into changing his or her mind about the program recommended by the consultant.

710 We accept that these types of tactics were fairly widely used by Tele-Direct's representatives. Last minute contact resulting in pressure on the customer and some confusion as to what the customer had to do to ensure the advertising would run as originally ordered occurred in several examples put before us. Mr. Harrison recounted the example of Mr. Kantor of Tiremag Corp. Mr. Kantor's order was delivered by registered mail to Tele-Direct in April 1993. Mr. Kantor was contacted by the Tele-Direct representative six months later, close to the closing date for the Brampton directory, and informed that no order for that directory had been received and that unless something was done, his advertising for the previous year would have to be used. Mr. Kantor insisted that he had already given them his instructions but Tele-Direct never located the package. The previous year's advertisement was run, then Tele-Direct located the package and admitted it had made a mistake. Similar problems occurred for Pat's Party Rentals, a client of Mr. Brouillet.[279] Other examples are the Britannia Restaurant & Banquet Hall, again a client of Mr. Brouillet, and the Muskoka Riverside Inn, a client of Mr. Blais.[280]

711 Eric Beesley of Georgetown Quik-Lube Ltd., who appeared in person, testified that, having submitted his order much earlier, he was contacted by the Tele-Direct representative the day before the closing date to attempt to persuade him to stay with his existing program. Then on the final day, he was called again and advised that he had to attend at the Tele-Direct office in person to make the changes. Mr. Beesley, however, was aware of the contractual clause allowing him to make changes in writing by a certain date, pointed out that he had complied with it and the advertising was processed as he had ordered.

712 There is only one documented case in the evidence in which a Tele-Direct representative counselled a customer *outright* not to honour a contract with a consultant. [281] Tele-Direct's guidelines explicitly warn Tele-Direct representatives not to provide advice with respect to customers' legal obligations. There is, however, abundant evidence of instances where customers refused to pay consultants following a meeting with the Tele-Direct representative. If the customer refuses to pay, the consultant is obliged to take legal action to recover the fees owed. [282] In general, where the consultants have gone to court, they have been successful in having the contract honoured. While it might be argued that the persistent refusals to pay by customers indicates dissatisfaction with the consultants' services rather than reflecting any tactics employed by Tele-Direct's representatives, on the evidence we accept that there is a link between the visit by the representative and the instances of refusal to pay the consultants' fees.

713 The issue in many of these incidents is whether Tele-Direct made innocent errors, or whether the climate in Tele-Direct towards consultants resulted in what was, in effect, sabotage of the consultants and their customers. An important reason for concluding that there was more than innocent errors at work is the evidence that Tele-Direct was willing to sacrifice the interests of customers by putting them in the middle of Tele-Direct's struggle against consultants. There is more than a hint of malevolence in the formal and explicit decision in the 1990 guidelines not to inform customers when orders submitted on their behalf were being refused (although this was changed in the 1992 guidelines).

(5) Anti-competitive Acts

714 The Director alleges a number of anti-competitive acts by Tele-Direct involving consultants relating to Tele-Direct's refusal to deal directly with consultants on behalf of advertisers, its discriminatory treatment of customers and customers' orders originating with consultants and its refusal to supply specifications to consultants. None are specifically listed in section 78 of the Act. As the list is not exhaustive, there is no reason not to assess the actions characterized by the Director as anti-competitive acts by Tele-Direct to see if they have the requisite exclusionary, predatory or disciplinary purpose.

715 The respondents argue that the challenged conduct cannot be anti-competitive because it was generally in accordance with the Tele-Direct guidelines for dealing with consultants, which they say were not intended to and do not prevent the consultants from doing business but rather render Tele-Direct's dealings with consultants "fair and consistent". They further submit that they have valid business reasons for their policy. These "business justifications" will be dealt with in detail for each alleged anti-competitive act.

716 In a related argument, the respondents submit that, to the extent that the Director is able to prove that Tele-Direct engaged in any of the alleged acts, those acts ceased in 1992 with the implementation of the most recent guidelines for dealing with consultants which have been consistently applied, unlike prior versions. They submit that any practice cannot be caught by section 79 as more than three years have elapsed since it ceased. We do not see validity in the argument. The 1992 guidelines are obviously still in force. The Director has not alleged that it is only the failure to follow the guidelines that is anti-competitive but that certain actions of Tele-Direct, which may not be contrary to the guidelines (refusal to deal directly with consultants on behalf of advertisers) or are simply not dealt with in the guidelines (some discriminatory acts, refusal to supply specifications), are anti-competitive. To the extent that the guidelines sanction conduct that the Director is alleging is anti-competitive, then the Director is, in effect, challenging the guidelines and their application also. The guidelines certainly do not prohibit (and may actually encourage) the particular conduct by Tele-Direct that is the subject of the allegations.

(a) Refusal to Deal Directly with Consultants

717 The respondents here repeat the argument that we dealt with earlier under the section concerning the abuse of dominant position with respect to publishers and the 20-directory requirement. They argue that a refusal *cannot* be an anti-competitive act and that they are not required to assist their "detractors" by dealing with consultants as that would be akin to placing a positive duty to act on the respondents. As we stated in that section, semantic arguments about whether the act in question is active or passive do little to advance the real issues in dispute. We will therefore proceed to analyze the more substantive arguments without further comment.

718 The evidence is clear that Tele-Direct has engaged, since the advent of Mr. Harrison and Tel-Ad in 1984, in the specific aspects of refusing to deal directly with consultants on behalf of customers set out under I. in the introduction above. Tele-Direct has refused to act on written instructions received from consultants on behalf of advertisers; refused to act upon oral instructions received from consultants on behalf of advertisers or meet consultants or the advertiser in the presence of consultants to receive same; and refused to deal with consultants on subsequent errors or problems.

719 In the eastern region between 1986 and 1990, Tele-Direct acted in contravention of its own 1986 guidelines by *accepting* orders from, at least, CEPAC 2000, Ad-Vice and Tel-Ad, as evidenced by the letters. Even those letters, however, make it clear that the order must be accompanied by a letter *from the customer on the customer's letterhead*.

720 There is also evidence that Tele-Direct refuses to accept oral instructions from consultants. The 1992 guidelines are clear that the Tele-Direct representative must not accept instructions, even indirectly, from anyone other than the customer. While the current guidelines allow the representative to meet with the customer with the consultant present, the representative is not required to do so. The evidence was that most of the time the representative refuses to meet with the customer with the consultant present. Likewise, Tele-Direct would not deal with consultants on follow-up matters on behalf of customers.

721 We must weigh the anti-competitive effects of the acts against the business justifications put forward by the respondents. There is no doubt that Tele-Direct was trying to make life difficult for the consultants by refusing to deal with them directly on behalf of advertisers. Tele-Direct did not want the consultants to have any legitimacy in their dealings with its customers. The 1990 guidelines were brought in to eliminate the slight leniency that had developed under the 1986 guidelines, which had placed letters from Tele-Direct in the hands of various eastern region consultants confirming that orders coming from them would be accepted and processed by Tele-Direct.

722 There are two possible types of adverse effects that might arise from Tele-Direct's refusal to deal with consultants acting on behalf of customers. The first is the possible increase in costs to the consultants that would result from having to do business in a somewhat roundabout way, rather than submitting orders directly. The second, and more important, effect is the effect on the consultants' credibility with customers when they have to explain to customers that they are not permitted by Tele-Direct to submit orders directly on their behalf but must use an indirect procedure. This might put the consultants in a negative light in the eyes of the customer, particularly if the customer is already generally aware of the background of acrimonious relations between Tele-Direct and consultants. Against that backdrop, the indirect procedure that the consultants must use for submitting orders to Tele-Direct might appear as a form of subterfuge.

723 The evidence does not indicate that cost increases to consultants from Tele-Direct's refusal have been a real issue. The consultants' businesses have experienced ups and downs. While Mr. Harrison was unable to grow his business between 1986 and 1992, servicing an average of 60 new accounts a year, in the last few years he has expanded and is now handling 200 to 250 new accounts a year. Mr. Brouillet testified that Ad-Vice revenues from Yellow Pages consulting were at a high between 1992 and 1994 but dropped roughly to 50 percent of that amount in the last two years. He has also diversified into other businesses in recent years. Mr. Blais eventually gave up and left the business.

724 Although all three of the mentioned consultants testified at the hearing, none of them expressly linked whatever difficulties that they might have experienced to an *increase in costs*. Even Mr. Blais did not do so. Undoubtedly, the consultants would like to have the advantage of being able to deal directly with Tele-Direct on behalf of advertisers. We find it instructive that Mr. Harrison has been operating since the mid-1980's, and still operates, in spite of Tele-Direct's refusal to deal directly with him in a representative capacity. Evidently, he, and other consultants no doubt, have managed to find an alternative to direct submission of orders that does not impose significant increased costs, or any increased costs at all, on their businesses. We cannot, therefore, identify any adverse cost effects on consultants resulting from Tele-Direct's refusal to deal with them acting on behalf of advertisers.

725 The question of possible negative reputational effects or damage to consultants' credibility arising from Tele-Direct's refusal to deal with them acting for customers is complex. To the extent that consultants lose reputation or credibility, customers

will be less likely to demand their services. We do have evidence from the consultants that they have suffered negative reputational effects. For example, Mr. Brouillet testified that he could not keep sales help because of the negative environment; sales personnel felt they were regarded by advertisers as not legitimate, as "scam" or "con" artists.

726 Unfortunately, it is difficult to determine whether these effects result from the refusal by Tele-Direct to deal directly or from other actions of Tele-Direct that are not alleged to be anti-competitive. The Director has not challenged as anti-competitive Tele-Direct's general hostility towards consultants, as manifested by the placing of advertising warning customers about consultants, writing letters to customers and sending out its representatives to their premises with messages to the same effect. In our view, the negative reputational effects on consultants are due largely to the general environment created by Tele-Direct rather than the specific refusal to deal directly with consultants acting for advertisers. Any connection between the negative reputational effect or loss of credibility on the part of consultants and the refusal to deal directly is very weak.

727 We turn to Tele-Direct's business justifications for its consultant guidelines and, thus, for its refusal to accept written or oral instructions from consultants or deal with them on follow-up matters. The respondents' general position is that their refusal to deal with consultants "is clearly an efficient response to the damaging effect of the consultants on their business". They point out that the objective of the consultants is to decrease directory advertising which is exactly the opposite of the respondents' objective, which is, in their words, to sell directory advertising "in order to increase the usage of their directories and produce a more complete directory." Because the consultants generally serve customers on a one-time basis, the respondents take the position that consultants have a "perverse" incentive to "undersell", which detracts from the completeness of the directories.

728 We have already dealt with the "completeness" argument as part of the analysis of tied selling. As we concluded there, it is far from clear that all increases in advertising (especially size and colour which are targeted by consultants for reduction) contribute to completeness. Therefore, the "upselling" of size and colour by Tele-Direct representatives cannot be assumed to be socially beneficial, nor can the "downselling" of those attributes by consultants be assumed to be socially detrimental. The optimal situation is one in which both points of view are freely available to advertisers so that the advertisers themselves can make the choice.

729 At paragraph 840 of their written argument, the respondents have also provided the following more detailed justifications for issuing and following their consultant guidelines:

> (i) the consultants do not accept responsibility for payment for the advertising;
>
> (ii) to ensure that the customer is fully informed with respect to the advertising they are purchasing and their available options;
>
> (iii) to ensure customers understand with whom they are dealing;
>
> (iv) to prevent the conflicts that may occur if the Respondents' sales representatives were to take instructions directly from the consultants;
>
> (v) to ensure that advertisers are aware of new programs and initiatives.

730 We need only deal with the first point. The Director has in effect admitted the validity of the respondents' first business justification, that consultants do not accept financial responsibility for the advertising, by the remedies he seeks. At paragraph 69(b)(iii) of the application, the proposed remedy was:

> ... that the Respondents accept orders for advertising space on behalf of any party that can satisfy the Respondents' reasonable requirements of evidence of authority to act on behalf of an advertiser and *capacity to pay for the space requested*.
>
> (emphasis added)

At paragraph 391 of the written argument, the following further remedy was added:

> ... that the Respondents be prohibited from requiring that customers who choose to utilize the services of a third party to place advertising be required to enter into a contract directly with the Respondents where the third party who has satisfied the Respondents' reasonable requirements of evidence of authority to act on behalf of the advertiser and *where the third party has guaranteed payment on behalf of the principal*.
>
> (emphasis added)

731 These proposed remedies imply that in the Director's view it is reasonable for Tele-Direct to insist on financial guarantees if Tele-Direct is to deal with consultants as representatives of the customer. The consultants do not currently accept any financial responsibility. What the Director has done is to suggest an alternative method of operations for Tele-Direct in its dealings with consultants. He is proposing, in effect, that Tele-Direct begin to deal directly with consultants acting for advertisers by creating a new third sales channel (in addition to the internal sales force and agents).

732 There is evidence that dealing directly with the consultants would require Tele-Direct to set up an additional interface to deal with them. As described by Mr. Logan of the YPPA, this was the experience of US West, which set up a group of specially trained employees to deal with consultants to avoid problems with its sales force when it dealt directly with consultants. Such direct dealing, therefore, would obviously entail an additional cost to Tele-Direct. Further, Tele-Direct does not currently deal with guarantees in the sense proposed by the Director. Agents, of course, simply pay up front. A system would have to be set up to accommodate this new procedure.

733 In the circumstances, we think that the additional costs that Tele-Direct would incur if it were forced to deal with consultants directly on behalf of advertisers is a valid justification for not doing so, given that no adverse cost effects on agents were proven and that any negative reputational effects that are attributable to the refusal to deal directly are, at best, weak. We conclude, therefore, that, overall, Tele-Direct is not engaging in anti-competitive acts by refusing to deal directly with consultants on behalf of advertisers and, in particular, by refusing to accept written or oral instructions from, or engage in follow-up communication with consultants acting on behalf of advertisers.

(b) Discriminatory Acts

734 The discriminatory acts involve Tele-Direct's actions after the customer has submitted an order based on a consultant's advice and the effects that flow therefrom. Notwithstanding Tele-Direct's stated policy, orders submitted by a customer are sometimes returned because Tele-Direct believes a consultant was involved in the preparation of the order. There is no justification for Tele-Direct precluding an advertiser from seeking the advice of a consultant if the advertiser so chooses. Indeed, that is what one part of Tele-Direct's written guidelines states. Yet, the guidelines, even the 1992 guidelines, also mandate the return of certain customer orders. The fact that Mr. De Sève, a senior executive of Tele-Direct, is aware, and apparently condones, the return of customer orders for suspicion of consultant involvement proves that these were not merely isolated instances or errors.

735 Further, the history of the 1990 guidelines underlines the fact that Tele-Direct was fully aware of and, in fact, sanctioned the foreseen negative consequences of those guidelines for its advertisers. The advertisers' interests were sacrificed in order to hamper the consultants. The effect of the 1990 guidelines, as Tele-Direct itself recognized when they were first drafted, was to place the advertiser in the middle of the battle between Tele-Direct and the consultants, to the detriment of the advertiser.

736 A document attached to the guidelines identifies "perceived weaknesses" in the guidelines which were to be reviewed with the legal advisors. The first related to the fact that Tele-Direct would be rejecting any package delivered by a consultant or bearing any external indication of consultant involvement even if delivered by the customer or also bearing customer information on its face. Packages would therefore be rejected even though they might contain instructions from the customer on the customer's letterhead. A second concern was whether it was a reasonable business approach not to notify customers that the letter/package delivered to Tele-Direct had been rejected and returned to the consultant. In spite of these misgivings, the new policy was put in place.

737 The internal document dealing with the incident where 23 orders prepared by Mr. Blais were rejected even though they were under customers' signatures states that legal counsel, in fact, recommended against the procedure in the guidelines which permitted this type of rejection. Counsel, as reported in the letter, was of the view that the customers had the right to deal with whomever they wished in designing their advertising and further had the right to send Tele-Direct their instructions on their letterhead and expect that they would be acted on as coming from them, provided that Tele-Direct was not required to deal directly with the consultant and the correspondence did not carry any consultant identification.

738 The respondents did not attempt to provide a business justification for rejecting or returning customer orders where there was no evidence of non-compliance with specifications or of late delivery. In the circumstances, we find that the rejection, return, denial of receipt or refusal to process customer orders involving consultants constitute anti-competitive acts.

739 As noted earlier, the Director is not of the view that Tele-Direct's insistence on visiting a customer after the customer has signed a contract with a consultant and submitted an order to Tele-Direct is by itself an anti-competitive act. He says that the issue relates to what the representative tells the customer and how the order received from the customer is treated. We agree that this is the crux of the difficulty. The anti-competitive acts are those that lead the customers to believe that they will be disadvantaged or that actually harm them because they have used a consultant. These include suspicious errors, last minute contact resulting in confusion for the advertiser about what must be done to have the new advertising run or resulting in missed deadlines, identifying errors or problems in the advertising that would not otherwise be a problem and informing customers that their orders might not be processed. We accept that such incidents occurred and that there is no assurance that they will not be repeated whenever consultants are seen as a threat.

740 The respondents argue that they were trying in all cases to ensure that their business operated efficiently by requiring consultants to meet deadlines and specifications. We have found that noncompliance with specifications and deadlines were largely pretexts for an attempt to pressure customers into changing their minds about a consultant's recommendations. Most of the incidents in evidence are more accurately characterized as highly disruptive because of the negative impact on customers rather than ensuring the smooth operation of Tele-Direct's business as argued. We have no hesitation in finding that statements or actions by Tele-Direct to discourage advertisers from dealing with consultants by expressly or implicitly indicating that advertisers will thereby be disadvantaged by Tele-Direct constitute anti-competitive acts.

741 The Director alleges that the respondents discriminate against consultants by refusing to meet with customers to take instructions originating in advice from consultants. On its face this looks very much like the allegation listed in I.(b) and forming part of the refusal by Tele-Direct to deal directly with consultants on behalf of advertisers. Presumably, the discriminatory act being alleged here is a refusal to accept oral instructions from customers using consultants while oral orders from customers not using consultants are accepted and acted on. As has already been noted, Tele-Direct requires that customers using consultants sign Tele-Direct's documents. In and of itself, this is not an anti-competitive act. It might, however, be a discriminatory act if customers not using consultants are not required to sign a contract in like circumstances.

742 However, the evidence of Mr. Giddings is that, by and large, all of Tele-Direct's customers sign its documents. In fact, Mr. Giddings testified that the only contracts which do not require signing are those contracts renewing advertising worth less than $100. Further, Mr. Giddings indicated that for those contracts which are not signed, if there is a conflict between the customer and the representative as to what advertising was actually ordered, which results in a "write-off", the representative is financially responsible for the write-off. This policy does not seem unreasonable on an operational basis. With respect to orders which Tele-Direct will accept orally from customers dealing with its representatives (that is, those under $100), there is no evidence that consultants deal with or are interested in obtaining clients whose orders are so small. We do not find this allegation to constitute an anti-competitive act.

743 There is no doubt that those discriminatory acts of Tele-Direct which we have found to be anti-competitive constitute a practice. They are not "isolated acts".

(c) Specifications

744 The Director submits that Tele-Direct's refusal to supply specifications to consultants is an anti-competitive act. He argues that consultants cannot adequately advise the customers who choose to use their services without up-to-date access to basic technical information. The Director points to evidence of Tele-Direct using alleged non-compliance with specifications to delay orders or discredit consultants in customers' eyes.

(i) Majority View (Rothstein J. and C. Lloyd)

745 The majority of the Tribunal are unable to agree with the Director for the following reasons. We see the refusal by Tele-Direct to provide specifications to consultants as another manifestation of Tele-Direct's general aversion to having any relationship with consultants. Looking at the experience of consultants and Tele-Direct's refusal to supply specifications to them, the evidence is that this has not adversely affected their ability to compete. Consultants have been in business since 1984 and we have heard of no difficulty experienced by them because Tele-Direct refused to provide them with specifications. [283] In one way or another, they were aware of what Tele-Direct's specifications required.

746 As to whether Tele-Direct not providing specifications to consultants would cause a problem in the future, Mr. Brouillet stated:

> ... If there were changes in their specifications and we were not informed about it, then obviously, there would be a problem. If there was really a problem, the client only had to call us within 24 hours, we could fix what was wrong and forward that to Tele-Direct. [284]

There is no evidence before us that suggests that Tele-Direct's specifications change frequently. If anything we are left with the contrary impression from the absence of evidence from consultants that frequent changes were a problem. Mr. Brouillet stated that once a problem is pointed out it can be quickly fixed. On the basis of this evidence, we are satisfied that any changes to specifications will become known by consultants quickly. We, therefore, have no basis upon which to infer that refusal to provide specifications to consultants will, in any material way, adversely affect their ability to compete in the future.

747 The respondents did not argue the business justification "that customers understand with whom they are dealing" to justify the refusal to supply specifications to consultants, although this was raised as a justification for other acts. However, we are of the view, based on the evidence, that this business justification is applicable here. There is evidence before us of a number of instances in which there was confusion on the part of advertisers as to the exact relationship of a consultant with Tele-Direct. [285]

748 We infer from the way in which some consultants operate that this confusion could be exacerbated if a consultant, on visiting a proposed customer, is armed with up-to-date specifications obtained from Tele-Direct. There are indications in the evidence that in their initial contact with advertisers, consultants do not go out of their way to distinguish themselves from Tele-Direct. In some cases, the evidence is that the customer remains confused as to the exact relationship between the consultant and Tele-Direct. [286] In other cases, it is apparent that while an advertiser may initially be confused, the fact that the consultant does not represent Tele-Direct eventually becomes apparent. It may become apparent in conversation between the advertiser and consultant or when the advertiser is requested to pay the consultant separate from Tele-Direct. In the case of Ad-Vice, a follow-up letter makes this clear. [287]

749 However, in our view, it is the initial confusion that creates the difficulty. We do not think consultants should be "getting their foot in the door" of advertisers because of such initial confusion. Being provided with specifications by Tele-Direct could be used by them as a form of "calling card" signifying a relationship with Tele-Direct that does not really exist. Notwithstanding that in many cases the confusion is eventually cleared up, we do think customers are best served when they know from the outset precisely with whom they are dealing and in this case, the relationship or lack of relationship between Tele-Direct and a consultant. We therefore think that Tele-Direct is justified in refusing to provide specifications to consultants and conclude that such refusal is not an anti-competitive act.

750 While we are not satisfied that the Director has made a case that the refusal to provide specifications to consultants is an anti-competitive act, we are not unmindful that ultimately it is the advertisers that might encounter difficulty if they retain the services of consultants who use incorrect specifications. It is for this reason that we have, in providing for a remedy for discriminatory acts against advertisers, required Tele-Direct, at its option, to take positive steps to revise a customer's order that is not submitted in compliance with its specifications so that the order complies or advise the customer what is wrong and how the customer may revise the order in accordance with its specifications.

(ii) Minority View (F. Roseman)

751 In my view, the refusal to supply specifications is an anti-competitive act. While differing from the majority in their conclusion, I accept that there is little evidence of past harm to consultants from the refusal. Nevertheless, consultants may suffer adverse effects in the future should Tele-Direct change its specifications. The consultants will eventually learn of the changes through trial and error but this leaves a considerable degree of uncertainty during an indeterminate transitional period. Therefore, there is the likelihood that the consultants will be significantly hampered so that the refusal to supply specifications should be considered an anti-competitive act given the complete absence of any sound business justification for the refusal.

752 The respondents have not advanced any valid business justification. They argue that the refusal is justified by the uniqueness and complexity of Tele-Direct's business and its desire to maintain the value and quality of its product. It is difficult to see how avoidable errors in orders prepared by consultants (and submitted by customers) contribute to quality.

753 I do not accept the majority's view that the evidence supports the conclusion that the availability of specifications to consultants would result in increased confusion on the part of customers as to the consultants' identity and purpose. I agree with the majority that it is impossible to identify the source of the confusion that apparently arose for some customers.[288] However, it is noteworthy that none of the incidents of confusion referred to by the majority was linked to Mr. Harrison[289] but only to Mr. Brouillet. Yet, it is Mr. Harrison who has been able to obtain ongoing access to Tele-Direct's specifications from YPPA through an affiliate in the United States. Because I am of the view that refusal to supply specifications will likely significantly hamper the consultants' ability to compete and that there is no valid business justification for the refusal, I conclude that the refusal constitutes an anti-competitive act.

(6) Substantial Lessening of Competition

754 The competitive effectiveness of consultants has been reduced as a result of Tele-Direct's practice of discriminatory acts. Consultants incur higher costs as a result of being forced to defend themselves before customers and by having to seek the aid of the courts in enforcing their contracts. These activities require time and expense that could otherwise be spent in attracting and serving customers.

755 In addition, the consultants' ability to attract new business is negatively affected when their customers are inconvenienced or harmed by Tele-Direct's discriminatory acts. Customers so affected are unlikely to be repeat customers or to recommend the services of consultants to other Yellow Pages advertisers.

756 Although consultants currently service a small portion of the total telephone directory advertising revenue, they are competitively significant. Tele-Direct was forced to respond positively to the presence of consultants by improving its servicing of its customers. Thus, consultants have had and can continue to have a significant positive influence on Tele-Direct's level of service to its customers as Tele-Direct legitimately strives to offset the inroads that consultants make into its sale of Yellow Pages advertising.

757 It is difficult to arrive at a numerical determination of the effect on consultants of the practice of discriminatory acts we have found to be anti-competitive because the acts are intermingled with other forces that hamper consultants. What we know, however, is that the consultants' ability to compete is limited and fragile as compared to Tele-Direct's virtual monopoly through its control of publishing. Consultants, by the nature of their services, have little ongoing business and must convince advertisers

to pay for their services when these advertisers could place advertising in directories without incurring such expense, i.e., the market for their services is necessarily a "thin" one.

758 Where a firm with a high degree of market power is found to have engaged in anti-competitive conduct, smaller impacts on competition resulting from that conduct will meet the test of being "substantial" than where the market situation was less uncompetitive to begin with. [290] In these circumstances, particularly Tele-Direct's overwhelming market power, even a small impact on the volume of consultants' business, of which there is some evidence, by the anti-competitive acts must be considered substantial. Of course, in the future, in the absence of any order by the Tribunal, there would be no constraint on Tele-Direct intensifying discriminatory acts against consultants and exacerbating an already substantial effect on them. We have no difficulty concluding that Tele-Direct's proven practice of anti-competitive acts has had, is having or is likely to have the effect of lessening competition substantially in the market.

(7) Remedies

759 The Tribunal recognizes that consultants' interests are antithetical to Tele-Direct's and that Tele-Direct should not be forced to assist consultants. However, consultants must be able to compete with Tele-Direct to provide services to advertisers. Tele-Direct cannot use its market power to impede consultants' activities and to disadvantage customers who wish to retain the services of consultants. On the other hand, Tele-Direct must not be restrained from competing fairly with consultants.

760 We have concluded that Tele-Direct's refusal to deal with the consultants directly on behalf of advertisers is not an anti-competitive act. No remedy is provided in this respect. Nor is any remedy provided for Tele-Direct's refusal to provide specifications to consultants.

761 We have found that Tele-Direct engaged in a practice of discriminatory acts against consultants and customers who use consultants resulting in a substantial lessening of competition. While many of the acts in evidence occurred more than three years before the filing of the Director's application, the practice continues. The practice of these acts is prohibited. Customers using consultants must be treated by Tele-Direct no differently than customers who do not use consultants.

762 For greater certainty, we elaborate on this remedy. Where a customer uses a consultant and the customer submits an order for advertising in the Yellow Pages, Tele-Direct is prohibited from rejecting the order. Tele-Direct may accept the customer's order without revisiting or contacting the customer to attempt to change the customer's mind. It will be open to Tele-Direct to act on the documents submitted by the customer or, if it considers it necessary, require the customer to sign a Tele-Direct document. If Tele-Direct decides to accept the order as it is, Tele-Direct is prohibited from not processing it or unduly delaying its processing and from refusing to confirm to the customer that the order will be processed as submitted. If the order is accepted and it turns out there is noncompliance with Tele-Direct's specifications, then the order must be processed in accordance with a revision made by Tele-Direct that complies with the specifications or the customer must be advised promptly that the order does not comply with specifications and informed of the exact problem and how to rectify it.

763 Alternatively, Tele-Direct has the option of providing further advice to the customer to try to convince the customer to change the order submitted. It may do so, including visiting the customer, but it is prohibited from employing the techniques that we have condemned as anti-competitive when doing so. For example, Tele-Direct may not delay until close to the closing date for submitting orders for a directory to contact the customer about alleged problems in the order. Tele-Direct may not advise the customer who used a consultant that the order does not conform to Tele-Direct's specifications or is otherwise unacceptable unless there is a material problem, in which case, Tele-Direct must provide the necessary information so the customer can cure the problem. Tele-Direct cannot use problems with the order in such a way as to leave the customer only with the option of reverting to the prior year's advertisement or having no advertisement appear. Nor may Tele-Direct delay until close to the closing date so that if the Tele-Direct's representative is able to convince the customer to change the order from that recommended by the consultant, that the customer does not have the opportunity of contacting the consultant if the customer wishes further advice from that source.

764 Subsequent efforts by Tele-Direct to resell the advertisers should be restricted to the merits of the advertising recommended by the consultant. Tele-Direct is prohibited from having its representatives discuss the role of or advisability of using a consultant at this time. We recognize that it may be difficult to distinguish between legitimate "puffing" of Tele-Direct's service and disparaging comments or inferences about the consultant's service. In view of the instances of disparaging comments by Tele-Direct that have occurred, we caution Tele-Direct to ensure that its instructions to its representatives are clear that in their follow-up meetings they are not to disparage consultants. What would be of concern would be evidence of systematic continuous representations that are untrue or that disparage consultants in these follow-up meetings.

765 For example, it is simply untrue that customers would receive the same advice from Tele-Direct for no cost as from a consultant who charges a fee because Tele-Direct representatives will rarely if ever recommend a reduction in advertising, which is the essence of the consultants' advice. The fact that consultants have a short-term relationship with a customer may be true but comments to this effect are disparaging if made with a view to causing a customer to lose confidence in a consultant's advice, not based on the merits of that advice. Tele-Direct should ensure that in these meetings its representatives restrict their selling effort to the merits of the advertising.

Observation by C. Lloyd and F. Roseman

766 We would have preferred to see a prohibition on attempted reselling by Tele-Direct's representative after an order was received from a customer. In our view, Tele-Direct has ample opportunity to establish a situation of trust and confidence between its customers and its representatives. If it fails to use its opportunities and customers choose to take the advice of a consultant because they perceive that they have not received quality service from Tele-Direct, then, ideally, that would be the end of the matter for that directory year. We have chosen, however, not to dispute the Director's concession that Tele-Direct should not be precluded from visiting advertisers after they have submitted an order.

X. Order

767 FOR THESE REASONS, THE TRIBUNAL ORDERS THAT:

Definitions

1. In this order,

(a) "market" shall mean a market as defined by Tele-Direct for purposes of its commissionability rules prior to the filing of the application in this matter, and, for greater certainty, there shall in future be no fewer than six markets in Quebec and seven markets in Ontario;

(b) "consultants" shall mean firms which advise telephone directory advertisers on how to increase the effectiveness of and reduce expenditures on telephone directory advertising, primarily in the Yellow Pages, and which assist advertisers in the placement of orders for telephone directory advertising, but does not include firms which are accredited advertising agencies.

Tied Selling

2. The respondents are prohibited from continuing to engage in tied selling, namely tying the supply of advertising space by them to the acquisition of advertising services from them, for customers advertising in six, seven and eight markets.

Abuse of Dominant Position

3. The respondents are prohibited from engaging in the practice of discriminatory acts relating to consultants and customers of consultants.

Remaining Allegations

4. The remainder of the application of the Director is dismissed.

Interpretation

5. The Director or the respondents may apply to the Tribunal for directions or an order interpreting any of the provisions of this order.

Confidentiality

6. As required by paragraph 11(1) of the Confidentiality (Protective) Order issued by the Tribunal on March 30, 1995, the panel determines that a "reasonable period" for the retention, in a secure and organized manner, by the respondents of those protected documents returned to them by the Director upon completion or final disposition of this proceeding and any appeals relating thereto, shall be five years.

Footnotes

1 R.S.C. 1985, c. C-34.

2 Others include the remaining portion of Bell Canada, Télébec, Maritime Tel & Tel, etc.

3 E.g., the Corporation of the City of Thunder Bay, Amtelecom Inc. (Aylmer, Straffordville and Port Burwell), the Corporation of the Town of Kenora.

4 Tying was a minor portion of the case in *Director of Investigation and Research v. The NutraSweet Company* (1990), 32 C.P.R. (3d) 1, [1990] C.C.T.D. No. 17 (QL).

5 The words "Yellow Pages" and "Pages jaunes" are registered trade-marks of the respondents in Canada although they are considered generic or descriptive in the United States. Tele-Direct licenses its trade-marks to other telco directory publishers in Canada but not to non-telco directory publishers.

6 Approximately 10 percent of Tele-Direct (Publications) Inc. 1994 directory revenue came from expenditures in the white pages.

7 The very small and the very large accounts.

8 Under this rule, in very general terms, to qualify for commission, an account must involve advertising in at least 20 Yellow Pages directories within Tele-Direct's territory and at least 20 percent of the total value of the advertising must be placed in directories of another publisher outside Tele-Direct's territory.

9 R.S.C. 1985, c. C-50.

10 *Gustavson Drilling (1964) Limited v. M.N.R.* (1975), [1977] 1 S.C.R. 271 at 279.

11 P. Côté, *The Interpretation of Legislation in Canada*, 2d ed. (Quebec: Yvon Blais, 1991) at 118, 123.

12 *Driedger on the Construction of Statutes*, 3d ed. by R. Sullivan (Toronto: Butterworths, 1994) at 514-15.

13 *Supra* note 4.

14 *Ibid.* at 35.

15 [1988] 2 S.C.R. 595 at 625-26.

16 *Kibale v. Canada* (1990), 123 N.R. 153 (F.C.A.). See also rule 409 of the Federal Court Rules.

17 *Canada v. Maritime Group (Canada) Inc.*, [1993] 1 F.C. 131 (T.D.)

18 *Director of Investigation and Research v. AGT Directory Limited et al.*, CT-94/2.

19 *Director of Investigation and Research v. AGT Directory Limited* (18 November 1994), CT-94/2, Consent Order at para. 3, [1994] C.C.T.D. No. 24 (QL).

20 *Angle v. M.N.R.* (1974), [1975] 2 S.C.R. 248.

21 G. Spencer Bower & A.K. Turner, *The Doctrine of Res Judicata*, 2d ed. (London: Butterworths, 1969) at 37.

22 *Supra* note 20 at 255.

23 *Trade-marks Act*, R.S.C. 1985, c. T-13.

24 A "trade-mark" is defined in s. 2 of the *Trade-marks Act* as "a mark that is used by a person for the purpose of distinguishing or so as to distinguish wares or services manufactured, sold, leased, hired or performed by him from those manufactured, sold, leased, hired or performed by others...."

25 *Trade-marks Act*, s. 19.

26 S. 50(1) of the *Trade-marks Act*, as am. S.C. 1993, c. 15, s. 69, provides:

For the purposes of this Act, if an entity is licensed by or with the authority of the owner of the trade-mark to use the trade-mark in a country and the owner has, under the licence, direct or indirect control of the character or quality of the wares or services, then the use, advertisement or display of the trade-mark in that country as or in a trade-mark, trade-name or otherwise by that entity has, and is deemed always to have had, the same effect as such a use, advertisement or display of the trade-mark in that country by the owner.

27 E.g., comparative advertising or use of trade-mark in a merely descriptive sense, for example, does not constitute infringement: see *Clairol International Corp. v. Thomas Supply & Equipment Co.*, [1968] 2 Ex. C.R. 552 at 556; *Syntex Inc. v. Apotex Inc.* (1984), 1 C.P.R. (3d) 145 (F.C.A.).

28 483 F.Supp. 82 at 86-87 (1977).

29 (1995), 61 C.P.R. (3d) 12 (F.C.T.D.).

30 In fact, neither the Director nor the respondents directed the Tribunal to any cases where a party was ordered to license a trade-mark.

31 (1995), 64 C.P.R. (3d) 216, [1995] C.C.T.D. No. 20 (QL) (Comp. Trib.).

32 Or surrogates such as service, quality, etc.

33 *NutraSweet*, *supra* note 4; *Director of Investigation and Research v. Laidlaw Waste Systems Ltd.* (1992), 40 C.P.R. (3d) 289, [1992] C.C.T.D. No. 1 (QL); *D & B*, *supra* note 31.

34 [1995] 3 F.C. 557 (C.A). An important issue in *Southam* was whether the two Pacific Press dailies and various community newspapers, all owned by Southam, were in the same product market. The Tribunal found that they were not; the Court of Appeal reversed on this point. An appeal to the Supreme Court is pending.

35 *Ibid.* at 632-33.

36 *Southam* was followed in *R. v. Clarke Transport Canada Inc.* (1995), 130 D.L.R. (4th) 500 (Ont. Ct. (Gen. Div.)), (1995) 64 C.P.R. (3d) 289. While the Director referred to that decision, it was not argued in any detail nor, apparently, relied on by either side.

37 *Supra* note 34 at 633.

38 Confidential exhibit CJ-14 (blue vol. 5), tab 173; confidential exhibit CJ-19 (blue vol. 10), tab 285 (Newfoundland).

39 The participants were asked if they would shift their advertising from Tele-Direct to an independent *directory* in response to a 15 percent increase in Tele-Direct's prices.

40 Consumer and Corporate Affairs Canada, Director of Investigation and Research, *Merger Enforcement Guidelines*, Information Bulletin No. 5 (Supply and Services Canada, March 1991).

41 *Supra* note 34 at 635, 637-38.

42 *Ibid.* at 637.

43 *Ibid.* at 640.

44 *Ibid.* at 636-37.

45 Associate Professor of Economics and Business Administration at Simon Fraser University.

46 Professor of Economics and Public Affairs at Princeton University.

47 As opposed to "national" or "brand awareness" advertising which promotes a product wholly apart from *any* location.

48 [1968] 2 Ex. C.R. 275 at 305-306.

49 Respondents' Book of Authorities, vol. 6, tabs A,B.

50 Respondents' Book of Authorities, vol. 6, tabs C, D; vol. 3, tab 41.

51 Respondents' Book of Authorities, vol. 3, tabs 38, 47; Director's Book of Authorities in Reply, tabs 6, 7, 9.

52 This is, of course, co-extensive with their definition of local advertising.

53 Confidential exhibit CJ-16 (blue vol. 7), tab 215 at 118727.

54 *Ibid.* at 118801.

55 At the hearing, counsel for the respondents attempted to convince the Tribunal to attribute less weight to the letter than we otherwise might on the grounds that it was not prepared with the assistance of an economist and that it was produced in a compressed period of time. The letter was written by Tele-Direct's Vice-president of Marketing with the assistance of a number of lawyers from counsel's office. We have no information as to the extent of the economic background of any of those lawyers. It is signed by the President of Tele-Direct. During the discovery process the respondents resisted production of the letter on the grounds that it was protected by settlement negotiation privilege. The Tribunal ruled that the letter did not fall within that privilege and ordered it produced. We have no hesitation, for the purposes for which we refer to the letter, of attributing significant weight to it.

56 Exhibit J-5 (green vol. 3), tab 239 at 86008.

57 *Ibid.*

58 Apparently there is some experimentation in some American centres with allowing restaurants to run advertisements that include menus. In a relatively stable economic environment firms in such an industry might be willing to risk committing themselves to prices for as long as a year.

59 See, e.g., the testimony of Jack Forrester of HOJ Car and Truck Rentals, that he does not use Yellow Pages for specials or promotions: transcript at 5:778 (11 September 1995); the testimony of Jean-Yves Laberge of the Turpin Group of automobile sales and leasing businesses, that he puts prices and specials in his newspaper advertisement but not in the Yellow Pages: transcript at 13:2406-407 (3

October 1995); and the testimony of Steve Kantor of Tiremag Corp., who sells wheels and tires, that he cannot use Yellow Pages to advertise seasonal product offerings or prices: transcript at 17:3288-89 (11 October 1995).

60 Paragraph 24 of Professor Willig's rebuttal affidavit (exhibit R-181) reads:

... 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.

61 It is commonplace economics that a firm with market power will set prices where the demand for its product is elastic; that is, at the point where a further increase in price would cause a reduction in revenue. Some of the reduction in revenue may result from consumers switching to other products which are the closest substitutes *at that price*, but which would not be considered by these consumers as substitutes if the firm with market power were pricing its product *at a competitive level*. This so-called "cellophane fallacy" (originating from criticism of the decision of the Supreme Court of the United States in *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377 (1956)) can result in the mistaken conclusion that a firm does not have market power because of the presence of substitutes when in fact the reverse is true -- the substitution is occurring *because of* the exercise of market power. In principle markets should be defined at competitive prices.

62 Confidential exhibit CJ-28 (black vol. 7), tab 42 at 129284. Customers who disconnected their business telephone service are not included. There was no general price change between 1993 and 1994, although there were a number of incentive plans.

63 Confidential exhibit CJ-14 (blue vol. 5), tab 173.

64 Confidential exhibit CJ-87 (black vol. 14), tab 111 at 134805; confidential exhibit CJ-33 (black vol. 12), tab 85 at 132815.

65 "Non-believers", "inadequate response from advertising" and "don't need large recognition".

66 For example, individuals in professions prohibited from advertising, variety stores, construction sites.

67 Confidential exhibit CJ-18 (blue vol. 9), tab 249.

68 Contrary to Tele-Direct's habitual use of the term, the "non-advertisers" studied may have had a bold listing.

69 *Supra* note 67 at 107661, 107681 (emphasis added). One non-advertiser was just starting up his business and could not make the current edition deadline.

70 E.g., Elliott reports: confidential exhibit CJ-14 (blue vol. 5), tab 173 (January 1993) and confidential exhibit CJ-19 (blue vol. 10), tab 285 (February 1993 - Newfoundland); V.I.A. survey: confidential exhibit CJ-11 (blue vol. 2), tab 89; Yellow Pages Satisfaction Study (Omnifacts Research): confidential exhibit CJ-15 (blue vol. 6), tab 199.

71 The term "complement" has been used in this context primarily in its ordinary sense and not in its strict economic sense. No one has asserted that the different advertising vehicles are complements in the sense that a reduction in the price of one vehicle would lead to an increase in the price of the other. Rather the term has been used to indicate that Yellow Pages perform a different function than other vehicles and are thus needed to complete an advertising programme.

72 *Supra* note 70.

73 *Ibid.* New advertisers were generally very small companies; established customers were larger.

74 *Ibid.* at 116796.

75 *Ibid.* at 116811-12.

76 In terms of actual switching behaviour, the respondents referred to evidence of a locksmith who cut his Yellow Pages spending and bought brochures, on the advice of a Yellow Pages consultant, and of a photographer who was visited by a newspaper consultant who designed a smaller Yellow Pages advertisement for him. The implications of the existence and practices of the consultants for substitutability will be dealt with in the next section. Both newspaper and Yellow Pages consultants use a similar methodology, in

that they attempt to convince an advertiser that a smaller, less expensive Yellow Pages advertisement will be equally effective *in the Yellow Pages*. The Director also provided numerous examples of "non-switching" where increases or decreases in spending on other media were unrelated to spending on Yellow Pages.

77 Newspaper advertisements were identified for establishments in the businesses represented by the top five Yellow Pages headings in the region's Tele-Direct directories. Then, those establishments with newspaper advertisements were sought in their local Tele-Direct Yellow Pages directories. Overall, the search found 542 newspaper advertisers in these categories. Of this group, 39% had display advertisements in both the searched newspaper and in the local Tele-Direct Yellow Pages directory, while 61% of the newspaper advertisers had no display advertisement in their local Tele-Direct Yellow Pages directory. (The 61% is comprised of 42% who had no Yellow Pages business phone number, and hence no listing in the Tele-Direct Yellow Pages of any kind. Another 12% did have lightface classified listings in the local Tele-Direct Yellow Pages directory, but no advertisement in that directory of any kind. Yet another 6% had a boldface listing in their local Tele-Direct Yellow Pages directory, but no display advertisement in that directory.)

78 Expert affidavit of R. Willig (17 August 1995): exhibit R-180 at paras. 20-22, appendix 2B.

79 Exhibit R-116. One of the three contained pricing information in the newspaper and not in the directory.

80 There is an important difference between Yellow Pages and non-classified advertising in other print media (or electronic media, for that matter) that results from the fact that media with editorial or entertainment content usually prefer to have minimum percentage of such content. The effect is to create an opportunity cost to having larger advertisements, because they absorb some of the available space for other content. This consideration is not present in the case of Yellow Pages and should not affect the pricing of larger advertisements.

81 Confidential exhibit CJ-15 (blue vol. 6), tab 199 at 116802.

82 See Competition Database Binder (1994): confidential exhibit CJ-15 (blue vol. 6), tab 205; 1994 Sensitive Market Report: confidential exhibit CJ-29 (black vol. 8), tab 51; Directory Publishers in Tele-Direct Operating Area: confidential exhibit CJ-32 (black vol. 11), tab 77 at 132125-45.

83 For further details, see the facts set out in the section entitled "C. Market for Advertising Space - Publishing" in chapter "IX. Abuse of Dominant Position", *infra*.

84 Mr. Giddings' testimony on this topic was confusing. He testified at various times that the course, or perhaps one module of it (which a discovery answer indicated had never been used for training purposes), was given to new representatives in about 1990 and that it, or some part of it, had been repeated for unknown numbers in 1993 and 1994. However, he also testified that no new premise sales representatives had been hired since 1992 casting doubt as to how many times and to how many persons the course was given.

85 The use of the average premise remuneration errs on the side of being too high. The other type of sales representative, a telephone sales representative, earns, on average, only about 60 percent of what a premise representative earns. Also, Mr. Giddings did say at one point that this course was given to *new* representatives, who would likely earn less than average in any case.

86 Exhibit J-2 (red vol. 2), tab 82 at 8833.

87 *Ibid.*, tab 81 at 8827.

88 Exhibit J-2 (red vol. 2), tab 116 at 13525.

89 Confidential exhibit CJ-10 (blue vol. 1), tab 17 at 106527-28.

90 Radio - 4%, television - 6%, other - 11%, newspapers - 19% and Yellow Pages - 60%: confidential exhibit CJ-18 (blue vol. 9), tab 243 at 107177ff.

91 Professor of Economics at the University of British Columbia.

92 While it is true that price comparisons with the newspapers are used, including different sizes of newspaper advertisements and advertisements with red, the message is that it is cheaper to use the Yellow Pages regardless of the size or colour of the advertisement.

93 The 1993 prices were revised in February 1992. The respondents rely heavily on this particular exercise; it is reviewed in detail below.

94 Consistency in cost per thousand of circulation across directories.

95 Ms. McIlroy explained that the "junked directories" are those that never enter into circulation. Tele-Direct used the volume of junked directories to forecast how many copies should be printed and to ensure that estimate was realistic. If many of the copies printed end up as junked directories, this over-inflates Tele-Direct's circulation figures.

96 The 1992 exercise (for 1994) is not included as prices were not increased.

97 Information on business papers and outdoor came from only one source.

98 Transcript at 44:9285-86, 9290 (22 November 1995).

99 Confidential exhibit CJ-12 (blue vol. 3), tab 115 at 109881.

100 Confidential exhibit CJ-32 (black vol. 11), tab 76 at 132008-9 (public) (with covering memorandum).

101 Transcript at 44:9283-84 (22 November 1995).

102 East Office Competition Analysis: confidential exhibit CJ-13 (blue vol. 4), tab 158 at 115094.

103 Transcript at 20:3827 (16 October 1995).

104 Transcript at 39:8077-78 (15 November 1995).

105 As already indicated, Tele-Direct responded with zero price increases, advertiser incentive programs, promotional campaigns and improvements to its own directories.

106 Pricing Policy - CPI & Media Price Evolution (1984-1994): confidential exhibit CR-158 at 111314; Tele-Direct Price Up vs. Canada Inflation Rate and Other Media: confidential exhibit CJ-29 (black vol. 8), tab 48 at 129708.

107 *NutraSweet*, *supra* note 4; *Laidlaw*, *supra* note 33; *D & B*, *supra* note 31.

108 *Laidlaw*, *ibid.* at 325; *D & B*, *ibid.* at 254-55.

109 Overview of Other Publishers in Tele-Direct Markets: confidential exhibit CR-170; Tele-Direct (Publications) Inc. - Profitability Study for 1994: confidential exhibit CR-185. Tele-Direct's 1994 published revenues were the most recent available at the time of the hearing. Exhibit CR-170 was put forward by the respondents as their most up-to-date information on independents' revenues and so we will refer to it to the exclusion of the various other numbers and documents brought up during Mr. Renwicke's testimony. Exhibit CR-170 provides two different bottom line totals for number of independent directories and revenue. The difference is accounted for by cessation of publication by one publisher with ten directories and revenues of $1.5 million. The totals that have been used are those that include that publisher and its revenues.

110 Telephone Directory Competition in Ontario/Quebec: confidential exhibit CJ-13 (blue vol. 4), tab 164; testimony of D. Renwicke: transcript at 46:9679-80 (27 November 1995). This figure was calculated based on a research study conducted in the United States which determined that independents overall had 5.9 percent of telco directory revenues. The 1993 Simba/Communications Trends study places independents at under 7 percent of total national revenues: confidential exhibit CJ-14 (blue vol. 5), tab 174.

111 According to the respondents' map of other publishers (exhibit R-159), only DSP and Tele-Direct are in Sault Ste. Marie, Elliot Lake and Wawa; only White and Tele-Direct are in St. Catharines and Niagara Falls. There are the Locator and Easy to Read directories in Fort Erie but there is no local revenue information on the record. It cannot be very high based on averages taken from Overview

of Other Publishers in Tele-Direct Markets (confidential exhibit CR-170). Niagara calculation: Tele-Direct 1994 published revenues for Niagara Falls, St. Catharines and Fort Erie taken from Tele-Direct's 1994 Corporate Post Canvass Analysis Report (confidential exhibit CJ-28 (black vol. 7), tab 42 at 128980); White's 1994 revenue was stated by Richard Lewis to be 17 percent of Tele-Direct's revenue (transcript at 22:4363-64 (18 October 1995)). Sault Ste. Marie calculation: Tele-Direct 1994 published revenues for the Sault Ste. Marie, Elliot Lake and Wawa taken from Tele-Direct's 1994 Corporate Post Canvass Analysis Report (confidential exhibit CJ-28 (black vol. 7), tab 42 at 128983); DSP 1994 (year 2) revenues taken from DSP - Sault Ste. Marie Directory - Gross Revenue from 1993 to 1995 (confidential exhibit CA-109).

112 Overview of Other Publishers in Tele-Direct Markets: confidential exhibit CR-170.

113 Tele-Direct's 1994 Corporate Post Canvass Analysis Report: confidential exhibit CJ-28 (black vol. 7), tab 42 at 128982.

114 Phone numbers that people could call to get anything from up-to-date news, weather and sports, to medical information and their daily horoscope.

115 *Director of Investigation and Research v. Southam Inc.* (1992), 43 C.P.R. (3d) 161 at 281-82, [1992] C.C.T.D. No. 7 (QL).

116 The same point is made in P.S. Crampton, *Mergers and the Competition Act* (Toronto: Carswell, 1990) at 435-37.

117 "Lessons of Yellow Pages Competition": confidential exhibit CJ-14 (blue vol. 5), tab 174 at 115924.

118 *Ibid.* at 115982.

119 *Ibid.* at 115984.

120 White's prices in 1994 were generally about 25 percent less than Tele-Direct's for in-column, about 40 percent less for display and about 55 less for red display: exhibit A-103. White first published in Niagara in 1993 with a prototype directory in which advertisers could advertise free of charge. The 1994 prices are for its first "revenue" directory in which advertisers paid for their advertising. Likewise, in Sault Ste. Marie, the DSP rates reflected substantial discounts off Tele-Direct's, with greater discounts for display and coloured display than for other types of advertisements: YPPA Rates and Data Information for the period 1992-95: exhibit A-111.

121 For example, area sports team schedules, seating diagrams for theatres and arenas, a listing of local golf courses, highway access information, historical sites, schedule of events, maps, senior citizens' services listings, human services' listings, "kid's pages", bus routes, customs and goods and services tax information.

122 For example, it is a "flip" directory with the Canadian cities on one side and the neighbouring American cities on the other. The book also includes a "reverse directory" -- listings by phone number first.

123 Confidential exhibit CJ-14 (blue vol. 5), tab 73 at 115416-18.

124 Expert rebuttal affidavit of R. Willig (30 August 1995): exhibit R-181 at 13, paras. 46-48.

125 Transcript at 56:11663, 11667-68 (23 January 1996).

126 Transcript at 32:6559-61 (3 November 1995).

127 Transcript at 41:8556-57 (17 November 1995).

128 All the work relating to contract verification and dealing with complaints is already done by Tele-Direct. What is performed by Bell Canada are simply the mechanical steps of bill preparation and mailing.

129 YPPA Rates and Data Information for the period 1992-95: exhibit A-111 at 9.

130 Leaving aside dynamic, innovation-driven industries, to which telephone directories do not belong.

131 In Sault Ste. Marie, DSP charges a premium for red ranging from 36 to 50 percent for full page, half page, double half column (1/4 page), double quarter column (1/8 page) and quarter column (1/16 page). For each doubling in size, however, DSP price increases are 56 percent to 76 percent, considerably lower than Tele-Direct's size premium. In Niagara Falls, White charges only between eight and nine percent premium for red, with one exception, a quarter column advertisement, which reflects a 28 percent increase. For each doubling in size, White charges from 74 to 91 percent more.

132 Each year 25 customers of each sales representatives are asked questions relating to the quality of the service provided by the representative.

133 1984-2 Trade Cas. (CCH) ¶ 66,080 at 66,024-25 (7th Cir. 1984).

134 *Ibid.* at 66,025.

135 Professor of Economics and Director of the Policy and Economic Analysis Program at the University of Toronto.

136 P.E. Areeda, H. Hovenkamp & E. Elhauge, *Antitrust Law*, vol. 10 (Boston: Little, Brown, 1996) at 175.

137 466 U.S. 2.

138 The majority consisted of Stevens, Brennan, White, Marshall and Blackmun JJ. The minority included O'Connor, Powell, Rehnquist JJ. and Burger C.J.

139 *Supra* note 137 at 21-22.

140 *Ibid.* at 43.

141 *Ibid.* at 46.

142 *Ibid.* at 19 n. 30.

143 *Supra* note 136 at 269.

144 1987-1 Trade Cas. (CCH) ¶67,628 (9th Cir. 1987).

145 No. CV 77-3450-FW (Dist. Ct. C.D. Cal. 8 June 1981).

146 *Ibid.* at 17.

147 No. CV-93-3650 LGB (U.S. Dist. Ct. C.D. Cal. 2 August 1994), appeal pending.

148 Transcript at 66:13762-63 (26 February 1996).

149 57 F.3d 1317 (4th Cir. 1995).

150 1987-2 Trade Cas. (CCH) ¶ 67,683 (11th Cir. 1987).

151 *Ibid.* at 58,482.

152 *Ibid.* at 58,483.

153 *Ibid.*

154 *Ibid.* at 58,484.

155 Or these might have been provided by the advertiser's "advertising agency" and not the ASR.

156 *Supra* note 150 at 58,484.

157 Confidential exhibit CJ-16 (blue vol. 7), tab 214 (public), art. 10.

158 Exhibit J-5 (green vol. 3), tab 154 at 32277.

159 Exhibit J-4 (green vol. 2), tab 99 at 28021-22.

160 The evidence is that agents charged separately for artwork when the commission rate was 15 percent but do not do so at the 25 percent commission rate.

161 833 F.2d 606 (6th Cir. 1987).

162 1990-2 Trade Cas. (CCH) ¶ 69,154 (6th Cir. 1990).

163 *Ibid.* at 64,348.

164 P.E. Areeda, *Antitrust Law*, vol. 9 (Boston: Little, Brown, 1991) at 330-31.

165 *Ibid.* at 333.

166 *Ibid.* at 347.

167 The element of no separate charge, or separate billing, for services, which the respondents appear to allude to as part of this argument, is another issue which is dealt with in the next section.

168 1988-1 Trade Cas. (CCH) ¶ 67,971 (7th Cir. 1988).

169 *Supra* note 137 at 18.

170 *Ibid.* at 6 n. 4.

171 One advertiser (Turpin Group Inc.) participates in a trade-mark advertisement for General Motors dealers for which General Motors, a national advertiser, uses DAC. Turpin's own advertising is treated as local and it deals with Tele-Direct's internal sales force.

172 The evidence is that the agencies generally keep servicing existing clients and prospecting for new clients separate; adding new clients is usually the primary responsibility of one or more designated persons. Out of the five CMRs that testified, two pay commission for new clients; only one of those offers that incentive to all employees, the other has a vice-president who is responsible for new business.

173 Only two of the multi-directory (leaving aside the one who is in only two directories) advertisers were clients of consultants and only one of those talked about uniformity of advertisements and co-ordinating dates and deadlines.

174 E.g., the "Autopro" line of automobile parts is offered by licensed Autopro mechanics and service stations across the country; the franchisees of Location Pelletier offer short-term vehicle rentals under that banner but usually operate another business as well.

175 A similar conclusion was reached in the United Kingdom by the Office of Fair Trading ("OFT") in its 1984 report on the Yellow Pages industry: exhibit J-6 (green vol. 4), tab 282. When British Telecom withdrew all commission and internalized services through an exclusive sales contractor, the advertising agencies argued that they were placed at a disadvantage in competing to offer services to advertisers as the advertiser had to pay for the sales contractor's services, included in the rate card price, and then pay again to use the services of an agent. The OFT concluded that the "administration of the account" on the advertiser's behalf, by which they meant the day-to-day running of the account (negotiating claims, authorizations, proof-checking, paying bills) could not be carried out by the sales contractor and would either be done by the advertiser using its own resources or an agent. In respect of those services, therefore, the agencies were not competing with the sales contractor but rather with the advertiser's own resources.

176 Counsel for the respondents appeared to take the position that advertisers did not incur higher costs of using agents in those cases where the advertisers placed advertisements in a number of directories that were issued throughout the year. Although this argument

has a superficial appeal because it appears that advertisers are paying on a periodic basis either way, it is not valid. Advertisers who use an agent must pay in advance for each directory as opposed to over a 12 month period if they use Tele-Direct.

177 Of the seven agency clients, five, to all appearances, would not meet the eight-market criteria; the sixth apparently does but does not meet the 20-directory requirement for the 1993 rule. The seventh may meet the 1993 definition but as a group advertisement which is problematic for other reasons (see chapter "IX. Abuse of Dominant Position" under "D. Market for Advertising Services", *infra*). The three advertisers who currently use Tele-Direct but would like to use an agent are similar: a franchiser, a large regional advertiser and a company with three offices in two provinces.

178 Among the agency clients, HOJ Car and Truck Rentals, for example, spends $125,000 annually and has 36 franchises, all located in southwestern Ontario. Location Pelletier spends $120,000 to $160,000 annually but its 60 licensees are all within the province of Quebec. Stephensons' Rent-all Inc., as Mr. Day of Day Advertising Group, Inc. testified, became non-commissionable when the eight-market rule came in and that was when it began to do the "extra" advertising. Stephensons has 38 retail outlets in southern Ontario and spends $140,000 on Yellow Pages advertising. Among the consultant clients, Canac-Marquis Grenier has 10 outlets across Quebec and spends $50,000 on its advertising; Tiremag Corp. spends $20,000 although it has only one outlet.

179 Professor of Law and Director of the Law and Economics Programme at the University of Toronto.

180 *Supra* note 175.

181 We note from Tele-Direct's 1994 Corporate Post Canvass Analysis Report that "new" advertisers, those using Yellow Pages for the first time or new businesses, are certainly among the smaller Tele-Direct advertisers. Selling effort is especially important with respect to new advertisers. The average *annual* expenditure by a new advertiser is $839, less than half the average for all advertisers. Less than one-half of one percent of new advertisers spend $1,000 or more *per month* where the corresponding percentage among established advertisers is about 3.5 times greater. Apparently, the typical new Yellow Pages advertiser starts with a small advertisement, in which case it is the value of the medium and the "sales pitch" which are important and not other advertising services.

182 We should note here that while the Director refers to space and services, Professor Trebilcock refers to three elements: space, consulting advice (design, graphics, layout, etc.) and selling effort (or pure promotion of the value of the medium). He recognizes that selling effort is clearly variable in relation to space. That is the genesis of the principal-agent problem dealt with later in this section.

183 Expert rebuttal affidavit of M.E. Slade (28 August 1995): exhibit A-119 at 11.

184 Expert affidavit of M. Trebilcock (18 August 1995): exhibit R-174(b) at para. 27.

185 AGT Directory Limited only pays 25 percent on foreign numbers (as do all publishers) but pays 15 percent on *any other* advertising, including local accounts.

186 Except for Edmonton Tel: advertising in Calgary and Edmonton would qualify under its rule.

187 *Supra* note 184 at para. 27.

188 *Ibid.*

189 The evidence of Mr. Lewis of White was that White pays commission (in the United States and presumably also in Canada) on any account submitted by a CMR without restriction. The commission rate is 23 percent for established directories and 30 percent for newer directories. Likewise, DSP pays CMRs commission on any account.

190 E.g., for White: eight percent of revenues in U.S. placed by agents; in Canada, one-half of one percent of revenues placed by agents.

191 In circumstances where the dominant players are telco publishers and those publishers only pay commission on national and regional accounts, it follows that agents are active mainly in those sectors. They are not set up to service local accounts even if independents pay commission on those. Thus, because the dominant players do not want to use agents for local accounts, independents *cannot*, even if they wanted to, rely solely on agents but must use an internal sales force. Professor Slade is of the view that agents would tend to serve this market over time if the major publishers changed their policies and provided a broader market. Further, as the independent

is usually the newcomer into a market dominated by the telco publisher, agents are reluctant to recommend a new directory, even for national and regional accounts where at least some of the major players pay commission, until it has proven itself.

192 *Supra* note 184 at para. 22.

193 Based on the evidence of the representatives of CMRs who testified; together those CMRs account for a large portion of commissionable sales.

194 Confidential exhibit CJ-32 (black vol. 11), tab 83 at 132667ff.

195 Exhibit J-1 (red vol. 1), tab 61.

196 Total salaries were allocated to CANYPS, agencies, NAMs and GSF.

197 To anticipate questions that might arise as a result of the discussion of Tele-Direct's latest contribution to profit study, the same percentage cost of customer service (the payment to Bell Canada) and "melt" is used for both agents and NAMs. There is some tipping of the scales in favour of agents with respect to the cost of customer service since it is applied net of commission in the case of agents. On the other hand, no account is taken of the fact that agents pay up-front and the customers of NAMs pay over a year.

198 Confidential exhibit CR-185.

199 Transcript at 34:7026 (7 November 1995).

200 Transcript at 36:7370 (9 November 1995).

201 Depreciation of the scanner (a common cost since it is caused neither by internal sales force or CMRs) is divided equally between internal sales force and agents based on relative volume of items by number scanned from these sources. Based on the revenue methodology otherwise employed most of the depreciation would be allocated to internal sales force.

202 The reason why CCS has such a large impact is that under Tele-Direct's contract with Bell Canada the revenue from agents who are billed by Tele-Direct rather than Bell are not subject to the payment of CCS. Thus the average payment of CCS is much lower in the case of agents than of internal sales force.

203 By proposing the further alternative remedy of reverting to the pre-1975 commission rule.

204 We are referring to monetary amounts here because that is the way the evidence came in. Other criteria, such as number of markets, are more informative and other evidence was presented in that form. We attempt to relate the two measures below.

205 While the document is not explicit, the data were gathered in 1993 so we infer these are 1993 figures: confidential exhibit CJ-31 (black vol. 10), tab 69 at 131635.

206 Agents are agents for or "represent" advertisers in the sense that they place advertising on the advertisers' behalf but, as indicated earlier, agents have an independent interest and existence apart from advertisers in other aspects of service provision.

207 1993-1 Trade Cas. (CCH) ¶ 70,266 (S.D.N.Y. 1993).

208 *Ibid* at 70,333.

209 *Ibid.* at 70,334.

210 R.S.C. 1985 (2d Supp.), c. 19.

211 Consumer and Corporate Affairs Canada, *Competition Law Amendments: A Guide* (Supply and Services Canada, December 1985).

212 *NutraSweet*, *supra* note 4 at 47.

213 *Laidlaw*, *supra* note 33 at 333.

214 *NutraSweet*, *supra* note 4 at 34.

215 *D & B*, *supra* note 31 at 257.

216 *Ibid.* at 261.

217 *Ibid.* at 262.

218 *Ibid.* at 265.

219 They rely mainly on *Clear Communications Ltd. v. Telecom Corp. of New Zealand* (1994), 174 N.R. 266 (P.C.).

220 Advertising in a prototype directory is provided free to businesses. A prototype serves to lend credibility to a new publisher's claim that it will, in fact, produce a directory and affords the publisher an opportunity to prove to advertisers the value of advertising in its directory.

221 DSP also included a "reverse" directory -- listings by phone number first.

222 The exceptions for Tele-Direct's directories were the neighbourhood directories and areas subject to rescoping or splitting of directories. At the request of other telcos, like Newfoundland Tel and Northern Tel, prices were also frozen in those directories in 1995.

223 In the first year (1993), all existing advertisers renewing or purchasing advertising received the next size up or colour, if applicable, at no extra charge. In 1994, all advertisers who participated in the program in 1993 were offered the next size up free, free colour or a 15 percent rebate if they renewed or increased their advertising. Those who had not participated in 1993 and new advertisers were given a 15 percent rebate. In the third and final year, the program became even more complex with different choices available to 1994 participants who were renewing depending on which option they had chosen (rebate/free size up or colour) in 1994. Non-advertisers and non-participants were again offered a 15 percent rebate as were 1994 participants who were increasing their advertising.

224 In 1995, when Unifone was no longer present, advertisers were offered a 15 percent rebate if they increased their advertising but participants in the 1994 program could receive the rebate if they renewed their upsized or colour item.

225 Confidential exhibit CJ-87 (black vol. 14), tab 104 at 134481.

226 Formerly called BDR Audio Network.

227 Exhibit R-152.

228 For a more complete discussion of this issue, see *infra* in this section on abuse of dominance in publishing under "(b) Alleged Anti-competitive Acts", "(ii) Targeting/Raising Rivals' Costs".

229 T.G. Krattenmaker & S.C. Salop, "Competition and Cooperation in the Market for Exclusionary Rights" (1986) 76:2 Amer. Econ. Rev. 109.

230 D.T. Scheffman, "The Application of Raising Rivals' Costs Theory to Antitrust" (1992) 37 Antitrust Bulletin 187.

231 Transcript at 64:13167-68, 13170 (16 February 1996).

232 *Ibid.* at 13169.

233 *The Concise Oxford Dictionary*, 7th ed. (Oxford: Clarendon Press) at 1094.

234 Tele-Direct would be unrestricted in its responses if it implemented those responses throughout its territory.

235 Mr. Bourke wrote to Mr. Renwicke stating that postal codes should be left as a section rather than integrated as part of the listing (as White had done), otherwise "we'll [n]ever get rid of it": confidential exhibit CJ-86 (black vol. 13), tab 101 at 134297.

236 Confidential exhibit CJ-33 (black vol. 12), tab 88 at 133221A.

237 Transcript at 21:4088-89 (17 October 1995).

238 Transcript at 20:3918-19 (16 October 1995).

239 In brief, the essence of the test is that a price below reasonably anticipated short-run marginal costs is predatory while a price above short-run marginal costs is not. Because marginal cost data are often unavailable, average variable cost is generally used as a proxy. For a summary of the conclusions of Areeda and Turner on this topic, see *Antitrust Law*, vol. 3 (Toronto: Little, Brown, 1978) at para. 711d.

240 There would evidently be little point in the incumbent pursuing an aggressive course of responses in every market subject to entry solely to make an impression or deliver a threat since that strategy would have already been defeated. If there was widespread response by the incumbent in all markets in which entry occurred or was threatened, consumers would benefit in the short-term with no discernible long-term negative effects.

241 Anticipated sales are expressed as a percentage of estimated revenue of the existing directory. This does not mean that all sales are drawn from the incumbent as the demand for directory advertising is expected to increase when a second publication is introduced.

242 For further explanation of this matter, see chapter "VII. Control: Market Power" under "A. Indirect Approach: Market Structure", "(2) Barriers to Entry", "(c) (i) Subscriber Listing Information", *supra*.

243 Sham litigation could include a claim with no reasonable cause of action which might be struck out at an early stage of proceedings or a claim based on facts that were untrue or otherwise not supportive of the claim, in which case, the litigation could be extensive.

244 R.H. Bork, *The Antitrust Paradox* (New York: Basic Books, 1978) at 347.

245 Some mention was made that the copyright claim might be a "broad" interpretation of the existing American law but that is hardly definitive.

246 *Laidlaw*, *supra* note 33 at 298.

247 Confidential exhibit CJ-86 (black vol. 13), tab 96 at 134118.

248 Draft contract and covering letter: confidential exhibit CJ-87 (black vol. 14), tab 114 at 134825-27.

249 Confidential exhibit CJ-31 (black vol. 10), tab 68 at 131548-54.

250 *Ibid.* at 131555.

251 Transcript at 42:8856 (20 November 1995).

252 Confidential exhibit CJ-31 (black vol. 10), tab 68 at 131550.

253 *Ibid.* at 131551.

254 The September 1993 letter also uses the word "superior" and essentially the same language about "measurable deliverables" (confidential exhibit CJ-31 (black vol. 10), tab 68 at 131555) as later appeared in the January 1994 contract.

255 Confidential exhibit CJ-86 (black vol. 13), tab 95 at 134080.

256 *Ibid.* at 134107.

257 Entry meaning the attempt by DSP to establish itself in the Sault Ste Marie market on an economic basis with a revenue directory; that is, not the publication of a prototype directory alone.

258 *Supra* note 4 at 34-35.

259 See further discussion, *supra* at 123.

260 See further discussion of market share below under "Analysis Respecting the Existing Commissionable Market".

261 *Supra* note 4 at 47.

262 Both sides agreed that the agents' market share in 1993 was about 80 percent: confidential exhibit CJ-31 (black vol. 10), tab 69 at 131680. Adjusting to exclude sales into Tele-Direct's directories by agents based outside of Tele-Direct's territory, we arrive at approximately 75 percent for agents and 25 percent for Tele-Direct.

263 The difficulty here is that some franchisees or licensees carry on a number of businesses besides the licensed or franchised one and they do not operate their business under a "corporate" name. They wish to be listed in the advertisement under their own name, which often has high recognition value in their community, while still participating in the group advertising to promote the licence or franchise. An example is the Autopro dealers: the licensed Autopro garages or service stations do not carry the "Autopro" name. Tele-Direct does not permit them to be listed under their individual names.

264 There was evidence of an occasional advertisement that appears to be a group advertisement or something resembling a group advertisement but we are satisfied that it is Tele-Direct's policy not to permit group advertising.

265 These assertions ignore the fact that Tele-Direct representatives would rarely, if ever, give advice on how to reduce spending.

266 Tele-Direct threatened him with legal action, apparently for breach of copyright in its contractual terms and conditions.

267 Confidential exhibit CJ-10 (blue vol. 1), tab 5 (public).

268 Not affiliated with Mr. Harrison.

269 Initially, Tele-Direct refused to accept orders from Mr. Brouillet, until he obtained a copy of the letter sent to CEPAC 2000.

270 Operating procedures prior to December 1990: confidential exhibit CJ-11 (blue vol. 2), tab 58 at 107788 (public).

271 Operating procedures, December 1990: *ibid.* at 107792 (public).

272 *Ibid.*

273 There is some question as to whether the consultants affected were notified specifically of the change in policy or of the exact terms of the new policy. Messrs. Brouillet and Blais said that they were not.

274 Confidential exhibit CJ-12 (blue vol. 3), tab 105 at 109796 (public).

275 Testimony of P. de Sève: transcript at 44:9123-27 (22 November 1995); testimony of D. Renwicke: transcript at 46:9630-34 (27 November 1995).

276 Confidential exhibit CJ-27 (black vol. 6), tab 33 at 128522.

277 E.g., Postime Distributors (wrong paper, wrong size), Paul's Quality Woodcraft (non-compliance with specifications in general), M & L Service (wrong paper) and Canac-Marquis Grenier (borderless advertisement not allowed).

278 The advertisement was for Canac-Marquis Grenier.

279 The order was sent in under her signature on July 15, 1991. On September 30, 1991, the client received a form letter from Tele-Direct stating that the material had been returned to the consultant without processing. (As of that date, Ad-Vice had not received anything back.) The customer panicked, thinking her advertising would not appear. Mr. Brouillet was unable to obtain confirmation that the advertising would appear as ordered. The client ended up dealing directly with Tele-Direct and Mr. Brouillet had to sue to recover his fee.

280 The Britannia Restaurant & Banquet Hall order was sent in on August 2, 1991. On September 25, 1991, shortly before the closing date, Tele-Direct faxed the client its contract documents, which described the previous year's program. The client simply signed the documents, thinking they represented the new order. The old program appeared, the client protested, Tele-Direct insisted on full payment, the client refused to pay and was eventually barred from placing further advertising in Tele-Direct's directories. A Tele-Direct notation on a document relating to this customer indicates some concern even on its part about what transpired. The Muskoka Riverside Inn submitted its order prior to the deadline for making changes. The order was returned to the consultant and the client notified he had to send the order himself. The client missed the deadline for changing artwork and Tele-Direct ran the old advertising.

281 L.J. Sunshine Hardwood Flooring. Ad-Vice has sued the customer for breach of contract. In his defence, the customer claims that the Tele-Direct representative advised him that he had been "misrepresented" and should stop payment on his cheque.

282 Or, evidently, write off the account or accept a reduced fee in settlement, as Mr. Blais did on one occasion.

283 This is not to say that Tele-Direct did not reject some orders based on non-compliance with specifications. This may have been the fault of the consultant not to conform to the specifications of which he was aware or because Tele-Direct, without justification, wished to create difficulty for a consultant. But Tele-Direct's rejection of orders was not attributable to consultants not being aware of what Tele-Direct's specifications required.

284 Transcript at 15:2762 (6 October 1995).

285 Evidence of Mr. Lee of M & L Service, Mr. and Mrs. Jovandin of L.J. Sunshine Hardwood Flooring, Mr. Fox of Fox & Partners Limited, Mr. Harmic of Dominion Springs Corporation, Mr. McMaster of H.R. Home Renovations. Of course, the consultants blamed Tele-Direct for the confusion and Tele-Direct blamed the consultants. We cannot say for certain how the confusion about the relationship between Tele-Direct and consultants arose in each case but it does appear there was confusion in the minds of some customers.

286 E.g., Mr. Lee of M & L Service.

287 The package provided by Mr. Brouillet to his clients advises the client that the Tele-Direct representative will be in contact to transfer the advertising program to the Tele-Direct forms.

288 *Supra* note 287.

289 *Ibid.* All of the incidents cited related to clients of Ad-Vice except for Mr. Fox of Fox & Partners Limited, who was not linked to a specific consultant.

290 The approach we adopt is implicit in *Director of Investigation and Research v. Imperial Oil Ltd.* (26 January 1990), CT8903/390, Reasons and Decision at 16, [1990] C.C.T.D. No. 1 (QL) (Comp. Trib.) and in U.S. Dept. of Justice/Federal Trade Comm'n, *Horizontal Merger Guidelines*, (2 April 1992) at 1.51. Although dealing with a consent order, *Imperial* in effect addresses the issue of what constitutes a substantial lessening of competition when there are varying initial degrees of market power by evaluating what is required to cure the alleged substantial lessening of competition. Similarly, the Guidelines view any numerical increase in concentration more severely the higher the initial market share of the acquiring firm.

SUPREME COURT OF CANADA

CITATION: Canada (Minister of Citizenship and Immigration) *v.* Vavilov, 2019 SCC 65

APPEAL HEARD: December 4, 5, 6, 2018
JUDGMENT RENDERED: December 19, 2019
DOCKET: 37748

BETWEEN:

Minister of Citizenship and Immigration
Appellant

and

Alexander Vavilov
Respondent

- and -

Attorney General of Ontario, Attorney General of Quebec, Attorney General of British Columbia, Attorney General of Saskatchewan, Canadian Council for Refugees, Advocacy Centre for Tenants Ontario - Tenant Duty Counsel Program, Ontario Securities Commission, British Columbia Securities Commission, Alberta Securities Commission, Ecojustice Canada Society, Workplace Safety and Insurance Appeals Tribunal (Ontario), Workers' Compensation Appeals Tribunal (Northwest Territories and Nunavut), Workers' Compensation Appeals Tribunal (Nova Scotia), Appeals Commission for Alberta Workers' Compensation, Workers' Compensation Appeals Tribunal (New Brunswick), British Columbia International Commercial Arbitration Centre Foundation, Council of Canadian Administrative Tribunals, National Academy of Arbitrators, Ontario Labour-Management Arbitrators' Association, Conférence des arbitres du Québec, Canadian Labour Congress, National Association of Pharmacy Regulatory Authorities, Queen's Prison Law Clinic, Advocates for the Rule of Law, Parkdale Community Legal Services, Cambridge Comparative Administrative Law Forum, Samuelson-Glushko Canadian Internet Policy and Public Interest Clinic, Canadian Bar Association, Canadian Association of Refugee Lawyers, Community & Legal Aid Services Programme, Association québécoise des avocats et avocates en droit de l'immigration and First Nations Child & Family Caring Society of Canada
Interveners

CORAM: Wagner C.J. and Abella, Moldaver, Karakatsanis, Gascon, Côté, Brown, Rowe and Martin JJ.

JOINT REASONS FOR JUDGMENT: (paras. 1 to 197)	Wagner C.J. and Moldaver, Gascon, Côté, Brown, Rowe and Martin JJ.
JOINT CONCURRING REASONS: (paras. 198 to 343)	Abella and Karakatsanis JJ.

NOTE: This document is subject to editorial revision before its reproduction in final form in the *Canada Supreme Court Reports*.

CANADA (CITIZENSHIP AND IMMIGRATION) *v.* VAVILOV

Minister of Citizenship and Immigration *Appellant*

v.

Alexander Vavilov *Respondent*

and

Attorney General of Ontario,
Attorney General of Quebec,
Attorney General of British Columbia,
Attorney General of Saskatchewan,
Canadian Council for Refugees,
Advocacy Centre for Tenants Ontario - Tenant Duty Counsel Program,
Ontario Securities Commission,
British Columbia Securities Commission,
Alberta Securities Commission,
Ecojustice Canada Society,
Workplace Safety and Insurance Appeals Tribunal (Ontario),
Workers' Compensation Appeals Tribunal (Northwest Territories and Nunavut), Workers' Compensation Appeals Tribunal (Nova Scotia),
Appeals Commission for Alberta Workers' Compensation,
Workers' Compensation Appeals Tribunal (New Brunswick),
British Columbia International Commercial Arbitration Centre Foundation,
Council of Canadian Administrative Tribunals,
National Academy of Arbitrators,
Ontario Labour-Management Arbitrators' Association,
Conférence des arbitres du Québec,
Canadian Labour Congress,
National Association of Pharmacy Regulatory Authorities,
Queen's Prison Law Clinic,
Advocates for the Rule of Law,
Parkdale Community Legal Services,
Cambridge Comparative Administrative Law Forum,
Samuelson-Glushko Canadian Internet Policy and Public Interest Clinic,
Canadian Bar Association,

Canadian Association of Refugee Lawyers,
Community & Legal Aid Services Programme,
Association québécoise des avocats et avocates en droit de l'immigration and
First Nations Child & Family Caring Society of Canada *Interveners*

Indexed as: Canada (Minister of Citizenship and Immigration) *v.* Vavilov

2019 SCC 65

File No.: 37748.

2018: December 4, 5, 6; 2019: December 19.

Present: Wagner C.J. and Abella, Moldaver, Karakatsanis, Gascon, Côté, Brown, Rowe and Martin JJ.

ON APPEAL FROM THE FEDERAL COURT OF APPEAL

Administrative law — Judicial review — Standard of review — Proper approach to judicial review of administrative decisions — Proper approach to reasonableness review.

Citizenship — Canadian citizens — Registrar of Citizenship cancelling certificate of Canadian citizenship issued to Canadian-born son of parents later revealed to be Russian spies — Decision of Registrar based on interpretation of statutory exception to general rule that person born in Canada is Canadian citizen — Exception stating that Canadian-born child is not citizen if either parent was *representative or employee in Canada of foreign government at time of child's birth — Whether Registrar's decision to cancel certificate of citizenship was reasonable — Citizenship Act, R.S.C. 1985, c. 29, s. 3(2)(a).*

V was born in Toronto in 1994. At the time of his birth, his parents were posing as Canadians under assumed names. In reality, they were foreign nationals working on assignment for the Russian foreign intelligence service. V did not know that his parents were not who they claimed to be. He believed that he was a Canadian citizen by birth, he lived and identified as a Canadian, and he held a Canadian passport. In 2010, V's parents were arrested in the United States and charged with espionage. They pled guilty and were returned to Russia. Following their arrest, V's attempts to renew his Canadian passport proved unsuccessful. However, in 2013, he was issued a certificate of Canadian citizenship.

Then, in 2014, the Canadian Registrar of Citizenship cancelled V's certificate on the basis of her interpretation of s. 3(2)(a) of the *Citizenship Act*. This provision exempts children of "a diplomatic or consular officer or other representative or employee in Canada of a foreign government" from the general rule that individuals born in Canada acquire Canadian citizenship by birth. The Registrar concluded that because V's parents were employees or representatives of Russia at the time of V's birth, the exception to the rule of citizenship by birth in s. 3(2)(a), as she interpreted it, applied to V, who therefore was not, and had never been, entitled to citizenship. V's application for judicial review of the Registrar's decision was dismissed by the Federal Court. The Court of Appeal allowed V's appeal and quashed the Registrar's decision because it was unreasonable. The Minister of Citizenship and Immigration appeals.

Held: The appeal should be dismissed.

Per **Wagner** C.J. and **Moldaver**, **Gascon**, **Côté**, **Brown**, **Rowe** and **Martin** JJ.: The Registrar's decision to cancel V's certificate of citizenship was unreasonable, and the Court of Appeal's decision to quash it should be upheld. It was not reasonable for the Registrar to interpret s. 3(2)(a) of the *Citizenship Act* as applying to children of individuals who have not been granted diplomatic privileges and immunities at the time of the children's birth.

More generally, this appeal and its companion cases (*Bell Canada v. Canada (Attorney General)*, 2019 SCC 66) provide an opportunity to consider and clarify the law applicable to the judicial review of administrative decisions as addressed in *Dunsmuir v. New Brunswick*, 2008 SCC 9, [2008] 1 S.C.R. 190, and subsequent cases. The submissions presented to the Court have highlighted two aspects of the current framework which need clarification. The first aspect is the analysis for determining the standard of review. The second aspect is the need for better guidance from this Court on the proper application of the reasonableness standard.

It has become clear that *Dunsmuir*’s promise of simplicity and predictability has not been fully realized. Certain aspects of the current standard of review framework are unclear and unduly complex. The former contextual analysis has proven to be unwieldy and offers limited practical guidance for courts attempting to determine the standard of review. The practical effect is that courts struggle in conducting the analysis, and debates surrounding the appropriate standard and its application continue to overshadow the review on the merits, thereby undermining access to justice. A reconsideration of the Court’s approach is therefore necessary in order to bring greater coherence and predictability to this area of law. A revised framework to determine the standard of review where a court reviews the merits of an administrative decision is needed.

In setting out a revised framework, this decision departs from the Court’s existing jurisprudence on standard of review in certain respects. Any reconsideration of past precedents can be justified only by compelling circumstances and requires carefully weighing the impact on legal certainty and predictability against the costs of continuing to follow a flawed approach. Although adhering to the established jurisprudence will generally promote certainty and predictability, in some instances doing so will create or perpetuate uncertainty. In such circumstances, following a prior decision would be contrary to the underlying values of clarity and certainty in the law.

The revised standard of review analysis begins with a presumption that reasonableness is the applicable standard in all cases. Where a legislature has created an administrative decision maker for the specific purpose of administering a statutory scheme, it must be presumed that the legislature also intended that decision maker to fulfill its mandate and interpret the law applicable to all issues that come before it. Where a legislature has not explicitly provided that a court is to have a more involved role in reviewing the decisions of that decision maker, it can safely be assumed that the legislature intended a minimum of judicial interference. Respect for these institutional design choices requires a reviewing court to adopt a posture of restraint. Thus, whenever a court reviews an administrative decision, it should start with the presumption that the applicable standard of review for all aspects of that decision will be reasonableness. As a result, it is no longer necessary for courts to engage in a contextual inquiry in order to identify the appropriate standard. Conclusively closing the door on the application of a contextual analysis to determine the applicable standard streamlines and simplifies the standard of review framework. As well, with the presumptive application of the reasonableness standard, the relative expertise of administrative decision makers is no longer relevant to a determination of the standard of review. It is simply folded into the new starting point. Relative expertise remains, however, a relevant consideration in conducting reasonableness review.

The presumption of reasonableness review can be rebutted in two types of situations. The first is where the legislature has indicated that it intends a different standard to apply. This will be the case where it has explicitly prescribed the applicable standard of review. Any framework rooted in legislative intent must respect clear statutory language. The legislature may also direct that derogation from the presumption is appropriate by providing for a statutory appeal mechanism from an administrative decision to a court, thereby signalling the legislature's intent that appellate standards apply when a court reviews the decision. Where a legislature has provided a statutory appeal mechanism, it has subjected the administrative regime to appellate oversight and it expects the court to scrutinize such administrative decisions on an appellate basis. The applicable standard is therefore to be determined with reference to the nature of the question and to the jurisprudence on appellate standards of review. Where, for example, a court hears an appeal from an administrative decision, it would apply the standard of correctness to questions of law, including on statutory interpretation and the scope of a decision maker's authority. Where the scope of the statutory appeal includes questions of fact or questions of mixed fact and law, the standard is palpable and overriding error for such questions.

Giving effect to statutory appeal mechanisms in this way departs from the Court's recent jurisprudence. This shift is necessary in order to bring coherence and conceptual balance to the standard of review analysis and is justified by weighing the values of certainty and correctness. First, there has been significant and valid judicial and academic criticism of the Court's recent approach to statutory appeal rights and of the inconsistency inherent in a standard of review framework based on legislative intent that otherwise declines to give meaning to an express statutory right of appeal. Second, there is no satisfactory justification for the recent trend in the Court's jurisprudence to give no effect to statutory rights of appeal in the standard of review analysis, absent exceptional wording. More generally, there is no convincing reason to presume that legislatures mean something entirely different when they use the word "appeal" in an administrative law statute. Accepting that the legislature intends an appellate standard of review to be applied also helps to explain why many statutes provide for both appeal and judicial review mechanisms, thereby indicating two roles for reviewing courts. Finally, because the presumption of reasonableness review is no longer premised upon notions of relative expertise and is now based on respect for the legislature's institutional design choice, departing from the presumption of reasonableness review in the context of a statutory appeal respects this legislative choice.

The second situation in which the presumption of reasonableness review will be rebutted is where the rule of law requires that the standard of correctness be applied. This will be the case for certain categories of legal questions, namely constitutional questions, general questions of law of central importance to the legal system as a whole and questions related to the jurisdictional boundaries between two or more administrative bodies. First, questions regarding the division of powers between Parliament and the provinces, the relationship between the legislature and the other branches of the state, the scope of Aboriginal and treaty rights under s. 35 of the *Constitution Act, 1982*, and other constitutional matters require a final and determinate answer from the courts. Second, the rule of law requires courts to have the final word with regard to general questions of law that are of central importance to the legal system as a whole because they require uniform and consistent answers. Third, the rule of law requires courts to intervene where one administrative body has interpreted the scope of its authority in a manner that is incompatible with the jurisdiction of another since the rule of law cannot tolerate conflicting orders and proceedings where they result in a true operational conflict between two administrative bodies. The application of the correctness standard for such questions therefore respects the unique role of the judiciary in interpreting the Constitution and ensures that courts are able to provide the last word on questions for which the rule of law requires consistency and for which a final and determinate answer is necessary.

The general rule of reasonableness review, when coupled with these limited exceptions, offers a comprehensive approach to determining the applicable standard of review. The possibility that another category could be recognized as requiring a derogation from the presumption of reasonableness review in a future case is not definitively foreclosed. However, any new basis for correctness review would be exceptional and would need to be consistent with this framework and the overarching principles set out in this decision. Any new correctness category based on legislative intent would require a signal of legislative intent as strong and compelling as a legislated standard of review or a statutory appeal mechanism. Similarly, a new correctness category based on the rule of law would be justified only where failure to apply correctness review would undermine the rule of law and jeopardize the proper functioning of the justice system in a manner analogous to the three situations described in this decision.

For example, the Court is not persuaded that it should recognize a distinct correctness category for legal questions on which there is persistent discord within an administrative body. A lack of unanimity within an administrative tribunal is the price to pay for decision-making freedom and independence. While discord can lead to legal incoherence, a more robust form of reasonableness review is capable of guarding against such threats to the rule of law. As well, jurisdictional questions should no longer be recognized as a distinct category subject to correctness review; there are no clear markers to distinguish such questions from other questions related to interpreting an administrative decision maker's enabling statute. A proper application of the reasonableness standard will enable courts to ensure that administrative bodies have acted within the scope of their lawful authority without having to conduct a preliminary assessment on jurisdictional issues and without having to apply the correctness standard.

Going forward, a court seeking to determine what standard of review is appropriate should look to this decision first in order to determine how the general framework applies. Doing so may require the court to resolve subsidiary questions on which past precedents will often continue to provide helpful guidance and will continue to apply essentially without modification, such as cases concerning general questions of law of central importance to the legal system as a whole or those relating to jurisdictional boundaries between administrative bodies. On other issues, such as the effect of statutory appeal mechanisms, true questions of jurisdiction or the former contextual analysis, certain cases will necessarily have less precedential force.

There is also a need for better guidance from the Court on the proper application of the reasonableness standard, what that standard entails and how it should be applied in practice. Reasonableness review is meant to ensure that courts intervene in administrative matters only where it is truly necessary to do so in order to safeguard the legality, rationality and fairness of the administrative process. Its starting point lies in the principle of judicial restraint and in demonstrating respect for the distinct role of administrative decision makers. However, it is not a "rubber-stamping" process or a means of sheltering decision makers from accountability. While courts must recognize the legitimacy and authority of administrative decision makers and adopt a posture of respect, administrative decision makers must adopt a culture of justification and demonstrate that their exercise of delegated public power can be justified. In conducting reasonableness review, a court must consider the outcome of the administrative decision in light of its underlying rationale, to ensure that the decision as a whole is transparent, intelligible and justified. Judicial review is concerned with both the outcome of the decision and the reasoning process that led to that outcome. To accept otherwise would undermine, rather than demonstrate respect toward, the institutional role of the administrative decision maker.

Reasonableness review is methodologically distinct from correctness review. The court conducting a reasonableness review must focus on the decision the administrative decision maker actually made, including the justification offered for it. A court applying the reasonableness standard does not ask what decision it would have made in place of the administrative decision maker, attempt to ascertain the range of possible conclusions, conduct a new analysis or seek to determine the correct solution to the problem. Instead, the reviewing court must consider only whether the decision made by the decision maker, including both the rationale for the decision and the outcome to which it led, was unreasonable.

In cases where reasons are required, they are the starting point for reasonableness review, as they are the primary mechanism by which decision makers show that their decisions are reasonable. Reasons are the means by which the decision maker communicates the rationale for its decision: they explain how and why a decision was made, help to show affected parties that their arguments have been considered and that the decision was made in a fair and lawful manner, and shield against arbitrariness. A principled approach to reasonableness review is therefore one which puts those reasons first. This enables a reviewing court to assess whether the decision as a whole is reasonable. Attention to the decision maker’s reasons is part of how courts demonstrate respect for the decision-making process.

In many cases, formal reasons for a decision will not be given or required. Even without reasons, it is possible for the record and the context to reveal that a decision was made on the basis of an improper motive or for another impermissible reason. There will nonetheless be situations in which neither the record nor the larger context sheds light on the basis for the decision. In such cases, the reviewing court must still examine the decision in light of the relevant factual and legal constraints on the decision maker in order to determine whether the decision is reasonable.

It is conceptually useful to consider two types of fundamental flaws that tend to render a decision unreasonable. The first is a failure of rationality internal to the reasoning process. To be reasonable, a decision must be based on an internally coherent reasoning that is both rational and logical. A failure in this respect may lead a reviewing court to conclude that a decision must be set aside. Reasonableness review is not a line-by-line treasure hunt for error. However, the reviewing court must be able to trace the decision maker's reasoning without encountering any fatal flaws in its overarching logic. Because formal reasons should be read in light of the record and with due sensitivity to the administrative regime in which they were given, a decision will be unreasonable if the reasons for it, read holistically, fail to reveal a rational chain of analysis or if they reveal that the decision was based on an irrational chain of analysis. A decision will also be unreasonable where the conclusion reached cannot follow from the analysis undertaken or if the reasons read in conjunction with the record do not make it possible to understand the decision maker's reasoning on a critical point. Similarly, the internal rationality of a decision may be called into question if the reasons exhibit clear logical fallacies.

The second type of fundamental flaw arises when a decision is in some respect untenable in light of the relevant factual and legal constraints that bear on it. Although reasonableness is a single standard that already accounts for context, and elements of a decision's context should not modulate the standard or the degree of scrutiny by the reviewing court, what is reasonable in a given situation will always depend on the constraints imposed by the legal and factual context of the particular decision under review. These contextual constraints dictate the limits and contours of the space in which the decision maker may act and the types of solutions it may adopt. The governing statutory scheme, other relevant statutory or common law, the principles of statutory interpretation, the evidence before the decision maker and facts of which the decision maker may take notice, the submissions of the parties, the past practices and decisions of the administrative body, and the potential impact of the decision on the individual to whom it applies, are all elements that will generally be relevant in evaluating whether a given decision is reasonable. Such elements are not a checklist; they may vary in significance depending on the context and will necessarily interact with one another.

Accordingly, a reviewing court may find that a decision is unreasonable when examined against these contextual considerations. Because administrative decision makers receive their powers by statute, the governing statutory scheme is likely to be the most salient aspect of the legal context relevant to a particular decision. A proper application of the reasonableness standard is capable of allaying the concern that an administrative decision maker might interpret the scope of its own authority beyond what the legislature intended. Whether an interpretation is justified will depend on the context, including the language chosen by the legislature in describing the limits and contours of the decision maker's authority.

Both statutory and common law will also impose constraints on how and what an administrative decision maker can lawfully decide. Any precedents on the issue before the administrative decision maker or on a similar issue, as well as international law in some administrative decision making contexts, will act as a constraint on what the decision maker can reasonably decide. Whether an administrative decision maker has acted reasonably in adapting a legal or equitable doctrine involves a highly context-specific determination.

Matters of statutory interpretation are not treated uniquely and, as with other questions of law, may be evaluated on a reasonableness standard. Where this is the applicable standard, the reviewing court does not undertake a *de novo* analysis of the question or ask itself what the correct decision would have been. But an approach to reasonableness review that respects legislative intent must assume that those who interpret the law, whether courts or administrative decision makers, will do so in a manner consistent with the modern principle of statutory interpretation. Administrative decision makers are not required to engage in a formalistic statutory interpretation exercise in every case. But whatever form the interpretive exercise takes, the merits of an administrative decision maker's interpretation of a statutory provision must be consistent with the text, context and purpose of the provision.

Furthermore, the decision maker must take the evidentiary record and the general factual matrix that bears on its decision into account, and its decision must be reasonable in light of them. The reasonableness of a decision may be jeopardized where the decision maker has fundamentally misapprehended or failed to account for the evidence before it. The reasons must also meaningfully account for the central issues and concerns raised by the parties, even though reviewing courts cannot expect administrative decision makers to respond to every argument or line of possible analysis.

While administrative decision makers are not bound by their previous decisions, they must be concerned with the general consistency of administrative decisions. Therefore, whether a particular decision is consistent with the administrative body's past decisions is also a constraint that the reviewing court should consider when determining whether an administrative decision is reasonable. Finally, individuals are entitled to greater procedural protection when the decision in question involves the potential for significant personal impact or harm. Where the impact of a decision on an individual's rights and interests is severe, the reasons provided to that individual must reflect the stakes. The principle of responsive justification means that if a decision has particularly harsh consequences for the affected individual, the decision maker must explain why its decision best reflects the legislature's intention.

The question of the appropriate remedy — specifically, whether a court that quashes an unreasonable decision should exercise its discretion to remit the matter to the decision maker for reconsideration with the benefit of the court's reasons — is multi-faceted. The choice of remedy must be guided by the rationale for applying the reasonableness standard to begin with, including the recognition by the reviewing court that the legislature has entrusted the matter to the administrative decision maker, and not to the court, concerns related to the proper administration of the justice system, the need to ensure access to justice and the goal of expedient and cost-efficient decision making. Giving effect to these principles in the remedial context means that where a decision reviewed by applying the reasonableness standard cannot be upheld, it will most often be appropriate to remit the matter to the decision maker for reconsideration with the benefit of the court's reasons. However, there are limited scenarios in which remitting the matter would stymie the timely and effective resolution of matters in a manner that no legislature could have intended. An intention that the administrative decision maker decide the matter at first instance cannot give rise to endless judicial reviews and subsequent reconsiderations. Declining to remit a matter to the decision maker may be appropriate where it becomes evident that a particular outcome is inevitable and that remitting the case would therefore serve no useful purpose. Elements like concern for delay, fairness to the parties, urgency of providing a resolution to the dispute, the nature of the particular regulatory regime, whether the administrative decision maker had a genuine opportunity to weigh in on the issue in question, costs to the parties, and efficient use of public resources may also influence the exercise of a court's discretion to remit the matter.

In the case at bar, there is no basis for departing from the presumption of reasonableness review. The Registrar's decision has come before the courts by way of judicial review, not by way of a statutory appeal. Given that Parliament has not prescribed the standard to be applied, there is no indication that the legislature intended a standard of review other than reasonableness. The Registrar's decision does not give rise to any constitutional questions, general questions of law of central importance to the legal system as a whole or questions regarding the jurisdictional boundaries between administrative bodies. As a result, the standard to be applied in reviewing the Registrar's decision is reasonableness.

The Registrar's decision was unreasonable. She failed to justify her interpretation of s. 3(2)(a) in light of the constraints imposed by s. 3 considered as a whole, by international treaties that inform its purpose, by the jurisprudence on the interpretation of s. 3(2)(a), and by the potential consequences of her interpretation. Each of these elements — viewed individually and cumulatively — strongly supports the conclusion that s. 3(2)(a) was not intended to apply to children of foreign government representatives or employees who have not been granted diplomatic privileges and immunities. Though V had raised many of these considerations, the Registrar failed to address those submissions in her reasons and did not do more than conduct a cursory review of the legislative history of s. 3(2)(a) and conclude that her interpretation was not explicitly precluded by its text.

First, the Registrar failed to address the immediate statutory context of s. 3(2)(a), which provides clear support for the conclusion that all of the persons contemplated by s. 3(2)(a) must have been granted diplomatic privileges and immunities in some form for the exception to apply. Second, the Registrar disregarded compelling submissions that s. 3(2) is a narrow exception consistent with established principles of international law and with the leading international treaties that extend diplomatic privileges and immunities to employees and representatives of foreign governments. Third, it was a significant omission to ignore the relevant cases that were before the Registrar which suggest that s. 3(2)(a) was intended to apply only to those individuals whose parents have been granted diplomatic privileges and immunities. Finally, there is no evidence that the Registrar considered the potential consequences of expanding her interpretation of s. 3(2)(a) to include all individuals who have not been granted diplomatic privileges and immunities. Rules concerning citizenship require a high degree of interpretive consistency in order to shield against arbitrariness. The Registrar's interpretation cannot be limited to the children of spies — its logic would be equally applicable to other scenarios. As well, provisions such as s. 3(2)(a) must be given a narrow interpretation because they potentially take away rights which otherwise benefit from a liberal and broad interpretation. Yet there is no indication that the Registrar considered the potential harsh consequences of her interpretation, or whether, in light of those potential consequences, Parliament would have intended s. 3(2)(a) to apply in this manner. Although the Registrar knew her interpretation was novel, she failed to provide a rationale for her expanded interpretation.

It was therefore unreasonable for the Registrar to find that s. 3(2)(a) can apply to individuals whose parents have not been granted diplomatic privileges and immunities in Canada. It is undisputed that V's parents had not been granted such privileges and immunities. No purpose would therefore be served by remitting this matter to the Registrar. Given that V was born in Canada, his status is governed only by the general rule of citizenship by birth. He is a Canadian citizen.

Per **Abella** and **Karakatsanis** JJ.: There is agreement with the majority that the appeal should be dismissed. The Registrar's decision to cancel V's citizenship certificate was unreasonable and was properly quashed by the Court of Appeal.

There is also agreement with the majority that there should be a presumption of reasonableness in judicial review. The contextual factors analysis should be eliminated from the standard of review framework, and "true questions of jurisdiction" should be abolished as a separate category of issues subject to correctness review. However, the elimination of these elements does not support the foundational changes to judicial review outlined in the majority's framework that result in expanded correctness review. Rather than confirming a meaningful presumption of deference for administrative decision-makers, the majority strips away deference from hundreds of administrative actors, based on a formalistic approach that ignores the legislature's intention to leave certain legal and policy questions to administrative decision-makers. The majority's presumption of reasonableness review rests on a totally new understanding of legislative intent and the rule of law and prohibits any consideration of well-established foundations for deference. By dramatically expanding the circumstances in which generalist judges will be entitled to substitute their own views for those of specialized decision-makers who apply their mandates on a daily basis, the majority's framework fundamentally reorients the relationship between administrative actors and the judiciary, thus advocating a profoundly different philosophy of administrative law.

The majority's framework rests on a flawed and incomplete conceptual account of judicial review, one that unjustifiably ignores the specialized expertise of administrative decision-makers and reads out the foundations of the modern understanding of legislative intent. Instead of understanding legislative intent as being the intention to leave legal questions within their mandate to specialized decision-makers with expertise, the majority removes expertise from the equation entirely. In so doing, the majority disregards the historically accepted reason why the legislature intended to delegate authority to an administrative actor. In particular, such an approach ignores the possibility that specialization and expertise are embedded into this legislative choice. Post-*Dunsmuir*, the Court has been steadfast in confirming the central role of specialization and expertise, affirming their connection to legislative intent, and recognizing that they give administrative decision-makers the interpretative upper hand on questions of law. Specialized expertise has become the core rationale for deference. Giving proper effect to the legislature's choice to delegate authority to an administrative decision-maker requires understanding the advantages that the decision-maker may enjoy in exercising its mandate. Chief among those advantages are the institutional expertise and specialization inherent to administering a particular mandate on a daily basis. In interpreting their enabling statutes, administrative actors may have a particularly astute appreciation for the on-the-ground consequences of particular legal interpretations, of statutory context, of the purposes that a provision or legislative scheme are meant to serve, and of specialized terminology. The advantages stemming from specialization and expertise provide a robust foundation for deference. The majority's approach accords no weight to such institutional advantages and banishes expertise from the standard of review analysis entirely. The removal of the current conceptual basis for deference opens the gates to expanded correctness review.

In the majority's framework, deference gives way whenever the rule of law demands it. This approach, however, flows from a court-centric conception of the rule of law. The rule of law means that administrative decision-makers make legal determinations within their mandate; it does not mean that only judges decide questions of law with an unrestricted license to substitute their opinions for those of administrative actors through correctness review. The majority's approach not only erodes the presumption of deference; it erodes confidence in the fact that law-making and legal interpretation are shared enterprises between courts and administrative decision-makers. Moreover, access to justice is at the heart of the legislative choice to establish a robust system of administrative law. This goal is compromised when a narrow conception of the rule of law is invoked to impose judicial hegemony over administrative decision-makers, which adds unnecessary expense and complexity. Authorizing more incursions into the administrative system by judges and permitting *de novo* review of every legal decision adds to the delay and cost of obtaining a final decision.

The majority's reformulation of "legislative intent" invites courts to apply an irrebuttable presumption of correctness review whenever an administrative scheme includes a right of appeal. Elevating appeal clauses to indicators of correctness review creates a two-tier system that defers to the expertise of administrative decision-makers only where there is no appeal clause. Yet appeal rights do not represent a different institutional structure that requires a more searching form of review. The mere fact that a statute contemplates an appeal says nothing about the degree of deference required in the review process. The majority's position hinges almost entirely on a textualist argument — i.e., that the presence of the word "appeal" indicates a legislative intent that courts apply the same standards of review found in civil appellate jurisprudence. This disregards long-accepted institutional distinctions between courts and administrative decision-makers. The continued use by legislatures of the term "appeal" cannot be imbued with the intent that the majority ascribes to it. The idea that appellate standards of review must be applied to every right of appeal is entirely unsupported by the jurisprudence. For at least 25 years, the Court has not treated statutory rights of appeal as a determinative reflection of legislative intent, and such clauses have played little or no role in the standard of review analysis. Moreover, pre-*Dunsmuir*, statutory rights of appeal were still seen as only one factor and not as unequivocal indicators of correctness review. Absent exceptional circumstances, a statutory right of appeal does not displace the presumption of reasonableness.

The majority's disregard for precedent and *stare decisis* has the potential to undermine both the integrity of the Court's decisions, and public confidence in the stability of the law. *Stare decisis* places significant limits on the Court's ability to overturn its precedents. The doctrine promotes the predictable and consistent development of legal principles, fosters reliance on judicial decisions, and contributes to the integrity of the judicial process. Respect for precedent also safeguards the Court's institutional legitimacy. The precedential value of a judgment does not expire with the tenure of the panel of judges that decided it. When the Court does choose to overrule its own precedents, it should do so carefully, with moderation, and with due regard for all the important considerations that undergird the doctrine of *stare decisis*. A nuanced balance must be struck between maintaining the stability of the common law and ensuring that the law is flexible and responsive enough to adapt to new circumstances and societal norms. *Stare decisis* plays a critical role in maintaining that balance and upholding the rule of law.

There is no principled justification for departing from the existing jurisprudence and abandoning the Court's long-standing view of how statutory appeal clauses impact the standard of review analysis. In doing so, the majority disregards the high threshold required to overturn the Court's decisions. The unprecedented wholesale rejection of an entire body of jurisprudence that is particularly unsettling.

The affected cases are numerous and include many decisions conducting deferential review even in the face of a statutory right of appeal and bedrock judgments affirming the relevance of administrative expertise to the standard of review analysis. Overruling these judgments flouts *stare decisis*, which prohibits courts from overturning past decisions that simply represent a choice with which the current bench does not agree. The majority's approach also has the potential to disturb settled interpretations of many statutes that contain a right of appeal; every existing interpretation of such statutes that has been affirmed under a reasonableness standard will be open to fresh challenge. Moreover, if the Court, in its past decisions, misconstrued the purpose of statutory appeal clauses, legislatures were free to clarify this interpretation through legislative amendment. In the absence of legislative correction, the case for overturning decisions is even less compelling.

The Court should offer additional direction on reasonableness review so that judges can provide careful and meaningful oversight of the administrative justice system while respecting its legitimacy and the perspectives of its front-line, specialized decision-makers. However, rather than clarifying the role of reasons and how to review them, the majority revives the kind of search for errors that dominated the Court's prior jurisprudence. The majority's multi-factored, open-ended list of constraints on administrative decision making will encourage reviewing courts to dissect administrative reasons in a line-by-line hunt for error. These constraints may function in practice as a wide-ranging catalogue of hypothetical errors to justify quashing an administrative decision. Structuring reasonableness review in this fashion effectively imposes on administrative decision-makers a higher standard of justification than on trial judges. Such an approach undercuts deference. Reasonableness review should instead focus on the concept of deference to administrative decision-makers and to the legislative intention to confide in them a mandate. Curial deference is the hallmark of reasonableness review, setting it apart from the substitution of opinion permitted under correctness.

Deference imposes three requirements on courts conducting reasonableness review. First, deference is the attitude a reviewing court must adopt towards an administrative decision-maker. Deference mandates respect for the legislative choice to entrust a decision to administrative actors rather than to the courts, for the important role that administrative decision-makers play, and for their specialized expertise and the institutional setting in which they operate. Reviewing courts must pay respectful attention to the reasons offered for an administrative decision, make a genuine effort to understand why the decision was made, and give the decision a fair and generous construction. Second, deference affects how a court frames the question it must answer and the nature of its analysis. A reviewing court does not ask how it would have resolved an issue, but rather whether the answer provided by the decision-maker was unreasonable. Ultimately, whether an administrative decision is reasonable depends on the context, and a reviewing court must be attentive to all relevant circumstances, including the reasons offered to support the decision, the record, the statutory scheme and the particular issues raised, among other factors. Third, deferential review impacts how a reviewing court evaluates challenges to a decision. The party seeking judicial review bears the onus of showing that the decision was unreasonable; the decision-maker does not have to persuade the court that its decision is reasonable.

The administrative decision itself is the focal point of the review exercise. In all cases, the question remains whether the challenging party has demonstrated that a decision is unreasonable. Where reasons are neither required nor available, reasonableness may be justified by past decisions of the administrative body or in light of the procedural context. Where reasons are provided, they serve as the natural starting point to determine whether the decision-maker acted reasonably. By beginning with the reasons, read in light of the surrounding context and the grounds raised, reviewing courts provide meaningful oversight while respecting the legitimacy of specialized administrative decision making. Reviewing courts should approach the reasons with respect for the specialized decision-makers, their significant role and the institutional context chosen by the legislator. Reviewing courts should not second-guess operational implications, practical challenges and on-the-ground knowledge and must remain alert to specialized concepts or language. Further, a reviewing court is not restricted to the four corners of the written reasons and should, if faced with a gap in the reasons, look to other materials to see if they shed light on the decision, including: the record of any formal proceedings and the materials before the decision-maker, past decisions of the administrative body, and policies or guidelines developed to guide the type of decision under review. These materials may assist a court in understanding the outcome. In these ways, reviewing courts may legitimately supplement written reasons without supplanting the analysis. Reasons must be read together with the outcome to determine whether the result falls within a range of possible outcomes. This approach puts substance over form where the basis for a decision is evident on the record, but not clearly expressed in written reasons.

As well, a court conducting deferential review must view claims of error in context and with caution, cognizant of the need to avoid substituting its opinion for that of those empowered and better equipped to answer the questions at issue. Because judicial substitution is incompatible with deference, reviewing courts must carefully evaluate the challenges raised to ensure they go to the reasonableness of the decision rather than representing a mere difference of opinion. Courts must also consider the materiality of any alleged errors. An error that is peripheral to the reasoning process is not sufficient to justify quashing a decision. The same deferential approach must apply with equal force to statutory interpretation cases. In such cases, a court should not assess the decision by determining what, in its own view, would be a reasonable interpretation. Such an approach imperils deference. A *de novo* interpretation of a statute necessarily omits the perspective of the front-line, specialized administrative body that routinely applies the statutory scheme in question. By placing that perspective at the heart of the judicial review inquiry, courts display respect for specialization and expertise, and for the legislative choice to delegate certain questions to non-judicial bodies. Conversely, by imposing their own interpretation of a statute, courts undermine legislative intent.

In the instant case, there is agreement with the majority that the standard of review is reasonableness. The Registrar's reasons failed to respond to V's submission that the objectives of s. 3(2)(a) of the *Citizenship Act* require its terms to be read narrowly. Instead, the Registrar interpreted s. 3(2)(a) broadly, based on a purely textual assessment. This reading was only reasonable if the text is read in isolation from its objective. Nothing in the history of this provision indicates that Parliament intended to widen its scope. Furthermore, the judicial treatment of this provision also points to the need for a narrow interpretation. In addition, the text of s. 3(2)(c) can be seen as undermining the Registrar's interpretation of s. 3(2)(a), because the former denies citizenship to children born to individuals who enjoy diplomatic privileges and immunities equivalent to those granted to persons referred to in the latter. This suggests that s. 3(2)(a) covers only those employees in Canada of a foreign government who have such privileges and immunities, in contrast with V's parents. By ignoring the objectives of s. 3 as a whole, the Registrar's decision was unreasonable.

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APPEAL from a judgment of the Federal Court of Appeal (Stratas, Webb and Gleason JJ.A.), 2017 FCA 132, [2018] 3 F.C.R. 75, 52 Imm. L.R. (4th) 1, 30 Admin. L.R. (6th) 1, [2017] F.C.J. No. 638 (QL), 2017 CarswellNat 2791 (WL Can.), setting aside a decision of Bell J., 2015 FC 960, [2016] 2 F.C.R. 39, 38 Imm. L.R. (4th) 110, [2015] F.C.J. No. 981 (QL), 2015 CarswellNat 3740 (WL Can.). Appeal dismissed.

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Karen Andrews, for the intervener the Advocacy Centre for Tenants Ontario - Tenant Duty Counsel Program.

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Laura Bowman and *Bronwyn Roe*, for the intervener Ecojustice Canada Society.

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Adam Goldenberg, for the intervener Advocates for the Rule of Law.

Toni Schweitzer, for the intervener Parkdale Community Legal Services.

Paul Warchuk and *Francis Lévesque*, for the intervener the Cambridge Comparative Administrative Law Forum.

James Plotkin and *Alyssa Tomkins*, for the intervener the Samuelson-Glushko Canadian Internet Policy and Public Interest Clinic.

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The following is the judgment delivered by

THE CHIEF JUSTICE AND MOLDAVER, GASCON, CÔTÉ, BROWN, ROWE AND MARTIN JJ. —

[1] This appeal and its companion cases (see *Bell Canada v. Canada (Attorney General)*, 2019 SCC 66), provide this Court with an opportunity to re-examine its approach to judicial review of administrative decisions.

[2] In these reasons, we will address two key aspects of the current administrative law jurisprudence which require reconsideration and clarification. First, we will chart a new course forward for determining the standard of review that applies when a court reviews the merits of an administrative decision. Second, we will provide additional guidance for reviewing courts to follow when conducting reasonableness review. The revised framework will continue to be guided by the principles underlying judicial review that this Court articulated in *Dunsmuir v. New Brunswick*, 2008 SCC 9, [2008] 1 S.C.R. 190: that judicial review functions to

maintain the rule of law while giving effect to legislative intent. We will also affirm the need to develop and strengthen a culture of justification in administrative decision making.

[3] We will then address the merits of the case at bar, which relates to an application for judicial review of a decision by the Canadian Registrar of Citizenship concerning Alexander Vavilov, who was born in Canada and whose parents were later revealed to be Russian spies. The Registrar found on the basis of an interpretation of s. 3(2)(a) of the *Citizenship Act*, R.S.C. 1985, c. C-29, that Mr. Vavilov was not a Canadian citizen and cancelled his certificate of citizenship under s. 26(3) of the *Citizenship Regulations*, SOR/93-246. In our view, the standard of review to be applied to the Registrar's decision is reasonableness, and the Registrar's decision was unreasonable. We would therefore uphold the Federal Court of Appeal's decision to quash it, and would dismiss the Minister of Citizenship and Immigration's appeal.

I. <u>Need for Clarification and Simplification of the Law of Judicial Review</u>

[4] Over the past decades, the law relating to judicial review of administrative decisions in Canada has been characterized by continuously evolving jurisprudence and vigorous academic debate. This area of the law concerns matters which are fundamental to our legal and constitutional order, and seeks to navigate the proper relationship between administrative decision makers, the courts and individuals in our society. In parallel with the law, the role of administrative decision

making in Canada has also evolved. Today, the administration of countless public bodies and regulatory regimes has been entrusted to statutory delegates with decision-making power. The number, diversity and importance of the matters that come before such delegates has made administrative decision making one of the principal manifestations of state power in the lives of Canadians.

[5] Given the ubiquity and practical importance of administrative decision making, it is essential that administrative decision makers, those subject to their decisions and courts tasked with reviewing those decisions have clear guidance on how judicial review is to be performed.

[6] In granting leave to appeal in the case at bar and in its companion cases, this Court's leave to appeal judgment made clear that it viewed these appeals as an opportunity to consider the law applicable to the judicial review of administrative decisions as addressed in *Dunsmuir* and subsequent cases. In light of the importance of this issue, the Court appointed two *amici curiae*, invited the parties to devote a substantial portion of their submissions to the standard of review issue, and granted leave to 27 interveners, comprising 4 attorneys general and numerous organizations representing the breadth of the Canadian administrative law landscape. We have, as a result, received a wealth of helpful submissions on this issue. Despite this Court's review of the subject in *Dunsmuir*, some aspects of the law remain challenging. In particular, the submissions presented to the Court have highlighted two aspects of the current framework which need clarification.

[7] The first aspect is the analysis for determining the standard of review. It has become clear that *Dunsmuir*'s promise of simplicity and predictability in this respect has not been fully realized. In *Dunsmuir*, a majority of the Court merged the standards of "patent unreasonableness" and "reasonableness *simpliciter*" into a single "reasonableness" standard, thus reducing the number of standards of review from three to two: paras. 34-50. It also sought to simplify the analysis for determining the applicable standard of review: paras. 51-64. Since *Dunsmuir*, the jurisprudence has evolved to recognize that reasonableness will be the applicable standard for most categories of questions on judicial review, including, presumptively, when a decision maker interprets its enabling statute: see, e.g., *Alberta (Information and Privacy Commissioner) v. Alberta Teachers' Association*, 2011 SCC 61, [2011] 3 S.C.R. 654; *Mouvement laïque québécois v. Saguenay (City)*, 2015 SCC 16, [2015] 2 S.C.R. 3, at para. 46; *Canadian National Railway Co. v. Canada (Attorney General)*, 2014 SCC 40, [2014] 2 S.C.R. 135, at para. 55; *Canadian Artists' Representation v. National Gallery of Canada*, 2014 SCC 42, [2014] 2 S.C.R. 197, at para. 13; *Smith v. Alliance Pipeline Ltd.*, 2011 SCC 7, [2011] 1 S.C.R. 160, at paras. 26 and 28; *Canada (Citizenship and Immigration) v. Khosa*, 2009 SCC 12, [2009] 1 S.C.R. 339, at para. 25; *Dunsmuir*, at para. 54. The Court has indicated that this presumption may be rebutted by showing the issue on review falls within a category of questions attracting correctness review: see *McLean v. British Columbia (Securities Commission)*, 2013 SCC 67, [2013] 3 S.C.R. 895, at para. 22. It may also be rebutted by showing that the context indicates that the legislature intended the standard of review to be correctness: *McLean*, at para. 22; *Edmonton (City) v. Edmonton East (Capilano) Shopping

Centres Ltd., 2016 SCC 47, [2016] 2 S.C.R. 293, at para. 32; *Canada (Canadian Human Rights Commission) v. Canada (Attorney General)*, 2018 SCC 31, [2018] 2 S.C.R. 230 ("*CHRC*"), at paras. 45-46. However, uncertainty about when the contextual analysis remains appropriate and debate surrounding the scope of the correctness categories have sometimes caused confusion and made the analysis unwieldy: see, e.g., P. Daly, "Struggling Towards Coherence in Canadian Administrative Law? Recent Cases on Standard of Review and Reasonableness" (2016), 62 *McGill L.J.* 527.

[8] In addition, this analysis has in some respects departed from the theoretical foundations underpinning judicial review. While the application of the reasonableness standard is grounded, in part, in the necessity of avoiding "undue interference" in the face of the legislature's intention to leave certain questions with administrative bodies rather than with the courts (see *Dunsmuir*, at para. 27), that standard has come to be routinely applied even where the legislature has provided for a different institutional structure through a statutory appeal mechanism.

[9] The uncertainty that has followed *Dunsmuir* has been highlighted by judicial and academic criticism, litigants who have come before this Court, and organizations that represent Canadians who interact with administrative decision makers. These are not light critiques or theoretical challenges. They go to the core of the coherence of our administrative law jurisprudence and to the practical implications of this lack of coherence. This Court, too, has taken note. In *Wilson v.*

Atomic Energy of Canada Ltd., 2016 SCC 29, [2016] 1 S.C.R. 770, at para. 19, Abella J. expressed the need to "simplify the standard of review labyrinth we currently find ourselves in" and offered suggestions with a view to beginning a necessary conversation on the way forward. It is in this context that the Court decided to grant leave to hear this case and the companion cases jointly.

[10] This process has led us to conclude that a reconsideration of this Court's approach is necessary in order to bring greater coherence and predictability to this area of law. We have therefore adopted a revised framework for determining the standard of review where a court reviews the merits of an administrative decision. The analysis begins with a presumption that reasonableness is the applicable standard in all cases. Reviewing courts should derogate from this presumption only where required by a clear indication of legislative intent or by the rule of law.

[11] The second aspect is the need for better guidance from this Court on the proper application of the reasonableness standard. The Court has heard concerns that reasonableness review is sometimes perceived as advancing a two-tiered justice system in which those subject to administrative decisions are entitled only to an outcome somewhere between "good enough" and "not quite wrong". These concerns have been echoed by some members of the legal profession, civil society organizations and legal clinics. The Court has an obligation to take these perspectives seriously and to ensure that the framework it adopts accommodates all types of administrative decision making, in areas that range from immigration, prison

administration and social security entitlements to labour relations, securities regulation and energy policy.

[12] These concerns regarding the application of the reasonableness standard speak to the need for this Court to more clearly articulate what that standard entails and how it should be applied in practice. Reasonableness review is methodologically distinct from correctness review. It is informed by the need to respect the legislature's choice to delegate decision-making authority to the administrative decision maker rather than to the reviewing court. In order to fulfill *Dunsmuir*'s promise to protect "the legality, the reasonableness and the fairness of the administrative process and its outcomes", reasonableness review must entail a sensitive and respectful, but robust, evaluation of administrative decisions: para. 28.

[13] Reasonableness review is an approach meant to ensure that courts intervene in administrative matters only where it is truly necessary to do so in order to safeguard the legality, rationality and fairness of the administrative process. It finds its starting point in the principle of judicial restraint and demonstrates a respect for the distinct role of administrative decision makers. However, it is not a "rubber-stamping" process or a means of sheltering administrative decision makers from accountability. It remains a robust form of review.

[14] On the one hand, courts must recognize the legitimacy and authority of administrative decision makers within their proper spheres and adopt an appropriate posture of respect. On the other hand, administrative decision makers must adopt a

culture of justification and demonstrate that their exercise of delegated public power can be "justified to citizens in terms of rationality and fairness": the Rt. Hon. B. McLachlin, "The Roles of Administrative Tribunals and Courts in Maintaining the Rule of Law" (1998), 12 *C.J.A.L.P.* 171, at p. 174 (emphasis deleted); see also M. Cohen-Eliya and I. Porat, "Proportionality and Justification" (2014), 64 *U.T.L.J.* 458, at pp. 467-70.

[15] In conducting a reasonableness review, a court must consider the outcome of the administrative decision in light of its underlying rationale in order to ensure that the decision as a whole is transparent, intelligible and justified. What distinguishes reasonableness review from correctness review is that the court conducting a reasonableness review must focus on the decision the administrative decision maker actually made, including the justification offered for it, and not on the conclusion the court itself would have reached in the administrative decision maker's place.

II. Determining the Applicable Standard of Review

[16] In the following sections, we set out a revised framework for determining the standard of review a court should apply when the merits of an administrative decision are challenged. It starts with a presumption that reasonableness is the applicable standard whenever a court reviews administrative decisions.

[17] The presumption of reasonableness review can be rebutted in two types of situations. The first is where the legislature has indicated that it intends a different standard or set of standards to apply. This will be the case where the legislature explicitly prescribes the applicable standard of review. It will also be the case where the legislature has provided a statutory appeal mechanism from an administrative decision to a court, thereby signalling the legislature's intent that appellate standards apply when a court reviews the decision. The second situation in which the presumption of reasonableness review will be rebutted is where the rule of law requires that the standard of correctness be applied. This will be the case for certain categories of questions, namely constitutional questions, general questions of law of central importance to the legal system as a whole and questions related to the jurisdictional boundaries between two or more administrative bodies. The general rule of reasonableness review, when coupled with these limited exceptions, offers a comprehensive approach to determining the applicable standard of review. As a result, it is no longer necessary for courts to engage in a "contextual inquiry" (*CHRC*, at paras. 45-47, see also *Dunsmuir*, at paras. 62-64; *McLean*, at para. 22) in order to identify the appropriate standard.

[18] Before setting out the framework for determining the standard of review in greater detail, we wish to acknowledge that these reasons depart from the Court's existing jurisprudence on standard of review in certain respects. Any reconsideration such as this can be justified only by compelling circumstances, and we do not take this decision lightly. A decision to adjust course will always require the Court to

carefully weigh the impact on legal certainty and predictability against the costs of continuing to follow a flawed approach: see *Canada (Attorney General) v. Bedford*, 2013 SCC 72, [2013] 3 S.C.R. 1101, at para. 47; *Canada v. Craig*, 2012 SCC 43, [2012] 2 S.C.R. 489, at paras. 24-27; *Ontario (Attorney General) v. Fraser*, 2011 SCC 20, [2011] 2 S.C.R. 3, at paras. 56-57 and 129-31, 139; *R. v. Henry*, 2005 SCC 76, [2005] 3 S.C.R. 609, at paras. 43-44; *R. v. Bernard*, [1988] 2 S.C.R. 833, at pp. 849-50.

[19] On this point, we recall the observation of Gibbs J. in *Queensland v. Commonwealth* (1977), 139 C.L.R. 585 (H.C.A.), which this Court endorsed in *Craig*, at para. 26:

> No Justice is entitled to ignore the decisions and reasoning of his predecessors, and to arrive at his own judgment as though the pages of the law reports were blank, or as though the authority of a decision did not survive beyond the rising of the Court. A Justice, unlike a legislator, cannot introduce a programme of reform which sets at nought decisions formerly made and principles formerly established. It is only after the most careful and respectful consideration of the earlier decision, and after giving due weight to all the circumstances, that a Justice may give effect to his own opinions in preference to an earlier decision of the Court.

[20] Nonetheless, this Court has in the past revisited precedents that were determined to be unsound in principle, that had proven to be unworkable and unnecessarily complex to apply, or that had attracted significant and valid judicial, academic and other criticism: *Craig*, at paras. 28-30; *Henry*, at paras. 45-47; *Fraser*, at para. 135 (per Rothstein J., concurring in the result); *Bernard*, at pp. 858-59. Although adhering to the established jurisprudence will generally promote certainty

and predictability, in some instances doing so will create or perpetuate uncertainty in the law: *Minister of Indian Affairs and Northern Development v. Ranville*, [1982] 2 S.C.R. 518, at p. 528; *Bernard*, at p. 858; *R. v. B. (K.G.)*, [1993] 1 S.C.R. 740, at p. 778. In such circumstances, "following the prior decision because of *stare decisis* would be contrary to the underlying value behind that doctrine, namely, clarity and certainty in the law": *Bernard*, at p. 858. These considerations apply here.

[21] Certain aspects of the current framework are unclear and unduly complex. The practical effect of this lack of clarity is that courts sometimes struggle in conducting the standard of review analysis, and costly debates surrounding the appropriate standard and its application continue to overshadow the review on the merits in many cases, thereby undermining access to justice. The words of Binnie J. in his concurring reasons in *Dunsmuir*, at para. 133, are still apt:

> [J]udicial review is burdened with undue cost and delay. Litigants understandably hesitate to go to court to seek redress for a perceived administrative injustice if their lawyers cannot predict with confidence even what standard of review will be applied . . . . If litigants do take the plunge, they may find the court's attention focussed not on their complaints, or the government's response, but on lengthy and arcane discussions of something they are told is [the choice of standard analysis] . . . . A victory before the reviewing court may be overturned on appeal because the wrong "standard of review" was selected. A small business denied a licence or a professional person who wants to challenge disciplinary action should be able to seek judicial review without betting the store or the house on the outcome . . . .

Regrettably, we find ourselves in a similar position following *Dunsmuir*. As Karakatsanis J. observed in *Edmonton East*, at para. 35, "[t]he contextual approach can generate uncertainty and endless litigation concerning the standard of review." While counsel and courts attempt to work through the complexities of determining the standard of review and its proper application, litigants "still find the merits waiting in the wings for their chance to be seen and reviewed": *Wilson*, at para. 25, per Abella J.

[22] As noted in *CHRC*, this Court "has for years attempted to simplify the standard of review analysis in order to 'get the parties away from arguing about the tests and back to arguing about the substantive merits of their case'": para. 27, quoting *Alberta Teachers*, at para. 36, citing *Dunsmuir*, at para. 145, per Binnie J. The principled changes set out below seek to promote the values underlying *stare decisis* and to make the law on the standard of review more certain, coherent and workable going forward.

A. *Presumption That Reasonableness Is the Applicable Standard*

[23] Where a court reviews the merits of an administrative decision (i.e., judicial review of an administrative decisions other than a review related to a breach of natural justice and/or the duty of procedural fairness), the standard of review it applies must reflect the legislature's intent with respect to the role of the reviewing court, except where giving effect to that intent is precluded by the rule of law. The starting point for the analysis is a presumption that the legislature intended the standard of review to be reasonableness.

[24] Parliament and the provincial legislatures are constitutionally empowered to create administrative bodies and to endow them with broad statutory powers: *Dunsmuir*, at para. 27. Where a legislature has created an administrative decision maker for the specific purpose of administering a statutory scheme, it must be presumed that the legislature also intended that decision maker to be able to fulfill its mandate and interpret the law as applicable to all issues that come before it. Where a legislature has not explicitly prescribed that a court is to have a role in reviewing the decisions of that decision maker, it can safely be assumed that the legislature intended the administrative decision maker to function with a minimum of judicial interference. However, because judicial review is protected by s. 96 of the *Constitution Act, 1867*, legislatures cannot shield administrative decision making from curial scrutiny entirely: *Dunsmuir*, at para. 31; *Crevier v. Attorney General of Quebec*, [1981] 2 S.C.R. 220, at pp. 236-37; *U.E.S., Local 298 v. Bibeault*, [1988] 2 S.C.R. 1048, at p. 1090. Nevertheless, respect for these institutional design choices made by the legislature requires a reviewing court to adopt a posture of restraint on review.

[25] For years, this Court's jurisprudence has moved toward a recognition that the reasonableness standard should be the starting point for a court's review of an administrative decision. Indeed, a presumption of reasonableness review is already a well-established feature of the standard of review analysis in cases in which administrative decision makers interpret their home statutes: see *Alberta Teachers*, at para. 30; *Saguenay*, at para. 46; *Edmonton East*, at para. 22. In our view, it is now

appropriate to hold that whenever a court reviews an administrative decision, it should start with the presumption that the applicable standard of review for all aspects of that decision will be reasonableness. While this presumption applies to the administrative decision maker's interpretation of its enabling statute, the presumption also applies more broadly to other aspects of its decision.

[26] Before turning to an explanation of how the presumption of reasonableness review may be rebutted, we believe it is desirable to clarify one aspect of the conceptual basis for this presumption. Since *C.U.P.E. v. N.B. Liquor Corporation*, [1979] 2 S.C.R. 227, the central rationale for applying a deferential standard of review in administrative law has been a respect for the legislature's institutional design choice to delegate certain matters to non-judicial decision makers through statute: *C.U.P.E.*, at pp. 235-36. However, this Court has subsequently identified a number of other justifications for applying the reasonableness standard, some of which have taken on influential roles in the standard of review analysis at various times.

[27] In particular, the Court has described one rationale for applying the reasonableness standard as being the relative expertise of administrative decision makers with respect to the questions before them: see, e.g., *C.U.P.E.*, at p. 236; *Pushpanathan v. Canada (Minister of Citizenship and Immigration)*, [1998] 1 S.C.R. 982, at paras. 32-35; *Pezim v. British Columbia (Superintendent of Brokers)*, [1994] 2 S.C.R. 557, at pp. 591-92; *Canada (Director of Investigation and Research) v.*

Southam Inc., [1997] 1 S.C.R. 748, at paras. 50-53; *Dunsmuir,* at para. 49, quoting D. J. Mullan, "Establishing the Standard of Review: The Struggle for Complexity?" (2004), 17 *C.J.A.L.P.* 59, at p. 93; see also *Dunsmuir,* at para. 68. However, this Court's jurisprudence has sometimes been deeply divided on the question of what expertise entails in the administrative context, how it should be assessed and how it should inform the standard of review analysis: see, e.g., *Khosa*, at paras. 23-25, per Binnie J. for the majority, compared to paras. 93-96, per Rothstein J., concurring in the result; *Edmonton East*, at para. 33, per Karakatsanis J. for the majority, compared to paras. 81-86, per Côté and Brown JJ., dissenting. In the era of what was known as the "pragmatic and functional" approach, which was first set out in *Bibeault*, a decision maker's expertise relative to that of the reviewing court was one of the key contextual factors said to indicate legislative intent with respect to the standard of review, but the decision maker was not presumed to have relative expertise. Instead, whether a decision maker had greater expertise than the reviewing court was assessed in relation to the specific question at issue and on the basis of a contextual analysis that could incorporate factors such as the qualification of an administrative body's members, their experience in a particular area and their involvement in policy making: see, e.g., *Pezim*, at pp. 591-92; *Southam*, at paras. 50-53; *Dr. Q v. College of Physicians and Surgeons of British Columbia*, 2003 SCC 19, [2003] 1 S.C.R. 226, at paras. 28-29; *Canada (Deputy Minister of National Revenue) v. Mattel Canada Inc.*, 2001 SCC 36, [2001] 2 S.C.R. 100, at paras. 28-32; *Moreau-Bérubé v. New Brunswick (Judicial Council),* 2002 SCC 11, [2002] 1 S.C.R. 249, at para. 50.

[28] Unfortunately, this contextual analysis proved to be unwieldly and offered limited practical guidance for courts attempting to assess an administrative decision maker's relative expertise. More recently, the dominant approach in this Court has been to accept that expertise simply inheres in an administrative body by virtue of the specialized function designated for it by the legislature: *Edmonton East*, at para. 33. However, if administrative decision makers are understood to possess specialized expertise on all questions that come before them, the concept of expertise ceases to assist a reviewing court in attempting to distinguish questions for which applying the reasonableness standard is appropriate from those for which it is not.

[29] Of course, the fact that the specialized role of administrative decision makers lends itself to the development of expertise and institutional experience is not the only reason that a legislature may choose to delegate decision-making authority. Over the years, the Court has pointed to a number of other compelling rationales for the legislature to delegate the administration of a statutory scheme to a particular administrative decision maker. These rationales have included the decision maker's proximity and responsiveness to stakeholders, ability to render decisions promptly, flexibly and efficiently, and ability to provide simplified and streamlined proceedings intended to promote access to justice.

[30] While specialized expertise and these other rationales may all be reasons for a legislature to delegate decision-making authority, a reviewing court need not evaluate which of these rationales apply in the case of a particular decision maker in

order to determine the standard of review. Instead, in our view, it is the *very fact* that the legislature has chosen to delegate authority which justifies a default position of reasonableness review. The Court has in fact recognized this basis for applying the reasonableness standard to administrative decisions in the past. In *Khosa*, for example, the majority understood *Dunsmuir* to stand for the proposition that "with or without a privative clause, a measure of deference has come to be accepted as appropriate where a particular decision had been allocated to an administrative decision-maker rather than to the courts": para. 25. More recently, in *Edmonton East*, Karakatsanis J. explained that a presumption of reasonableness review "respects the principle of legislative supremacy and the choice made to delegate decision making to a tribunal, rather than the courts": para. 22. And in *CHRC*, Gascon J. explained that "the fact that the legislature has allocated authority to a decision maker other than the courts is itself an indication that the legislature intended deferential review": para. 50. In other words, respect for this institutional design choice and the democratic principle, as well as the need for courts to avoid "undue interference" with the administrative decision maker's discharge of its functions, is what justifies the presumptive application of the reasonableness standard: *Dunsmuir*, at para. 27.

[31] We wish to emphasize that because these reasons adopt a presumption of reasonableness as the starting point, expertise is no longer relevant to a determination of the standard of review as it was in the contextual analysis. However, we are not doing away with the role of expertise in administrative decision making. This

consideration is simply folded into the new starting point and, as explained below, expertise remains a relevant consideration in conducting reasonableness review.

[32] That being said, our starting position that the applicable standard of review is reasonableness is not incompatible with the rule of law. However, because this approach is grounded in respect for legislative choice, it also requires courts to give effect to clear legislative direction that a different standard was intended. Similarly, a reviewing court must be prepared to derogate from the presumption of reasonableness review where respect for the rule of law requires a singular, determinate and final answer to the question before it. Each of these situations will be discussed in turn below.

B. *Derogation From the Presumption of Reasonableness Review on the Basis of Legislative Intent*

[33] This Court has described respect for legislative intent as the "polar star" of judicial review: *C.U.P.E. v. Ontario (Minister of Labour)*, 2003 SCC 29, [2003] 1 S.C.R. 539, at para. 149. This description remains apt. The presumption of reasonableness review discussed above is intended to give effect to the legislature's choice to leave certain matters with administrative decision makers rather than the courts. It follows that this presumption will be rebutted where a legislature has indicated that a different standard should apply. The legislature can do so in two ways. First, it may explicitly prescribe through statute what standard courts should apply when reviewing decisions of a particular administrative decision maker.

Second, it may direct that derogation from the presumption of reasonableness review is appropriate by providing for a statutory appeal mechanism from an administrative decision maker to a court, thereby signalling the application of appellate standards.

(1) Legislated Standards of Review

[34] Any framework rooted in legislative intent must, to the extent possible, respect clear statutory language that prescribes the applicable standard of review. This Court has consistently affirmed that legislated standards of review should be given effect: see, e.g., *R. v. Owen*, 2003 SCC 33, [2003] 1 S.C.R. 779, at paras. 31-32; *Khosa*, at paras. 18-19; *British Columbia (Workers' Compensation Board) v. Figliola*, 2011 SCC 52, [2011] 3 S.C.R. 422, at para. 20; *Moore v. British Columbia (Education)*, 2012 SCC 61, [2012] 3 S.C.R. 360, at para. 55; *McCormick v. Fasken Martineau DuMoulin LLP*, 2014 SCC 39, [2014] 2 S.C.R. 108, at para. 16; *British Columbia (Workers' Compensation Appeal Tribunal) v. Fraser Health Authority*, 2016 SCC 25, [2016] 1 S.C.R. 587, at paras. 8 and 29; *British Columbia Human Rights Tribunal v. Schrenk*, 2017 SCC 62, [2017] 2 S.C.R. 795, at para. 28.

[35] It follows that where a legislature has indicated that courts are to apply the standard of correctness in reviewing certain questions, that standard must be applied. In British Columbia, the legislature has established the applicable standard of review for many tribunals by reference to the *Administrative Tribunals Act*, S.B.C. 2004, c. 45: see ss. 58 and 59. For example, it has provided that the standard of review applicable to decisions on questions of statutory interpretation by the B.C.

Human Rights Tribunal is to be correctness: *ibid.*, s. 59(1); *Human Rights Code*, R.S.B.C. 1996, c. 210, s. 32. We continue to be of the view that where the legislature has indicated the applicable standard of review, courts are bound to respect that designation, within the limits imposed by the rule of law.

(2) Statutory Appeal Mechanisms

[36] We have reaffirmed that, to the extent possible, the standard of review analysis requires courts to give effect to the legislature's institutional design choices to delegate authority through statute. In our view, this principled position also requires courts to give effect to the legislature's intent, signalled by the presence of a statutory appeal mechanism from an administrative decision to a court, that the court is to perform an appellate function with respect to that decision. Just as a legislature may, within constitutional limits, insulate administrative decisions from judicial interference, it may also choose to establish a regime "which does not exclude the courts but rather makes them part of the enforcement machinery": *Seneca College of Applied Arts and Technology v. Bhadauria*, [1981] 2 S.C.R. 181, at p. 195. Where a legislature has provided that parties may appeal from an administrative decision to a court, either as of right or with leave, it has subjected the administrative regime to appellate oversight and indicated that it expects the court to scrutinize such administrative decisions on an appellate basis. This expressed intention necessarily rebuts the blanket presumption of reasonableness review, which is premised on giving effect to a legislature's decision to leave certain issues with a body other than a court.

This intention should be given effect. As noted by the intervener Attorney General of Quebec in its factum, [TRANSLATION] "[t]he requirement of deference must not sterilize such an appeal mechanism to the point that it changes the nature of the decision-making process the legislature intended to put in place": para. 2.

[37] It should therefore be recognized that, where the legislature has provided for an appeal from an administrative decision to a court, a court hearing such an appeal is to apply appellate standards of review to the decision. This means that the applicable standard is to be determined with reference to the nature of the question and to this Court's jurisprudence on appellate standards of review. Where, for example, a court is hearing an appeal from an administrative decision, it would, in considering questions of law, including questions of statutory interpretation and those concerning the scope of a decision maker's authority, apply the standard of correctness in accordance with *Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235, at para. 8. Where the scope of the statutory appeal includes questions of fact, the appellate standard of review for those questions is palpable and overriding error (as it is for questions of mixed fact and law where the legal principle is not readily extricable): see *Housen*, at paras. 10, 19 and 26-37. Of course, should a legislature intend that a different standard of review apply in a statutory appeal, it is always free to make that intention known by prescribing the applicable standard through statute.

[38] We acknowledge that giving effect to statutory appeal mechanisms in this way departs from the Court's recent jurisprudence. However, after careful

consideration, we are of the view that this shift is necessary in order to bring coherence and conceptual balance to the standard of review analysis and is justified by a weighing of the values of certainty and correctness: *Craig*, at para. 27. Our conclusion is based on the following considerations.

[39] First, there has been significant judicial and academic criticism of this Court's recent approach to statutory appeal rights: see, e.g., Y.-M. Morissette, "What is a 'reasonable decision'?" (2018), 31 *C.J.A.L.P.* 225, at p. 244; the Hon. J.T. Robertson, *Administrative Deference: The Canadian Doctrine that Continues to Disappoint* (April 18, 2018) (online), at p. 8; the Hon. D. Stratas, "The Canadian Law of Judicial Review: A Plea for Doctrinal Coherence and Consistency" (2016), 42 *Queen's L.J.* 27, at p. 33; Daly, at pp. 541-42; *Québec (Procureure générale) v. Montréal (Ville)*, 2016 QCCA 2108, 17 Admin. L.R. (6th) 328, at paras. 36-46; *Bell Canada v. 7265921 Canada Ltd.*, 2018 FCA 174, 428 D.L.R. (4th) 311, at paras. 190-92, per Nadon J.A., concurring, and at 66 and 69-72, per Rennie J.A., dissenting; *Garneau Community League v. Edmonton (City)*, 2017 ABCA 374, 60 Alta. L.R. (6th) 1, at paras. 91 and 93-95, per Slatter J.A., concurring; *Nova Scotia (Attorney General) v. S&D Smith Central Supplies Limited*, 2019 NSCA 22, at paras. 250, 255-64 and 274-302 (CanLII), per Beveridge J.A., dissenting; *Atlantic Mining NS Corp. (D.D.V. Gold Limited) v. Oakley*, 2019 NSCA 14, at paras. 9-14 (CanLII). These critiques seize on the inconsistency inherent in a standard of review framework based on legislative intent that otherwise declines to give meaning to an express statutory right of appeal. This criticism observes that legislative choice is not one-

dimensional; rather, it pulls in two directions. While a legislative choice to delegate to an administrative decision maker grounds a presumption of reasonableness on the one hand, a legislative choice to enact a statutory right of appeal signals an intention to ascribe an appellate role to reviewing courts on the other hand.

[40] This Court has in the past held that the existence of significant and valid judicial, academic and other criticism of its jurisprudence may justify reconsideration of a precedent: *Craig*, at para. 29; *R. v. Robinson*, [1996] 1 S.C.R. 683, at paras. 35-41. This consideration applies in the instant case. In particular, the suggestion that the recent treatment of statutory rights of appeal represents a departure from the conceptual basis underpinning the standard of review framework is itself a compelling reason to re-examine the current approach: *Khosa*, at para. 87, per Rothstein J., concurring in the result.

[41] Second, there is no satisfactory justification for the recent trend in this Court's jurisprudence to give no effect to statutory rights of appeal in the standard of review analysis absent exceptional wording: see *Tervita Corp. v. Canada (Commissioner of Competition)*, 2015 SCC 3, [2015] 1 S.C.R. 161, at paras. 35-39. Indeed, this approach is itself a departure from earlier jurisprudence: the Hon. J. T. Robertson, "Judicial Deference to Administrative Tribunals: A Guide to 60 Years of Supreme Court Jurisprudence" (2014), 66 *S.C.L.R.* (2d) 1, at pp. 91-93. Under the former "pragmatic and functional" approach to determining the applicable standard of review, the existence of a privative clause or a statutory right of appeal

was one of four contextual factors that a court would consider in order to determine the standard that the legislature intended to apply to a particular decision. Although a statutory appeal clause was not determinative, it was understood to be a key factor indicating that the legislature intended that a less deferential standard of review be applied: see, e.g., *Pezim*, at pp. 589-92; *British Columbia Telephone Co. v. Shaw Cable Systems (B.C.) Ltd.*, [1995] 2 S.C.R. 739, at paras. 28-31; *Southam*, at paras. 30-32, 46 and 54-55; *Pushpanathan*, at paras. 30-31; *Dr. Q*, at para. 27; *Mattel*, at paras. 26-27; *Law Society of New Brunswick v. Ryan*, 2003 SCC 20, [2003] 1 S.C.R. 247, at paras. 21 and 27-29; *Barrie Public Utilities v. Canadian Cable Television Assn.*, 2003 SCC 28, [2003] 1 S.C.R. 476, at para. 11; *Monsanto Canada Inc. v. Ontario (Superintendent of Financial Services)*, 2004 SCC 54, [2004] 3 S.C.R. 152, at para. 7.

[42] The Court did indeed sometimes find that, even in a statutory appeal, a deferential standard of review was warranted for the legal findings of a decision maker that lay at the heart of the decision maker’s expertise: see, e.g., *Pezim*. In other instances, however, the Court concluded that the existence of a statutory appeal mechanism and the fact that the decision maker did not have greater expertise than a court on the issue being considered indicated that correctness was the appropriate standard, including on matters involving the interpretation of the administrative decision maker’s home statute: see, e.g., *Mattel*, at paras. 26-33; *Barrie Public Utilities*, at paras. 9-19; *Monsanto*, at paras. 6-16.

[43] Yet as, in *Dunsmuir*, *Alberta Teachers*, *Edmonton East* and subsequent cases, the standard of review analysis was simplified and shifted from a contextual analysis to an approach more focused on categories, statutory appeal mechanisms ceased to play a role in the analysis. Although this simplification of the standard of review analysis may have been a laudable change, it did not justify ceasing to give *any* effect to statutory appeal mechanisms. *Dunsmuir* itself provides little guidance on the rationale for this change. The majority in *Dunsmuir* was silent on the role of a statutory right of appeal in determining the standard of review, and did not refer to the prior treatment of statutory rights of appeal under the pragmatic and functional approach.

[44] More generally, there is no convincing reason to presume that legislatures mean something entirely different when they use the word "appeal" in an administrative law statute than they do in, for example, a criminal or commercial law context. Accepting that the word "appeal" refers to the same type of procedure in all these contexts also accords with the presumption of consistent expression, according to which the legislature is presumed to use language such that the same words have the same meaning both within a statute and across statutes: R. Sullivan, *Sullivan on the Construction of Statutes* (6th ed. 2014), at p. 217. Accepting that the legislature intends an appellate standard of review to be applied when it uses the word "appeal" also helps to explain why many statutes provide for *both* appeal and judicial review mechanisms in different contexts, thereby indicating two roles for reviewing courts: see, e.g., *Federal Courts Act*, R.S.C. 1985, c. F-7, ss. 27 and 28. This offers further

support for giving effect to statutory rights of appeal. Our colleagues' suggestion that our position in this regard "hinges" on what they call a "textualist argument" (at para. 246) is inaccurate.

[45] That there is no principled rationale for ignoring statutory appeal mechanisms becomes obvious when the broader context of those mechanisms is considered. The existence of a limited right of appeal, such as a right of appeal on questions of law or a right of appeal with leave of a court, does not preclude a court from considering other aspects of a decision in a judicial review proceeding. However, if the same standards of review applied regardless of whether a question was covered by the appeal provision, and regardless of whether an individual subject to an administrative decision was granted leave to appeal or applied for judicial review, the appeal provision would be completely redundant — contrary to the well-established principle that the legislature does not speak in vain: *Attorney General of Quebec v. Carrières Ste-Thérèse Ltée*, [1985] 1 S.C.R. 831, at p. 838.

[46] Finally, and most crucially, the appeals now before the Court have allowed for a comprehensive and considered examination of the standard of review analysis with the goal of remedying the conceptual and practical difficulties that have made this area of the law challenging for litigants and courts alike. To achieve this goal, the revised framework must, for at least two reasons, give effect to statutory appeal mechanisms. The first reason is conceptual. In the past, this Court has looked past an appeal clause primarily when the decision maker possessed greater relative

expertise — what it called the "specialization of duties" principle in *Pezim*, at p. 591. But, as discussed above, the presumption of reasonableness review is no longer premised upon notions of relative expertise. Instead, it is now based on respect for the legislature's institutional design choice, according to which the authority to make a decision is vested in an administrative decision maker rather than in a court. It would be inconsistent with this conceptual basis for the presumption of reasonableness review to disregard clear indications that the legislature has intentionally chosen a more involved role for the courts. Just as recognizing a presumption of reasonableness review on all questions respects a legislature's choice to leave some matters first and foremost to an administrative decision maker, departing from that blanket presumption in the context of a statutory appeal respects the legislature's choice of a more involved role for the courts in supervising administrative decision making.

[47] The second reason is that, building on developments in the case law over the past several years, this decision conclusively closes the door on the application of a contextual analysis to determine the applicable standard, and in doing so streamlines and simplifies the standard of review framework. With the elimination of the contextual approach to selecting the standard of review, the need for statutory rights of appeal to play a role becomes clearer. Eliminating the contextual approach means that statutory rights of appeal must now either play no role in administrative law or be accepted as directing a departure from the default position of reasonableness review. The latter must prevail.

[48] Our colleagues agree that the time has come to put the contextual approach espoused in *Dunsmuir* to rest and adopt a presumption of reasonableness review. We part company on the extent to which the departure from the contextual approach requires corresponding modifications to other aspects of the standard of review jurisprudence. We consider that the elimination of the contextual approach represents an incremental yet important adjustment to Canada's judicial review roots. While it is true that this Court has, in the past several years of jurisprudential development, warned that the contextual approach should be applied "sparingly" (*CHRC*, at para. 46), it is incorrect to suggest that our jurisprudence was such that the elimination of the contextual analysis was "all but complete": reasons of Abella and Karakatsanis JJ., at para. 277; see, in this regard, *CHRC*, at paras. 44-54; *Saguenay*, at para. 46; *Tervita*, at para. 35; *McLean*, at para. 22; *Edmonton East*, at para. 32; *Rogers Communications Inc. v. Society of Composers, Authors and Music Publishers of Canada*, 2012 SCC 35, [2012] 2 S.C.R. 283, at para. 15. The contextual analysis was one part of the broader standard of review framework set out in *Dunsmuir*. A departure from this aspect of the *Dunsmuir* framework requires a principled rebalancing of the framework as a whole in order to maintain the equilibrium between the roles of administrative decision makers and reviewing courts that is fundamental to administrative law.

[49] In our view, with the starting position of this presumption of reasonableness review, and in the absence of a searching contextual analysis, legislative intent can only be given effect in this framework if statutory appeal

mechanisms, as clear signals of legislative intent with respect to the applicable standard of review, are given effect through the application of appellate standards by reviewing courts. Conversely, in such a framework that is based on a presumption of reasonableness review, contextual factors that courts once looked to as signalling deferential review, such as privative clauses, serve no independent or additional function in identifying the standard of review.

[50] We wish, at this juncture, to make three points regarding how the presence of a statutory appeal mechanism should inform the choice of standard analysis. First, we note that statutory regimes that provide for parties to appeal to a court from an administrative decision may allow them to do so in all cases (that is, as of right) or only with leave of the court. While the existence of a leave requirement will affect whether a court will hear an appeal from a particular decision, it does not affect the standard to be applied if leave is given and the appeal is heard.

[51] Second, we note that not all legislative provisions that contemplate a court reviewing an administrative decision actually provide a right of appeal. Some provisions simply recognize that all administrative decisions are subject to judicial review and address procedural or other similar aspects of judicial review in a particular context. Since these provisions do not give courts an appellate function, they do not authorize the application of appellate standards. Some examples of such provisions are ss. 18 to 18.2, 18.4 and 28 of the *Federal Courts Act*, which confer jurisdiction on the Federal Court and the Federal Court of Appeal to hear and

determine applications for judicial review of decisions of federal bodies and grant remedies, and also address procedural aspects of such applications: see *Khosa*, at para. 34. Another example is the current version of s. 470 of Alberta's *Municipal Government Act*, R.S.A. 2000, c. M-26, which does not provide for an appeal to a court, but addresses procedural considerations and consequences that apply "[w]here a decision of an assessment review board is the subject of an application for judicial review": s. 470(1).

[52] Third, we would note that statutory appeal rights are often circumscribed, as their scope might be limited with reference to the types of questions on which a party may appeal (where, for example, appeals are limited to questions of law) or the types of decisions that may be appealed (where, for example, not every decision of an administrative decision maker may be appealed to a court), or to the party or parties that may bring an appeal. However, the existence of a circumscribed right of appeal in a statutory scheme does not on its own preclude applications for judicial review of decisions, or of aspects of decisions, to which the appeal mechanism does not apply, or by individuals who have no right of appeal. But any such application for judicial review is distinct from an appeal, and the presumption of reasonableness review that applies on judicial review cannot then be rebutted by reference to the statutory appeal mechanism.

C. *The Applicable Standard Is Correctness Where Required by the Rule of Law*

[53] In our view, respect for the rule of law requires courts to apply the standard of correctness for certain types of legal questions: constitutional questions, general questions of law of central importance to the legal system as a whole and questions regarding the jurisdictional boundaries between two or more administrative bodies. The application of the correctness standard for such questions respects the unique role of the judiciary in interpreting the Constitution and ensures that courts are able to provide the last word on questions for which the rule of law requires consistency and for which a final and determinate answer is necessary: *Dunsmuir*, at para. 58.

[54] When applying the correctness standard, the reviewing court may choose either to uphold the administrative decision maker's determination or to substitute its own view: *Dunsmuir*, at para. 50. While it should take the administrative decision maker's reasoning into account — and indeed, it may find that reasoning persuasive and adopt it — the reviewing court is ultimately empowered to come to its own conclusions on the question.

(1) Constitutional Questions

[55] Questions regarding the division of powers between Parliament and the provinces, the relationship between the legislature and the other branches of the state, the scope of Aboriginal and treaty rights under s. 35 of the *Constitution Act, 1982*, and other constitutional matters require a final and determinate answer from the courts. Therefore, the standard of correctness must continue to be applied in

reviewing such questions: *Dunsmuir*, para. 58; *Westcoast Energy Inc. v. Canada (National Energy Board)*, [1998] 1 S.C.R. 322.

[56] The Constitution — both written and unwritten — dictates the limits of all state action. Legislatures and administrative decision makers are bound by the Constitution and must comply with it. A legislature cannot alter the scope of its own constitutional powers through statute. Nor can it alter the constitutional limits of executive power by delegating authority to an administrative body. In other words, although a legislature may choose what powers it delegates to an administrative body, it cannot delegate powers that it does not constitutionally have. The constitutional authority to act must have determinate, defined and consistent limits, which necessitates the application of the correctness standard.

[57] Although the *amici* questioned the approach to the standard of review set out in *Doré v. Barreau du Québec*, 2012 SCC 12, [2012] 1 S.C.R. 395, a reconsideration of that approach is not germane to the issues in this appeal. However, it is important to draw a distinction between cases in which it is alleged that the effect of the administrative decision being reviewed is to unjustifiably limit rights under the *Canadian Charter of Rights and Freedoms* (as was the case in *Doré*) and those in which the issue on review is whether a provision of the decision maker's enabling statute violates the *Charter* (see, e.g., *Nova Scotia (Workers' Compensation Board) v. Martin*, 2003 SCC 54, [2003] 2 S.C.R. 504, at para. 65). Our jurisprudence holds that

an administrative decision maker's interpretation of the latter issue should be reviewed for correctness, and that jurisprudence is not displaced by these reasons.

(2) General Questions of Law of Central Importance to the Legal System as a Whole

[58] In *Dunsmuir*, a majority of the Court held that, in addition to constitutional questions, general questions of law which are "both of central importance to the legal system as a whole and outside the adjudicator's specialized area of expertise" will require the application of the correctness standard: para. 60, citing *Toronto (City) v. C.U.P.E., Local 79*, 2003 SCC 63, [2003] 3 S.C.R. 77, at para. 62, per LeBel J., concurring. We remain of the view that the rule of law requires courts to have the final word with regard to general questions of law that are "of central importance to the legal system as a whole". However, a return to first principles reveals that it is not necessary to evaluate the decision maker's specialized expertise in order to determine whether the correctness standard must be applied in cases involving such questions. As indicated above (at para. 31) of the reasons, the consideration of expertise is folded into the new starting point adopted in these reasons, namely the presumption of reasonableness review.

[59] As the majority of the Court recognized in *Dunsmuir*, the key underlying rationale for this category of questions is the reality that certain general questions of law "require uniform and consistent answers" as a result of "their impact on the administration of justice as a whole": *Dunsmuir*, para. 60. In these cases, correctness

review is necessary to resolve general questions of law that are of "fundamental importance and broad applicability", with significant legal consequences for the justice system as a whole or for other institutions of government: see *Toronto (City)*, at para. 70; *Alberta (Information and Privacy Commissioner) v. University of Calgary*, 2016 SCC 53, [2016] 2 S.C.R. 555, at para. 20; *Canadian National Railway*, at para. 60; *Chagnon v. Syndicat de la fonction publique et parapublique du Québec*, 2018 SCC 39, [2018] 2 S.C.R. 687, at para. 17; *Saguenay*, at para. 51; *Canada (Canadian Human Rights Commission) v. Canada (Attorney General)*, 2011 SCC 53, [2011] 3 S.C.R. 471 ("*Mowat*"), at para. 22; *Commission scolaire de Laval v. Syndicat de l'enseignement de la région de Laval*, 2016 SCC 8, [2016] 1 S.C.R. 29, at para. 38. For example, the question in *University of Calgary* could not be resolved by applying the reasonableness standard, because the decision would have had legal implications for a wide variety of other statutes and because the uniform protection of solicitor-client privilege — at issue in that case — is necessary for the proper functioning of the justice system: *University of Calgary*, at paras. 19-26. As this shows, the resolution of general questions of law "of central importance to the legal system as a whole" has implications beyond the decision at hand, hence the need for "uniform and consistent answers".

[60] This Court's jurisprudence continues to provide important guidance regarding what constitutes a general question of law of central importance to the legal system as a whole. For example, the following general questions of law have been held to be of central importance to the legal system as a whole: when an

administrative proceeding will be barred by the doctrines of *res judicata* and abuse of process (*Toronto (City)*, at para. 15); the scope of the state's duty of religious neutrality (*Saguenay*, at para. 49); the appropriateness of limits on solicitor-client privilege (*University of Calgary*, at para. 20); and the scope of parliamentary privilege (*Chagnon*, at para. 17). We caution, however, that this jurisprudence must be read carefully, given that expertise is no longer a consideration in identifying such questions: see, e.g., *CHRC*, at para. 43.

[61] We would stress that the mere fact that a dispute is "of wider public concern" is not sufficient for a question to fall into this category — nor is the fact that the question, when framed in a general or abstract sense, touches on an important issue: see, e.g., *Communications, Energy and Paperworkers Union of Canada, Local 30 v. Irving Pulp & Paper, Ltd.*, 2013 SCC 34, [2013] 2 S.C.R. 458, at para. 66; *McLean*, at para. 28; *Barreau du Québec v. Quebec (Attorney General)*, 2017 SCC 56, [2017] 2 S.C.R. 488, at para. 18. The case law reveals many examples of questions this Court has concluded are *not* general questions of law of central importance to the legal system as a whole. These include whether a certain tribunal can grant a particular type of compensation (*Mowat*, at para. 25); when estoppel may be applied as an arbitral remedy (*Nor-Man Regional Health Authority Inc. v. Manitoba Association of Health Care Professionals*, 2011 SCC 59, [2011] 3 S.C.R. 616, at paras. 37-38); the interpretation of a statutory provision prescribing timelines for an investigation (*Alberta Teachers*, at para. 32); the scope of a management rights clause in a collective agreement (*Irving Pulp & Paper*, at paras. 7, 15-16 and 66, per

Rothstein and Moldaver JJ., dissenting but not on this point); whether a limitation period had been triggered under securities legislation (*McLean*, at paras. 28-31); whether a party to a confidential contract could bring a complaint under a particular regulatory regime (*Canadian National Railway*, at para. 60); and the scope of an exception allowing non-advocates to represent a minister in certain proceedings (*Barreau du Québec*, at paras. 17-18). As these comments and examples indicate, this does not mean that simply because expertise no longer plays a role in the selection of the standard of review, questions of central importance are now transformed into a broad catch-all category for correctness review.

[62] In short, general questions of law of central importance to the legal system as a whole require a single determinate answer. In cases involving such questions, the rule of law requires courts to provide a greater degree of legal certainty than reasonableness review allows.

(3) Questions Regarding the Jurisdictional Boundaries Between Two or More Administrative Bodies

[63] Finally, the rule of law requires that the correctness standard be applied in order to resolve questions regarding the jurisdictional boundaries between two or more administrative bodies: *Dunsmuir*, para. 61. One such question arose in *Regina Police Assn. Inc. v. Regina (City) Board of Police Commissioners*, 2000 SCC 14, [2000] 1 S.C.R. 360, in which the issue was the jurisdiction of a labour arbitrator to consider matters of police discipline and dismissal that were otherwise subject to a

comprehensive legislative regime. Similarly, in *Quebec (Commission des droits de la personne et des droits de la jeunesse) v. Quebec (Attorney General)*, 2004 SCC 39, [2004] 2 S.C.R. 185, the Court considered a jurisdictional dispute between a labour arbitrator and the Quebec Human Rights Tribunal.

[64] Administrative decisions are rarely contested on this basis. Where they are, however, the rule of law requires courts to intervene where one administrative body has interpreted the scope of its authority in a manner that is incompatible with the jurisdiction of another. The rationale for this category of questions is simple: the rule of law cannot tolerate conflicting orders and proceedings where they result in a true operational conflict between two administrative bodies, pulling a party in two different and incompatible directions: see *British Columbia Telephone Co.*, at para. 80, per McLachlin J. (as she then was), concurring. Members of the public must know where to turn in order to resolve a dispute. As with general questions of law of central importance to the legal system as a whole, the application of the correctness standard in these cases safeguards predictability, finality and certainty in the law of administrative decision making.

D. *A Note Regarding Jurisdictional Questions*

[65] We would cease to recognize jurisdictional questions as a distinct category attracting correctness review. The majority in *Dunsmuir* held that it was "without question" (para. 50) that the correctness standard must be applied in reviewing jurisdictional questions (also referred to as true questions of jurisdiction or

vires). True questions of jurisdiction were said to arise "where the tribunal must explicitly determine whether its statutory grant of power gives it the authority to decide a particular matter": see *Dunsmuir*, at para. 59; *Quebec (Attorney General) v. Guérin*, 2017 SCC 42, [2017] 2 S.C.R. 3, at para. 32. Since *Dunsmuir*, however, majorities of this Court have questioned the necessity of this category, struggled to articulate its scope and "expressed serious reservations about whether such questions can be distinguished as a separate category of questions of law": *McLean*, at para. 25, referring to *Alberta Teachers*, at para. 34; *Edmonton East*, at para. 26; *Guérin*, at paras. 32-36; *CHRC*, at paras. 31-41.

[66] As Gascon J. noted in *CHRC*, the concept of "jurisdiction" in the administrative law context is inherently "slippery": para. 38. This is because, in theory, any challenge to an administrative decision can be characterized as "jurisdictional" in the sense that it calls into question whether the decision maker had the authority to act as it did: see *CHRC*, at para. 38; *Alberta Teachers*, at para. 34; see similarly *City of Arlington, Texas v. Federal Communications Commission*, 569 U.S. 290 (2013), at p. 299. Although this Court's jurisprudence contemplates that only a much narrower class of "truly" jurisdictional questions requires correctness review, it has observed that there are no "clear markers" to distinguish such questions from other questions related to the interpretation of an administrative decision maker's enabling statute: see *CHRC*, at para. 38. Despite differing views on whether it is possible to demarcate a class of "truly" jurisdictional questions, there is general agreement that "it is often difficult to distinguish between exercises of delegated

power that raise truly jurisdictional questions from those entailing an unremarkable application of an enabling statute": *CHRC*, at para. 111, per Brown J., concurring. This tension is perhaps clearest in cases where the legislature has delegated broad authority to an administrative decision maker that allows the latter to make regulations in pursuit of the objects of its enabling statute: see, e.g., *Green v. Law Society of Manitoba*, 2017 SCC 20, **[2017] 1 S.C.R. 360**; *West Fraser Mills Ltd. v. British Columbia (Workers' Compensation Appeal Tribunal)*, 2018 SCC 22, [2018] 1 S.C.R. 635.

[67] In *CHRC*, the majority, while noting this inherent difficulty — and the negative impact on litigants of the resulting uncertainty in the law — nonetheless left the question of whether the category of true questions of jurisdiction remains necessary to be determined in a later case. After hearing submissions on this issue and having an adequate opportunity for reflection on this point, we are now in a position to conclude that it is not necessary to maintain this category of correctness review. The arguments that support maintaining this category — in particular the concern that a delegated decision maker should not be free to determine the scope of its own authority — can be addressed adequately by applying the framework for conducting reasonableness review that we describe below. Reasonableness review is both robust and responsive to context. A proper application of the reasonableness standard will enable courts to fulfill their constitutional duty to ensure that administrative bodies have acted within the scope of their lawful authority without having to conduct a preliminary assessment regarding whether a particular interpretation raises a "truly"

or “narrowly” jurisdictional issue and without having to apply the correctness standard.

[68] Reasonableness review does not give administrative decision makers free rein in interpreting their enabling statutes, and therefore does not give them licence to enlarge their powers beyond what the legislature intended. Instead, it confirms that the governing statutory scheme will always operate as a constraint on administrative decision makers and as a limit on their authority. Even where the reasonableness standard is applied in reviewing a decision maker’s interpretation of its authority, precise or narrow statutory language will necessarily limit the number of *reasonable* interpretations open to the decision maker — perhaps limiting it one. Conversely, where the legislature has afforded a decision maker broad powers in general terms — and has provided no right of appeal to a court — the legislature’s intention that the decision maker have greater leeway in interpreting its enabling statute should be given effect. Without seeking to import the U.S. jurisprudence on this issue wholesale, we find that the following comments of the Supreme Court of the United States in *Arlington*, at p. 307, are apt:

> The fox-in-the-henhouse syndrome is to be avoided not by establishing an arbitrary and undefinable category of agency decision-making that is accorded no deference, but by taking seriously, and applying rigorously, in all cases, statutory limits on agencies’ authority. Where [the legislature] has established a clear line, the agency cannot go beyond it; and where [the legislature] has established an ambiguous line, the agency can go no further than the ambiguity will fairly allow. But in rigorously applying the latter rule, a court need not pause to puzzle over whether the interpretive question presented is “jurisdictional” . . . .

E. *Other Circumstances Requiring a Derogation from the Presumption of Reasonableness Review*

[69] In these reasons, we have identified five situations in which a derogation from the presumption of reasonableness review is warranted either on the basis of legislative intent (i.e., legislated standards of review and statutory appeal mechanisms) or because correctness review is required by the rule of law (i.e., constitutional questions, general questions of law of central importance to the legal system as a whole, and questions regarding jurisdictional boundaries between administrative bodies). This framework is the product of careful consideration undertaken following extensive submissions and based on a thorough review of the relevant jurisprudence. We are of the view, at this time, that these reasons address all of the situations in which a reviewing court should derogate from the presumption of reasonableness review. As previously indicated, courts should no longer engage in a contextual inquiry to determine the standard of review or to rebut the presumption of reasonableness review. Letting go of this contextual approach will, we hope, "get the parties away from arguing about the tests and back to arguing about the substantive merits of their case": *Alberta Teachers*, at para. 36, quoting *Dunsmuir*, at para. 145, per Binnie J., concurring.

[70] However, we would not definitively foreclose the possibility that another category could be recognized as requiring a derogation from the presumption of reasonableness review in a future case. But our reluctance to pronounce that the list of exceptions to the application of a reasonableness standard is closed should not be

understood as inviting the routine establishment of new categories requiring correctness review. Rather, it is a recognition that it would be unrealistic to declare that we have contemplated every possible set of circumstances in which legislative intent or the rule of law will require a derogation from the presumption of reasonableness review. That being said, the recognition of any new basis for correctness review would be exceptional and would need to be consistent with the framework and the overarching principles set out in these reasons. In other words, any new category warranting a derogation from the presumption of reasonableness review on the basis of legislative intent would require a signal of legislative intent as strong and compelling as those identified in these reasons (i.e., a legislated standard of review or a statutory appeal mechanism). Similarly, the recognition of a new category of questions requiring correctness review that is based on the rule of law would be justified only where failure to apply correctness review would undermine the rule of law and jeopardize the proper functioning of the justice system in a manner analogous to the three situations described in these reasons.

[71] The *amici curiae* suggest that, in addition to the three categories of legal questions identified above, the Court should recognize an additional category of legal questions that would require correctness review on the basis of the rule of law: legal questions regarding which there is persistent discord or internal disagreement within an administrative body leading to legal incoherence. They argue that correctness review is necessary in such situations because the rule of law breaks down where legal inconsistency becomes the norm and the law's meaning comes to depend on the

identity of the decision maker. The *amici curiae* submit that, where competing reasonable legal interpretations linger over time at the administrative level — such that a statute comes to mean, simultaneously, both "yes" and "no" — the courts must step in to provide a determinative answer to the question without according deference to the administrative decision maker: factum of the *amici curiae*, at para. 91.

[72] We are not persuaded that the Court should recognize a distinct correctness category for legal questions on which there is persistent discord within an administrative body. In *Domtar Inc. v. Quebec (Commission d'appel en matière de lésions professionnelles)*, [1993] 2 S.C.R. 756, this Court held that "a lack of unanimity [within a tribunal] is the price to pay for the decision-making freedom and independence given to the members of these tribunals": p. 800; see also *Ellis-Don Ltd. v. Ontario (Labour Relations Board)*, 2001 SCC 4, [2001] 1 S.C.R. 221, at para. 28. That said, we agree that the hypothetical scenario suggested by the *amici curiae* — in which the law's meaning depends on the identity of the individual decision maker, thereby leading to legal incoherence — is antithetical to the rule of law. In our view, however, the more robust form of reasonableness review set out below, which accounts for the value of consistency and the threat of arbitrariness, is capable, in tandem with internal administrative processes to promote consistency and with legislative oversight (see *Domtar*, at p. 801), of guarding against threats to the rule of law. Moreover, the precise point at which internal discord on a point of law would be so serious, persistent and unresolvable that the resulting situation would amount to "legal incoherence" and require a court to step in is not obvious. Given these practical

difficulties, this Court's binding jurisprudence and the hypothetical nature of the problem, we decline to recognize such a category in this appeal.

III. Performing Reasonableness Review

[73] This Court's administrative law jurisprudence has historically focused on the analytical framework used to determine the applicable standard of review, while providing relatively little guidance on how to conduct reasonableness review in practice.

[74] In this section of our reasons, we endeavour to provide that guidance. The approach we set out is one that focuses on justification, offers methodological consistency and reinforces the principle "that reasoned decision-making is the lynchpin of institutional legitimacy": *amici curiae* factum, at para. 12.

[75] We pause to note that our colleagues' approach to reasonableness review is not fundamentally dissimilar to ours. Our colleagues emphasize that reviewing courts should respect administrative decision makers and their specialized expertise, should not ask how they themselves would have resolved an issue and should focus on whether the applicant has demonstrated that the decision is unreasonable: paras. 288, 289 and 291. We agree. As we have stated above, at para. 13, reasonableness review finds its starting point in judicial restraint and respects the distinct role of administrative decision makers. Moreover, as explained below, reasonableness

review considers all relevant circumstances in order to determine whether the applicant has met their onus.

A. *Procedural Fairness and Substantive Review*

[76] Before turning to a discussion of the proposed approach to reasonableness review, we pause to acknowledge that the requirements of the duty of procedural fairness in a given case — and in particular whether that duty requires a decision maker to give reasons for its decision — will impact how a court conducts reasonableness review.

[77] It is well established that, as a matter of procedural fairness, reasons are not required for all administrative decisions. The duty of procedural fairness in administrative law is "eminently variable", inherently flexible and context-specific: *Knight v. Indian Head School Division No. 19*, [1990] 1 S.C.R. 653, at p. 682; *Baker v. Canada (Minister of Citizenship and Immigration)*, [1999] 2 S.C.R. 817, at paras. 22-23; *Moreau-Bérubé*, at paras. 74-75; *Dunsmuir*, at para. 79. Where a particular administrative decision-making context gives rise to a duty of procedural fairness, the specific procedural requirements that the duty imposes are determined with reference to all of the circumstances: *Baker*, at para. 21. In *Baker*, this Court set out a non-exhaustive list of factors that inform the content of the duty of procedural fairness in a particular case, one aspect of which is whether written reasons are required. Those factors include: (1) the nature of the decision being made and the

process followed in making it; (2) the nature of the statutory scheme; (3) the importance of the decision to the individual or individuals affected; (4) the legitimate expectations of the person challenging the decision; and (5) the choices of procedure made by the administrative decision maker itself: *Baker*, at paras. 23-27; see also *Congrégation des témoins de Jéhovah de St-Jérôme-Lafontaine v. Lafontaine (Village)*, 2004 SCC 48, [2004] 2 S.C.R. 650, at para. 5. Cases in which written reasons tend to be required include those in which the decision-making process gives the parties participatory rights, an adverse decision would have a significant impact on an individual or there is a right of appeal: *Baker*, at para. 43; D. J. M. Brown and the Hon. J. M. Evans, with the assistance of D. Fairlie, *Judicial Review of Administrative Action in Canada* (loose-leaf), vol. 3, at p. 12-54.

[78] In the case at bar and in its companion cases, reasons for the administrative decisions at issue were both required and provided. Our discussion of the proper approach to reasonableness review will therefore focus on the circumstances in which reasons for an administrative decision are required and available to the reviewing court.

[79] Notwithstanding the important differences between the administrative context and the judicial context, reasons generally serve many of the same purposes in the former as in the latter: *R. v. Sheppard*, 2002 SCC 26, [2002] 1 S.C.R. 869, at paras. 15 and 22-23. Reasons explain how and why a decision was made. They help to show affected parties that their arguments have been considered and demonstrate

that the decision was made in a fair and lawful manner. Reasons shield against arbitrariness as well as the perception of arbitrariness in the exercise of public power: *Congrégation des témoins de Jéhovah de St-Jérôme-Lafontaine*, at paras. 12-13. As L'Heureux-Dubé J. noted in *Baker*, "[t]hose affected may be more likely to feel they were treated fairly and appropriately if reasons are given": para. 39, citing S.A. de Smith, J. Jowell and Lord Woolf, *Judicial Review of Administrative Action* (5th ed. 1995), at pp. 459-60. And as Jocelyn Stacey and the Hon. Alice Woolley persuasively write, "public decisions gain their democratic and legal authority through a process of public justification" which includes reasons "that justify [the] decisions [of public decision makers] in light of the constitutional, statutory and common law context in which they operate": "Can Pragmatism Function in Administrative Law?" (2016), 74 *S.C.L.R.* (2d) 211, at p. 220.

[80] The process of drafting reasons also necessarily encourages administrative decision makers to more carefully examine their own thinking and to better articulate their analysis in the process: *Baker*, at para. 39. This is what Justice Sharpe describes — albeit in the judicial context — as the "discipline of reasons": *Good Judgment*: *Making Judicial Decisions* (2018), at p. 134; see also *Sheppard*, at para. 23.

[81] Reasons facilitate meaningful judicial review by shedding light on the rationale for a decision: *Baker*, at para. 39. In *Newfoundland and Labrador Nurses' Union v. Newfoundland and Labrador (Treasury Board)*, 2011 SCC 62, [2011] 3

S.C.R. 708, the Court reaffirmed that "the purpose of reasons, when they are required, is to demonstrate 'justification, transparency and intelligibility'": para. 1, quoting *Dunsmuir*, at para. 47; see also *Suresh v. Canada (Minister of Citizenship and Immigration)*, 2002 SCC 1, [2002] 1 S.C.R. 3, at para. 126. The starting point for our analysis is therefore that where reasons are required, they are the primary mechanism by which administrative decision makers show that their decisions are reasonable — both to the affected parties and to the reviewing courts. It follows that the provision of reasons for an administrative decision may have implications for its legitimacy, including in terms both of whether it is procedurally fair and of whether it is substantively reasonable.

B. *Reasonableness Review Is Concerned With the Decision-making Process and Its Outcomes*

[82] Reasonableness review aims to give effect to the legislature's intent to leave certain decisions with an administrative body while fulfilling the constitutional role of judicial review to ensure that exercises of state power are subject to the rule of law: see *Dunsmuir*, at paras. 27-28 and 48; *Catalyst Paper Corp. v. North Cowichan (District)*, 2012 SCC 2, [2012] 1 S.C.R. 5, at para. 10; *Reference re Remuneration of Judges of the Provincial Court of Prince Edward Island*, [1997] 3 S.C.R. 3, at para. 10.

[83] It follows that the focus of reasonableness review must be on the decision actually made by the decision maker, including both the decision maker's reasoning

process and the outcome. The role of courts in these circumstances is to *review*, and they are, at least as a general rule, to refrain from deciding the issue themselves. Accordingly, a court applying the reasonableness standard does not ask what decision it would have made in place of that of the administrative decision maker, attempt to ascertain the "range" of possible conclusions that would have been open to the decision maker, conduct a *de novo* analysis or seek to determine the "correct" solution to the problem. The Federal Court of Appeal noted in *Delios v. Canada (Attorney General)*, 2015 FCA 117, 472 N.R. 171, that, "as reviewing judges, we do not make our own yardstick and then use that yardstick to measure what the administrator did": at para. 28; see also *Ryan*, at paras. 50-51. Instead, the reviewing court must consider only whether the decision made by the administrative decision maker — including both the rationale for the decision and the outcome to which it led — was unreasonable.

[84] As explained above, where the administrative decision maker has provided written reasons, those reasons are the means by which the decision maker communicates the rationale for its decision. A principled approach to reasonableness review is one which puts those reasons first. A reviewing court must begin its inquiry into the reasonableness of a decision by examining the reasons provided with "respectful attention" and seeking to understand the reasoning process followed by the decision maker to arrive at its conclusion: see *Dunsmuir*, at para. 48, quoting D. Dyzenhaus, "The Politics of Deference: Judicial Review and Democracy", in M. Taggart, ed., *The Province of Administrative Law* (1997), 279, at p. 286.

[85] Developing an understanding of the reasoning that led to the administrative decision enables a reviewing court to assess whether the decision as a whole is reasonable. As we will explain in greater detail below, a reasonable decision is one that is based on an internally coherent and rational chain of analysis and that is justified in relation to the facts and law that constrain the decision maker. The reasonableness standard requires that a reviewing court defer to such a decision.

[86] Attention to the decision maker's reasons is part of how courts demonstrate respect for the decision-making process: see *Dunsmuir*, at paras. 47-49. In *Dunsmuir*, this Court explicitly stated that the court conducting a reasonableness review is concerned with "the qualities that make a decision reasonable, referring both to the process of articulating the reasons and to outcomes": para. 47. Reasonableness, according to *Dunsmuir*, "is concerned mostly with the existence of justification, transparency and intelligibility within the decision-making process", as well as "with whether the decision falls within a range of possible, acceptable outcomes which are defensible in respect of the facts and law": *ibid.* In short, it is not enough for the outcome of a decision to be *justifiable*. Where reasons for a decision are required, the decision must also be *justified*, by way of those reasons, by the decision maker to those to whom the decision applies. While some outcomes may be so at odds with the legal and factual context that they could never be supported by intelligible and rational reasoning, an otherwise reasonable outcome also cannot stand if it was reached on an improper basis.

[87] This Court's jurisprudence since *Dunsmuir* should not be understood as having shifted the focus of reasonableness review away from a concern with the reasoning process and toward a nearly exclusive focus on the *outcome* of the administrative decision under review. Indeed, that a court conducting a reasonableness review properly considers both the outcome of the decision and the reasoning process that led to that outcome was recently reaffirmed in *Delta Air Lines Inc. v. Lukács*, 2018 SCC 2, [2018] 1 S.C.R. 6, at para. 12. In that case, although the outcome of the decision at issue may not have been unreasonable in the circumstances, the decision was set aside because the outcome had been arrived at on the basis of an unreasonable chain of analysis. This approach is consistent with the direction in *Dunsmuir* that judicial review is concerned with *both* outcome *and* process. To accept otherwise would undermine, rather than demonstrate respect toward, the institutional role of the administrative decision maker.

C. *Reasonableness Is a Single Standard That Accounts for Context*

[88] In any attempt to develop a coherent and unified approach to judicial review, the sheer variety of decisions and decision makers that such an approach must account for poses an inescapable challenge. The administrative decision makers whose decisions may be subject to judicial review include specialized tribunals exercising adjudicative functions, independent regulatory bodies, ministers, front-line decision makers, and more. Their decisions vary in complexity and importance, ranging from the routine to the life-altering. These include matters of "high policy"

on the one hand and "pure law" on the other. Such decisions will sometimes involve complex technical considerations. At other times, common sense and ordinary logic will suffice.

[89] Despite this diversity, reasonableness remains a single standard, and elements of a decision's context do not modulate the standard or the degree of scrutiny by the reviewing court. Instead, the particular context of a decision constrains what will be reasonable for an administrative decision maker to decide in a given case. This is what it means to say that "[r]easonableness is a single standard that takes its colour from the context": *Khosa*, at para. 59; *Catalyst*, at para. 18; *Halifax (Regional Municipality) v. Nova Scotia (Human Rights Commission)*, 2012 SCC 10, **[2012] 1 S.C.R. 364,** at para. 44; *Wilson*, at para. 22, per Abella J.; *Canada (Attorney General) v. Igloo Vikski Inc.*, 2016 SCC 38, [2016] 2 S.C.R. 80, at para. 57, per Côté J., dissenting but not on this point; *Law Society of British Columbia v. Trinity Western University*, 2018 SCC 32, **[2018] 2 S.C.R. 293,** at para. 53.

[90] The approach to reasonableness review that we articulate in these reasons accounts for the diversity of administrative decision making by recognizing that what is reasonable in a given situation will always depend on the constraints imposed by the legal and factual context of the particular decision under review. These contextual constraints dictate the limits and contours of the space in which the decision maker may act and the types of solutions it may adopt. The fact that the contextual constraints operating on an administrative decision maker may vary from one

decision to another does not pose a problem for the reasonableness standard, because each decision must be both justified by the administrative body and evaluated by reviewing courts in relation to its own particular context.

D. *Formal Reasons for a Decision Should Be Read in Light of the Record and With Due Sensitivity to the Administrative Setting in Which They Were Given*

[91] A reviewing court must bear in mind that the written reasons given by an administrative body must not be assessed against a standard of perfection. That the reasons given for a decision do "not include all the arguments, statutory provisions, jurisprudence or other details the reviewing judge would have preferred" is not on its own a basis to set the decision aside: *Newfoundland Nurses*, at para. 16. The review of an administrative decision can be divorced neither from the institutional context in which the decision was made nor from the history of the proceedings.

[92] Administrative decision makers cannot always be expected to deploy the same array of legal techniques that might be expected of a lawyer or judge — nor will it always be necessary or even useful for them to do so. Instead, the concepts and language employed by administrative decision makers will often be highly specific to their fields of experience and expertise, and this may impact both the form and content of their reasons. These differences are not necessarily a sign of an unreasonable decision — indeed, they may be indicative of a decision maker's strength within its particular and specialized domain. "Administrative justice" will

not always look like “judicial justice”, and reviewing courts must remain acutely aware of that fact.

[93] An administrative decision maker may demonstrate through its reasons that a given decision was made by bringing that institutional expertise and experience to bear: see *Dunsmuir*, at para. 49. In conducting reasonableness review, judges should be attentive to the application by decision makers of specialized knowledge, as demonstrated by their reasons. Respectful attention to a decision maker’s demonstrated expertise may reveal to a reviewing court that an outcome that might be puzzling or counterintuitive on its face nevertheless accords with the purposes and practical realities of the relevant administrative regime and represents a reasonable approach given the consequences and the operational impact of the decision. This demonstrated experience and expertise may also explain why a given issue is treated in less detail.

[94] The reviewing court must also read the decision maker’s reasons in light of the history and context of the proceedings in which they were rendered. For example, the reviewing court might consider the evidence before the decision maker, the submissions of the parties, publicly available policies or guidelines that informed the decision maker’s work, and past decisions of the relevant administrative body. This may explain an aspect of the decision maker’s reasoning process that is not apparent from the reasons themselves, or may reveal that an apparent shortcoming in the reasons is not, in fact, a failure of justification, intelligibility or transparency.

Opposing parties may have made concessions that had obviated the need for the decision maker to adjudicate on a particular issue; the decision maker may have followed a well-established line of administrative case law that no party had challenged during the proceedings; or an individual decision maker may have adopted an interpretation set out in a public interpretive policy of the administrative body of which he or she is a member.

[95] That being said, reviewing courts must keep in mind the principle that the exercise of public power must be justified, intelligible and transparent, not in the abstract, but to the individuals subject to it. It would therefore be unacceptable for an administrative decision maker to provide an affected party formal reasons that fail to justify its decision, but nevertheless expect that its decision would be upheld on the basis of internal records that were not available to that party.

[96] Where, even if the reasons given by an administrative decision maker for a decision are read with sensitivity to the institutional setting and in light of the record, they contain a fundamental gap or reveal that the decision is based on an unreasonable chain of analysis, it is not ordinarily appropriate for the reviewing court to fashion its own reasons in order to buttress the administrative decision. Even if the outcome of the decision could be reasonable under different circumstances, it is not open to a reviewing court to disregard the flawed basis for a decision and substitute its own justification for the outcome: *Delta Air Lines*, at paras. 26-28. To allow a reviewing court to do so would be to allow an administrative decision maker to

abdicate its responsibility to justify to the affected party, in a manner that is transparent and intelligible, the basis on which it arrived at a particular conclusion. This would also amount to adopting an approach to reasonableness review focused solely on the outcome of a decision, to the exclusion of the rationale for that decision. To the extent that cases such as *Newfoundland Nurses* and *Alberta Teachers* have been taken as suggesting otherwise, such a view is mistaken.

[97] Indeed, *Newfoundland Nurses* is far from holding that a decision maker's grounds or rationale for a decision is irrelevant. It instead tells us that close attention must be paid to a decision maker's written reasons and that they must be read holistically and contextually, for the very purpose of understanding the basis on which a decision was made. We agree with the observations of Rennie J. in *Komolafe v. Canada (Minister of Citizenship and Immigration)*, 2013 FC 431, 16 Imm. L.R. (4th) 267, at para. 11:

> *Newfoundland Nurses* is not an open invitation to the Court to provide reasons that were not given, nor is it licence to guess what findings might have been made or to speculate as to what the tribunal might have been thinking. This is particularly so where the reasons are silent on a critical issue. It is ironic that *Newfoundland Nurses*, a case which at its core is about deference and standard of review, is urged as authority for the supervisory court to do the task that the decision maker did not do, to supply the reasons that might have been given and make findings of fact that were not made. This is to turn the jurisprudence on its head. *Newfoundland Nurses* allows reviewing courts to connect the dots on the page where the lines, and the direction they are headed, may be readily drawn . . . .

[98] As for *Alberta Teachers*, it concerned a very specific and exceptional circumstance in which the reviewing court had exercised its discretion to consider a question of statutory interpretation on judicial review, even though that question had not been raised before the administrative decision maker and, as a result, no reasons had been given on that issue: paras. 22-26. Furthermore, it was agreed that the ultimate decision maker — the Information and Privacy Commissioner's delegate — had applied a well-established interpretation of the statutory provision in question and that, had she been asked for reasons to justify her interpretation, she would have adopted reasons the Commissioner had given in past decisions. In other words, the reasons of the Commissioner that this Court relied on to find that the administrative decision was reasonable were not merely reasons that *could* have been offered, in an abstract sense, but reasons that *would* have been offered had the issue been raised before the decision maker. Far from suggesting in *Alberta Teachers* that reasonableness review is concerned primarily with outcome, as opposed to rationale, this Court rejected the position that a reviewing court is entitled to "reformulate a tribunal's decision in a way that casts aside an unreasonable chain of analysis in favour of the court's own rationale for the result": para. 54, quoting *Petro-Canada v. British Columbia (Workers' Compensation Board)*, 2009 BCCA 396, 276 B.C.A.C. 135, at paras. 53 and 56. In *Alberta Teachers*, this Court also reaffirmed the importance of giving proper reasons and reiterated that "deference under the reasonableness standard is best given effect when administrative decision makers provide intelligible and transparent justification for their decisions, and when courts ground their review of the decision in the reasons provided": para. 54. Where a

decision maker's rationale for an essential element of the decision is not addressed in the reasons and cannot be inferred from the record, the decision will generally fail to meet the requisite standard of justification, transparency and intelligibility.

E. *A Reasonable Decision Is One That Is Both Based on an Internally Coherent Reasoning and Justified in Light of the Legal and Factual Constraints That Bear on the Decision*

[99] A reviewing court must develop an understanding of the decision maker's reasoning process in order to determine whether the decision as a whole is reasonable. To make this determination, the reviewing court asks whether the decision bears the hallmarks of reasonableness — justification, transparency and intelligibility — and whether it is justified in relation to the relevant factual and legal constraints that bear on the decision: *Dunsmuir*, at paras. 47 and 74; *Catalyst*, at para. 13.

[100] The burden is on the party challenging the decision to show that it is unreasonable. Before a decision can be set aside on this basis, the reviewing court must be satisfied that there are sufficiently serious shortcomings in the decision such that it cannot be said to exhibit the requisite degree of justification, intelligibility and transparency. Any alleged flaws or shortcomings must be more than merely superficial or peripheral to the merits of the decision. It would be improper for a reviewing court to overturn an administrative decision simply because its reasoning exhibits a minor misstep. Instead, the court must be satisfied that any shortcomings or flaws relied on by the party challenging the decision are sufficiently central or significant to render the decision unreasonable.

[101] What makes a decision unreasonable? We find it conceptually useful here to consider two types of fundamental flaws. The first is a failure of rationality internal to the reasoning process. The second arises when a decision is in some respect untenable in light of the relevant factual and legal constraints that bear on it. There is however, no need for reviewing courts to categorize failures of reasonableness as belonging to one type or the other. Rather, we use these descriptions simply as a convenient way to discuss the types of issues that may show a decision to be unreasonable.

(1) A Reasonable Decision Is Based on an Internally Coherent Reasoning

[102] To be reasonable, a decision must be based on reasoning that is both rational and logical. It follows that a failure in this respect may lead a reviewing court to conclude that a decision must be set aside. Reasonableness review is not a "line-by-line treasure hunt for error": *Irving Pulp & Paper*, at para. 54, citing *Newfoundland Nurses*, at para. 14. However, the reviewing court must be able to trace the decision maker's reasoning without encountering any fatal flaws in its overarching logic, and it must be satisfied that "there is [a] line of analysis within the given reasons that could reasonably lead the tribunal from the evidence before it to the conclusion at which it arrived": *Ryan*, at para. 55; *Southam*, at para. 56. Reasons that "simply repeat statutory language, summarize arguments made, and then state a peremptory conclusion" will rarely assist a reviewing court in understanding the rationale underlying a decision and "are no substitute for statements of fact, analysis,

inference and judgment": R. A. Macdonald and D. Lametti, "Reasons for Decision in Administrative Law" (1990), 3 *C.J.A.L.P.* 123, at p. 139; see also *Gonzalez v. Canada (Minister of Citizenship and Immigration)*, 2014 FC 750, 27 Imm. L.R. (4th) 151, at paras. 57-59.

[103] While, as we indicated earlier (at paras. 89-96), formal reasons should be read in light of the record and with due sensitivity to the administrative regime in which they were given, a decision will be unreasonable if the reasons for it, read holistically, fail to reveal a rational chain of analysis or if they reveal that the decision was based on an irrational chain of analysis: see *Wright v. Nova Scotia (Human Rights Commission)*, 2017 NSSC 11, 23 Admin. L.R. (6th) 110; *Southam*, at para. 56. A decision will also be unreasonable where the conclusion reached cannot follow from the analysis undertaken (see *Sangmo v. Canada (Citizenship and Immigration)*, 2016 FC 17, at para. 21 (CanLII)) or if the reasons read in conjunction with the record do not make it possible to understand the decision maker's reasoning on a critical point (see *Blas v. Canada (Citizenship and Immigration)*, 2014 FC 629, 26 Imm. L.R. (4th) 92, at paras. 54-66; *Reid v. Criminal Injuries Compensation Board*, 2015 ONSC 6578; *Lloyd v. Canada (Attorney General)*, 2016 FCA 115, 2016 D.T.C. 5051; *Taman v. Canada (Attorney General)*, 2017 FCA 1, [2017] 3 F.C.R. 520, at para. 47).

[104] Similarly, the internal rationality of a decision may be called into question if the reasons exhibit clear logical fallacies, such as circular reasoning, false dilemmas, unfounded generalizations or an absurd premise. This is not an invitation

to hold administrative decision makers to the formalistic constraints and standards of academic logicians. However, a reviewing court must ultimately be satisfied that the decision maker's reasoning "adds up".

(2) A Reasonable Decision Is Justified in Light of the Legal and Factual Constraints That Bear on the Decision

[105] In addition to the need for internally coherent reasoning, a decision, to be reasonable, must be justified in relation to the constellation of law and facts that are relevant to the decision: *Dunsmuir*, at para. 47; *Catalyst*, at para. 13; *Nor-Man Regional Health Authority*, at para. 6. Elements of the legal and factual contexts of a decision operate as constraints on the decision maker in the exercise of its delegated powers.

[106] It is unnecessary to catalogue all of the legal or factual considerations that could constrain an administrative decision maker in a particular case. However, in the sections that follow, we discuss a number of elements that will generally be relevant in evaluating whether a given decision is reasonable, namely the governing statutory scheme; other relevant statutory or common law; the principles of statutory interpretation; the evidence before the decision maker and facts of which the decision maker may take notice; the submissions of the parties; the past practices and decisions of the administrative body; and the potential impact of the decision on the individual to whom it applies. These elements are not a checklist for conducting reasonableness review, and they may vary in significance depending on the context.

They are offered merely to highlight some elements of the surrounding context that can cause a reviewing court to lose confidence in the outcome reached.

[107] A reviewing court may find that a decision is unreasonable when examined against these contextual considerations. These elements necessarily interact with one another: for example, a reasonable penalty for professional misconduct in a given case must be justified *both* with respect to the types of penalties prescribed by the relevant legislation and with respect to the nature of the underlying misconduct.

(a) *Governing Statutory Scheme*

[108] Because administrative decision makers receive their powers by statute, the governing statutory scheme is likely to be the most salient aspect of the legal context relevant to a particular decision. That administrative decision makers play a role, along with courts, in elaborating the precise content of the administrative schemes they administer should not be taken to mean that administrative decision makers are permitted to disregard or rewrite the law as enacted by Parliament and the provincial legislatures. Thus, for example, while an administrative body may have considerable discretion in making a particular decision, that decision must ultimately comply "with the rationale and purview of the statutory scheme under which it is adopted": *Catalyst*, at paras. 15 and 25-28; see also *Green*, at para. 44. As Rand J. noted in *Roncarelli v. Duplessis*, [1959] S.C.R. 121, at p. 140, "there is no such thing as absolute and untrammelled 'discretion'", and any exercise of discretion must accord with the purposes for which it was given: see also *Congrégation des témoins*

de Jéhovah de St-Jérôme-Lafontaine, at para. 7; *Montréal (City) v. Montreal Port Authority*, 2010 SCC 14, [2010] 1 S.C.R. 427, at paras. 32-33; *Nor-Man Regional Health Authority*, at para. 6. Likewise, a decision must comport with any more specific constraints imposed by the governing legislative scheme, such as the statutory definitions, principles or formulas that prescribe the exercise of a discretion: see *Montréal (City)*, at paras. 33 and 40-41; *Canada (Attorney General) v. Almon Equipment Limited*, 2010 FCA 193, [2011] 4 F.C.R. 203, at paras. 38-40. The statutory scheme also informs the acceptable approaches to decision making: for example, where a decision maker is given wide discretion, it would be unreasonable for it to fetter that discretion: see *Delta Air Lines*, at para. 18.

[109] As stated above, a proper application of the reasonableness standard is capable of allaying the concern that an administrative decision maker might interpret the scope of its own authority beyond what the legislature intended. As a result, there is no need to maintain a category of "truly" jurisdictional questions that are subject to correctness review. Although a decision maker's interpretation of its statutory grant of authority is generally entitled to deference, the decision maker must nonetheless properly justify that interpretation. Reasonableness review does not allow administrative decision makers to arrogate powers to themselves that they were never intended to have, and an administrative body cannot exercise authority which was not delegated to it. Contrary to our colleagues' concern (at para. 285), this does not reintroduce the concept of "jurisdictional error" into judicial review, but merely

identifies one of the obvious and necessary constraints imposed on administrative decision makers.

[110] Whether an interpretation is justified will depend on the context, including the language chosen by the legislature in describing the limits and contours of the decision maker's authority. If a legislature wishes to precisely circumscribe an administrative decision maker's power in some respect, it can do so by using precise and narrow language and delineating the power in detail, thereby tightly constraining the decision maker's ability to interpret the provision. Conversely, where the legislature chooses to use broad, open-ended or highly qualitative language — for example, "in the public interest" — it clearly contemplates that the decision maker is to have greater flexibility in interpreting the meaning of such language. Other language will fall in the middle of this spectrum. All of this is to say that certain questions relating to the scope of a decision maker's authority may support more than one interpretation, while other questions may support only one, depending upon the text by which the statutory grant of authority is made. What matters is whether, in the eyes of the reviewing court, the decision maker has properly justified its interpretation of the statute in light of the surrounding context. It will, of course, be impossible for an administrative decision maker to justify a decision that strays beyond the limits set by the statutory language it is interpreting.

(b) *Other Statutory or Common Law*

[111] It is evident that both statutory and common law will impose constraints on how and what an administrative decision maker can lawfully decide: see *Dunsmuir*, at paras. 47 and 74. For example, an administrative decision maker interpreting the scope of its regulation-making authority in order to exercise that authority cannot adopt an interpretation that is inconsistent with applicable common law principles regarding the nature of statutory powers: see *Katz Group Canada Inc. v. Ontario (Health and Long-Term Care)*, 2013 SCC 64, [2013] 3 S.C.R. 810, at paras. 45-48. Neither can a body instructed by legislation to determine what tax rate is applicable in accordance with an existing tax system ignore that system and base its determination on a "fictitious" system it has arbitrarily created: *Montréal (City)*, at para. 40. Where a relationship is governed by private law, it would be unreasonable for a decision maker to ignore that law in adjudicating parties' rights within that relationship: *Dunsmuir*, at para. 74. Similarly, where the governing statute specifies a standard that is well known in law and in the jurisprudence, a reasonable decision will generally be one that is consistent with the established understanding of that standard: see, e.g., the discussion of "reasonable grounds to suspect" in *Canada (Minister of Transport, Infrastructure and Communities) v. Farwaha*, 2014 FCA 56, [2015] 2 F.C.R. 1006, at paras. 93-98.

[112] Any precedents on the issue before the administrative decision maker or on a similar issue will act as a constraint on what the decision maker can reasonably decide. An administrative body's decision may be unreasonable on the basis that the body failed to explain or justify a departure from a binding precedent in which the

same provision had been interpreted. Where, for example, there is a relevant case in which a court considered a statutory provision, it would be unreasonable for an administrative decision maker to interpret or apply the provision without regard to that precedent. The decision maker would have to be able to explain why a different interpretation is preferable by, for example, explaining why the court's interpretation does not work in the administrative context: M. Biddulph, "Rethinking the Ramification of Reasonableness Review: *Stare Decisis* and Reasonableness Review on Questions of Law" (2018), 56 *Alta. L.R.* 119, at p. 146. There may be circumstances in which it is quite simply unreasonable for an administrative decision maker to fail to apply or interpret a statutory provision in accordance with a binding precedent. For instance, where an immigration tribunal is required to determine whether an applicant's act would constitute a criminal offence under Canadian law (see, e.g., *Immigration and Refugee Protection Act*, S.C. 2001, c. 27, ss. 35-37), it would clearly not be reasonable for the tribunal to adopt an interpretation of a criminal law provision that is inconsistent with how Canadian criminal courts have interpreted it.

[113] That being said, administrative decision makers will not necessarily be required to apply equitable and common law principles in the same manner as courts in order for their decisions to be reasonable. For example, it may be reasonable for a decision maker to adapt a common law or equitable doctrine to its administrative context: see *Nor-Man Regional Health Authority*, at paras. 5-6, 44-45, 52, 54 and 60. Conversely, a decision maker that rigidly applies a common law doctrine without

adapting it to the relevant administrative context may be acting unreasonably: see *Delta Air Lines*, at paras. 16-17 and 30. In short, whether an administrative decision maker has acted reasonably in adapting a legal or equitable doctrine involves a highly context-specific determination.

[114] We would also note that in some administrative decision making contexts, international law will operate as an important constraint on an administrative decision maker. It is well established that legislation is presumed to operate in conformity with Canada's international obligations, and the legislature is "presumed to comply with . . . the values and principles of customary and conventional international law": *R. v. Hape*, 2007 SCC 26, [2007] 2 S.C.R. 292, at para. 53; *R. v. Appulonappa*, 2015 SCC 59, [2015] 3 S.C.R. 754, at para. 40. Since *Baker*, it has also been clear that international treaties and conventions, even where they have not been implemented domestically by statute, can help to inform whether a decision was a reasonable exercise of administrative power: *Baker*, at paras. 69-71.

(c) *Principles of Statutory Interpretation*

[115] Matters of statutory interpretation are not treated uniquely and, as with other questions of law, may be evaluated on a reasonableness standard. Although the general approach to reasonableness review described above applies in such cases, we recognize that it is necessary to provide additional guidance to reviewing courts on this point. This is because reviewing courts are accustomed to resolving questions of statutory interpretation in a context in which the issue is before them at first instance

or on appeal, and where they are expected to perform their own independent analysis and come to their own conclusions.

[116] Reasonableness review functions differently. Where reasonableness is the applicable standard on a question of statutory interpretation, the reviewing court does not undertake a *de novo* analysis of the question or "ask itself what the correct decision would have been": *Ryan*, at para. 50. Instead, just as it does when applying the reasonableness standard in reviewing questions of fact, discretion or policy, the court must examine the administrative decision as a whole, including the reasons provided by the decision maker and the outcome that was reached.

[117] A court interpreting a statutory provision does so by applying the "modern principle" of statutory interpretation, that is, that the words of a statute must be read "in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament": *Rizzo & Rizzo Shoes Ltd. (Re)*, [1998] 1 S.C.R. 27, at para. 21, and *Bell ExpressVu Limited Partnership v. Rex*, 2002 SCC 42, [2002] 2 S.C.R. 559, at para. 26, both quoting E. Driedger, *Construction of Statutes* (2nd ed. 1983), at p. 87. Parliament and the provincial legislatures have also provided guidance by way of statutory rules that explicitly govern the interpretation of statutes and regulations: see, e.g., *Interpretation Act*, R.S.C. 1985, c. I-21.

[118] This Court has adopted the "modern principle" as the proper approach to statutory interpretation, because legislative intent can be understood only by reading

the language chosen by the legislature in light of the purpose of the provision and the entire relevant context: Sullivan, at pp. 7-8. Those who draft and enact statutes expect that questions about their meaning will be resolved by an analysis that has regard to the text, context and purpose, regardless of whether the entity tasked with interpreting the law is a court or an administrative decision maker. An approach to reasonableness review that respects legislative intent must therefore assume that those who interpret the law — whether courts or administrative decision makers — will do so in a manner consistent with this principle of interpretation.

[119] Administrative decision makers are not required to engage in a formalistic statutory interpretation exercise in every case. As discussed above, formal reasons for a decision will not always be necessary and may, where required, take different forms. And even where the interpretive exercise conducted by the administrative decision maker is set out in written reasons, it may look quite different from that of a court. The specialized expertise and experience of administrative decision makers may sometimes lead them to rely, in interpreting a provision, on considerations that a court would not have thought to employ but that actually enrich and elevate the interpretive exercise.

[120] But whatever form the interpretive exercise takes, the merits of an administrative decision maker's interpretation of a statutory provision must be consistent with the text, context and purpose of the provision. In this sense, the usual principles of statutory interpretation apply equally when an administrative decision

maker interprets a provision. Where, for example, the words used are “precise and unequivocal”, their ordinary meaning will usually play a more significant role in the interpretive exercise: *Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54, [2005] 2 S.C.R. 601, at para. 10. Where the meaning of a statutory provision is disputed in administrative proceedings, the decision maker must demonstrate in its reasons that it was alive to these essential elements.

[121] The administrative decision maker’s task is to interpret the contested provision in a manner consistent with the text, context and purpose, applying its particular insight into the statutory scheme at issue. It cannot adopt an interpretation it knows to be inferior — albeit plausible — merely because the interpretation in question appears to be available and is expedient. The decision maker’s responsibility is to discern meaning and legislative intent, not to “reverse-engineer” a desired outcome.

[122] It can happen that an administrative decision maker, in interpreting a statutory provision, fails entirely to consider a pertinent aspect of its text, context or purpose. Where such an omission is a minor aspect of the interpretive context, it is not likely to undermine the decision as a whole. It is well established that decision makers are not required “to explicitly address all possible shades of meaning” of a given provision: *Construction Labour Relations v. Driver Iron Inc.*, 2012 SCC 65, [2012] 3 S.C.R. 405, at para. 3. Just like judges, administrative decision makers may find it unnecessary to dwell on each and every signal of statutory intent in their

reasons. In many cases, it may be necessary to touch upon only the most salient aspects of the text, context or purpose. If, however, it is clear that the administrative decision maker may well, had it considered a key element of a statutory provision's text, context or purpose, have arrived at a different result, its failure to consider that element would be indefensible, and unreasonable in the circumstances. Like other aspects of reasonableness review, omissions are not stand-alone grounds for judicial intervention: the key question is whether the omitted aspect of the analysis causes the reviewing court to lose confidence in the outcome reached by the decision maker.

[123] There may be other cases in which the administrative decision maker has not explicitly considered the meaning of a relevant provision in its reasons, but the reviewing court is able to discern the interpretation adopted by the decision maker from the record and determine whether that interpretation is reasonable.

[124] Finally, even though the task of a court conducting a reasonableness review is *not* to perform a *de novo* analysis or to determine the "correct" interpretation of a disputed provision, it may sometimes become clear in the course of reviewing a decision that the interplay of text, context and purpose leaves room for a single reasonable interpretation of the statutory provision, or aspect of the statutory provision, that is at issue: *Dunsmuir*, at paras. 72-76. One case in which this conclusion was reached was *Nova Tube Inc./Nova Steel Inc. v. Conares Metal Supply Ltd.*, 2019 FCA 52., in which Laskin J.A., after analyzing the reasoning of the administrative decision maker (at paras. 26-61 (CanLII)), held that the decision

maker's interpretation had been unreasonable, and, furthermore, that the factors he had considered in his analysis weighed so overwhelmingly in favour of the opposite interpretation that that was the only reasonable interpretation of the provision: para. 61. As discussed below, it would serve no useful purpose in such a case to remit the interpretative question to the original decision maker. Even so, a court should generally pause before definitively pronouncing upon the interpretation of a provision entrusted to an administrative decision maker.

(d) *Evidence Before the Decision Maker*

[125] It is trite law that the decision maker may assess and evaluate the evidence before it and that, absent exceptional circumstances, a reviewing court will not interfere with its factual findings. The reviewing court must refrain from "reweighing and reassessing the evidence considered by the decision maker": *CHRC*, at para. 55; see also *Khosa*, at para. 64; *Dr. Q*, at paras. 41-42. Indeed, many of the same reasons that support an appellate court's deferring to a lower court's factual findings, including the need for judicial efficiency, the importance of preserving certainty and public confidence, and the relatively advantageous position of the first instance decision maker, apply equally in the context of judicial review: see *Housen*, at paras. 15-18; *Dr. Q*, at para. 38; *Dunsmuir*, at para. 53.

[126] That being said, a reasonable decision is one that is justified in light of the facts: *Dunsmuir*, para. 47. The decision maker must take the evidentiary record and the general factual matrix that bears on its decision into account, and its decision must

be reasonable in light of them: see *Southam*, at para. 56. The reasonableness of a decision may be jeopardized where the decision maker has fundamentally misapprehended or failed to account for the evidence before it. In *Baker*, for example, the decision maker had relied on irrelevant stereotypes and failed to consider relevant evidence, which led to a conclusion that there was a reasonable apprehension of bias: para. 48. Moreover, the decision maker's approach would *also* have supported a finding that the decision was unreasonable on the basis that the decision maker showed that his conclusions were not based on the evidence that was actually before him: para. 48.

(e) *Submissions of the Parties*

[127] The principles of justification and transparency require that an administrative decision maker's reasons meaningfully account for the central issues and concerns raised by the parties. The principle that the individual or individuals affected by a decision should have the opportunity to present their case fully and fairly underlies the duty of procedural fairness and is rooted in the right to be heard: *Baker*, at para. 28. The concept of responsive reasons is inherently bound up with this principle, because reasons are the primary mechanism by which decision makers demonstrate that they have actually *listened* to the parties.

[128] Reviewing courts cannot expect administrative decision makers to "respond to every argument or line of possible analysis" (*Newfoundland Nurses*, at para. 25), or to "make an explicit finding on each constituent element, however

subordinate, leading to its final conclusion" (para 16). To impose such expectations would have a paralyzing effect on the proper functioning of administrative bodies and would needlessly compromise important values such as efficiency and access to justice. However, a decision maker's failure to meaningfully grapple with key issues or central arguments raised by the parties may call into question whether the decision maker was actually alert and sensitive to the matter before it. In addition to assuring parties that their concerns have been heard, the process of drafting reasons with care and attention can alert the decision maker to inadvertent gaps and other flaws in its reasoning: *Baker*, at para. 39.

(f) *Past Practices and Past Decisions*

[129] Administrative decision makers are not bound by their previous decisions in the same sense that courts are bound by *stare decisis*. As this Court noted in *Domtar*, "a lack of unanimity is the price to pay for the decision-making freedom and independence" given to administrative decision makers, and the mere fact that some conflict exists among an administrative body's decisions does not threaten the rule of law: p. 800. Nevertheless, administrative decision makers and reviewing courts alike must be concerned with the general consistency of administrative decisions. Those affected by administrative decisions are entitled to expect that like cases will generally be treated alike and that outcomes will not depend merely on the identity of the individual decision maker — expectations that do not evaporate simply because the parties are not before a judge.

[130] Fortunately, administrative bodies generally have a range of resources at their disposal to address these types of concerns. Access to past reasons and summaries of past reasons enables multiple individual decision makers within a single organization (such as administrative tribunal members) to learn from each other's work, and contributes to a harmonized decision-making culture. Institutions also routinely rely on standards, policy directives and internal legal opinions to encourage greater uniformity and guide the work of frontline decision makers. This Court has also held that plenary meetings of a tribunal's members can be an effective tool to "foster coherence" and "avoid . . . conflicting results": *IWA v. Consolidated-Bathurst Packaging Ltd.*, [1990] 1 S.C.R. 282, at pp. 324-28. Where disagreement arises within an administrative body about how to appropriately resolve a given issue, that institution may also develop strategies to address that divergence internally and on its own initiative. Of course, consistency can also be encouraged through less formal methods, such as the development of training materials, checklists and templates for the purpose of streamlining and strengthening institutional best practices, provided that these methods do not operate to fetter decision making.

[131] Whether a particular decision is consistent with the administrative body's past decisions is also a constraint that the reviewing court should consider when determining whether an administrative decision is reasonable. Where a decision maker *does* depart from longstanding practices or established internal authority, it bears the justificatory burden of explaining that departure in its reasons. If the decision maker does not satisfy this burden, the decision will be unreasonable. In this

sense, the legitimate expectations of the parties help to determine both whether reasons are required and what those reasons must explain: *Baker*, at para. 26. We repeat that this does not mean administrative decision makers are bound by internal precedent in the same manner as courts. Rather, it means that a decision that departs from longstanding practices or established internal decisions will be reasonable if that departure is justified, thereby reducing the risk of arbitrariness, which would undermine public confidence in administrative decision makers and in the justice system as a whole.

[132] As discussed above, it has been argued that correctness review would be required where there is "persistent discord" on questions on law in an administrative body's decisions. While we are not of the view that such a correctness category is required, we would note that reviewing courts have a role to play in managing the risk of persistently discordant or contradictory legal interpretations within an administrative body's decisions. When evidence of internal disagreement on legal issues has been put before a reviewing court, the court may find it appropriate to telegraph the existence of an issue in its reasons and encourage the use of internal administrative structures to resolve the disagreement. And if internal disagreement continues, it may become increasingly difficult for the administrative body to justify decisions that serve only to preserve the discord.

(g) *Impact of the Decision on the Affected Individual*

[133] It is well established that individuals are entitled to greater procedural protection when the decision in question involves the potential for significant personal impact or harm: *Baker*, at para. 25. However, this principle also has implications for how a court conducts reasonableness review. Central to the necessity of adequate justification is the perspective of the individual or party over whom authority is being exercised. Where the impact of a decision on an individual's rights and interests is severe, the reasons provided to that individual must reflect the stakes. The principle of responsive justification means that if a decision has particularly harsh consequences for the affected individual, the decision maker must explain why its decision best reflects the legislature's intention. This includes decisions with consequences that threaten an individual's life, liberty, dignity or livelihood.

[134] Moreover, concerns regarding arbitrariness will generally be more acute in cases where the consequences of the decision for the affected party are particularly severe or harsh, and a failure to grapple with such consequences may well be unreasonable. For example, this Court has held that the Immigration Appeal Division should, when exercising its equitable jurisdiction to stay a removal order under the *Immigration and Refugee Protection Act*, consider the potential foreign hardship a deported person would face: *Chieu v. Canada (Minister of Citizenship and Immigration)*, 2002 SCC 3, [2002] 1 S.C.R. 84.

[135] Many administrative decision makers are entrusted with an extraordinary degree of power over the lives of ordinary people, including the most vulnerable

among us. The corollary to that power is a heightened responsibility on the part of administrative decision makers to ensure that their reasons demonstrate that they have considered the consequences of a decision and that those consequences are justified in light of the facts and law.

F. *Review in the Absence of Reasons*

[136] Where the duty of procedural fairness or the legislative scheme mandates that reasons be given to the affected party but none have been given, this failure will generally require the decision to be set aside and the matter remitted to the decision maker: see, e.g., *Congrégation des témoins de Jéhovah de St-Jérôme-Lafontaine*, at para. 35. Also, where reasons are provided but they fail to provide a transparent and intelligible justification as explained above, the decision will be unreasonable. In many cases, however, neither the duty of procedural fairness nor the statutory scheme will require that formal reasons be given at all: *Baker*, at para. 43.

[137] Admittedly, applying an approach to judicial review that prioritizes the decision maker's justification for its decisions can be challenging in cases in which formal reasons have not been provided. This will often occur where the decision-making process does not easily lend itself to producing a single set of reasons, for example, where a municipality passes a bylaw or a law society renders a decision by holding a vote: see, e.g., *Catalyst*; *Green*; *Trinity Western University*. However, even in such circumstances, the reasoning process that underlies the decision will not usually be opaque. It is important to recall that a reviewing court must look to the

record as a whole to understand the decision, and that in doing so, the court will often uncover a clear rationale for the decision: *Baker*, at para. 44. For example, as McLachlin C.J. noted in *Catalyst*, "[t]he reasons for a municipal bylaw are traditionally deduced from the debate, deliberations, and the statements of policy that give rise to the bylaw": para. 29. In that case, not only were "the reasons [in the sense of rationale] for the bylaw . . . clear to everyone", they had also been laid out in a five-year plan: para. 33. Conversely, even without reasons, it is possible for the record and the context to reveal that a decision was made on the basis of an improper motive or for another impermissible reason, as, for example, in *Roncarelli*.

[138] There will nonetheless be situations in which no reasons have been provided and neither the record nor the larger context sheds light on the basis for the decision. In such a case, the reviewing court must still examine the decision in light of the relevant constraints on the decision maker in order to determine whether the decision is reasonable. But it is perhaps inevitable that without reasons, the analysis will then focus on the outcome rather than on the decision maker's reasoning process. This does not mean that reasonableness review is less robust in such circumstances, only that it takes a different shape.

G. *A Note on Remedial Discretion*

[139] Where a court reviews an administrative decision, the question of the appropriate remedy is multi-faceted. It engages considerations that include the reviewing court's common law or statutory jurisdiction and the great diversity of

elements that may influence a court's decision to exercise its discretion in respect of available remedies. While we do not aim to comprehensively address here the issue of remedies on judicial review, we do wish to briefly address the question of whether a court that quashes an unreasonable decision should exercise its discretion to remit the matter to the decision maker for reconsideration with the benefit of the court's reasons.

[140] Where the reasonableness standard is applied in conducting a judicial review, the choice of remedy must be guided by the rationale for applying that standard to begin with, including the recognition by the reviewing court that the legislature has entrusted the matter to the administrative decision maker, and not to the court, to decide: see *Delta Air Lines*, at para. 31. However, the question of remedy must also be guided by concerns related to the proper administration of the justice system, the need to ensure access to justice and "the goal of expedient and cost-efficient decision making, which often motivates the creation of specialized administrative tribunals in the first place": *Alberta Teachers*, at para. 55.

[141] Giving effect to these principles in the remedial context means that where a decision reviewed by applying the reasonableness standard cannot be upheld, it will most often be appropriate to remit the matter to the decision maker to have it reconsider the decision, this time with the benefit of the court's reasons. In reconsidering its decision, the decision maker may arrive at the same, or a different, outcome: see *Delta Air Lines*, at paras. 30-31.

[142] However, while courts should, as a general rule, respect the legislature's intention to entrust the matter to the administrative decision maker, there are limited scenarios in which remitting the matter would stymie the timely and effective resolution of matters in a manner that no legislature could have intended: *D'Errico v. Canada (Attorney General)*, 2014 FCA 95, at paras. 18-19 (CanLII). An intention that the administrative decision maker decide the matter at first instance cannot give rise to an endless merry-go-round of judicial reviews and subsequent reconsiderations. Declining to remit a matter to the decision maker may be appropriate where it becomes evident to the court, in the course of its review, that a particular outcome is inevitable and that remitting the case would therefore serve no useful purpose: see *Mobil Oil Canada Ltd. v. Canada-Newfoundland Offshore Petroleum Board*, [1994] 1 S.C.R. 202, at pp. 228-30; *Renaud v. Quebec (Commission des affaires sociales)*, [1999] 3 S.C.R. 855; *Groia v. Law Society of Upper Canada*, 2018 SCC 27, [2018] 1 S.C.R. 772, at para. 161; *Sharif v. Canada (Attorney General)*, 2018 FCA 205, 50 C.R. (7th) 1, at paras. 53-54; *Maple Lodge Farms Ltd. v. Canadian Food Inspection Agency*, 2017 FCA 45, 411 D.L.R. (4th) 175, at paras. 51-56 and 84; *Gehl v. Canada (Attorney General)*, 2017 ONCA 319, at paras. 54 and 88 (CanLII). Elements like concern for delay, fairness to the parties, urgency of providing a resolution to the dispute, the nature of the particular regulatory regime, whether the administrative decision maker had a genuine opportunity to weigh in on the issue in question, costs to the parties, and the efficient use of public resources may also influence the exercise of a court's discretion to remit a matter, just as they may influence the exercise of its discretion to quash a decision that is flawed: see *MiningWatch Canada v. Canada*

(Fisheries and Oceans), 2010 SCC 2, [2010] 1 S.C.R. 6, at paras. 45-51; *Alberta Teachers*, at para. 55.

IV. Role of Prior Jurisprudence

[143] Given that this appeal and its companion cases involve a recalibration of the governing approach to the choice of standard of review analysis and a clarification of the proper application of the reasonableness standard, it will be necessary to briefly address how the existing administrative law jurisprudence should be treated going forward. These reasons set out a holistic revision of the framework for determining the applicable standard of review. A court seeking to determine what standard is appropriate in a case before it should look to these reasons first in order to determine how this general framework applies to that case. Doing so may require the court to resolve subsidiary questions on which past precedents will often continue to provide helpful guidance. Indeed, much of the Court's jurisprudence, such as cases concerning general questions of law of central importance to the legal system as a whole or those relating to jurisdictional boundaries between two or more administrative bodies, will continue to apply essentially without modification. On other issues, certain cases —including those on the effect of statutory appeal mechanisms, "true" questions of jurisdiction or the former contextual analysis — will necessarily have less precedential force. As for cases that dictated how to conduct reasonableness review, they will often continue to provide insight, but should be used carefully to ensure that their application is aligned in principle with these reasons.

[144] This approach strives for future doctrinal stability under the new framework while clarifying the continued relevance of the existing jurisprudence. Where a reviewing court is not certain how these reasons relate to the case before it, it may find it prudent to request submissions from the parties on both the appropriate standard and the application of that standard.

[145] Before turning to Mr. Vavilov's case, we pause to note that our colleagues mischaracterize the framework developed in these reasons as being an "encomium" for correctness, and a turn away from the Court's deferential approach to the point of being a "eulogy" for deference (at paras. 199 and 201). With respect, this is a gross exaggeration. Assertions that these reasons adopt a formalistic, court-centric view of administrative law (at paras. 229 and 240), enable an unconstrained expansion of correctness review (at para. 253) or function as a sort of checklist for "line-by-line" reasonableness review (at para. 284), are counter to the clear wording we use and do not take into consideration the delicate balance that we have accounted for in setting out this framework.

V. Mr. Vavilov's Application for Judicial Review

[146] The case at bar involves an application for judicial review of a decision made by the Canadian Registrar of Citizenship on August 15, 2014. The Registrar's decision concerned Mr. Vavilov, who was born in Canada and whose parents were later revealed to be undercover Russian spies. The Registrar determined that Mr. Vavilov was not a Canadian citizen on the basis of an interpretation of s. 3(2)(a) of

the *Citizenship Act* and cancelled his certificate of citizenship under s. 26(3) of the *Citizenship Regulations*. We conclude that the standard of review applicable to the Registrar's decision is reasonableness, and that the Registrar's decision was unreasonable. We would uphold the decision of the Federal Court of Appeal to quash the Registrar's decision and would not remit the matter to the Registrar for redetermination.

A. *Facts*

[147] Mr. Vavilov was born in Toronto as Alexander Foley on June 3, 1994. At the time of his birth, his parents were posing as Canadians under the assumed names of Tracey Lee Ann Foley and Donald Howard Heathfield. In reality, they were Elena Vavilova and Andrey Bezrukov, two foreign nationals working on a long-term assignment for the Russian foreign intelligence service, the SVR. Their false Canadian identities had been assumed prior to the birth of Mr. Vavilov and of his older brother, Timothy, for purposes of a "deep cover" espionage network under the direction of the SVR. The United States Department of Justice refers to it as the "illegals" program.

[148] Ms. Vavilova and Mr. Bezrukov were deployed to Canada to establish false personal histories as Western citizens. They worked, ran a business, pursued higher education and, as noted, had two children here. After their second son was born, the family moved to France, and later to the United States. In the United States, Mr. Bezrukov obtained a Masters of Public Administration at Harvard University and

worked as a consultant, all while working to collect information on a variety of sensitive national security issues for the SVR. The nature of the undercover work of Ms. Vavilova and Mr. Bezrukov meant that there was no point at which either of them had any publicly acknowledged affiliation with the Russian state, held any official diplomatic or consular status, or had been granted any diplomatic privilege or immunity.

[149] Until he was about 16 years old, Mr. Vavilov did not know that his parents were not who they claimed to be. He believed that he was a Canadian citizen by birth, lived and identified as a Canadian, held a Canadian passport, learned both official languages and was proud of his heritage. His parents' true identities became known to him on June 27, 2010, when they were arrested in the United States and charged (along with several other individuals) with conspiracy to act as unregistered agents of a foreign government. On July 8, 2010, they pled guilty, admitted their status as Russian citizens acting on behalf of the Russian state, and were returned to Russia in a "spy swap" the following day. Mr. Vavilov has described the revelation as a traumatic event characterized by disbelief and a crisis of identity.

[150] Just prior to his parents' deportation, Mr. Vavilov left the United States with his brother on a trip that had been planned before their parents' arrest, going first to Paris, and then to Russia on a tourist visa. In October 2010, Mr. Vavilov unsuccessfully attempted to renew his Canadian passport through the Canadian Embassy in Moscow. Although he submitted to DNA testing and changed his

surname from Foley to Vavilov at the behest of passport authorities, his second attempt to obtain a Canadian passport in December 2011 was also unsuccessful. He was then informed that despite his Canadian birth certificate, he would also need to obtain and provide a certificate of Canadian citizenship before he would be issued a passport. Mr. Vavilov applied for that certificate in October 2012, and it was issued to him on January 15, 2013. At that point, he made another passport application through the Canadian Embassy in Buenos Aires, Argentina, and, after a delay, applied for mandamus, a process that was settled out of court in June 2013. The Minister of Citizenship and Immigration undertook to issue a new travel document to Mr. Vavilov by July 19, 2013.

[151] However, Mr. Vavilov never received a passport. Instead, he received a "procedural fairness letter" from the Canadian Registrar of Citizenship dated July 18, 2013 in which the Registrar stated that Mr. Vavilov had not been entitled to a certificate of citizenship, that his certificate of citizenship had been issued in error and that, pursuant to s. 3(2)(a) of the *Citizenship Act*, he was not a citizen of Canada. Mr. Vavilov was invited to make submissions in response, and he did so. On August 15, 2014, the Registrar formally cancelled Mr. Vavilov's Canadian citizenship certificate pursuant to s. 26(3) of the *Citizenship Regulations*.

B. *Procedural History*

(1) Registrar's Decision

[152] In a brief letter sent to Mr. Vavilov on August 15, 2014, the Registrar informed him that she was cancelling his certificate of citizenship pursuant to s. 26(3) of the *Citizenship Regulations* on the basis that he was not entitled to it. The Registrar summarized her position as follows:

a) Although Mr. Vavilov was born in Toronto, neither of his parents was a citizen of Canada, and neither of them had been lawfully admitted to Canada for permanent residence at the time of his birth.

b) In 2010, Mr. Vavilov's parents were convicted of "conspiracy to act in the United States as a foreign agent of a foreign government", and recognized as unofficial agents working as "illegals" for the SVR.

c) As a result, the Registrar believed that, at the time of Mr. Vavilov's birth, his parents were "employees or representatives of a foreign government".

d) Accordingly, pursuant to s. 3(2)(a) of the *Citizenship Act*, Mr. Vavilov had never been a Canadian citizen and had not been entitled to receive the certificate of Canadian citizenship that had been issued to him in 2013. Section 3(2)(a) provides that s. 3(1)(a) of the *Citizenship Act* (which grants citizenship by birth to persons born in Canada after February 14, 1977) does not apply to an individual if, at the time of the individual's birth, neither of their parents was a citizen or lawfully admitted to Canada for permanent residence and either parent was "a diplomatic or consular officer or other representative or employee in Canada of a foreign government."

[153] For these reasons, the Registrar cancelled the certificate and indicated that Mr. Vavilov would no longer be recognized as a Canadian citizen. The Registrar's letter did not offer any analysis or interpretation of s. 3(2)(a) of the *Citizenship Act*. However, it appears that in coming to her decision, the Registrar relied on a 12-page report prepared by a junior analyst, which included an interpretation of this key statutory provision.

[154] In that report, the analyst provided a timeline of the procedural history of Mr. Vavilov's file, a summary of the investigation into and charges against his parents in the United States, and background information on the SVR's "illegals" program. The analyst also discussed several provisions of the *Citizenship Act*, including s. 3(2)(a), and it is this aspect of her report that is most relevant to Mr. Vavilov's application for judicial review. The analyst's ultimate conclusion was that the certificate of citizenship issued to Mr. Vavilov in January 2013 was issued in error, as his parents had been "working as employees or representatives of a foreign government (the Russian Federation) during the time they resided in Canada, including at the time of Mr. Vavilov's birth", and that "[a]s such, Mr. Vavilov was not entitled to receive a citizenship certificate pursuant to paragraph 3(2)(a) of the *Citizenship Act*": A.R., Vol. I, at p. 3. The report was dated June 24, 2014.

[155] In discussing the relevant legislation, the analyst cited s. 3(1)(a) of the *Citizenship Act*, which establishes the general rule that persons born in Canada after February 14, 1977 are Canadian citizens. The analyst also referred to an exception to that general rule set out in s. 3(2) of the *Citizenship Act*, which reads as follows:

> (2) Paragraph (1)(a) does not apply to a person if, at the time of his birth, neither of his parents was a citizen or lawfully admitted to Canada for permanent residence and either of his parents was
>
> (a) a diplomatic or consular officer or other representative or employee in Canada of a foreign government;
>
> (b) an employee in the service of a person referred to in paragraph (a); or
>
> (c) an officer or employee in Canada of a specialized agency of the United Nations or an officer or employee in Canada of any other international organization to whom there are granted, by or under any Act of Parliament, diplomatic privileges and immunities certified by the Minister of Foreign Affairs to be equivalent to those granted to a person or persons referred to in paragraph (a).

[156] The analyst noted that s. 3(2)(a) refers both to diplomatic and consular officers and to *other* representatives or employees of a foreign government. She acknowledged that the term “diplomatic or consular officer” is defined in s. 35(1) of the *Interpretation Act* and that the definition lists a large number of posts within a foreign mission or consulate. However, the analyst observed that no statutory definition exists for the phrase “other representative or employee in Canada of a foreign government.”

[157] The analyst compared the wording of s. 3(2)(a) with that of a similar provision in predecessor legislation. That provision, s. 5(3)(b) of the *Canadian Citizenship Act*, R.S.C. 1970, c. C-19, excluded from citizenship children whose "responsible parent" at the time of birth was:

> (i) a foreign diplomatic or consular officer or a representative of a foreign
> government accredited to Her Majesty,
> (ii) an employee of a foreign government attached to or in the service of a foreign diplomatic mission or consulate in Canada, or
> (iii) an employee in the service of a person referred to in subparagraph (i).

[158] The analyst reasoned that because s. 3(2)(a) "makes reference to 'representatives or employees of a foreign government,' but does not link the representatives or employees to 'attached to or in the service of a foreign diplomatic mission or consulate in Canada' (as did the earlier version of the provision), it is reasonable to maintain that this provision intends to encompass individuals not included in the definition of 'diplomatic and consular staff'": A.R., vol. I, at p. 7.

[159] Although the analyst acknowledged that "Ms. Vavilova and Mr. Bezrukov, were employed in Canada by a foreign government without the benefits or protections (i.e.: immunity) that accompany diplomatic, consular, or official status positions", she concluded that they were nonetheless "unofficial employees or representatives" of Russia at the time of Mr. Vavilov's birth: A.R., vol. I, at p. 13. The exception in s. 3(2)(a) of the *Citizenship Act*, as she interpreted it, therefore applied to Mr. Vavilov. As a result, the analyst recommended that the Canadian

Registrar of Citizenship "recall" Mr. Vavilov's certificate on the basis that he was not, and had never been, entitled to citizenship.

(2) Federal Court (Bell J.), 2015 FC 960, [2016] 2 F.C.R. 39

[160] Mr. Vavilov sought and was granted leave to bring an application for judicial review of the Registrar's decision in the Federal Court pursuant to s. 22.1 of the *Citizenship Act*. His application was dismissed.

[161] The Federal Court rejected Mr. Vavilov's argument that the Registrar had breached her duty of procedural fairness by failing to disclose the documentation that had prompted the procedural fairness letter. In the Federal Court's view, the Registrar had provided Mr. Vavilov sufficient information to allow him to meaningfully respond, and had thereby satisfied the requirements of procedural fairness in the circumstances.

[162] The Federal Court also rejected Mr. Vavilov's challenge to the Registrar's interpretation of s. 3(2)(a) of the *Citizenship Act*. Applying the correctness standard, the Federal Court agreed with the Registrar that undercover foreign operatives living in Canada fall within the meaning of the phrase "diplomatic or consular officer or other representative or employee in Canada of a foreign government" in s. 3(2)(a). In the Federal Court's view, to interpret s. 3(2)(a) in any other way would render the phrase "other representative or employee in Canada of a foreign government" meaningless and would lead to the "absurd result" that "children

of a foreign diplomat, registered at an embassy, who conducts spy operations, cannot claim Canadian citizenship by birth in Canada but children of those who enter unlawfully for the very same purpose, become Canadian citizens by birth": para. 25.

[163] Finally, the Federal Court was satisfied, given the evidence, that the Registrar's conclusion that Mr. Vavilov's parents had at the time of his birth been in Canada as part of an undercover operation for the Russian government was reasonable.

(3) Federal Court of Appeal (Stratas J.A. with Webb J.A. Concurring; Gleason J.A. Dissenting), 2017 FCA 132, [2018] 3 F.C.R. 75

[164] A majority of the Federal Court of Appeal allowed Mr. Vavilov's appeal from the Federal Court's judgment and quashed the Registrar's decision.

[165] The Court of Appeal unanimously rejected Mr. Vavilov's argument that he had been denied procedural fairness by the Registrar. In the Court of Appeal's view, the Registrar had provided Mr. Vavilov sufficient information in the procedural fairness letter to enable him to know the case to meet. Even if Mr. Vavilov had been entitled to more information at the time of that letter, the court indicated that his procedural fairness challenge would nevertheless have failed because he had subsequently obtained that additional information through his own efforts and was able to make meaningful submissions.

[166] The Court of Appeal was also unanimously of the view that the appropriate standard of review for the Registrar's interpretation and application of s. 3(2)(a) of the *Citizenship Act* was reasonableness. It split, however, on the application of that standard to the Registrar's decision.

[167] The majority of the Court of Appeal concluded that the analyst's interpretation of s. 3(2)(a), which the Registrar had adopted, was unreasonable and that the Registrar's decision should be quashed. The analysis relied on by the Registrar on the statutory interpretation issue was confined to a consideration of the text of s. 3(2)(a) and an abbreviated review of its legislative history, which totally disregarded its purpose or context. In the majority's view, such a "cursory and incomplete approach to statutory interpretation" in a case such as this was indefensible: para. 44. Moreover, when the provision's purpose and its context were taken into account, the only reasonable conclusion was that the phrase "employee in Canada of a foreign government" in s. 3(2)(a) was meant to apply only to individuals who have been granted diplomatic privileges and immunities under international law. Because it was common ground that neither of Mr. Vavilov's parents had been granted such privileges or immunities, s. 3(2)(a) did not apply to him. The cancellation of his citizenship certificate on the basis of s. 3(2)(a) therefore could not stand, and Mr. Vavilov was entitled to Canadian citizenship under the *Citizenship Act*.

[168] The dissenting judge disagreed, finding that the Registrar's interpretation of s. 3(2)(a) was reasonable. According to the dissenting judge, the text of that provision admits of at least two rational interpretations: one that includes all employees of a foreign government and one that is restricted to those who have been granted diplomatic privileges and immunities. In the dissenting judge's view, the former interpretation is not foreclosed by the context or the purpose of the provision. It was thus open to the Registrar to conclude that Mr. Vavilov's parents fell within the scope of s. 3(2)(a). The dissenting judge would have upheld the Registrar's decision.

C. *Analysis*

(1) Standard of Review

[169] Applying the standard of review analysis set out above leads to the conclusion that the standard to be applied in reviewing the merits of the Registrar's decision is reasonableness.

[170] When a court reviews the merits of an administrative decision, reasonableness is presumed to be the applicable standard of review, and there is no basis for departing from that presumption in this case. The Registrar's decision has come before the courts by way of judicial review, not by way of a statutory appeal. On this point, we note that ss. 22.1 through 22.4 of the *Citizenship Act* lay down rules that govern applications for judicial review of decisions made under that Act, one of which, in s. 22.1(1), is that such an application may be made only with leave of the

Federal Court. However, none of these provisions allow for a party to bring an appeal from a decision under the *Citizenship Act*. Given this fact, and given that Parliament has not prescribed the standard to be applied on judicial review of the decision at issue, there is no indication that the legislature intended a standard of review other than reasonableness to apply. The Registrar's decision does not give rise to any constitutional questions, general questions of law of central importance to the legal system as a whole or questions regarding the jurisdictional boundaries between two or more administrative bodies. As a result, the standard to be applied in reviewing the decision is reasonableness.

(2) Review for Reasonableness

[171] The principal issue before this Court is whether it was reasonable for the Registrar to find that Mr. Vavilov's parents had been "other representative[s] or employee[s] in Canada of a foreign government" within the meaning of s. 3(2)(a) of the *Citizenship Act*.

[172] In our view, it was not. The Registrar failed to justify her interpretation of s. 3(2)(a) of the *Citizenship Act* in light of the constraints imposed by the text of s. 3 of the *Citizenship Act* considered as a whole, by other legislation and international treaties that inform the purpose of s. 3, by the jurisprudence on the interpretation of s. 3(2)(a), and by the potential consequences of her interpretation. Each of these elements — viewed individually and cumulatively — strongly supports the conclusion that s. 3(2)(a) was not intended to apply to children of foreign government

representatives or employees who have not been granted diplomatic privileges and immunities. Though Mr. Vavilov raised many of these considerations in his submissions in response to the procedural fairness letter (A.R., vol. IV, at pp. 448-52), the Registrar failed to address those submissions in her reasons and did not, to justify her interpretation of s. 3(2)(a), do more than conduct a cursory review of the legislative history and conclude that her interpretation was not explicitly precluded by the text of s. 3(2)(a).

[173] Our review of the Registrar's decision leads us to conclude that it was unreasonable for her to find that the phrase "diplomatic or consular officer or other representative or employee in Canada of a foreign government" applies to individuals who have not been granted diplomatic privileges and immunities in Canada. It is undisputed that Mr. Vavilov's parents had not been granted such privileges and immunities. No purpose would therefore be served by remitting this matter to the Registrar.

(a) *Section 3(2) of the Citizenship Act*

[174] The analyst justified her conclusion that Mr. Vavilov is not a citizen of Canada by reasoning that his parents were "other representative[s] or employee[s] in Canada of a foreign government" within the meaning of s. 3(2)(a) of the *Citizenship Act*. Section 3(2)(a) provides that children of "a diplomatic or consular officer or other representative or employee in Canada of a foreign government" are exempt from the general rule in s. 3(1)(a) that individuals born in Canada after February 14,

1977 acquire Canadian citizenship by birth. The analyst observed that although the term "diplomatic or consular officer" is defined in the *Interpretation Act* and does not apply to individuals like Mr. Vavilov's parents, the phrase "other representative or employee in Canada of a foreign government" is not so defined, and may apply to them.

[175] The analyst's attempt to give the words "other representative or employee in Canada of a foreign government" a meaning distinct from that of "diplomatic or consular officer" is sensible. It is generally consistent with the principle of statutory interpretation that Parliament intends each word in a statute to have meaning: Sullivan, at p. 211. We accept that if the phrase "other representative or employee in Canada of a foreign government" were considered in isolation, it could apply to a spy working in the service of a foreign government in Canada. However, the analyst failed to address the immediate statutory context of s. 3(2)(a), including the closely related text in s. 3(2)(c):

> (2) Paragraph (1)(a) does not apply to a person if, at the time of his birth, neither of his parents was a citizen or lawfully admitted to Canada for permanent residence and either of his parents was
>
> (a) a diplomatic or consular officer or other representative or employee in Canada of a foreign government;
>
> (b) an employee in the service of a person referred to in paragraph (a); or
>
> (c) an officer or employee in Canada of a specialized agency of the United Nations or an officer or employee in Canada of any other international organization to whom there are granted, by or under any Act of Parliament, diplomatic privileges and immunities

certified by the Minister of Foreign Affairs to be equivalent to those granted to a person or persons referred to in paragraph (a).

[176] As the majority of the Court of Appeal noted (at paras. 61-62), the wording of s. 3(2)(c) provides clear support for the conclusion that *all* of the persons contemplated by s. 3(2)(a) — including those who are “employee[s] in Canada of a foreign government” — must have been granted diplomatic privileges and immunities in some form. If, as the Registrar concluded, s. 3(2)(a) includes persons who do not benefit from these privileges or immunities, it is difficult to understand how effect could be given to the explicit equivalency requirement articulated in s. 3(2)(c). However, the analyst did not account for this tension in the immediate statutory context of s. 3(2)(a).

(b) *The Foreign Missions and International Organizations Act and the Treaties It Implements*

[177] Before the Registrar, Mr. Vavilov argued that s. 3(2) of the *Citizenship Act* must be read in conjunction with both the *Foreign Missions and International Organizations Act*, S.C. 1991, c. 41 (“*FMIOA*”), and the *Vienna Convention on Diplomatic Relations*, Can. T.S. 1966 No. 29 (“*VCDR*”). The *VCDR* and the *Vienna Convention on Consular Relations*, Can. T.S. 1974 No. 25, are the two leading treaties that extend diplomatic and/or consular privileges and immunities to employees and representatives of foreign governments in diplomatic missions and consular posts. Parliament has implemented the relevant provisions of both conventions by means of s. 3(1) of the *FMIOA*.

[178] To begin, we note that Canada affords citizenship in accordance both with the principle of *jus soli*, the acquisition of citizenship through birth regardless of the parents' nationality, and with that of *jus sanguinis*, the acquisition of citizenship by descent, that is through a parent: *Citizenship Act*, s. 3(1)(a) and (b); see I. Brownlie, *Principles of Public International Law* (5th ed. 1998), at pp. 391-93. These two principles operate as a backdrop to s. 3 of the *Citizenship Act* as a whole. It is undisputed that s. 3(2)(a) operates as an exception to these general rules. However, Mr. Vavilov took a narrower view of that exception than did the Registrar. In his submissions to the Registrar, he argued that Parliament intended s. 3(2) of the *Citizenship Act* to simply mirror the *FMIOA* and the *VCDR*, as well as Article II of the *Optional Protocol to the Vienna Convention on Diplomatic Relations, concerning Acquisition of Nationality*, 500 U.N.T.S. 223, which provides that "[m]embers of the mission not being nationals of the receiving State, and members of their families forming part of their household, shall not, solely by the operation of the law of the receiving State, acquire the nationality of that State". Mr. Vavilov made the following submission to the Registrar:

> The purpose in excluding diplomats and their families, including newborn children, from acquiring citizenship in the receiving state relates to the immunities which extend to this group of people. Diplomats and their family members are immune from criminal prosecution and civil liability in the receiving state. As such, they cannot acquire citizenship in the receiving state and also benefit from these immunities. A citizen has duties and responsibilities to its country. Immunity is inconsistent with this principle and so does not apply to citizens. See Article 37 of the *Convention*.
>
> Section 3(2) legislates into Canadian domestic law the above principles and should be narrowly interpreted with these purposes in

> mind. The term "employee in Canada of a foreign government" must be interpreted to mean an employee of a diplomatic mission, or connected to it, who benefits from the immunities of the *Convention*. Any other interpretation would lead to absurd results. There is no purpose served in excluding any child born of a person not having a connection to a diplomatic mission in Canada while sojourning here from the principle of *Jus soli*.
>
> (A.R., vol. IV, at pp. 449-50)

[179] In *Al-Ghamdi v. Canada (Minister of Foreign Affairs & International Trade)*, 2007 FC 559, 64 Imm. L. R. (3d) 67, a case which was referred to in the analyst's report and which we will discuss in greater detail below, the Federal Court, at para. 53, quoted a passage by Professor Brownlie on this point:

> Of particular interest are the special rules relating to the jus soli, appearing as exceptions to that principle, the effect of the exceptions being to remove the cases where its application is clearly unjustifiable. A rule which has very considerable authority stipulated that children born to persons having diplomatic immunity shall not be nationals by birth of the state to which the diplomatic agent concerned is accredited. Thirteen governments stated the exception in the preliminaries of the Hague Codification Conference. In a comment on the relevant article of the Harvard draft on diplomatic privileges and immunities it is stated: 'This article is believed to be declaratory of an established rule of international law'. The rule receives ample support from legislation of states and expert opinion. The Convention on Certain Questions relating to the Conflict of Nationality Laws of 1930 provides in Article 12: 'Rules of law which confer nationality by reasons of birth on the territory of a State shall not apply automatically to children born to persons enjoying diplomatic immunities in the country where the birth occurs.'
>
> In 1961 the United Nations Conference on Diplomatic Intercourse and Immunities adopted an Optional Protocol concerning Acquisition of Nationality, which provided in Article II: 'Members of the mission not being nationals of the receiving State, and members of their families forming part of their household, shall not, solely by the operation of the law of the receiving State, acquire the nationality of that State'.

> Some states extend the rule to the children of consuls, and there is some support for this from expert opinion. [Emphasis deleted.]
>
> (Brownlie, at pp. 392-93).

[180] Mr. Vavilov included relevant excerpts from the parliamentary debate that had preceded the enactment of the *Citizenship Act* in support of his argument that the very purpose of s. 3(2) of the *Citizenship Act* was to align Canada's citizenship rules with these principles of international law. These excerpts describe s. 3(2) as "conform[ing] to international custom" and as having been drafted with the intention of "exclud[ing] children born in Canada to diplomats from becoming Canadian citizens": Hon. J. Hugh Faulkner, Secretary of State of Canada, House of Commons, *Minutes of Proceedings and Evidence of the Standing Committee on Broadcasting, Films and Assistance to the Arts, respecting Bill C-20*, *An Act respecting citizenship*, No. 34, 1st Sess., 30th Parl., February 24, 1976, at 34:23. The record of that debate also reveals that Parliament took care to avoid the danger that because of how some provisions were written, "a number of other people would be affected such as those working for large foreign corporations": *ibid*. Although the analyst discussed the textual difference between s. 3(2) and a similar provision in the former *Canadian Citizenship Act*, she did not grapple with these other elements of the legislative history, despite the fact that they cast considerable doubt on her conclusions, indicating that s. 3(2) was not intended to affect the status of individuals whose parents have not been granted diplomatic privileges and immunities.

[181] In attempting to distinguish the meaning of the phrase "other representative or employee in Canada of a foreign government" from that of the term "diplomatic or consular officer", the analyst also appeared to overlook the possibility that some individuals who fall into the former category might be granted privileges or immunities despite not being considered "diplomatic or consular officer[s]" under the *Interpretation Act*. Yet, as the majority of the Federal Court of Appeal pointed out, such individuals do in fact exist: paras. 53-55, citing *FMIOA*, at ss. 3 and 4 and Sched. II, Articles 1, 41, 43, 49, and 53. In light of Mr. Vavilov's submissions regarding the purpose of s. 3(2), the failure to consider this possibility is a noticeable omission.

[182] It is well established that domestic legislation is presumed to comply with Canada's international obligations, and that it must be interpreted in a manner that reflects the principles of customary and conventional international law: *Appulonappa*, at para. 40; see also *Pushpanathan*, at para. 51; *Baker*, at para. 70; *GreCon Dimter inc. v. J.R. Normand inc.*, 2005 SCC 46, [2005] 2 S.C.R. 401, at para. 39; *Hape*, at paras. 53- 54; *B010 v. Canada (Citizenship and Immigration)*, 2015 SCC 58, [2015] 3 S.C.R. 704, at para. 48; *India v. Badesha*, 2017 SCC 44, [2017] 2 S.C.R. 127, at para. 38; *Office of the Children's Lawyer v. Balev*, 2018 SCC 16, [2018] 1 S.C.R. 398, at paras. 31-32. Yet the analyst did not refer to the relevant international law, did not inquire into Parliament's purpose in enacting s. 3(2) and did not respond to Mr. Vavilov's submissions on this issue. Nor did she advance any alternate explanation for why Parliament would craft such a provision in the first place. In the face of

compelling submissions that the underlying rationale of s. 3(2) was to implement a narrow exception to a general rule in a manner that was consistent with established principles of international law, the analyst and the Registrar chose a different interpretation without offering any reasoned explanation for doing so.

(c) *Jurisprudence Interpreting Section 3(2) of the Citizenship Act*

[183] Although the analyst cited three Federal Court decisions on s. 3(2)(a) of the *Citizenship Act* in a footnote, she dismissed them as being irrelevant on the basis that they related only to "individuals whose parents maintained diplomatic status in Canada at the time of their birth". But this distinction, while true, does not explain why the *reasoning* employed in those decisions, which directly concerned the scope, the meaning and the legislative purpose of s. 3(2)(a), was inapplicable in Mr. Vavilov's case. Had the analyst considered just the three cases cited in her report — *Al-Ghamdi*; *Lee v. Canada (Minister of Citizenship and Immigration)*, 2008 FC 614, [2009] 1 F.C.R. 204; and *Hitti v. Canada (Minister of Citizenship and Immigration)*, 2007 FC 294, 310 F.T.R. 169 — it would have been evident to her that she needed to grapple with and justify her interpretation in light of the persuasive and comprehensive legal reasoning that supports the position that s. 3(2)(a) was intended to apply only to those individuals whose parents have been granted diplomatic privileges and immunities.

[184] In *Al-Ghamdi*, the Federal Court considered the constitutionality of paras. (a) and (c) of s. 3(2) of the *Citizenship Act* in reviewing a decision in which

Passport Canada had refused to issue a passport to a child of a Saudi Arabian diplomat. In its reasons, the court came to a number of conclusions regarding the purpose and scope of s. 3(2), including, at para. 5, that:

> The only individuals covered in paragraphs 3(2)(a) and (c) of the *Citizenship Act* are children of individuals with diplomatic status. These are individuals who enter Canada under special circumstances and without undergoing any of the normal procedures. Most importantly, while in Canada, they are granted all of the immunities and privileges of diplomats . . . .

[185] The court went on to extensively document the link between the exception to the rule of citizenship by birth set out in s. 3(2) of the *Citizenship Act* and the rules of international law, the *FMIOA* and the *VCDR*: *Al-Ghamdi*, at paras. 52 et. seq. It noted that there is an established rule of international law that children born to parents who enjoy diplomatic immunities are not entitled to automatic citizenship by birth, and that their status in this respect is an exception to the principle of *jus soli*: *Al-Ghamdi*, at para. 53, quoting Brownlie, at pp. 391-93. In finding that the exceptions under s. 3(2) to citizenship on the basis of *jus soli* do not infringe the rights of children of diplomats under s. 15 of the *Charter*, the court emphasized that *all* children to whom s. 3(2) applies are entitled to an "extraordinary array of privileges under the *Foreign Missions and International Organizations Act*": *Al-Ghamdi*, at para. 62. Citing the *VCDR*, it added that "[i]t is precisely because of the vast array of privileges accorded to diplomats and their families, which are by their very nature inconsistent with the obligations of citizenship, that a person who enjoys diplomatic status cannot acquire citizenship": para. 63. In its analysis under s. 1 of the

Charter, the court found that the choice to deny citizenship to individuals provided for in s. 3(2) is "tightly connected" to a pressing government objective of ensuring "that no citizen is immune from the obligations of citizenship", such as the obligations to pay taxes and comply with the criminal law: *Al-Ghamdi*, at paras. 74-75. In the case at bar, the analyst failed entirely to engage with the arguments endorsed by the Federal Court in *Al-Ghamdi* despite the court's key finding that s. 3(2)(a) applies only to "children born of foreign diplomats or an equivalent", a conclusion upon which the very constitutionality of the provision turned: *Al-Ghamdi*, at paras. 3, 9, 27, 28, 56 and 59.

[186] In *Lee*, another case cited by the analyst, the Federal Court confirmed the finding in *Al-Ghamdi* that "[t]he only individuals covered in paragraphs 3(2)(a) and (c) of the *Citizenship Act* are children of individuals with diplomatic status": *Lee*, at para. 77. The court found in *Lee* that the "functional duties of the applicant's father" were not relevant to whether or not the applicant was excluded from citizenship pursuant to s. 3(2)(a) of the *Citizenship Act*: para. 58. Rather, what mattered was only that at the time of the applicant's birth, his father had been a registered consular official and had held a diplomatic passport and the title of Vice-Consul: paras. 44, 58, 61 and 63.

[187] *Hitti*, the third case cited in the analyst's report, concerned a decision to confiscate two citizenship certificates on the basis that, under s. 3(2) of the *Citizenship Act*, their holders had never been entitled to them. In that case, the

applicants' father, a Lebanese citizen, had been employed as an information officer of the League of Arab States in Ottawa. Although the League did not have diplomatic standing at that time, Canada had agreed as a matter of courtesy to extend diplomatic status to officials of the League's information centre, treating them as "attachés" of their home countries' embassies: *Hitti*, at paras. 6 and 9; see also *Interpretation Act*, s. 35(1). Mr. Hitti argued he did not, in practice, fulfill diplomatic tasks or act as a representative of Lebanon, but there was nonetheless a record of his being an accredited diplomat, enjoying the benefits of that status and being covered by the *VCDR* when his children were born: paras. 5 and 8. The Federal Court rejected a submission that Mr. Hitti would have had to perform duties in the service of Lebanon in order for his children to fall within the meaning of s. 3(2)(a), and concluded that "what Mr. Hitti did when he was in the country is not relevant": para. 32.

[188] What can be seen from both *Lee* and *Hitti* is that what matters, for the purposes of s. 3(2)(a), is not whether an individual carries out activities in the service of a foreign state while in Canada, but whether, at the relevant time, the individual has been granted diplomatic privileges and immunities. Thus, in addition to the Federal Court's decision in *Al-Ghamdi*, the analyst was faced with two cases in which the application of s. 3(2) had turned on the existence of diplomatic status rather than on the "functional duties" or activities of the child's parents. In these circumstances, it was a significant omission for her to ignore the Federal Court's reasoning when determining whether the espionage activities of Ms. Vavilova and Mr. Bezrukov were sufficient to ground the application of s. 3(2)(a).

(d) *Possible Consequences of the Registrar's Interpretation*

[189] When asked why the children of individuals referred to in s. 3(2)(a) would be excluded from acquiring citizenship by birth, another analyst involved in Mr. Vavilov's file (who had also been involved in Mr. Vavilov's brother's file) responded as follows:

> Well, usually the way we use section 3(2)(a) is for – you're right, for diplomats and that they don't -- because they are not -- they are not obliged . . . to the law of Canada and everything, so that's why their children do not obtain citizenship if they were born in Canada while the person was in Canada under that status. But then there is also this other part of the Act that says other representatives or employees of a foreign government in Canada, that may open the door for other person than diplomats and that's how we interpreted in this specific case 3(2)(a) but there is no jurisprudence on that.
>
> (R.R. transcript, at pp. 87-88)

[190] In other words, the officials responsible for these files were aware that s. 3(2)(a) was informed by the principle that individuals subject to the exception are "not obliged . . . to the law of Canada". They were also aware that the interpretation they had adopted in the case of the Vavilov brothers was a novel one. Although the Registrar knew this, she failed to provide a rationale for this expanded interpretation.

[191] Additionally, there is no evidence that the Registrar considered the potential consequences of expanding her interpretation of s. 3(2)(a) to include individuals who have not been granted diplomatic privileges and immunities. Citizenship has been described as "the right to have rights": U.S. Supreme Court

Chief Justice Earl Warren, as quoted in A. Brouwer, *Statelessness in Canadian Context: A Discussion Paper* (July 2003) (online), at p. 2. The importance of citizenship was recognized in *Benner v. Canada (Secretary of State)*, [1997] 1 S.C.R. 358, in which Iacobucci J., writing for this Court, stated: "I cannot imagine an interest more fundamental to full membership in Canadian society than Canadian citizenship": para. 68. This was reiterated in *Canada (Minister of Citizenship and Immigration) v. Tobiass*, [1997] 3 S.C.R. 391, in which this Court unanimously held that "[f]or some, such as those who might become stateless if deprived of their citizenship, it may be valued as highly as liberty": para. 108.

[192] It perhaps goes without saying that rules concerning citizenship require a high degree of interpretive consistency in order to shield against a perception of arbitrariness and to ensure conformity with Canada's international obligations. We can therefore only assume that the Registrar intended that this new interpretation of s. 3(2)(a) would apply to any other individual whose parent is employed by or represents a foreign government at the time of the individual's birth in Canada but has not been granted diplomatic privileges and immunities. The Registrar's interpretation would not, after all, limit the application of s. 3(2)(a) to the children of spies — its logic would be equally applicable to a number of other scenarios, including that of a child of a non-citizen worker employed by an embassy as a gardener or cook, or of a child of a business traveller who represents a foreign government-owned corporation. Mr. Vavilov had raised the fact that provisions such as s. 3(2)(a) must be given a narrow interpretation because they deny or potentially take away rights — that of

citizenship under s. 3(1) in this case — which otherwise benefit from a liberal and broad interpretation: *Brossard (Town) v. Québec (Commission des droits de la personne)*, [1988] 2 S.C.R. 279, at p. 307. Yet there is no indication that the Registrar considered the potential harsh consequences of her interpretation for such a large class of individuals, which included Mr. Vavilov, or the question whether, in light of those possible consequences, Parliament would have intended s. 3(2)(a) to apply in this manner.

[193] Moreover, we would note that despite following a different legal process, the Registrar's decision in this case had the same effect as a revocation of citizenship — a process which has been described by scholars as "a kind of 'political death'" — depriving Mr. Vavilov of his right to vote and the right to enter and remain in Canada: see A. Macklin, "Citizenship Revocation, the Privilege to Have Rights and the Production of the Alien" (2014), 40 *Queen's L.J.* 1, at pp. 7-8. While we question whether the Registrar was empowered to unilaterally alter Canada's position with respect to Mr. Vavilov's citizenship and recognize that the relationship between the cancellation of a citizenship certificate under s. 26 of the *Citizenship Regulations* and the revocation of an individual's citizenship (as set out in s. 10 of the *Citizenship Act*) is not clear, we leave this issue for another day because it was neither raised nor argued by the parties.

D. *Conclusion*

[194] Multiple legal and factual constraints may bear on a given administrative decision, and these constraints may interact with one another. In some cases, a failure to justify the decision against any one relevant constraint may be sufficient to cause the reviewing court to lose confidence in the reasonableness of the decision. Section 3 of the *Citizenship Act* considered as a whole, other legislation and international treaties that inform the purpose of s. 3, the jurisprudence cited in the analyst's report, and the potential consequences of the Registrar's decision point overwhelmingly to the conclusion that Parliament did not intend s. 3(2)(a) to apply to children of individuals who have not been granted diplomatic privileges and immunities. The Registrar's failure to justify her decision with respect to these constraints renders her interpretation unreasonable, and we would therefore uphold the Federal Court of Appeal's decision to quash the Registrar's decision.

[195] As noted above, we would exercise our discretion not to remit the matter to the Registrar for redetermination. Crucial to our decision is the fact that Mr. Vavilov explicitly raised all of these issues before the Registrar and that the Registrar had an opportunity to consider them but failed to do so. She offered no justification for the interpretation she adopted except for a superficial reading of the provision in question and a comment on part of its legislative history. On the other hand, there is overwhelming support — including in the parliamentary debate, established principles of international law, an established line of jurisprudence and the text of the provision itself — for the conclusion that Parliament did not intend s. 3(2)(a) of the *Citizenship Act* to apply to children of individuals who have not been granted

diplomatic privileges and immunities. That being said, we would stress that it is not our intention to offer a definitive interpretation of s. 3(2)(a) in all respects, nor to foreclose the possibility that multiple reasonable interpretations of other aspects might be available to administrative decision makers. In short, we do not suggest that there is necessarily "one reasonable interpretation" of the provision as a whole. But we agree with the majority of the Court of Appeal that it was *not* reasonable for the Registrar to interpret s. 3(2)(a) as applying to children of individuals who have not been granted diplomatic privileges and immunities at the time of the children's birth.

[196] Given that it is undisputed that Ms. Vavilova and Mr. Bezrukov, as undercover spies, were granted no such privileges, it would serve no purpose to remit the matter in this case to the Registrar. Given that Mr. Vavilov is a person who was born in Canada after February 14, 1977, his status is governed only by the general rule set out in s. 3(1)(a) of the *Citizenship Act*. He is a Canadian citizen.

E. *Disposition*

[197] The appeal is dismissed with costs throughout to Mr. Vavilov.

The following are the reasons delivered by

ABELLA AND KARAKATSANIS JJ. —

[198] Forty years ago, in *C.U.P.E., Local 963 v. New Brunswick Liquor Corporation*, [1979] 2 S.C.R. 227, this Court embarked on a course to recognize the unique and valuable role of administrative decision-makers within the Canadian legal order. Breaking away from the court-centric theories of years past, the Court encouraged judges to show deference when specialized administrative decision-makers provided reasonable answers to legal questions within their mandates. Building on this more mature understanding of administrative law, subsequent decisions of this Court sought to operationalize deference and explain its relationship to core democratic principles. These appeals offered a platform to clarify and refine our administrative law jurisprudence, while remaining faithful to the deferential path it has travelled for four decades.

[199] Regrettably, the majority shows our precedents no such fidelity. Presented with an opportunity to steady the ship, the majority instead dramatically reverses course — away from this generation's deferential approach and back towards a prior generation's more intrusive one. Rather than confirming a meaningful presumption of deference for administrative decision-makers, as our common law has increasingly done for decades, the majority's reasons strip away deference from hundreds of administrative actors subject to statutory rights of appeal; rather than following the consistent path of this Court's jurisprudence in understanding legislative intent as being the intention to leave legal questions within their mandate to specialized decision-makers with expertise, the majority removes expertise from the equation entirely and reformulates legislative intent as an overriding intention to

provide — or not provide — appeal routes; and rather than clarifying the role of reasons and how to review them, the majority revives the kind of search for errors that dominated the pre-*C.U.P.E.* era. In other words, instead of *reforming* this generation's evolutionary approach to administrative law, the majority *reverses* it, taking it back to the formalistic judge-centred approach this Court has spent decades dismantling.

[200] We support the majority's decision to eliminate the vexing contextual factors analysis from the standard of review framework and to abolish the shibboleth category of "true questions of jurisdiction". These improvements, accompanied by a meaningful presumption of deference for administrative decision-makers, would have simplified our judicial review framework and addressed many of the criticisms levied against our jurisprudence since *Dunsmuir v. New Brunswick*, [2008] 1 S.C.R. 190.

[201] But the majority goes much further and fundamentally reorients the decades-old relationship between administrative actors and the judiciary, by dramatically expanding the circumstances in which generalist judges will be entitled to substitute their own views for those of specialized decision-makers who apply their mandates on a daily basis. In so doing, the majority advocates a profoundly different philosophy of administrative law than the one which has guided our Court's jurisprudence for the last four decades. The majority's reasons are an encomium for correctness and a eulogy for deference.

The Evolution of Canadian Administrative Law

[202] The modern Canadian state "could not function without the many and varied administrative tribunals that people the legal landscape" (The Rt. Hon. Beverley McLachlin, *Administrative Tribunals and the Courts: An Evolutionary Relationship*, May 27, 2013 (online)). Parliament and the provincial legislatures have entrusted a broad array of complex social and economic challenges to administrative actors, including regulation of labour relations, welfare programs, food and drug safety, agriculture, property assessments, liquor service and production, infrastructure, the financial markets, foreign investment, professional discipline, insurance, broadcasting, transportation and environmental protection, among many others. Without these administrative decision-makers, "government would be paralyzed, and so would the courts" (Guy Régimbald, *Canadian Administrative Law* (2nd ed. 2015), at p. 3).

[203] In exercising their mandates, administrative decision-makers often resolve claims and disputes within their areas of specialization (Gus Van Harten et al., *Administrative Law: Cases, Text, and Materials* (7th ed. 2015), at p. 13). These claims and disputes vary greatly in scope and subject-matter. Corporate merger requests, professional discipline complaints by dissatisfied clients, requests for property reassessments and applications for welfare benefits, among many other matters, all fall within the purview of the administrative justice system.

[204] The administrative decision-makers tasked to resolve these issues come from many different walks of life (Van Harten et al., at p. 15). Some have legal

backgrounds, some do not. The diverse pool of decision-makers in the administrative system responds to the diversity of issues that it must resolve. To address this broad range of issues, administrative dispute-resolution processes are generally "[d]esigned to be less cumbersome, less expensive, less formal and less delayed" than their judicial counterparts — but "no less effectiv[e] or credibl[e]" (*Rasanen v. Rosemount Instruments Ltd.* (1994), 17 O.R. (3d) 267 (C.A.), at p. 279). In the field of labour relations, for example, Parliament explicitly rejected a court-based system to resolve workplace disputes in favour of a Labour Board, staffed with representatives from management and labour alongside an independent member (Bora Laskin, "Collective Bargaining in Ontario: A New Legislative Approach" (1943), 21 *Can. Bar Rev.* 684; John A. Willes, *The Ontario Labour Court: 1943-1944* (1979); Katherine Munro, "A 'Unique Experiment': The Ontario Labour Court, 1943-1944" (2014), 74 *Labour/Le Travail* 199). Other administrative processes — license renewals, zoning permit issuances and tax reassessments, for example — bear even less resemblance to the traditional judicial model.

[205] Courts, through judicial review, monitor the boundaries of administrative decision making. Questions about the standards of judicial review have been an enduring feature of Canadian administrative law. The debate, in recent times, has revolved around "reasonableness" and "correctness", and determining when each standard applies. On the one hand, "reasonableness" review expects courts to defer to decisions by specialized decision-makers that "are defensible in respect of the facts and law"; on the other, "correctness" review allows courts to substitute their own

opinions for those of the initial decision-maker (*Dunsmuir*, at paras. 47-50). This standard of review debate has profound implications for the extent to which reviewing courts may substitute their views for those of administrative decision-makers. At its core, it is a debate over two distinct philosophies of administrative law.

[206] The story of modern Canadian administrative law is the story of a shift away from the court-centric philosophy which denied administrative bodies the authority to interpret or shape the law. This approach found forceful expression in the work of Albert Venn Dicey. For Dicey, the rule of law meant the rule of courts. Dicey developed his philosophy at the end of the 19th century to encourage the House of Lords to restrain the government from implementing ameliorative social and welfare reforms administered by new regulatory agencies. Famously, Dicey asserted that administrative law was anathema to the English legal system (Albert Venn Dicey, *Introduction to the Study of the Law of the Constitution* (10th ed. 1959), at pp. 334-35). Because, in his view, only the judiciary had the authority to interpret law, there was no reason for a court to defer to legal interpretations proffered by administrative bodies, since their decisions did not constitute "law" (Kevin M. Stack, "Overcoming Dicey in Administrative Law" (2018), 68 *U.T.L.J.* 293, at p. 294).

[207] The canonical example of Dicey's approach at work is the House of Lords' decision in *Anisminic Ltd. v. Foreign Compensation Commission*, [1969] 2 A.C. 147, the judicial progenitor of "jurisdictional error". *Anisminic* entrenched non-deferential judicial review by endorsing a lengthy checklist of "jurisdictional errors"

capable of undermining administrative decisions. Lord Reid noted that there were two scenarios in which an administrative decision-maker would lose jurisdiction. The first was narrow and asked whether the legislature had empowered the administrative decision-maker to "enter on the inquiry in question" (p. 171). The second was wider:

> [T]here are many cases where, although the tribunal had jurisdiction to enter on the inquiry, it has done or failed to do something in the course of the inquiry which is of such a nature that its decision is a nullity. It may have given its decision in bad faith. It may have made a decision which it had no power to make. It may have failed in the course of the inquiry to comply with the requirements of natural justice. *It may in perfect good faith have misconstrued the provisions giving it power to act so that it failed to deal with the question remitted to it and decided some question which was not remitted to it. It may have refused to take into account something which it was required to take into account. Or it may have based its decision on some matter which, under the provisions setting it up, it had no right to take into account. I do not intend this list to be exhaustive.* [Emphasis added; p. 171.]

[208] The broad "jurisdictional error" approach in *Anisminic* initially found favour with this Court in cases like *Metropolitan Life Insurance Company v. International Union of Operating Engineers, Local 796*, [1970] S.C.R. 425, and *Bell v. Ontario Human Rights Commission*, [1971] S.C.R. 756. These cases "took the position that a definition of jurisdictional error should include any question pertaining to the interpretation of a statute made by an administrative tribunal", and in each case, "th[e] Court substituted what was, in its opinion, the correct interpretation of the enabling provision of the tribunal's statute for that of the tribunal" (*Canada (Attorney General) v. Public Service Alliance of Canada*, [1991] 1 S.C.R. 614, at p. 650, per Cory J., dissenting, but not on this point). In *Metropolitan Life*, for example, this

Court quashed a labour board's decision to certify a union, concluding that the Board had "ask[ed] itself the wrong question" and "decided a question which was not remitted to it" (p. 435). In *Bell*, this Court held that a human rights commission had strayed beyond its jurisdiction by deciding to investigate a complaint of racial discrimination filed against a landlord. The Court held that the Commission had incorrectly interpreted the term "self-contained dwelling uni[t]" found in s. 3 of the *Ontario Human Rights Code*, *1961-62*, S.O. 1961-62, c. 93, and by so doing, had lost jurisdiction to inquire into the complaint of discrimination (pp. 767 and 775).

[209] As these cases illustrate, the *Anisminic* approach proved easy to manipulate, allowing courts to characterize any question as "jurisdictional" and thereby give themselves latitude to substitute their own view of the appropriate answer without regard for the original decision-maker's decision or reasoning. The *Anisminic* era and the "jurisdictional error" approach were and continue to be subject to significant judicial and academic criticism (*Public Service Alliance*, at p. 650; *National Corn Growers Assn. v. Canada (Import Tribunal)*, [1990] 2 S.C.R. 1324, at p. 1335, per Wilson J., concurring; Beverley McLachlin, P.C., "'Administrative Law is Not for Sissies': Finding a Path Through the Thicket" (2016), 29 *C.J.A.L.P.* 127, at pp. 129-30; Jocelyn Stacey and Alice Woolley, "Can Pragmatism Function in Administrative Law?" (2016), 74 *S.C.L.R.* (2d) 211, at pp. 215-16; R.A. MacDonald, "Absence of Jurisdiction: A Perspective" (1983), 43 *R. du B.* 307).

[210] In 1979, the Court signaled a turn to a more deferential approach to judicial review with its watershed decision in *C.U.P.E.* There, the Court challenged the "jurisdictional error" model and planted the seeds of a home-grown approach to administrative law in Canada. In a frequently-cited passage, Dickson J., writing for a unanimous Court, cautioned that courts "should not be alert to brand as jurisdictional, and therefore subject to broader curial review, that which may be doubtfully so" (p. 233; cited in nearly 20 decisions of this Court, including *Dunsmuir*, at para. 35; *Canada (Citizenship and Immigration) v. Khosa*, [2009] 1 S.C.R. 339, at para. 45; *Alberta (Information and Privacy Commissioner) v. Alberta Teachers' Association*, [2011] 3 S.C.R. 654, at para. 33; *Canada (Canadian Human Rights Commission) v. Canada (Attorney General)*, [2018] 2 S.C.R. 230, at para. 31). The Court instead endorsed an approach that respected the legislature's decision to assign legal policy issues in some areas to specialized, non-judicial decision-makers. The Court recognized that legislative language could "bristl[e] with ambiguities" and that the interpretive choices made by administrative tribunals deserved respect from courts, particularly when, as in *C.U.P.E.*, the decision was protected by a privative clause (pp. 230 and 234-36).

[211] By championing "curial deference" to administrative bodies, *C.U.P.E.* embraced "a more sophisticated understanding of the role of administrative tribunals in the modern Canadian state" (*National Corn Growers*, at p. 1336, per Wilson J., concurring; *Domtar Inc. v. Quebec (Commission d'appel en matière de lésions professionnelles)*, [1993] 2 S.C.R. 756, at p. 800). As one scholar has observed:

> . . . legislatures and courts in . . . Canada have come to settle on the idea that the functional capacities of administrative agencies – their expertise, investment in understanding the practical circumstances at issue, openness to participation, and level of responsiveness to political change – justify not only their law-making powers but also judicial deference to their interpretations and decisions. *Law-making and legal interpretation are shared enterprises in the administrative state*. [Emphasis added.]
>
> (Stack, at p. 310)

[212] In explaining why courts must sometimes defer to administrative actors, *C.U.P.E.* embraced two related foundational justifications for Canada's approach to administrative law — one based on the legislature's express choice to have an administrative body decide the issues arising from its mandate; and one animated by the recognition that an administrative justice system could offer institutional advantages in relation to proximity, efficiency, and specialized expertise (David Dyzenhaus, "The Politics of Deference: Judicial Review and Democracy" in Michael Taggart, ed., *The Province of Administrative Law* (1997), 279 at p. 304).

[213] A new institutional relationship between the courts and administrative actors was thus being forged, based on "an understanding of the role of expertise in the modern administrative state" which "acknowledge[d] that judges are not always in the best position to interpret the law" (The Hon. Frank Iacobucci, "Articulating a Rational Standard of Review Doctrine: A Tribute to John Willis" (2002), 27 *Queen's L.J.* 859, at p. 866).

[214] In subsequent decades, the Court attempted to reconcile the deference urged by *C.U.P.E.* with the lingering concept of "jurisdictional error". In *U.E.S.*,

Local 298 v. Bibeault, [1988] 2 S.C.R. 1048, the Court introduced the "pragmatic and functional" approach for deciding when a matter was within the jurisdiction of an administrative body. Instead of describing jurisdiction as a preliminary or collateral matter, the *Bibeault* test directed reviewing courts to consider the wording of the enactment conferring jurisdiction on the administrative body, the purpose of the statute creating the tribunal, the reason for the tribunal's existence, the area of expertise of its members, and the nature of the question the tribunal had to decide — all to determine whether the legislator "intend[ed] the question to be within the jurisdiction conferred on the tribunal" (p. 1087; see also p. 1088). If so, the tribunal's decision could only be set aside if it was "patently unreasonable" (p. 1086).

[215] Although still rooted in a formalistic search for jurisdictional errors, the pragmatic and functional approach recognized that legislatures had assigned courts and administrative decision-makers distinct roles, and that the specialization and expertise of administrative decision-makers deserved deference. In her concurring reasons in *National Corn Growers*, Wilson J. noted that part of the process of moving away from Dicey's framework and towards a more sophisticated understanding of the role of administrative tribunals:

> . . . has involved a growing recognition on the part of courts that they may simply not be as well equipped as administrative tribunals or agencies to deal with issues which Parliament has chosen to regulate through bodies exercising delegated power, e.g., labour relations, telecommunications, financial markets and international economic relations. Careful management of these sectors often requires the use of experts who have accumulated years of experience and a specialized understanding of the activities they supervise. [p. 1336]

[216] By the mid-1990s, the Court had accepted that specialization and the legislative intent to leave issues to administrative decision-makers were inextricable and essential factors in the standard of review analysis. It stressed that "the expertise of the tribunal is of the utmost importance in determining the intention of the legislator with respect to the degree of deference to be shown to a tribunal's decision . . . [e]ven where the tribunal's enabling statute provides explicitly for appellate review" (*United Brotherhood of Carpenters and Joiners of America, Local 579 v. Bradco Construction Ltd.*, [1993] 2 S.C.R. 316, at p. 335). Of the factors relevant to setting the standard of review, expertise was held to be "the most important" (*Canada (Director of Investigation and Research) v. Southam Inc.*, [1997] 1 S.C.R. 748, at para. 50).

[217] Consistent with these judgments, this Court invoked the specialized expertise of a securities commission to explain why its decisions were entitled to deference on judicial review even when there was a statutory right of appeal. Writing for a unanimous Court, Iacobucci J. explained that "the concept of the specialization of duties requires that deference be shown to decisions of specialized tribunals on matters which fall squarely within the tribunal's expertise" (*Pezim v. British Columbia (Superintendent of Brokers)*, [1994] 2 S.C.R. 557, at p. 591; see also *Bell Canada v. Canada (Canadian Radio-Television and Telecommunications Commission)*, [1989] 1 S.C.R. 1722, at pp. 1745-46). Critically, the Court's willingness to show deference demonstrated that specialization outweighed a statutory appeal as the most significant indicator of legislative intent.

[218] In *Pushpanathan v. Canada (Minister of Citizenship and Immigration)*, [1998] 1 S.C.R. 982, the Court reformulated the pragmatic and functional approach, engaging four slightly different factors from those in *Bibeault*, namely: (1) whether there was a privative clause, or conversely, a right of appeal; (2) the expertise of the decision-maker on the matter in question relative to the reviewing court; (3) the purpose of the statute as a whole, and of the provision in particular; and (4) the nature of the problem, i.e., whether it was a question of law, fact, or mixed law and fact (paras. 29-37). Instead of using these factors to answer whether a question was jurisdictional, *Pushpanathan* deployed them to discern how much deference the legislature intended an administrative decision to receive on judicial review. *Pushpanathan* confirmed three standards of review: patent unreasonableness, reasonableness *simpliciter*, and correctness (para. 27; see also *Southam*, at paras. 55-56).

[219] Significantly, *Pushpanathan* did not disturb the finding reaffirmed in *Southam* that specialized expertise was the most important factor in determining whether a deferential standard applied. Specialized expertise thus remained integral to the calibration of legislative intent, even in the face of statutory rights of appeal (see *Law Society of New Brunswick v. Ryan*, [2003] 1 S.C.R. 247, at paras. 21 and 29-34; *Cartaway Resources Corp. (Re)*, [2004] 1 S.C.R. 672, at para. 45; *Council of Canadians with Disabilities v. VIA Rail Canada Inc.*, [2007] 1 S.C.R. 650, at paras. 88-92 and 100).

[220] Next came *Dunsmuir*, which sought to simplify the pragmatic and functional analysis while maintaining respect for the specialized expertise of administrative decision-makers. The Court merged the three standards of review into two: reasonableness and correctness. *Dunsmuir* also wove together the deferential threads running through the Court's administrative law jurisprudence, setting out a presumption of deferential review for certain categories of questions, including those where the decision-maker had expertise or was interpreting its "home" statute (paras. 53-54, per Bastarache and LeBel JJ., and para. 124, per Binnie J., concurring). Certain categories of issues remained subject to correctness review, including constitutional questions regarding the division of powers, true questions of jurisdiction, questions of law that were both of central importance to the legal system as a whole and outside the adjudicator's specialized area of expertise, and questions about jurisdictional lines between tribunals (paras. 58-61). Where the standard of review had not been satisfactorily determined in the jurisprudence, four contextual factors — the presence or absence of a privative clause, the purpose of the tribunal, the nature of the question at issue and the expertise of the tribunal — remained relevant to the standard of review analysis (para. 64).

[221] Notably, *Dunsmuir* did not mention statutory rights of appeal as one of the contextual factors, and left undisturbed their marginal role in the standard of review analysis. Instead, the Court explicitly affirmed the links between deference, the specialized expertise of administrative decision-makers and legislative intent. Justices LeBel and Bastarache held that "deference requires respect for the legislative

choices to leave some matters in the hands of administrative decision makers, for the processes and determinations that draw on particular expertise and experiences, and for the different roles of the courts and administrative bodies within the Canadian constitutional system" (para. 49). They noted that "in many instances, those working day to day in the implementation of frequently complex administrative schemes have or will develop a considerable degree of expertise or field sensitivity to the imperatives and nuances of the legislative regime" (para. 49, citing David J. Mullan, "Establishing the Standard of Review: The Struggle for Complexity?" (2004), 17 *C.J.A.L.P*. 59, at p. 93).

[222] Post-*Dunsmuir*, this Court continued to stress that specialized expertise is the basis for making administrative decision-makers, rather than the courts, the appropriate forum to decide issues falling within their mandates (see *Khosa*, at para. 25; *R. v. Conway*, [2010] 1 S.C.R. 765, at para. 53; *McLean v. British Columbia (Securities Commission)*, [2013] 3 S.C.R. 895, at paras. 30-33). Drawing on the concept of specialized expertise, the Court's post-*Dunsmuir* cases expressly confirmed a presumption of reasonableness review for an administrative decision-maker's interpretation of its home or closely-related statutes (see *Alberta Teachers' Association*, at paras. 39-41). As Gascon J. explained in *Mouvement laïque québécois v. Saguenay (City)*, [2015] 2 S.C.R. 3, at para. 46:

> Deference is in order where the Tribunal acts within its specialized area of expertise . . . (*Saskatchewan (Human Rights Commission) v. Whatcott*, 2013 SCC 11, [2013] 1 S.C.R. 467, at paras. 166-68; *Mowat*, at para. 24). In *Alberta (Information and Privacy*

> *Commissioner) v. Alberta Teachers' Association*, 2011 SCC 61, [2011] 3 S.C.R. 654, at paras. 30, 34 and 39, the Court noted that, on judicial review of a decision of a specialized administrative tribunal interpreting and applying its enabling statute, it should be presumed that the standard of review is reasonableness (*Canadian National Railway Co. v. Canada (Attorney General)*, 2014 SCC 40, [2014] 2 S.C.R. 135, at para. 55; *Canadian Artists' Representation v. National Gallery of Canada*, 2014 SCC 42, [2014] 2 S.C.R. 197 ("*NGC*"), at para. 13; *Khosa*, at para. 25; *Smith v. Alliance Pipeline Ltd.*, 2011 SCC 7, [2011] 1 S.C.R. 160, at paras. 26 and 28; *Dunsmuir*, at para. 54).

[223] And in *Edmonton (City) v. Edmonton East (Capilano) Shopping Centres Ltd.*, [2016] 2 S.C.R. 293, the majority recognized:

> The presumption of reasonableness is grounded in the legislature's choice to give a specialized tribunal responsibility for administering the statutory provisions, and the expertise of the tribunal in so doing. Expertise arises from the specialization of functions of administrative tribunals like the Board which have a habitual familiarity with the legislative scheme they administer . . . . [E]xpertise is something that inheres in a tribunal itself as an institution: ". . . at an institutional level, adjudicators . . . can be presumed to hold relative expertise in the interpretation of the legislation that gives them their mandate, as well as related legislation that they might often encounter in the course of their functions". [Citation omitted; para. 33.]

[224] The presumption of deference, therefore, operationalized the Court's longstanding jurisprudential acceptance of the "specialized expertise" principle in a workable manner, continuing the deferential path Dickson J. first laid out in *C.U.P.E.*

[225] As for statutory rights of appeal, they continued to be seen as either an irrelevant factor in the standard of review analysis or one that yielded to specialized expertise. So firmly entrenched was this principle that in cases like *Bell Canada v.*

Bell Aliant Regional Communications, [2009] 2 S.C.R. 764, *Smith v. Alliance Pipeline Ltd.*, [2011] 1 S.C.R. 160, *ATCO Gas and Pipelines Ltd. v. Alberta (Utilities Commission)*, [2015] 3 S.C.R. 219, and *Canada (Attorney General) v. Igloo Vikski Inc.*, [2016] 2 S.C.R. 80, the Court applied the reasonableness standard without even *referring* to the presence of an appeal clause. When appeal clauses *were* discussed, the Court consistently confirmed that they did not oust the application of judicial review principles.

[226] In *Khosa*, Binnie J. explicitly endorsed *Pezim* and rejected "the idea that in the absence of express statutory language . . . a reviewing court is 'to apply a correctness standard as it does in the regular appellate context'" (para. 26). This reasoning was followed in *Canada (Canadian Human Rights Commission) v. Canada (Attorney General)*, [2011] 3 S.C.R. 471 ("*Mowat*"), where the Court confirmed that "care should be taken not to conflate" judicial and appellate review (para. 30; see also para. 31). In *McLean*, decided two years after *Mowat*, the majority cited *Pezim* and other cases for the proposition that "general administrative law principles still apply" on a statutory appeal (see para. 21, fn. 2). Similarly, in *Mouvement laïque*, Gascon J. affirmed that

> [w]here a court reviews a decision of a specialized administrative tribunal, the standard of review must be determined on the basis of administrative law principles. This is true regardless of whether the review is conducted in the context of an application for judicial review or of a statutory appeal . . . . [para. 38]

[227] In *Edmonton East*, the Court considered — and again rejected — the argument that statutory appeals should form a new category of correctness review. As the majority noted, "recognizing issues arising on statutory appeals as a new category to which the correctness standard applies — as the Court of Appeal did in this case — would go against strong jurisprudence from this Court" (para. 28). Even the dissenting judges in *Edmonton East*, although of the view that the wording of the relevant statutory appeal clause and legislative scheme pointed to the correctness standard, nonetheless unequivocally stated that "a statutory right of appeal is not a new 'category' of correctness review" (para. 70).

[228] By the time these appeals were heard, contextual factors had practically disappeared from the standard of review analysis, replaced by a presumption of deference subject only to the correctness exceptions set out in *Dunsmuir* — which explicitly did *not* include statutory rights of appeal. In other words, the Court was well on its way to realizing *Dunsmuir*'s promise of a simplified analysis. Justice Gascon recognized as much last year in *Canadian Human Rights Commission*:

> *This contextual approach should be applied sparingly*. As held by the majority of this Court in *Alberta Teachers*, it is inappropriate to "retreat to the application of a full standard of review analysis where it can be determined summarily" . . . . After all, the "contextual approach can generate uncertainty and endless litigation concerning the standard of review" (*Capilano* [*Edmonton East*], at para. 35). The presumption of reasonableness review and the identified categories will generally be sufficient to determine the applicable standard. In the exceptional cases where such a contextual analysis may be justified to rebut the presumption, it need not be a long and detailed one (*Capilano* [*Edmonton East*], at para. 34). Where it has been done or referred to in the past, the analysis has been limited to determinative factors that showed a

> clear legislative intent justifying the rebuttal of the presumption (see, e.g., *Rogers*, at para. 15; *Tervita*, at paras. 35-36; see also, *Saguenay*, at paras. 50-51). [Emphasis added; para. 46.]

[229] In sum, for four decades, our standard of review jurisprudence has been clear and unwavering about the foundational role of specialized expertise and the limited role of statutory rights of appeal. Where confusion persists, it concerns the relevance of the contextual factors in *Dunsmuir*, the meaning of "true questions of jurisdiction" and how best to conduct reasonableness review. That was the backdrop against which these appeals were heard and argued. But rather than ushering in a simplified next act, these appeals have been used to rewrite the whole script, reassigning to the courts the starring role Dicey ordained a century ago.

The Majority's Reasons

[230] The majority's framework rests on a flawed and incomplete conceptual account of judicial review, one that unjustifiably ignores the specialized expertise of administrative decision-makers. Although the majority uses language endorsing a "presumption of reasonableness review", this presumption now rests on a totally new understanding of legislative intent and the rule of law. By prohibiting any consideration of well-established foundations for deference, such as "expertise . . . institutional experience . . . proximity and responsiveness to stakeholders . . . prompt[ness], flexib[ility], and efficien[cy]; and . . . access to justice", the majority reads out the foundations of the modern understanding of legislative intent in administrative law.

[231] In particular, such an approach ignores the possibility that specialization and other advantages are embedded into the legislative choice to delegate particular subject matters to administrative decision-makers. Giving proper effect to the legislature's choice to "delegate authority" to an administrative decision-maker requires understanding the *advantages* that the decision-maker may enjoy in exercising its mandate (*Dunsmuir*, at para. 49). As Iacobucci J. observed in *Southam*:

> Presumably if Parliament entrusts a certain matter to a tribunal and not (initially at least) to the courts, *it is because the tribunal enjoys some advantage that judges do not*. For that reason alone, review of the decision of a tribunal should often be on a standard more deferential than correctness. [Emphasis added; para. 55.]

[232] Chief among those advantages are the institutional expertise and specialization inherent to administering a particular mandate on a daily basis. Those appointed to administrative tribunals are often chosen precisely because their backgrounds and experience align with their mandate (Van Harten et al., at p. 15; Régimbald, at p. 463). Some administrative schemes explicitly require a degree of expertise from new members as a condition of appointment (*Edmonton East*, at para. 33; *Dr. Q v. College of Physicians and Surgeons of British Columbia*, [2003] 1 S.C.R. 226, at para. 29; Régimbald, at p. 462). As institutions, administrative bodies also benefit from specialization as they develop "habitual familiarity with the legislative scheme they administer" (*Edmonton East*, at para. 33) and "grappl[e] with issues on a repeated basis" (*Parry Sound (District) Social Services Administration Board v. O.P.S.E.U., Local 324*, [2003] 2 S.C.R. 157, at para. 53). Specialization and

expertise are further enhanced by continuing education and through meetings of the membership of an administrative body to discuss policies and best practices (Finn Makela, "Acquired Expertise of Administrative Tribunals and the Standard of Judicial Review: The Case of Grievance Arbitrators and Human Rights Law" (2013), 17 *C.L.E.L.J.* 345, at p. 349). In addition, the blended membership of some tribunals fosters special institutional competence in resolving "polycentric" disputes (*Pushpanathan*, at para. 36; *Dr. Q* at paras. 29-30; *Pezim*, at pp. 591-92 and 596).

[233] All this equips administrative decision-makers to tackle questions of law arising from their mandates. In interpreting their enabling statutes, for example, administrative actors may have a particularly astute appreciation for the on-the-ground consequences of particular legal interpretations; of statutory context; of the purposes that a provision or legislative scheme are meant to serve; and of specialized terminology used in their administrative setting. Coupled with this Court's acknowledgment that legislative provisions often admit of multiple reasonable interpretations, the advantages stemming from specialization and expertise provide a robust foundation for deference to administrative decision-makers on legal questions within their mandate (*C.U.P.E.*, at p. 236; *McLean*, at para. 37). As Professor H.W. Arthurs said:

> There is no reason to believe that a judge who reads a particular regulatory statute once in his life, perhaps in worst-case circumstances, can read it with greater fidelity to legislative purpose than an administrator who is sworn to uphold that purpose, who strives to do so daily, and is well-aware of the effect upon the purpose of the various alternate interpretations. There is no reason to believe that a legally-

> trained judge is better qualified to determine the existence or sufficiency or appropriateness of evidence on a given point than a trained economist or engineer, an arbitrator selected by the parties, or simply an experienced tribunal member who decides such cases day in and day out. There is no reason to believe that a judge whose entire professional life has been spent dealing with disputes one by one should possess an aptitude for issues which arise often because an administrative system dealing with cases in volume has been designed to strike an appropriate balance between efficiency and effective rights of participation.
>
> ("Protection against Judicial Review" (1983), 43 *R. du B.* 277, at p. 289)

[234] Judges of this Court have endorsed both this passage and the broader proposition that specialization and expertise justify the deference owed to administrative decision-makers (*National Corn Growers*, at p. 1343, per Wilson J., concurring). As early as *C.U.P.E.*, Dickson J. fused expertise and legislative intent by explaining that an administrative body's specialized expertise can be essential to achieving the purposes of a statutory scheme:

> The Act calls for a delicate balance between the need to maintain public services, and the need to maintain collective bargaining. Considerable sensitivity and unique expertise on the part of Board members is all the more required if the twin purposes of the legislation are to be met. [p. 236]

[235] Over time, specialized expertise would become the core rationale for deferring to administrative decision-makers (*Bradco Construction*, at p. 335; *Southam*, at para. 50; Audrey Macklin, "Standard of Review: Back to the Future?", in Colleen M. Flood and Lorne Sossin, eds., *Administrative Law in Context* (3rd ed. 2018), 381 at pp. 397-98). Post-*Dunsmuir*, the Court has been steadfast in confirming the central role of specialization and expertise, affirming their connection to

legislative intent, and recognizing that they give administrative decision-makers the "interpretative upper hand" on questions of law (*McLean*, at para. 40; see also *Conway*, at para. 53; *Mowat*, at para. 30; *Newfoundland and Labrador Nurses' Union v. Newfoundland and Labrador (Treasury Board)*, [2011] 3 S.C.R. 708, at para. 13; *Doré v. Barreau du Québec*, [2012] 1 S.C.R. 395, at para. 35; *Mouvement laïque*, at para. 46; *Khosa*, at para. 25; *Edmonton East*, at para. 33).

[236] Although the majority's approach extolls respect for the legislature's "institutional design choices", it accords no weight to the institutional advantages of specialization and expertise that administrative decision-makers possess in resolving questions of law. In so doing, the majority disregards the historically accepted reason *why* the legislature intended to delegate authority to an administrative actor.

[237] Nor are we persuaded by the majority's claim that "if administrative decision makers are understood to possess specialized expertise on all questions that come before them, the concept of expertise ceases to assist a reviewing court in attempting to distinguish questions for which applying the reasonableness standard is appropriate from those for which it is not". Here, the majority sets up a false choice: expertise must either be assessed on a case-by-case basis or play no role at all in a theory of judicial review.

[238] We disagree. While not every decision-maker necessarily has expertise on every issue raised in an administrative proceeding, reviewing courts do not engage in an individualized, case-by-case assessment of specialization and expertise. The

theory of deference is based not only on the legislative choice to delegate decisions, but also on institutional expertise and on "the reality that . . . those working day to day in the implementation of frequently complex administrative schemes have or will develop a considerable degree of expertise or field sensitivity to the imperatives and nuances of the legislative regime" (*Khosa*, at para. 25; see also *Nor-Man Regional Health Authority Inc. v. Manitoba Association of Health Care Professionals*, [2011] 3 S.C.R. 616, at para. 53; *Edmonton East*, at para. 33).

[239] The exclusion of expertise, specialization and other institutional advantages from the majority's standard of review framework is not merely a theoretical concern. The removal of the current "conceptual basis" for deference opens the gates to expanded correctness review. The majority's "presumption" of deference will yield all too easily to justifications for a correctness-oriented framework.

[240] In the majority's framework, deference gives way whenever the "rule of law" demands it. The majority's approach to the rule of law, however, flows from a court-centric conception of the rule of law rooted in Dicey's 19th century philosophy.

[241] The rule of law is not the rule of courts. A pluralist conception of the rule of law recognizes that courts are not the exclusive guardians of law, and that others in the justice arena have shared responsibility for its development, including administrative decision-makers. *Dunsmuir* embraced this more inclusive view of the rule of law by acknowledging that the "court-centric conception of the rule of law"

had to be "reined in by acknowledging that the courts do not have a monopoly on deciding all questions of law" (para. 30). As discussed in *Dunsmuir*, the rule of law is understood as meaning that administrative decision-makers make legal determinations within their mandate, and not that only judges decide questions of law with an unrestricted license to substitute their opinions for those of administrative actors through correctness review (see McLachlin, *Administrative Tribunals and the Courts: An Evolutionary Relationship*; The Hon. Thomas A. Cromwell, "What I Think I've Learned About Administrative Law" (2017), 30 *C.J.A.L.P.* 307, at p. 308; *Wilson v. Atomic Energy of Canada Ltd.*, [2016] 1 S.C.R. 770, at para. 31, per Abella J.).

[242] Moreover, central to any definition of the rule of law is access to a fair and efficient dispute resolution process, capable of dispensing timely justice (*Hryniak v. Mauldin*, [2014] 1 S.C.R. 87, at para. 1). This is an important objective for all litigants, from the sophisticated consumers of administrative justice, to, most significantly, the particularly vulnerable ones (Angus Grant and Lorne Sossin, "Fairness in Context: Achieving Fairness Through Access to Administrative Justice", in Colleen M. Flood and Lorne Sossin, eds., *Administrative Law in Context* (3rd ed. 2018), 341, at p. 342). For this reason, access to justice is at the heart of the legislative choice to establish a robust system of administrative law (Grant and Sossin, at pp. 342 and 369-70; Van Harten, et al., at p. 17; Régimbald, at pp. 2-3; McLachlin, *Administrative Tribunals and the Courts: An Evolutionary Relationship*). As Morissette J.A. has observed:

> . . . the aims of administrative law . . . generally gravitate towards promoting access to justice. The means contemplated are costless or inexpensive, simple and expeditious procedures, expertise of the decision-makers, coherence of reasons, consistency of results and finality of decisions.
>
> (Yves-Marie Morissette, "What is a 'reasonable decision'?" (2018), 31 *C.J.A.L.P.* 225, at p. 236)

[243] These goals are compromised when a narrow conception of the "rule of law" is invoked to impose judicial hegemony over administrative decision-makers. Doing so perverts the purpose of establishing a parallel system of administrative justice, and adds unnecessary expense and complexity for the public.

[244] The majority even calls for a reformulation of the "questions of central importance" category from *Dunsmuir* and permits courts to substitute their opinions for administrative decision-makers on "questions of central importance to the legal system as a whole", even if those questions fall squarely within the mandate and expertise of the administrative decision-maker. As noted in *Canadian Human Rights Commission*, correctness review was permitted only for questions "of central importance to the legal system *and* outside the specialized expertise of the adjudicator" (para. 28 (emphasis in original)). Broadening this category from its original characterization unduly expands the issues available for judicial substitution. Issues of discrimination, labour rights, and economic regulation of the securities markets (among many others) theoretically raise questions of vital importance for Canada and its legal system. But by ignoring administrative decision-makers' expertise on these matters, this category will inevitably provide more "room . . . for

both mistakes and manipulation" (Andrew Green, "Can There Be Too Much Context in Administrative Law? Setting the Standard of Review in Canadian Administrative Law" (2014), 47 *U.B.C. L. Rev.* 443, at p. 483). We would leave *Dunsmuir*'s description of this category undisturbed.[1]

[245] We also disagree with the majority's reformulation of "legislative intent" to include, for the first time, an invitation for courts to apply correctness review to legal questions whenever an administrative scheme includes a right of appeal. We do not see how appeal rights represent a "different institutional structure" that requires a more searching form of review. The mere fact that a statute contemplates a reviewing role for a court says nothing about the *degree of deference* required in the review process. Rights of appeal reflect different choices by different legislatures to permit review for different reasons, on issues of fact, law, mixed fact and law, and discretion, among others. Providing parties with a right of appeal can serve several purposes entirely unrelated to the standard of review, including outlining: where the appeal will take place (sometimes, at a different reviewing court than in the routes provided for judicial review); who is eligible to take part; when materials must be filed; how materials must be presented; the reviewing court's powers on appeal; any leave requirements; and the grounds on which the parties may appeal (among other things). By providing this type of structure and guidance, statutory appeal provisions may allow legislatures to promote efficiency and access to justice, in a way that exclusive reliance on the judicial review procedure would not have.

[1] Other than one of the two *amici*, no one asked us to modify this category.

[246] In reality, the majority's position on statutory appeal rights, although couched in language about "giv[ing] effect to the legislature's institutional design choices", hinges almost entirely on a textualist argument: the presence of the word "appeal" indicates a legislative intent that courts apply the same standards of review found in civil appellate jurisprudence.

[247] The majority's reliance on the "presumption of consistent expression" in relation to the single word "appeal" is misplaced and disregards long-accepted institutional distinctions between how courts and administrative decision-makers function. The language in each setting is different; the mandates are different; the policy bases are different. The idea that *Housen v. Nikolaisen*, [2002] 2 S.C.R. 235, must be inflexibly applied to every right of "appeal" within a statute — with no regard for the broader purposes of the statutory scheme or the practical implications of greater judicial involvement within it — is entirely unsupported by our jurisprudence.

[248] In addition, the majority's claim that legislatures "d[o] not speak in vain" is irreconcilable with its treatment of privative clauses, which play no role in its standard of review framework. If, as the majority claims, Parliament's decision to provide appeal routes must influence the standard of review analysis, there is no

principled reason why Parliament's decision via privative clauses to *prohibit* appeals should not be given comparable effect.[2]

[249] In any event, legislatures in this country have known for at least 25 years since *Pezim* that this Court has not treated statutory rights of appeal as a determinative reflection of legislative intent regarding the standard of review (*Pezim*, at p. 590). Against this reality, the continued use by legislatures of the term "appeal" cannot be imbued with the intent that the majority retroactively ascribes to it; doing so is inconsistent with the principle that legislatures are presumed to enact legislation in compliance with existing common law rules (Ruth Sullivan, *Statutory Interpretation* (3rd ed. 2016), at p. 315).

[250] Those legislatures, moreover, understood from our jurisprudence that this Court was committed to respecting *standards* of review that were statutorily prescribed, as British Columbia alone has done.[3] We agree with the Attorney General of Canada's position in the companion appeals of *Bell Canada v. Canada (Attorney General)*, 2019 SCC 66, that, absent exceptional circumstances, the existence of a

[2] The "constitutional concerns" cited by the majority are no answer to this dilemma — nothing in *Crevier v. Attorney General of Quebec*, [1981] 2 S.C.R. 220, prevents privative clauses from influencing the *standard* of review, as they did for years under the pragmatic and functional approach and in *C.U.P.E.* (David Dyzenhaus, "Dignity in Administrative Law: Judicial Deference in a Culture of Justification" (2012), 17 *Rev. Const. Stud.* 87, at p. 103; David Mullan, "Unresolved Issues on Standard of Review in Canadian Judicial Review of Administrative Action – The Top Fifteen!" (2013), 42 *Adv. Q.* 1, at p. 21).

[3] See *Administrative Tribunals Act*, S.B.C. 2004, c. 45. Quebec's recent attempt to introduce such legislation is another example of a legislature which understood that it was free to set standards of review, and that the mere articulation of a right of appeal did not dictate what those standards would be: see Bill 32, *An Act mainly to promote the efficiency of penal justice and to establish the terms governing the intervention of the Court of Québec with respect to applications for appeal*, 1st Sess., 42nd Leg., 2019.

statutory right of appeal does not displace the presumption that the standard of reasonableness applies.[4] The majority, however, has inexplicably chosen the template proposed by the *amici*,[5] recommending a sweeping overhaul of our approach to legislative intent and to the determination of the standard of review.

[251] The result reached by the majority means that hundreds of administrative decision-makers subject to different kinds of statutory rights of appeal — some in highly specialized fields, such as broadcasting, securities regulation and international trade — will now be subject to an irrebuttable presumption of correctness review. This has the potential to cause a stampede of litigation. Reviewing courts will have license to freely revisit legal questions on matters squarely within the expertise of administrative decision-makers, even if they are of no broader consequence outside of their administrative regimes. Even if specialized decision-makers provide reasonable interpretations of highly technical statutes with which they work daily, even if they provide internally consistent interpretations responsive to the parties' submissions and consistent with the text, context and purpose of the governing scheme, the administrative body's past practices and decisions, the common law, prior judicial rulings and international law, those interpretations can still be set aside by a reviewing court that simply takes a different view of the relevant statute. This risks undermining the integrity of administrative proceedings whenever there is a statutory right of appeal, rendering them little more than rehearsals for a judicial appeal — the

[4] The notion that legislative intent finds determinative expression in statutory rights of appeal found no support in the submissions of four of the five attorneys general who appeared before us.

[5] Even the *amici* did not go so far as to say that *all* appeal clauses were indicative of a legislative intent for courts to substitute their views on questions of law.

inverse of the legislative intent to establish a specialized regime and entrust certain legal and policy questions to non-judicial actors.

[252] Ironically, the majority's approach will be a roadblock to its promise of simplicity. Elevating appeal clauses to indicators of correctness review creates a two-tier system of administrative law: one tier that defers to the expertise of administrative decision-makers where there is no appeal clause; and another tier where such clauses permit judges to substitute their own views of the legal issues at the core of those decision-makers' mandates. Within the second tier, the application of appellate law principles will inevitably create confusion by encouraging segmentation in judicial review (*Mouvement laïque*, at para. 173, per Abella J., concurring in part; see also Paul Daly, "Struggling Towards Coherence in Canadian Administrative Law? Recent Cases on Standard of Review and Reasonableness" (2016), 62 *McGill L.J.* 527, at pp. 542-43; The Hon. Joseph T. Robertson, "Identifying the Review Standard: Administrative Deference in a Nutshell" (2017), 68 *U.N.B.L.J.* 145, at p. 162). Courts will be left with the task of identifying palpable and overriding errors for factual questions, extricating legal issues from questions of mixed fact and law, reviewing questions of law *de novo*, and potentially having to apply judicial review and appellate standards interchangeably if an applicant challenges in one proceeding multiple aspects of an administrative decision, some falling within an appeal clause and others not. It is an invitation to complexity and a barrier to access to justice.

[253] The majority's reasons "roll back the *Dunsmuir* clock to an era where some courts asserted a level of skill and knowledge in administrative matters which further experience showed they did not possess" (*Khosa*, at para. 26). The reasons elevate statutory rights of appeal to a determinative factor based on a formalistic approach that ignores the legislature's intention to leave certain legal and policy questions to specialized administrative decision-makers. This unravelling of Canada's carefully developed, deferential approach to administrative law returns us to the "black letter law" approach found in *Anisminic* and cases like *Metropolitan Life* whereby specialized decision-makers were subject to the pre-eminent determinations of a judge. Rather than building on *Dunsmuir*, which recognized that specialization is fundamentally intertwined with the legislative choice to delegate particular subject matters to administrative decision-makers, the majority's reasons banish expertise from the standard of review analysis entirely, opening the door to a host of new correctness categories which remain open to further expansion. The majority's approach not only erodes the presumption of deference; it erodes confidence in the existence — and desirability — of the "shared enterprises in the administrative state" of "[l]aw-making and legal interpretation" between courts and administrative decision-makers (Stack, at p. 310).

[254] But the aspect of the majority's decision with the greatest potential to undermine both the integrity of this Court's decisions, and public confidence in the stability of the law, is its disregard for precedent and *stare decisis*.

[255] *Stare decisis* places significant limits on this Court's ability to overturn its precedents. Justice Rothstein described some of these limits in *Canada v. Craig*, [2012] 2 S.C.R. 489, the case about horizontal *stare decisis* on which the majority relies:

> The question of whether this Court should overrule one of its own prior decisions was addressed recently in *Ontario (Attorney General) v. Fraser*, 2011 SCC 20, [2011] 2 S.C.R. 3. At paragraph 56, Chief Justice McLachlin and LeBel J., in joint majority reasons, noted that overturning a precedent of this Court is a step not to be lightly undertaken. *This is especially so when the precedent represents the considered views of firm majorities* (para. 57).
>
> Nonetheless, this Court has overruled its own decisions on a number of occasions. (See *R. v. Chaulk*, [1990] 3 S.C.R. 1303, at p. 1353, *per* Lamer C.J., for the majority; *R. v. B. (K.G.)*, [1993] 1 S.C.R. 740; *R. v. Robinson*, [1996] 1 S.C.R. 683.) *However, the Court must be satisfied based on compelling reasons that the precedent was wrongly decided and should be overruled* . . . .
>
> Courts must proceed with caution when deciding to overrule a prior decision. In *Queensland v. Commonwealth* (1977), 139 C.L.R. 585 (H.C.A.), at p. 599, Justice Gibbs articulated the required approach succinctly:
>
>> No Justice is entitled to ignore the decisions and reasoning of his predecessors, and to arrive at his own judgment as though the pages of the law reports were blank, or as though the authority of a decision did not survive beyond the rising of the Court. A Justice, unlike a legislator, cannot introduce a programme of reform which sets at nought decisions formerly made and principles formerly established. It is only after the most careful and respectful consideration of the earlier decision, and after giving due weight to all the circumstances, that a Justice may give effect to his own opinions in preference to an earlier decision of the Court. [Emphasis added; paras. 24-26.]

[256] Apex courts in several jurisdictions outside Canada have similarly stressed the need for caution and compelling justification before departing from precedent. The United States Supreme Court refrains from overruling its past decisions absent a "special justification", which must be over and above the belief that a prior case was wrongly decided (*Kimble v. Marvel Entertainment, LLC.*, 135 S. Ct. 2401 (2015), at p. 2409; see also *Halliburton Co. v. Erica P. John Fund, Inc.*, 573 U.S. 258 (2014), at p. 266; *Kisor v. Wilkie*, 139 S. Ct. 2400 (2019), at pp. 2418 and 2422; Bryan A. Garner et al., *The Law of Judicial Precedent* (2016), at pp. 35-36).

[257] Similarly, the House of Lords "require[d] much more than doubts as to the correctness of [a past decision] to justify departing from it" (*Fitzleet Estates Ltd. v. Cherry* (1977), 51 T.C. 708, at p. 718), an approach that the United Kingdom Supreme Court continues to endorse (*R. v. Taylor*, [2016] UKSC 5, [2016] 4 All E.R. 617, at para. 19; *Willers v. Joyce (No. 2)*, [2016] UKSC 44, [2017] 2 All E.R. 383, at para. 7; *Knauer v. Ministry of Justice*, [2016] UKSC 9, [2016] 4 All E.R. 897, at paras. 22-23).

[258] New Zealand's Supreme Court views "caution, often considerable caution" as the "touchstone" of its approach to horizontal *stare decisis*, and has emphasized that it will not depart from precedent "merely because, if the matter were being decided afresh, the Court might take a different view" (*Couch v. Attorney-General (No. 2)*, [2010] NZSC 27, [2010] 3 N.Z.L.R. 149, at paras. 105, per Tipping J., and 209, per McGrath J.).

[259] Restraint and respect for precedent also guide the High Court of Australia and South Africa's Constitutional Court when applying *stare decisis* (*Lee v. New South Wales Crime Commission*, [2013] HCA 39, 302 A.L.R. 363, at paras. 62-66 and 70; *Camps Bay Ratepayers' and Residents' Association v. Harrison*, [2010] ZACC 19, 2011 (4) S.A. 42, at pp. 55-56; *Buffalo City Metropolitan Municipality v. Asla Construction Ltd.*, [2019] ZACC 15, 2019 (4) S.A. 331, at para. 65).

[260] The virtues of horizontal *stare decisis* are widely recognized. The doctrine "promotes the evenhanded, predictable, and consistent development of legal principles, fosters reliance on judicial decisions, and contributes to the actual and perceived integrity of the judicial process" (*Kimble*, at p. 2409, citing *Payne v. Tennessee*, 501 U.S. 808 (1991), at p. 827). This Court has stressed the importance of *stare decisis* for "[c]ertainty in the law" (*Canada (Attorney General) v. Bedford*, [2013] 3 S.C.R. 1101, at para. 38; *R. v. Bernard*, [1988] 2 S.C.R. 833, at p. 849; *Minister of Indian Affairs and Northern Development v. Ranville*, [1982] 2 S.C.R. 518, at p. 527). Other courts have described *stare decisis* as a "foundation stone of the rule of law" (*Michigan v. Bay Mills Indian Community*, 572 U.S. 782 (2014), at p. 798; *Kimble*, at p. 2409; *Kisor*, at p. 2422; see also *Camps Bay*, at pp. 55-56; Jeremy Waldron, "Stare Decisis and the Rule of Law: A Layered Approach" (2012), 111 *Mich. L. Rev.* 1, at p. 28; Lewis F. Powell, Jr., "Stare Decisis and Judicial Restraint" (1990), 47 *Wash. & Lee L. Rev.* 281, at p. 288).

[261] Respect for precedent also safeguards this Court's institutional legitimacy. The precedential value of a judgment of this Court does not "expire with the tenure of the particular panel of judges that decided it" (*Plourde v. Wal-Mart Canada Corp.*, [2009] 3 S.C.R. 465, at para. 13). American cases have stressed similar themes:

> There is . . . a point beyond which frequent overruling would overtax the country's belief in the Court's good faith. Despite the variety of reasons that may inform and justify a decision to overrule, we cannot forget that such a decision is usually perceived (and perceived correctly) as, at the least, a statement that a prior decision was wrong. There is a limit to the amount of error that can plausibly be imputed to prior Courts. If that limit should be exceeded, disturbance of prior rulings would be taken as evidence that justifiable reexamination of principle had given way to drives for particular results in the short term. The legitimacy of the Court would fade with the frequency of its vacillation.
>
> (*Planned Parenthood of Southeastern Pennsylvania v. Casey, Governor of Pennsylvania*, 505 U.S. 833 (1992), at p. 866; see also *Florida Department of Health and Rehabilitative Services v. Florida Nursing Home Association*, 450 U.S. 147 (1981), at p. 153, per Stevens J., concurring.)

[262] Several scholars have made this point as well (see e.g., Michael J. Gerhardt, *The Power of Precedent* (2008), at p. 18; Garner et al., at p. 391). Aharon Barak has warned that

> overruling precedent damages the public's conception of the judicial role, and undermines the respect in which the public holds the courts and its faith in them. Precedent should not resemble a ticket valid only for the day of purchase.
>
> ("Overruling Precedent" (1986), 21 *Is.L.R.* 269, at p. 275)

[263] The majority's reasons, in our view, disregard the high threshold required to overturn one of this Court's decisions. The justification for the majority abandoning this Court's long-standing view of how statutory appeal clauses impact the standard of review analysis is that this Court's approach was "unsound in principle" and criticized by judges and academics. The majority also suggests that the Court's decisions set up an "unworkable and unnecessarily complex" system of judicial review. Abandoning them, the majority argues, would promote the values underlying *stare decisis*, namely "clarity and certainty in the law". In doing so, the majority discards several of this Court's bedrock administrative law principles.

[264] The majority leaves unaddressed the most significant rejection of this Court's jurisprudence in its reasons — its decision to change the entire "conceptual basis" for judicial review by excluding specialization, expertise and other institutional advantages from the analysis. The lack of any justification for this foundational shift — repeatedly invoked by the majority to sanitize further overturning of precedent — undercuts the majority's stated respect for *stare decisis* principles.

[265] The majority explains its decision to overrule the Court's prior decisions about appeal clauses by asserting that these precedents had "no satisfactory justification". It does not point, however, to any arguments different from those heard and rejected by other panels of this Court over the decades whose decisions are being discarded. Instead, the majority substitutes its own preferred approach to interpreting statutory rights of appeal — an approach rejected by several prior panels of this Court

in a line of decisions stretching back three decades. The rejection of such an approach was explicitly reaffirmed *no fewer than four times in the past ten years* (*Khosa*, at para. 26; *Mowat*, at paras. 30-31; *Mouvement laïque*, at para. 38; *Edmonton East*, at paras. 27-31; see also *McLean*, at para. 21).

[266] Overruling these judgments flouts *stare decisis* principles, which prohibit courts from overturning past decisions which "simply represen[t] a preferred choice with which the current Bench does not agree" (*Couch*, at para. 105; see also *Knauer*, at para. 22; *Casey*, at p. 864). "[T]he entire idea of *stare decisis* is that judges do not get to reverse a decision just because they never liked it in the first instance" (*Knick v. Township of Scott, Pennsylvania*, 139 S. Ct. 2162 (2019), at p. 2190, per Kagan J., dissenting). As the United States Supreme Court noted in *Kimble*:

> . . . an argument that we got something wrong—even a good argument to that effect—cannot by itself justify scrapping settled precedent. Or otherwise said, it is not alone sufficient that we would decide a case differently now than we did then. To reverse course, we require as well what we have termed a "special justification"—over and above the belief "that the precedent was wrongly decided." [Citation omitted; p. 2409.]

[267] But it is the unprecedented wholesale rejection of an entire body of jurisprudence that is particularly unsettling. The affected cases are too numerous to list in full here. It includes many decisions conducting deferential review even in the face of a statutory right of appeal (*Pezim*; *Southam*; *Committee for Equal Treatment of Asbestos Minority Shareholders v. Ontario (Securities Commission)*, [2001] 2 S.C.R. 132; *Dr. Q*; *Ryan*; *Cartaway*; *VIA Rail*; *Association des courtiers et agents*

immobiliers du Québec v. Proprio Direct inc., [2008] 2 S.C.R. 195; *Nolan v. Kerry (Canada) Inc.*, [2009] 2 S.C.R. 678; *McLean*; *Bell Canada (2009)*; *ATCO Gas*; *Mouvement laïque*; *Igloo Vikski*; *Edmonton East*) and bedrock judgments affirming the relevance of administrative expertise to the standard of review analysis and to "home statute" deference (*C.U.P.E.*; *National Corn Growers*; *Domtar Inc.*; *Bradco Construction*; *Southam*; *Pushpanathan*; *Alberta Teachers' Association*; *Canadian Human Rights Commission*, among many others).

[268] Most of those decisions were decided unanimously or by strong majorities. At no point, however, does the majority acknowledge this Court's strong reluctance to overturn precedents that "represen[t] the considered views of firm majorities" (*Craig*, at para. 24; *Ontario (Attorney General) v. Fraser*, [2011] 2 S.C.R. 3, at para. 57; see also *Nishi v. Rascal Trucking Ltd.*, [2013] 2 S.C.R. 438, at paras. 23-24), or to overrule decisions of a "recent vintage" (*Fraser*, at para. 57; see also *Nishi*, at para. 23). The decisions the majority *does* rely on, by contrast, involved overturning usually only one precedent and almost always an older one: *Craig* overruled a 34-year-old precedent; *R. v. Henry*, [2005] 3 S.C.R. 609, overruled a 19-year-old precedent (and another 15-year-old precedent, in part); and the dissenting judges in *Bernard* would have overruled a 10-year-old precedent.

[269] The majority's decision to overturn precedent also has the potential to disturb settled interpretations of many statutes that contain a right of appeal. Under the majority's approach, every existing interpretation of such statutes by an

administrative body that has been affirmed under a reasonableness standard of review will be open to fresh challenge. In *McLean*, for example, this Court acknowledged that a limitations period in British Columbia's *Securities Act*[6] had two reasonable interpretations, but deferred to the one the Commission preferred based on deferential review. We see no reason why an individual in the same situation as Ms. McLean could not now revisit our Court's decision through the statutory right of appeal in the *Securities Act*, and insist that a new reviewing court offer *its* definitive view of the relevant limitations period now that appeal clauses are interpreted to permit judicial substitution rather than deference.

[270] The majority does not address the chaos that such legal uncertainty will generate for those who rely on settled interpretations of administrative statutes to structure their affairs, despite the fact that protecting these reliance interests is a well-recognized and especially powerful reason for respecting precedent (Garner et al., at pp. 404-11; Neil Duxbury, *The Nature and Authority of Precedent* (2008), at pp. 118-19; *Kimble*, at pp. 2410-11). By changing the entire status quo, the majority's approach will undermine legal certainty — "the foundational principle upon which the common law relies" (*Bedford*, at para. 38; see also Cromwell, at p. 315).

[271] Moreover, if this Court had for over 30 years significantly misconstrued the purpose of statutory appeal routes by failing to recognize what *this* majority has ultimately discerned — that in enacting such routes, legislatures were unequivocally

[6] R.S.B.C. 1996, c. 418, s. 159

directing courts to review *de novo* every question of law that an administrative body addresses, regardless of that body's expertise — legislatures across Canada were free to clarify this interpretation and endorse the majority's favoured approach through legislative amendment. Given the possibility — and continued absence — of legislative correction, the case for overturning our past decisions is even less compelling (*Binus v. The Queen*, [1967] S.C.R. 594, at p. 601; see also *Kimble*, at p. 2409; *Kisor*, at pp. 2422-23; *Bilski v. Kappos, Under Secretary of Commerce for Intellectual Property and Director, Patent and Trademark Office*, 561 U.S. 593 (2010), at pp. 601-2).

[272] Each of these rationales for adhering to precedent — consistent affirmation, reliance interests and the possibility of legislative correction — was recently endorsed by the United States Supreme Court in *Kisor*. There, the Court invoked *stare decisis* to uphold two administrative law precedents which urged deference to administrative agencies when they interpreted ambiguous provisions in their regulations (*Bowles, Price Administrator v. Seminole Rock & Sand Co.*, 325 U.S. 410 (1945); *Auer v. Robbins*, 519 U.S. 452 (1997)). Writing for the majority on the issue of *stare decisis*, Justice Kagan explained at length why the doctrine barred the Court from overturning *Auer* or *Seminole Rock*. To begin, Justice Kagan reiterated the importance of *stare decisis* and the need for special justification to overcome its demands. She then explained that *stare decisis* carried even greater force than usual when applied to two decisions that had been affirmed by a "long line of precedents" going back 75 years or more and cited by lower courts thousands of times (p. 2422).

She noted that overturning the challenged precedents would cast doubt on many settled statutory interpretations and invite relitigation of cases (p. 2422). Finally, Justice Kagan reasoned that Congress remained free to overturn the cases if the Court had misconstrued legislative intent:

> . . . even if we are wrong about *Auer*, "Congress remains free to alter what we have done." In a constitutional case, only we can correct our error. But that is not so here. Our deference decisions are "balls tossed into Congress's court, for acceptance or not as that branch elects." And so far, at least, Congress has chosen acceptance. It could amend the APA or any specific statute to require the sort of *de novo* review of regulatory interpretations that Kisor favors. Instead, for approaching a century, it has let our deference regime work side-by-side with both the APA and the many statutes delegating rulemaking power to agencies. It has done so even after we made clear that our deference decisions reflect a presumption about congressional intent. And it has done so even after Members of this Court began to raise questions about the doctrine. Given that history — and Congress's continuing ability to take up Kisor's arguments — we would need a particularly "special justification" to now reverse *Auer*. [Citations omitted; pp. 2422-23]

[273] In the face of these compelling reasons for adhering to precedent, many of which have found resonance in this Court's jurisprudence, the majority's reliance on "judicial and academic criticism" falls far short of overcoming the demands of *stare decisis*. It is hard to see why the *obiter* views of the handful of Canadian judges referred to by the majority should be determinative or even persuasive. The majority omits the views of any academics or judges who *have* voiced support for a strong presumption of deference without identifying our approach to statutory rights of appeal as cause for concern (Dyzenhaus, "Dignity in Administrative Law: Judicial Deference in a Culture of Justification", at p. 109; Green, at pp. 489-90; Matthew

Lewans, *Administrative Law and Judicial Deference* (2016); Jonathan M. Coady, "The Time Has Come: Standard of Review in Canadian Administrative Law" (2017), 68 *U.N.B.L.J.* 87; The Hon. John M. Evans, "Standards of Review in Administrative Law" (2013), 26 *C.J.A.L.P.* 67, at p. 79; The Hon. John M. Evans, "Triumph of Reasonableness: But How Much Does It Really Matter?" (2014), 27 *C.J.A.L.P.* 101; Jerry V. DeMarco, "Seeking Simplicity in Canada's Complex World of Judicial Review" (2019), 32 *C.J.A.L.P.* 67).

[274] A selective assortment of criticism is not evidence of generalized criticism or unworkability. This Court frequently tackles contentious, high-profile cases that engender strong and persisting divisions of opinion. The public looks to us to definitively resolve those cases, regardless of the composition of the Court. As Hayne J. noted in *Lee*:

> To regard the judgments of this Court as open to reconsideration whenever a new argument is found more attractive than the principle expressed in a standing decision is to overlook the function which a final court of appeal must perform in defining the law. In difficult areas of the law, differences of legal opinion are inevitable; before a final court of appeal, the choice between competing legal solutions oftentimes turns on the emphasis or weight given by each of the judges to one factor against a countervailing factor ... *In such cases, the decision itself determines which solution is, for the purposes of the current law, correct*. It is not to the point to argue in the next case that, leaving the particular decision out of account, another solution is better supported by legal theory. *Such an approach would diminish the authority and finality of the judgments of this Court.* As the function of defining the law is vested in the Court rather than in the justices who compose it, a decision of the Court will be followed in subsequent cases by the Court, however composed, subject to the exceptional power which resides in the Court to permit reconsideration.

> Accordingly, as one commentator has put the point: "the previous decision is to be treated as the primary premise from which other arguments follow, and not just as one potential premise among an aggregate of competing premises". [Emphasis in original; footnote omitted.]
>
> (paras. 65-66, citing *Baker v. Campbell*, [1983] HCA 39, 153 C.L.R. 52, at pp. 102-3)

[275] This Court, in fact, has been clear that "criticism of a judgment is not sufficient to justify overruling it" (*Fraser*, at para. 86). Differences of legal and public opinion are a natural by-product of contentious cases like *R. v. Jordan*, [2016] 1 S.C.R. 631, or even *Housen*, which, as this Court acknowledged, was initially applied by appeal courts with "varying degrees of enthusiasm" (*H.L. v. Canada (Attorney General)*, [2005] 1 S.C.R. 401, at para. 76; see also Paul M. Perell, "The Standard of Appellate Review and The Ironies of Housen v. Nikolaisen" (2004), 28 *Adv. Q.* 40, at p. 53; Mike Madden, "Conquering the Common Law Hydra: A Probably Correct and Reasonable Overview of Current Standards of Appellate and Judicial Review" (2010), 36 *Adv. Q.* 269, at pp. 278-79 and 293; Paul J. Pape and John J. Adair, "Unreasonable review: The losing party and the palpable and overriding error standard" (2008), 27 *Adv. J.* 6, at p. 8; Geoff R. Hall, "Two Unsettled Questions in the Law of Contractual Interpretation: A Call to the Supreme Court of Canada" (2011), 50 *Can. Bus. L.J.* 434, at p. 436).

[276] To justify circumventing this Court's jurisprudence, the majority claims that the precedents being overturned *themselves* departed from the approach to statutory rights of appeal under the pragmatic and functional test. That, with respect,

is wrong. Ever since *Bell Canada (1989)* and in several subsequent decisions outlined earlier in these reasons, statutory rights of appeal have played little or no role in the standard of review analysis. Moreover, in pre-*Dunsmuir* cases, statutory rights of appeal were still seen as only one factor among others — and *not* as unequivocal indicators of correctness review (see, for example, *Canada (Deputy Minister of National Revenue) v. Mattel Canada Inc.*, [2001] 2 S.C.R. 100, at paras. 27-33; *Chieu v. Canada (Minister of Citizenship and Immigration)*, [2002] 1 S.C.R. 84, at paras. 23-24; *Harvard College v. Canada (Commissioner of Patents)*, [2002] 4 S.C.R. 45, at paras. 149-51). Our pre- and post-*Dunsmuir* cases on statutory rights of appeal shared in common an unwavering commitment to determining the standard of review in administrative proceedings using administrative law principles, even when appeal rights were involved.

[277] For the majority, the elimination of the contextual factors appears to have justified the reconstruction of the whole judicial review framework. Yet the elimination of the contextual analysis was all but complete in our post-*Dunsmuir* jurisprudence, and does not support the foundational changes to judicial review in the majority's decision. Neither that development, nor the majority's assertion that our precedents have proven "unclear and unduly complex", justifies the conclusion that *all* of our administrative law precedents — even those unconnected to the practical difficulties in applying *Dunsmuir* — are suddenly fair game.

[278] This Court is overturning a long line of well-established and recently-affirmed precedents in a whole area of law, including several unanimous or strong majority judgments. There is no principled justification for such a dramatic departure from this Court's existing jurisprudence.

Going Forward

[279] In our view, a more modest approach to modifying our past decisions, one that goes no further than necessary to clarify the law and its application, is justified. "[W]hen a court does choose to overrule its own precedents, it should do so carefully, with moderation, and with due regard for all the important considerations that undergird the doctrine" (Garner et al., at pp. 41-42). Such an approach to changing precedent preserves the integrity of the judicial process and, at a more conceptual level, of the law itself as a social construct. Michael J. Gerhardt summarized this approach eloquently:

> Judicial modesty is . . . . a disposition to respect precedents (as embodying the opinions of others), to learn from their and others' experiences, and to decide cases incrementally to minimize conflicts with either earlier opinions of the Court or other constitutional actors. [p. 7]

[280] Judicial modesty promotes the responsible development of the common law. Lord Tom Bingham described that process in his seminal work, *The Rule of Law* (2010):

> . . . it is one thing to move the law a little further along a line on which it is already moving, or to adapt it to accord with modern views and practices; it is quite another to seek to recast the law in a radically innovative or adventurous way, because that is to make it uncertain and unpredictable, features which are the antithesis of the rule of law. [pp. 45-46]
>
> (See also Robert J. Sharpe, *Good Judgment: Making Judicial Decisions* (2018), at p. 93; Beverley McLachlin, "The Role of the Supreme Court of Canada in Shaping the Common Law", in Paul Daly, ed., *Apex Courts and the Common Law* (2019), 25, at p. 35; *R. v. Salituro*, [1991] 3 S.C.R. 654, at p. 670; *Friedmann Equity Developments Inc. v. Final Note Ltd.*, [2000] 1 S.C.R. 842, at para. 42; *R. v. Kang-Brown*, [2008] 1 S.C.R. 456, at paras. 14-16, per Lebel J., and 73-74, per Binnie J., concurring.)

[281] Lord Bingham's comments highlight that a nuanced balance must be struck between maintaining the stability of the common law and ensuring that the law is flexible and responsive enough to adapt to new circumstances and shifts in societal norms. *Stare decisis* plays a critical role in maintaining that balance and upholding the rule of law. When *stare decisis* is respected, precedent acts as a stabilizing force: providing certainty as to what the law is, consistency that allows those subject to the law to order their affairs accordingly, and continuity that protects reliance on those legal consequences. *Stare decisis* is at the heart of the iterative development of the common law, fostering progressive, incremental and responsible change.

[282] So what do we suggest? We support a standard of review framework with a meaningful rule of deference, based on *both* the legislative choice to delegate decision-making authority to an administrative actor *and* on the specialized expertise that these decision-makers possess and develop in applying their mandates. Outside of the three remaining correctness categories from *Dunsmuir* — and absent clear and

explicit legislative direction on the *standard* of review — administrative decisions should be reviewed for reasonableness. Like the majority, we support eliminating the category of "true questions of jurisdiction" and foreclosing the use of the contextual factors identified in *Dunsmuir*. These developments introduce incremental changes to our judicial review framework, while respecting its underlying principles and placing the ball in the legislatures' court to modify the standards of review if they wish.

[283] To the extent that concerns were expressed about the quality of administrative decision making by some interveners who represented particularly vulnerable groups, we agree that they must be taken seriously. But the solution does not lie in authorizing more incursions into the administrative system by generalist judges who lack the expertise necessary to implement these sensitive mandates. Any perceived shortcomings in administrative decision making are not solved by permitting *de novo* review of every legal decision by a court and, as a result, adding to the delay and cost of obtaining a final decision. The solution lies instead in ensuring the proper qualifications and training of administrative decision-makers. Like courts, administrative actors are fully capable of, and responsible for, improving the quality of their own decision-making processes, thereby strengthening access to justice in the administrative justice system.

[284] We also acknowledge that this Court should offer additional direction on conducting reasonableness review.[7] We fear, however, that the majority's multi-factored, open-ended list of "constraints" on administrative decision making will encourage reviewing courts to dissect administrative reasons in a "line-by-line treasure hunt for error" (*Communications, Energy and Paperworkers Union of Canada, Local 30 v. Irving Pulp & Paper, Ltd.*, [2013] 2 S.C.R. 458, at para. 54). These "constraints" may function in practice as a wide-ranging catalogue of hypothetical errors to justify quashing an administrative decision — a checklist with unsettling similarities to the series of "jurisdictional errors" spelled out in *Anisminic* itself.

[285] Structuring reasonableness review in this fashion effectively imposes on administrative decision-makers a higher standard of justification than that applied to trial judges. Such an approach undercuts deference and revives a long-abandoned posture of suspicion towards administrative decision making. We are also concerned by the majority's warning that administrative decision-makers cannot "arrogate powers to themselves that they were never intended to have", an unhelpful truism that risks reintroducing the tortured concept of "jurisdictional error" by another name.

[286] We would advocate a continued approach to reasonableness review which focuses on the concept of *deference* and what it requires of reviewing courts. Curial deference, after all, is *the* hallmark of reasonableness review, setting it apart

[7] Consistent with requests from some commentators and some of the interveners at these hearings, including the Canadian Bar Association and the Council of Canadian Administrative Tribunals (see also Mullan, at pp. 76-78).

from the substitution of opinion permitted under the correctness standard. The choice of a particular standard of review — whether described as "correctness", "reasonableness" or in other terms — is fundamentally about "whether or not a reviewing court should defer"[8] to an administrative decision (see *Dunsmuir*, at para. 141, per Binnie J., concurring; Régimbald, at pp. 539-40). If courts, therefore, are to properly conduct "reasonableness" review, they must properly understand what deference means.

[287] In our view, deference imposes three requirements on courts conducting reasonableness review. It informs the attitude a reviewing court must adopt towards an administrative decision-maker; it affects how a court frames the question it must answer on judicial review; and it affects how a reviewing court evaluates challenges to an administrative decision.

[288] First and foremost, deference is an "attitude of the court" conducting reasonableness review (*Dunsmuir*, at para. 48). Deference mandates respect for the legislative choice to entrust a decision to administrative actors rather than to the courts, and for the important role that administrative decision-makers play in upholding and applying the rule of law (*Toronto (City) v. C.U.P.E., Local 79*, [2003] 3 S.C.R. 77, at para. 131, per LeBel J., concurring). Deference also requires respect for administrative decision-makers, their specialized expertise and the institutional setting in which they operate (*Dunsmuir*, at paras. 48-49). Reviewing courts must pay

[8] Factum of the intervener the Canadian Association of Refugee Lawyers, at para. 5; factum of the intervener the Council of Canadian Administrative Tribunals, at paras. 24-26.

"respectful attention" to the reasons offered for an administrative decision, make a genuine effort to understand why the decision was made, and give the decision a fair and generous construction in light of the entire record (*Newfoundland Nurses*, at paras. 11-14 and 17).

[289] Second, deference affects how a court frames the question it must answer when conducting judicial review. A reviewing court does not ask how it would have resolved an issue, but rather, whether the answer provided by the administrative decision-maker has been shown to be unreasonable (*Khosa*, at paras. 59 and 61-62; *Dunsmuir*, at para. 47). Framing the inquiry in this way ensures that the administrative decision under review is the focus of the analysis.

[290] This Court has often endorsed this approach to conducting reasonableness review. In *Ryan*, for example, Iacobucci J. explained:

> . . . When deciding whether an administrative action was unreasonable, a court should not at any point ask itself what the correct decision would have been . . . . The standard of reasonableness does not imply that a decision-maker is merely afforded a "margin of error" around what the court believes is the correct result.
>
> . . . Unlike a review for correctness, there will often be no single right answer to the questions that are under review against the standard of reasonableness . . . . Even if there could be, notionally, a single best answer, it is not the court's role to seek this out when deciding if the decision was unreasonable. [paras. 50-51]
>
> (See also *Volvo Canada Ltd. v. U.A.W., Local 720*, [1980] 1 S.C.R. 178, at p. 214; *Toronto (City)*, at paras. 94-95, per LeBel J., concurring; *VIA Rail*, at para. 101; *Mason v. Minister of Citizenship and Immigration*, 2019 FC 1251, at para. 22 (CanLII), per Grammond J.; Régimbald, at p. 539; Sharpe, at pp. 204 and 208; Paul Daly, "The Signal and the Noise in

> Administrative Law" (2017), 68 *U.N.B.L.J.* 68, at p. 85; Evans, "Triumph of Reasonableness: But How Much Does It Really Matter?", at p. 107.)

[291] Third, deferential review impacts how a reviewing court evaluates challenges to an administrative decision. Deference requires the applicant seeking judicial review to bear the onus of showing that the decision was unreasonable (*Williams Lake Indian Band v. Canada (Aboriginal Affairs and Northern Development)*, [2018] 1 S.C.R. 83, at para. 108; *Mission Institution v. Khela*, [2014] 1 S.C.R. 502, at para. 64; *May v. Ferndale Institution*, [2005] 3 S.C.R. 809, at para. 71; *Ryan*, at para. 48; *Southam*, at para. 61; *Northern Telecom Ltd. v. Communications Workers of Canada*, [1980] 1 S.C.R. 115, at p. 130). Focusing on whether the applicant has demonstrated that the decision is unreasonable reinforces the central role that administrative decisions play in a properly deferential review process, and confirms that the decision-maker does not have to persuade the court that its decision is reasonable.

[292] Assessing whether a decision is reasonable also requires a qualitative assessment. Reasonableness is a concept that pervades the law but is difficult to define with precision (*Dunsmuir*, at para. 46). It requires, by its very nature, a fact-specific inquiry that involves a certain understanding of common experience. Reasonableness cannot be reduced to a formula or a checklist of factors, many of which will not be relevant to a particular decision. Ultimately, whether an administrative decision is reasonable will depend on the context (*Catalyst Paper Corp. v. North Cowichan (District)*, [2012] 1 S.C.R. 5, at para. 18). Administrative

law covers an infinite variety of decisions and decision-making contexts, as LeBel J. colourfully explained in *Blencoe v. British Columbia (Human Rights Commission)*, [2000] 2 S.C.R. 307, at para. 158 (dissenting in part, but not on this point):

> . . . not all administrative bodies are the same. Indeed, this is an understatement. At first glance, labour boards, police commissions, and milk control boards may seem to have about as much in common as assembly lines, cops, and cows! Administrative bodies do, of course, have some common features, but the diversity of their powers, mandate and structure is such that to apply particular standards from one context to another might well be entirely inappropriate . . . .

[293] Deference, in our view, requires approaching each administrative decision on its own terms and in its own context. But we emphasize that the inherently contextual nature of reasonableness review does not mean that the degree of scrutiny applied by a reviewing court varies (*Alberta Teachers' Association*, at para. 47; *Wilson*, at para. 18). It merely means that when assessing a challenge to an administrative decision, a reviewing court must be attentive to all relevant circumstances, including the reasons offered to support the decision, the record, the statutory scheme and the particular issues raised by the applicant, among other factors (see, for example, *Suresh v. Canada (Minister of Citizenship and Immigration)*, [2002] 1 S.C.R. 3, at para. 40; *Newfoundland Nurses*, at para. 18; Van Harten et al., at p. 794). Without this context, it is impossible to determine what constitutes a sufficiently compelling justification to quash a decision under reasonableness review. Context may make a challenge to an administrative decision more or less persuasive

— but it does not alter the deferential posture of the reviewing court (*Suresh*, at para. 40).

[294] Deference, however, does not require reviewing courts to shirk their obligation to review the decision. So long as they maintain a respectful attitude, frame the judicial review inquiry properly and demand compelling justification for quashing a decision, reviewing courts are entitled to meaningfully probe an administrative decision. A thorough evaluation by a reviewing court is not "disguised correctness review", as some have used the phrase. Deference, after all, stems from respect, not inattention to detail.

[295] Bearing this in mind, we offer the following suggestions for conducting reasonableness review. We begin with situations where reasons are required.[9]

[296] The administrative decision is the focal point of the review exercise. Where reasons are provided, they serve as the natural starting point to determine whether the decision-maker acted reasonably (*Williams Lake*, at para. 36). By beginning with the reasons offered for the decision, read in light of the surrounding context and the grounds raised to challenge the decision, reviewing courts provide meaningful oversight while respecting the legitimacy of specialized administrative decision making.

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[9] Under the duty of procedural fairness outlined in *Baker v. Canada (Minister of Citizenship and Immigration)*, [1999] 2 S.C.R. 817, at para. 43.

[297] Reviewing courts should approach the reasons with respect for the specialized decision-makers, the significant role they have been assigned and the institutional context chosen by the legislator. Reasons should be approached generously, on their own terms. Reviewing courts should be hesitant to second-guess operational implications, practical challenges and on-the-ground knowledge used to justify an administrative decision. Reviewing courts must also remain alert to specialized concepts or language used in an administrative decision that may be unfamiliar to a generalist judge (*Newfoundland Nurses*, at para. 13; *Igloo Vikski*, at paras. 17 and 30). When confronted with unfamiliar language or modes of reasoning, judges should acknowledge that such differences are an inevitable, intentional and invaluable by-product of the legislative choice to assign a matter to the administrative system. They may lend considerable force to an administrative decision and, by the same token, render an applicant's challenge to that decision less compelling. Reviewing courts scrutinizing an administrative body's decision under the reasonableness framework should therefore keep in mind that the administrative body holds the "interpretative upper hand" (*McLean*, at para. 40).

[298] Throughout the review process, a court conducting deferential review must view claims of administrative error in context and with caution, cognizant of the need to avoid substituting its opinion for that of those empowered and better equipped to answer the questions at issue. Because judicial substitution is incompatible with deference, reviewing courts must carefully evaluate the challenges raised by an applicant to ensure they go to the *reasonableness* of the administrative decision.

[299] Unsurprisingly, applicants rarely present challenges to an administrative decision as explicit invitations for courts to substitute their opinions for those of administrative actors. Courts, therefore, must carefully probe challenges to administrative decisions to assess whether they amount, in substance, to a mere difference of opinion with how the administrative decision-maker weighed or prioritized the various factors relevant to the decision-making process. Allegations of error may, on deeper examination, simply reflect a legitimate difference in approach by an administrative decision-maker. By rooting out and rejecting such challenges, courts respect the valuable and distinct perspective that administrative bodies bring to answering legal questions, flowing from the considerable expertise and field sensitivity they develop by administering their mandate and working within the intricacies of their statutory context on a daily basis. The understanding and insights of administrative actors enhance the decision-making process and may be more conducive to reaching a result "that promotes effective public policy and administration . . . than the limited knowledge, detachment, and modes of reasoning typically associated with courts of law" (*National Corn Growers*, at pp. 1336-37 (emphasis deleted), per Wilson J., concurring, citing J. M. Evans et al., *Administrative Law: Cases, Text, and Materials* (3rd ed. 1989), at p. 414).

[300] When resolving challenges to an administrative decision, courts must also consider the *materiality* of any alleged errors in the decision-maker's reasoning. Under reasonableness review, an error is not necessarily sufficient to justify quashing a decision. Inevitably, the weight of an error will depend on the extent to which it

affects the decision. An error that is peripheral to the administrative decision-maker's reasoning process, or overcome by more compelling points advanced in support of the result, does not provide fertile ground for judicial review. Ultimately, the role of the reviewing court is to examine the decision as a whole to determine whether it is reasonable (*Dunsmuir*, at para. 47; *Khosa*, at para. 59). Considering the materiality of any impugned errors is a natural part of this exercise, and of reading administrative reasons "together with the outcome" (*Newfoundland Nurses*, at para. 14).

[301] Review of the decision as a whole is especially vital when an applicant alleges that an administrative decision contains material omissions. Significantly, and as this Court has frequently emphasized, administrative decision-makers are not required to consider and comment upon every issue raised by the parties in their reasons (*Construction Labour Relations v. Driver Iron Inc.*, [2012] 3 S.C.R. 405, at para. 3; *Newfoundland Nurses*, at para. 16, citing *Service Employees' International Union, Local No. 333 v. Nipawin District Staff Nurses Association*, [1975] 1 S.C.R. 382, at p. 391). Further, a reviewing court is not restricted to the four corners of the written reasons delivered by the decision-maker and should, if faced with a gap in the reasons, look to the record to see if it sheds light on the decision (*Williams Lake*, at para. 37; *Delta Air Lines Inc. v. Lukács*, [2018] 1 S.C.R. 6, at para. 23; *Newfoundland Nurses*, at para. 15; *Alberta Teachers' Association*, at paras. 53 and 56).

[302] The use of the record and other context to supplement a decision-maker's reasons has been the subject of some academic discussion (see, for example, Mullan,

at pp. 69-74). We support a flexible approach to supplementing reasons, which is consistent with the flexible approach used to determine whether administrative reasons must be provided to begin with and sensitive to the "day-to-day realities of administrative agencies" (*Baker*, at para. 44), which may not be conducive to the production of "archival" reasons associated with court judgments (para. 40, citing Roderick A. Macdonald and David Lametti, "Reasons for Decision in Administrative Law" (1990), 3 *C.J.A.L.P.* 123).

[303] Some materials that may help bridge gaps in a reviewing court's understanding of an administrative decision include: the record of any formal proceedings as well as the materials before the decision-maker, past decisions of the administrative body, and policies or guidelines developed to guide the type of decision under review (see Matthew Lewans, "Renovating Judicial Review" (2017), 68 *U.N.B.L.J.* 109, at pp. 137-38). Reviewing these materials may assist a court in understanding, "by inference", why an administrative decision-maker reached a particular outcome (*Baker*, at para. 44; see also *Williams Lake*, at para. 37; *Mills v. Ontario (Workplace Safety and Insurance Appeals Tribunal (Ont.)*, 2008 ONCA 436, 237 O.A.C. 71, at paras. 38-39). It may reveal further confirmatory context for a line of reasoning employed by the decision-maker — by showing, for example, that the decision-maker's understanding of the purpose of its statutory mandate finds support in the provision's legislative history (*Celgene Corp. v. Canada (Attorney General)*, [2011] 1 S.C.R. 3, at paras. 25-29). Reviewing the record can also yield responses to the specific challenges raised by an applicant on judicial review, responses that are

“consistent with the process of reasoning” applied by the administrative decision-maker (*Igloo Vikski*, at para. 45). In these ways, reviewing courts may legitimately supplement written reasons without “supplant[ing] the analysis of the administrative body” (*Lukács*, at para. 24).

[304] The “adequacy” of reasons, in other words, is not “a stand-alone basis for quashing a decision” (*Newfoundland Nurses*, at para. 14). As this Court has repeatedly confirmed, reasons must instead “be read together with the outcome and serve the purpose of showing whether the result falls within a range of possible outcomes” (*Newfoundland Nurses*, at para. 14; *Halifax (Regional Municipality) v. Canada (Public Works and Government Services)*, [2012] 2 S.C.R. 108, at para. 44; *Agraira v. Canada (Public Safety and Emergency Preparedness)*, [2013] 2 S.C.R. 559, at para. 52; *Williams Lake*, at para. 141, per Rowe J., dissenting, but not on this point). This approach puts substance over form in situations where the basis for a decision by a specialized administrative actor is evident on the record, but not clearly expressed in written reasons. Quashing decisions in such circumstances defeats the purpose of deference and thwarts access to justice by wasting administrative and judicial resources.

[305] In our view, therefore, if an applicant claims that an administrative decision-maker failed to address a relevant factor in reaching a decision, the reviewing court must consider the submissions and record before the decision-maker, and the materiality of any such omission to the decision rendered. An administrative

decision-maker's failure, for example, to refer to a particular statutory provision or the full factual record before it does not automatically entitle a reviewing court to conduct a *de novo* assessment of the decision under review. The inquiry must remain focussed on whether the applicant has satisfied the burden of showing that the omission renders the decision reached unreasonable.

[306] We acknowledge that respecting the line between reasonableness and correctness review has posed a particular challenge for judges when reviewing interpretation by administrative decision-makers of their statutory mandates. Judges routinely interpret statutes and have developed a template for how to scrutinize words in that context. But the same deferential approach we have outlined above must apply with equal force to statutory interpretation cases. When reviewing an administrative decision involving statutory interpretation, a court should not assess the decision by determining what, in its own view, would be a reasonable interpretation. Such an approach "imperils deference" (Paul Daly, "Unreasonable Interpretations of Law" (2014), 66 *S.C.L.R.* (2d) 233, at p. 250).

[307] We agree with Justice Evans that "once [a] court embarks on its own interpretation of the statute to determine the reasonableness of the tribunal's decision, there seems often to be little room for deference" (Evans, "Triumph of Reasonableness: But How Much Does It Really Matter?", at p. 109; see also *Mason*, at para. 34; Dyzenhaus, "Dignity in Administrative Law: Judicial Deference in a Culture of Justification", at p. 108; Daly, "Unreasonable Interpretations of Law", at

pp. 254-55). We add that a *de novo* interpretation of a statute, conducted as a prelude to "deferential" review, necessarily omits a vital piece of the interpretive puzzle: the perspective of the front-line, specialized administrative body that routinely applies the statutory scheme in question (Dyzenhaus, "The Politics of Deference: Judicial Review and Democracy", at p. 304; Paul Daly, "Deference on Questions of Law" (2011), 74 *Mod. L. Rev.* 694). By placing that perspective at the heart of the judicial review inquiry, courts display respect for administrative specialization and expertise, and for the legislative choice to delegate certain questions to non-judicial bodies.

[308] Conversely, by imposing their own interpretation of a statutory provision, courts *undermine* legislative intent to confide a mandate to the decision-maker. Applying a statute will almost always require some interpretation, making the interpretive mandate of administrative decision-makers inherent to their legislative mandate. The decision-maker who applies the statute has primary responsibility for interpreting the provisions in order to carry out their mandate effectively.

[309] Administrative decision-makers performing statutory interpretation should therefore be permitted to be guided by their expertise and knowledge of the practical realities of their administrative regime. In many cases, the "ordinary meaning" of a word or term makes no sense in a specialized context. And in some settings, law and policy are so inextricably at play that they give the words of a statute a meaning unique to a particular specialized context (*National Corn Growers*, at p. 1336, per Wilson J., concurring; *Domtar Inc.*, at p. 800). Further, not only are

statutory provisions sometimes capable of bearing more than one reasonable interpretation, they are sometimes drafted in general terms or with "purposeful ambiguity" in order to permit adaptation to future, unknown circumstances (see Felix Frankfurter, "Some Reflections on the Reading of Statutes" (1947), 47 *Colum. L. Rev.* 527, at p. 528). These considerations make it all the more compelling that reviewing courts avoid imposing judicial norms on administrative decision-makers or maintaining a dogmatic insistence on formalism. Where a decision-maker can explain its decision adequately, that decision should be upheld (Daly, "Unreasonable Interpretations of Law", at pp. 233-34, 250 and 254-55).

[310] Justice Brown's reasons in *Igloo Vikski* provide a useful illustration of a properly deferential approach to statutory interpretation. That case involved an interpretation of the *Customs Tariff*, S.C. 1997, c. 36, as it applies to hockey goaltender gloves. The Canada Border Services Agency had classified the gloves as "[g]loves, mittens [or] mitts". Igloo Vikski argued they should have been classified as sporting equipment. The Canadian International Trade Tribunal ("CITT") confirmed the initial classification. The Federal Court of Appeal reversed the decision.

[311] Acknowledging that the "specific expertise" of the CITT gave it the upper hand over a reviewing court with respect to certain questions of law, Justice Brown determined that the standard of review was reasonableness. Writing for seven other members of the Court, he carefully reviewed the reasons of the CITT and how it had engaged with Igloo Vikski's arguments before turning to the errors alleged by

Igloo Vikski and the Federal Court of Appeal. Conceding that the CITT reasons lacked "perfect clarity", Justice Brown nevertheless concluded that the Tribunal's interpretation was reasonable. While he agreed with Igloo Vikski that an alternate interpretation to that given by the CITT was available, the inclusive language of the applicable statute was broad enough to accommodate the CITT's reasonable interpretation. By beginning with the reasons offered for the interpretation and turning to the challenges mounted against it in light of the surrounding context, *Igloo Vikski* provides an excellent example of respectful and properly deferential judicial review.

[312] We conclude our discussion of reasonableness review by addressing cases where reasons are neither required nor available for judicial review. In these circumstances, a reviewing court should remain focussed on whether the decision has been shown to be unreasonable. The reasonableness of the decision may be justified by past decisions of the administrative body (see *Edmonton East*, at paras. 38 and 44-46; *Alberta Teachers' Association*, at paras. 56-64). In other circumstances, reviewing courts may have to assess the reasonableness of the outcome in light of the procedural context surrounding the decision (see *Law Society of British Columbia v. Trinity Western University*, [2018] 2 S.C.R. 293, at paras. 51-56; *Edmonton East*, at paras. 48-60; *Catalyst Paper Corp.*, at paras. 32-36). In all cases, the question remains whether the challenging party has demonstrated that a decision is unreasonable.

[313] In sum, reasonableness review is based on deference to administrative decision-makers and to the legislative intention to confide in them a mandate. Deference must inform the attitude of a reviewing court and the nature of its analysis: the court does not ask how it would have resolved the issue before the administrative decision-maker but instead evaluates whether the decision-maker acted reasonably. The reviewing court starts with the reasons offered for the administrative decision, read in light of the surrounding context and based on the grounds advanced to challenge the reasonableness of the decision. The reviewing court must remain focussed on the reasonableness of the decision viewed as a whole, in light of the record, and with attention to the materiality of any alleged errors to the decision-maker's reasoning process. By properly conducting reasonableness review, judges provide careful and meaningful oversight of the administrative justice system while respecting its legitimacy and the perspectives of its front-line, specialized decision-makers.

Application to Mr. Vavilov

[314] Alexander Vavilov challenges the Registrar of Citizenship's decision to cancel his citizenship certificate. The Registrar concluded that Mr. Vavilov was not a Canadian citizen, and therefore not entitled to a certificate of Canadian citizenship because, although he was born in Canada, his parents were "other representative[s] or employee[s] in Canada of a foreign government" within the meaning of s. 3(2)(a) of the *Citizenship Act*, R.S.C. 1985, c. C-29.

[315] The first issue is the applicable standard of review. We agree with the majority that reasonableness applies.

[316] The second issue is whether the Registrar was reasonable in concluding that the exception to Canadian citizenship in s. 3(2)(a) applies not only to parents who enjoy diplomatic privileges and immunities, but also to intelligence agents of a foreign government. The onus is therefore on Mr. Vavilov to satisfy the reviewing court that the decision was unreasonable. In our view, he has met that onus.

[317] Mr. Vavilov was born in Canada in 1994. His Russian parents, Elena Vavilova and Andrey Bezrukov, entered Canada at some point prior to his birth, assumed the identities of two deceased Canadians and fraudulently obtained Canadian passports. After leaving Canada to live in France, Mr. Vavilov and his family moved to the United States. While in the United States, Mr. Vavilov's parents became American citizens under their assumed Canadian identities. Mr. Vavilov and his older brother also obtained American citizenship.

[318] In June 2010, agents of the United States Federal Bureau of Investigation arrested Mr. Vavilov's parents and charged them with conspiracy to act as unregistered agents of a foreign government and to commit money laundering. Mr. Vavilov's parents pleaded guilty to the conspiracy charges in July 2010 and were returned to Russia in a spy swap. Around the same time, Mr. Vavilov and his brother travelled to Russia. The American government subsequently revoked Mr. Vavilov's

passport and citizenship. In December 2010, he was issued a Russian passport and birth certificate.

[319] From 2010 to 2013, Mr. Vavilov repeatedly sought a Canadian passport. In December 2011, he obtained an amended Ontario birth certificate, showing his parents' true names and places of birth. Using this birth certificate, Mr. Vavilov applied for and received a certificate of Canadian citizenship in January 2013. Relying on these certificates, Mr. Vavilov applied for an extension of his Canadian passport in early 2013. On July 18, 2013, the Registrar wrote to Mr. Vavilov, informing him that there was reason to believe the citizenship certificate had been erroneously issued and asking him for additional information.

[320] On April 22, 2014, Mr. Vavilov provided extensive written submissions to the Registrar. He argued that the narrow exception set out in s. 3(2) of the Act does not apply to him. Because he was born in Canada, he is entitled to Canadian citizenship. Mr. Vavilov also argued that the Registrar had failed to respect the requirements of procedural fairness.

[321] The Registrar wrote to Mr. Vavilov on August 15, 2014, cancelling his certificate of Canadian citizenship. In her view, because Mr. Vavilov met the two statutory restrictions in s. 3(2) of the Act, he was not a Canadian citizen. First, when Mr. Vavilov was born in Canada, neither of his parents were Canadian citizens or lawfully admitted to Canada for permanent residence. Second, as unofficial agents working for Russia's Foreign Intelligence Service, Mr. Vavilov's parents were "other

representative[s] or employee[s] in Canada of a foreign government" within the meaning of s. 3(2)(a).

[322] The Federal Court ([2016] 2 F.C.R. 39) dismissed Mr. Vavilov's application for judicial review. It found that the Registrar had satisfied the requirements of procedural fairness and, applying a correctness standard, determined that the Registrar's interpretation of s. 3(2)(a) was correct. The Federal Court then reviewed the application of s. 3(2)(a) on a reasonableness standard and concluded that the Registrar had reasonably determined that Mr. Vavilov's parents were working in Canada as undercover agents of the Russian government at the time of his birth.

[323] The Federal Court of Appeal ([2018] 3 F.C.R. 75) allowed the appeal and quashed the Registrar's decision to cancel Mr. Vavilov's citizenship certificate. Writing for the majority, Stratas J.A. agreed that the requirements of procedural fairness were met but held that the Registrar's interpretation of s. 3(2)(a) was unreasonable. In his view, only those who enjoy diplomatic privileges and immunities fall within the exception to citizenship found in s. 3(2)(a). Justice Stratas reached this conclusion after considering the context and purpose of the provision, its legislative history and international law principles related to citizenship and diplomatic privileges and immunities.

[324] As a general rule, administrative decisions are to be judicially reviewed for reasonableness. None of the correctness exceptions apply to the Registrar's

interpretation of the Act in this case. As such, the standard of review is reasonableness.

[325] The following provisions of the *Citizenship Act* are relevant to this appeal:

> **Persons who are citizens**
>
> **3 (1)** Subject to this Act, a person is a citizen if
>
> > **(a)** the person was born in Canada after February 14, 1977;
>
> . . .
>
> **Not applicable to children of foreign diplomats, etc.**
>
> **(2)** Paragraph (1)(a) does not apply to a person if, at the time of his birth, neither of his parents was a citizen or lawfully admitted to Canada for permanent residence and either of his parents was
>
> > **(a)** a diplomatic or consular officer or other representative or employee in Canada of a foreign government;
> >
> > **(b)** an employee in the service of a person referred to in paragraph (a); or
> >
> > **(c)** an officer or employee in Canada of a specialized agency of the United Nations or an officer or employee in Canada of any other international organization to whom there are granted, by or under any Act of Parliament, diplomatic privileges and immunities certified by the Minister of Foreign Affairs to be equivalent to those granted to a person or persons referred to in paragraph (a).

The general rule embodied in s. 3(1)(a) of the Act is that persons born in Canada are Canadian citizens. Section 3(2) sets out an exception to this rule. As such, if s. 3(2) applies to Mr. Vavilov, he was never a Canadian citizen.

[326] The specific issue in this case is whether the Registrar's interpretation of the statutory exception to citizenship was reasonable. Reasonableness review entails deference to the decision-maker, and we begin our analysis by examining the reasons offered by the Registrar in light of the context and the grounds argued.

[327] In this case, the Registrar's letter to Mr. Vavilov summarized the key points underlying her decision. In concluding that Mr. Vavilov was not entitled to Canadian citizenship, the Registrar adopted the recommendations of an analyst employed by Citizenship and Immigration Canada. As such, the analyst's report properly forms part of the reasons supporting the Registrar's decision.

[328] The analyst's report sought to answer the question of whether Mr. Vavilov was erroneously issued a certificate of Canadian citizenship. The report identifies the key question in this case as being whether either of Mr. Vavilov's parents was a "representative" or "employee" of a foreign government within the meaning of s. 3(2)(a). Much of the report relates to matters not disputed in this appeal, including the legal status of Mr. Vavilov's parents in Canada and their employment as Russian intelligence agents.

[329] The analyst began her analysis with the text of s. 3(2)(a). In concluding that the provision operates to deny Mr. Vavilov Canadian citizenship, she set out two textual arguments. First, she compared the current version of s. 3(2)(a) to an earlier iteration of the exception found in s. 5(3) of the *Canadian Citizenship Act*, R.S.C. 1970, c. C-19:

Not applicable to children of foreign diplomats, etc.

(3) Subsection (1) does not apply to a person if, at the time of that person's birth, his responsible parent

(*a*) is an alien who has not been lawfully admitted to Canada for permanent residence; and

(*b*) is

(i) a foreign diplomatic or consular officer or a representative of a foreign government <u>accredited to Her Majesty</u>,

(ii) an employee of a foreign government <u>attached to or in the service of a foreign diplomatic mission or consulate in Canada</u>, or

(iii) an employee in the service of a person referred to in subparagraph (i).

[330] The analyst stated that the removal of references to official accreditation or a diplomatic mission indicate that the previous exception was narrower than s. 3(2)(a). She then pointed out that the definition of "diplomatic or consular officer" in s. 35(1) of the *Interpretation Act*, R.S.C. 1985, c. I-21, clearly associates these individuals with diplomatic positions. Because the current version of s. 3(2)(a) does not link "other representative or employee in Canada of a foreign government" to a diplomatic mission, the analyst determined "it is reasonable to maintain that this provision intends to encompass individuals not included in the definition of 'diplomatic and consular staff.'" Finally, the analyst stated that the phrase "other representative or employee in Canada of a foreign government" has not been previously interpreted by a court.

[331] Beyond the analyst’s report, there is little in the record to supplement the Registrar’s reasons. There is no evidence about whether the Registrar has previously applied this provision to individuals like Mr. Vavilov, whose parents did not enjoy diplomatic privileges and immunities. Neither does there appear to be any internal policy, guideline or legal opinion to guide the Registrar in making these types of decisions.

[332] In challenging the Registrar’s decision, Mr. Vavilov bears the onus of demonstrating why it is not reasonable. Before this Court, Mr. Vavilov submitted that the analyst focussed solely on the text of the exception to citizenship. In his view, had the broader objectives of s. 3(2)(a) been considered, the analyst would have concluded that “other representative” or “employee” only applies to individuals who benefit from diplomatic privileges and immunities.

[333] In his submissions before the Registrar, Mr. Vavilov offered three reasons why the text of s. 3(2) must be read against the backdrop of Canadian and international law relating to the roles and functions of diplomats.

[334] First, Mr. Vavilov explained that s. 3(2)(a) should be read in conjunction with the *Foreign Missions and International Organizations Act*, S.C. 1991, c. 41 (“*FMIOA”*). This statute incorporates into Canadian law aspects of the *Vienna Convention on Diplomatic Relations*, Can. T.S. 1966 No. 29, Sched. I to the *FMIOA*, and the *Vienna Convention on Consular Relations*, Can. T.S. 1974 No. 25, Sched. II to the *FMIOA*, which deal with diplomatic privileges and immunities. He submitted

that s. 3(2) denies citizenship to children of diplomats because diplomatic privileges and immunities, including immunity from criminal prosecution and civil liability, are inconsistent with the duties and responsibilities of a citizen. Because Mr. Vavilov's parents did not enjoy such privileges and immunities, there would be no purpose in excluding their children born in Canada from becoming Canadian citizens.

[335] Second, Mr. Vavilov provided the Registrar with Hansard committee meeting minutes such as the comments of the Honourable J. Hugh Faulkner, Secretary of State, when introducing the amendments to s. 3(2), who explained that the provision had been redrafted to narrow the exception to citizenship.

[336] Third, Mr. Vavilov cited case law, arguing that: (i) the exception to citizenship should be narrowly construed because it takes away substantive rights (*Brossard (Town) v. Quebec Commission des droits de la personne*, [1988] 2 S.C.R. 279, at p. 307); (ii) s. 3(2)(a) must be interpreted functionally and purposively (*Medovarski v. Canada (Minister of Citizenship and Immigration)*, [2005] 2 S.C.R. 539, at para. 8); and (iii) because Mr. Vavilov's parents were not immune from criminal or civil proceedings, they fall outside the scope of s. 3(2) (*Greco v. Holy See (State of the Vatican City)*, [1999] O.J. No. 2467 (QL) (S.C.J.); *R. v. Bonadie* (1996), 109 C.C.C. (3d) 356 (Ont. C.J.); *Al-Ghamdi v. Canada (Minister of Foreign Affairs & International Trade)* (2007), 64 Imm. L.R. (3d) 67 (F.C.)).

[337] The Federal Court's decision in *Al-Ghamdi*, a case which challenged the constitutionality of s. 3(2)(a), was particularly relevant. In that case, Shore J. wrote

that s. 3(2)(a) only applies to the "children of individuals with diplomatic status" (paras. 5 and 65). Justice Shore also stated that "[i]t is precisely because of the vast array of privileges accorded to diplomats and their families, which are by their very nature inconsistent with the obligations of citizenship, that a person who enjoys diplomatic status cannot acquire citizenship" (para. 63).

[338] The Registrar's reasons failed to respond to Mr. Vavilov's extensive and compelling submissions about the objectives of s. 3(2)(a). It appears that the analyst misunderstood Mr. Vavilov's arguments on this point. In discussing the scope of s. 3(2), she wrote, "[c]ounsel argues that CIC [Citizenship and Immigration Canada] cannot invoke subsection 3(2) because CIC has not requested or obtained verification with the Foreign Affairs Protocol to prove that [Mr. Vavilov's parents] held diplomatic or consular status with the Russian Federation while they resided in Canada." It thus appears that the analyst did not recognize that Mr. Vavilov's argument was more fundamental in nature — namely, that the objectives of s. 3(2) require the terms "other representative" and "employee" to be read narrowly. During discovery, in fact, the analyst acknowledged that her research did not reveal a policy purpose behind s. 3(2)(a) or why the phrase "other representative or employee" was included in the Act. It also appears that the analyst did not understand the potential relevance of the *Al-Ghamdi* decision, since her report stated that "[t]he jurisprudence that does exist only relates to individuals whose parents maintained diplomatic status in Canada at the time of their birth."

[339] The Registrar, in the end, interpreted s. 3(2)(a) broadly, based on the analyst's purely textual assessment of the provision, including a comparison with the text of the previous version. This reading of "other representative or employee" was only reasonable if the text is read in isolation from its objective. Nothing in the history of this provision indicates that Parliament intended to widen its scope. Rather, as Mr. Vavilov points out, the modifications made to s. 3(2) in 1976 appear to mirror those embodied in the *Vienna Convention on Diplomatic Relations* and the *Vienna Convention on Consular Relations*, which were incorporated into Canadian law in 1977. The judicial treatment of this provision, in particular the statements in *Al-Ghamdi* about the narrow scope of s. 3(2)(a) and the inconsistency between diplomatic privileges and immunities and citizenship, also points to the need for a narrow interpretation of the exception to citizenship.

[340] In addition, as noted by the majority of the Federal Court of Appeal, the text of s. 3(2)(c) can be seen as undermining the Registrar's interpretation. That provision denies citizenship to children born to individuals who enjoy "diplomatic privileges and immunities certified by the Minister of Foreign Affairs to be equivalent to those granted to a person or persons referred to in paragraph (a)". As Stratas J.A. noted, this language suggests that s. 3(2)(a) covers *only* those "employee[s] in Canada of a foreign government" who have diplomatic privileges and immunities.

[341] By ignoring the objectives of the provision, the Registrar rendered an unreasonable decision. In particular, the arguments supporting a reading of s. 3(2)

that is restricted to those who have diplomatic privileges and immunities, likely would have changed the outcome in this case.

[342] Mr. Vavilov has satisfied us that the Registrar’s decision is unreasonable. As a result, the Court of Appeal properly quashed the Registrar’s decision to cancel Mr. Vavilov’s citizenship certificate, and he is thus entitled to a certificate of Canadian citizenship.

[343] We would therefore dismiss the appeal with costs to Mr. Vavilov throughout.

Appeal dismissed with costs throughout.

Solicitor for the appellant: Attorney General of Canada, Toronto.

Solicitors for the respondent: Jackman Nazami & Associates, Toronto; University of Windsor — Faculty of Law, Windsor.

Solicitor for the intervener the Attorney General of Ontario: Attorney General of Ontario, Toronto.

Solicitor for the intervener the Attorney General of Quebec: Attorney General of Quebec, Québec.

Solicitor for the intervener the Attorney General of British Columbia: Attorney General of British Columbia, Victoria.

Solicitor for the intervener the Attorney General of Saskatchewan: Attorney General of Saskatchewan, Regina.

Solicitor for the intervener the Canadian Council for Refugees: The Law Office of Jamie Liew, Ottawa.

Solicitor for the intervener the Advocacy Centre for Tenants Ontario - Tenant Duty Counsel Program: Advocacy Centre for Tenants Ontario, Toronto.

Solicitor for the interveners the Ontario Securities Commission, the British Columbia Securities Commission and the Alberta Securities Commission: Ontario Securities Commission, Toronto.

Solicitor for the intervener Ecojustice Canada Society: Ecojustice Canada Society, Toronto.

Solicitor for the interveners the Workplace Safety and Insurance Appeals Tribunal (Ontario), the Workers' Compensation Appeals Tribunal (Northwest

Territories and Nunavut), the Workers' Compensation Appeals Tribunal (Nova Scotia), the Appeals Commission for Alberta Workers' Compensation and the Workers' Compensation Appeals Tribunal (New Brunswick): Workplace Safety and Insurance Appeals Tribunal, Toronto.

Solicitors for the intervener the British Columbia International Commercial Arbitration Centre Foundation: Fasken Martineau DuMoulin, Vancouver.

Solicitors for the intervener the Council of Canadian Administrative Tribunals: Lax O'Sullivan Lisus Gottlieb, Toronto.

Solicitors for the interveners the National Academy of Arbitrators, the Ontario Labour-Management Arbitrators' Association and Conférence des arbitres du Québec: Susan L. Stewart, Toronto; Paliare Roland Rosenberg Rothstein, Toronto; Rae Christen Jeffries, Toronto.

Solicitors for the intervener the Canadian Labour Congress: Goldblatt Partners, Toronto.

Solicitors for the intervener the National Association of Pharmacy Regulatory Authorities: Shores Jardine, Edmonton.

Solicitors for the intervener Queen's Prison Law Clinic: Stockwoods, Toronto.

Solicitors for the intervener Advocates for the Rule of Law: McCarthy Tétrault, Vancouver.

Solicitor for the intervener the Parkdale Community Legal Services: Parkdale Community Legal Services, Toronto.

Solicitors for the intervener the Cambridge Comparative Administrative Law Forum: Cambridge University — The Faculty of Law, Cambridge, U.K.; White & Case, Washington, D.C.

Solicitors for the intervener the Samuelson-Glushko Canadian Internet Policy and Public Interest Clinic: Caza Saikaley, Ottawa.

Solicitors for the intervener the Canadian Bar Association: Gowling WLG (Canada), Ottawa.

Solicitors for the intervener the Canadian Association of Refugee Lawyers: Centre for Criminology & Sociolegal Studies — University of Toronto, Toronto; Legal Aid Ontario, Toronto.

Solicitor for the intervener the Community & Legal Aid Services Programme: Community & Legal Aid Services Programme, Toronto.

Solicitors for the intervener Association québécoise des avocats et avocates en droit de l'immigration: Nguyen, Tutunjian & Cliche-Rivard, Montréal; Hadekel Shams, Montréal.

Solicitors for the intervener the First Nations Child & Family Caring Society of Canada: Stikeman Elliott, Ottawa.

Telecom Decision CRTC 2014-398

PDF version

Route reference: Telecom Notice of Consultation 2013-685

Ottawa, 31 July 2014

File numbers: 8620-C12-201317230 and 8620-C12-201312082

Wholesale mobile wireless roaming in Canada – Unjust discrimination/undue preference

The Commission ***finds*** *that there were clear instances of unjust discrimination and undue preference by Rogers Communications Partnership with respect to (i) the imposition of exclusivity clauses in its wholesale mobile wireless roaming agreements with certain new entrants, and (ii) the wholesale mobile wireless roaming rates it charged certain new entrants. Consequently, the Commission* ***prohibits*** *exclusivity provisions in wholesale mobile wireless roaming agreements between Canadian carriers for service in Canada. Since the implementation of section 27.1 of the* Telecommunications Act *mitigates the risk of future unjust discrimination with respect to wholesale mobile wireless roaming rates, the Commission will not put in place a remedy in this regard.*

Introduction

1. Roaming service allows a mobile wireless carrier's retail customers to automatically access voice, data, and text services by using a visited carrier's network (also referred to as a host network) when they travel outside their home carrier's network footprint. For this access to take place, the home carrier and the visited carrier must enter into a wholesale mobile wireless roaming agreement (wholesale roaming agreement). These agreements for wholesale roaming services may be one-way (i.e. one carrier's customers can roam on the wireless network of the other carrier) or two-way/reciprocal (i.e. each carrier's customers can roam on the other carrier's wireless network). They may be for domestic or international roaming services.

2. Mobile wireless carriers are subject to conditions of licence imposed by Industry Canada under the *Radiocommunication Act* in order to use the spectrum needed to provide mobile wireless services.[1] Among other things, the conditions of licence require mobile wireless carriers to provide wholesale roaming services at commercially negotiated rates, terms, and conditions. If mobile wireless carriers are unable to successfully negotiate a wholesale roaming agreement within 60 days of a

[1] CPC-2-0-17 – *Conditions of Licence for Mandatory Roaming and Antenna Tower and Site Sharing and to Prohibit Exclusive Site Arrangements* (Issue 2, March 2013)

roaming proposal, they may have recourse to arbitration in accordance with *Industry Canada's Arbitration Rules and Procedures*.[2]

Background

3. Since the mid-1990s, the Commission has forborne from regulating mobile wireless services except with respect to its powers under section 24 and subsections 27(2), 27(3), and 27(4)[3] of the *Telecommunications Act* (the Act). As a result of forbearance, mobile wireless carriers are not, among other things, required to obtain prior Commission approval of the rates, terms, and conditions for mobile wireless services, including wholesale roaming. However, the Commission has retained the power to impose conditions on the offer and provision of services (section 24) and to make findings of undue preference or unjust discrimination (subsections 27(2), (3), and (4)).

4. In mid-2013, Commission staff undertook a fact-finding exercise to assess the impact of wholesale roaming agreements on the competitiveness of the Canadian wireless industry and the choices available to Canadians. As part of that exercise, on 30 August 2013, Commission staff requested information on roaming services from certain Canadian mobile wireless carriers, including copies of their wholesale roaming arrangements with other Canadian and U.S.-based carriers. Commission staff also met with representatives from some Canadian mobile wireless carriers to obtain additional information and clarification.

5. Based on the information obtained through the fact-finding exercise, the Commission found that some Canadian mobile wireless carriers were charging or proposing to charge significantly higher rates for wholesale mobile wireless roaming services to other Canadian mobile wireless carriers than to U.S.-based carriers. For instance, the rates that some Canadian carriers contracted to pay or were being asked to pay were many times higher than those that U.S.-based carriers paid, particularly with respect to data services. Further, some Canadian carriers were subject to more restrictive terms and conditions than those that applied to U.S.-based carriers.

6. These disparities in wholesale mobile wireless roaming rates, terms, and conditions gave rise to concerns that certain Canadian mobile wireless carriers may be subject to unjust discrimination or undue preference, contrary to subsection 27(2) of the Act.

[2] CPC-2-0-18 – *Industry Canada's Arbitration Rules and Procedures* (Issue 2, March 2013)

[3] The cited provisions are

24. The offering and provision of any telecommunications service by a Canadian carrier are subject to any conditions imposed by the Commission or included in a tariff approved by the Commission.

27(2) No Canadian carrier shall, in relation to the provision of a telecommunications service or the charging of a rate for it, unjustly discriminate or give an undue or unreasonable preference toward any person, including itself, or subject any person to an undue or unreasonable disadvantage.

27(3) The Commission may determine in any case, as a question of fact, whether a Canadian carrier has complied with section 25, this section or section 29, or with any decision made under section 24, 25, 29, 34 or 40.

27(4) The burden of establishing before the Commission that any discrimination is not unjust or that any preference or disadvantage is not undue or unreasonable is on the Canadian carrier that discriminates, gives the preference or subjects the person to the disadvantage.

Consequently, the Commission launched the current proceeding on 12 December 2013 to consider whether or not, as a question of fact, there is a situation of unjust discrimination or undue preference with respect to wholesale roaming agreements in Canada.

7. The Commission also announced that it would launch a second proceeding to examine the wholesale mobile wireless market more broadly and to determine whether it is sufficiently competitive (the second wireless proceeding). This proceeding was launched, through Telecom Notice of Consultation 2014-76, in February 2014.

8. On 28 March 2014, the Minister of Finance tabled Bill C-31, *An Act to implement certain provisions of the budget tabled in Parliament on February 11, 2014 and other measures*, which included a proposed amendment to the Act to establish caps to prevent Canadian carriers from charging other Canadian carriers more for wholesale mobile wireless roaming services than they charge their own customers for mobile voice, data, and text services. Bill C-31 received Royal Assent on 19 June 2014, and these caps now form part of a new section of the Act: section 27.1.

Proceeding

9. The Commission received interventions from the Bell companies,[4] Rogers Communications Partnership (RCP), and TELUS Communications Company (TCC) (collectively, the national wireless carriers); Bragg Communications Inc. carrying on business as Eastlink, Data & Audio-Visual Enterprises Wireless Inc. (Mobilicity), Quebecor Media Inc. on behalf of Videotron G.P., and Globalive Wireless Management Corp. (WIND) (collectively, the new entrants); MTS Inc., Saskatchewan Telecommunications, and TBayTel (collectively, the regional wireless carriers); the Competition Bureau; Lynx Mobility (Lynx); and Benjamin Klass, the Canadian Network Operators Consortium Inc. (CNOC), Fibernetics Corporation, Mobilexchange Ltd., the Public Interest Advocacy Centre (PIAC),[5] and Vaxination Informatique (together, the other interveners). Submissions were also received from members of the general public.

10. The public record of this proceeding, which closed on 5 June 2014, is available on the Commission's website at www.crtc.gc.ca or by using the file numbers provided above.

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[4] Bell Aliant Regional Communications, Limited Partnership (in respect of its subsidiaries KMTS; NorthernTel, Limited Partnership; and Télébec, Limited Partnership); Bell Mobility Inc.; Northwestel Inc.; and the members of the Comcentric Group (Brooke Telecom Co-operative Ltd., Bruce Telecom, Hay Communications Co-operative Limited, Huron Telecommunications Co-operative Limited, Mornington Communications Co-operative Limited, Quadro Communications Co-operative Inc., and Tuckersmith Communications Co-operative Limited)

[5] PIAC, the Consumers' Association of Canada, the National Pensioners Federation, and the Council of Senior Citizens Organizations of British Columbia presented their interventions together.

11. The wholesale roaming agreements filed on the record of this proceeding, as well as several portions of the parties' interventions, were filed in confidence. While confidential information cannot be disclosed in this decision, the Commission has analyzed and taken into account the full record of this proceeding in making its determinations.

Issues

12. This decision addresses the following issues:

- Is there, as a question of fact, a situation of unjust discrimination or undue preference with respect to the rates and other terms in wholesale roaming agreements in Canada?
- If so, what is the appropriate remedy?

Unjust discrimination or undue preference with respect to wholesale roaming agreements in Canada

13. Several parties, including the new entrants, Lynx, and the other interveners, alleged that the national wireless carriers are unjustly discriminating against other carriers or granting themselves an undue preference by engaging in one or more of the following activities:

- charging or proposing to charge wholesale mobile wireless roaming rates for voice, data and text services that are many times higher than
  - the rates they charge U.S.-based mobile wireless carriers;
  - the rates they charge other Canadian mobile wireless carriers;
  - the rates they charge their own retail customers for these services; and/or
  - their costs for providing wholesale mobile wireless roaming services; and/or
- imposing or proposing to impose other restrictive terms in wholesale roaming agreements, including terms with respect to exclusivity[6] and seamless roaming.[7]

14. These parties generally argued that the national wireless carriers are able to engage in unjustly discriminatory and unduly preferential behaviour because they are in a significantly better bargaining position than the new entrants and small mobile wireless carriers. This difference in bargaining positions results from the fact that

[6] In the current context, a term with respect to exclusivity usually prevents the recipient of wholesale mobile wireless roaming services from entering into an agreement for these services with another carrier providing service in the same service area.

[7] Seamless roaming provides for the uninterrupted flow of a voice call that transitions from a home network to a visited network or vice versa.

smaller carriers must enter into wholesale roaming agreements with the national wireless carriers in order to offer their own retail customers national wireless coverage, which in turn is necessary for them to be able to attract retail customers and remain competitive.

15. Several parties noted that in 2008-09, following the Industry Canada auction of spectrum licences for advanced wireless services (the AWS auction), most new entrants could enter into roaming agreements with only one national carrier, for network technology reasons. Most new entrants sought wholesale mobile wireless roaming over networks based on Global System for Mobile Communications (GSM) technology. This decision was based on many factors, including the availability of handsets, particularly smartphones that operate exclusively on these networks. As WIND pointed out, RCP was the only wireless operator in Canada whose network allowed roaming using GSM at that time; therefore, most of the new entrants that acquired spectrum in the AWS auction concluded roaming agreements with RCP.

16. The new entrants submitted that their current wholesale roaming agreements raise their costs, thereby adversely affecting their ability to compete in the retail market. They also submitted that arbitration is not an appropriate recourse to counter the imbalance in bargaining positions, as it is expensive and time consuming. They added that there are no guidelines to determine whether rates are commercially reasonable.

17. According to the Competition Bureau, the national wireless carriers can use wholesale roaming agreements as a strategic tool to ensure that new entrants are not, and do not become, effective competitors. The Bureau submitted that if new entrants are not able to compete effectively, there is a significant risk that they will either become niche players with little competitive effect or simply exit the Canadian mobile wireless market.

18. The national wireless carriers denied that they had engaged in any unjust discrimination or undue preference with respect to (i) the rates they charged for wholesale mobile wireless roaming services, or (ii) other terms in their wholesale roaming agreements, such as exclusivity and seamless roaming.

19. According to the national wireless carriers, wholesale roaming agreements with U.S.-based mobile wireless carriers cannot be compared to agreements with other Canadian mobile wireless carriers, as the former are generally two-way agreements and the latter are generally one-way agreements. In addition, they argued that domestic and international markets cannot be compared. Similarly, they submitted that retail mobile wireless rates cannot be compared to wholesale mobile wireless roaming rates because a national carrier’s retail customers remain on their home network and do not access a visited network, and are therefore not roaming.

20. The national wireless carriers argued that any differences in wholesale mobile wireless roaming rates are based on a number of factors, including reciprocity, traffic volume, traffic balance, access to vast or unique geographic coverage, the timing of

the wholesale roaming agreement, and whether the agreement is part of a broader relationship such as a joint-build or network sharing arrangement.

21. With respect to other terms, the national wireless carriers generally argued that exclusivity typically results in lower rates. They also submitted that seamless roaming is not widely provided to international partners.

22. The national wireless carriers stated that if new entrants believe that any wholesale mobile wireless roaming rates and other terms are not commercially reasonable, they can request arbitration according to *Industry Canada's Arbitration Rules and Procedures*, which is subject to tight timelines. They also submitted that there are currently multiple options available to new entrants for wholesale roaming.

Commission's analysis and determinations

23. The Commission's analysis of an allegation of undue preference or unreasonable disadvantage under subsection 27(2) of the Act is conducted in two phases:

- it must first determine whether the conduct in question is discriminatory or constitutes a preference; and
- where it so determines, it must then decide whether the discrimination is unjust or the preference is undue.

Phase 1: Determination of discrimination or preference

24. With respect to the first part of the test, wholesale mobile wireless roaming services provide the same functionality, regardless of whether they are provided (i) domestically or to U.S.-based carriers, or (ii) pursuant to one-way or two-way wholesale roaming agreements. Consequently, the Commission considers that, notwithstanding the differences in how they are provisioned, these services can be compared to determine whether there is discrimination or preference under subsection 27(2) of the Act. In the Commission's view, the different circumstances and trade-offs reflected in wholesale roaming agreements are relevant in determining whether any discrimination or preference is unjust or undue.

25. The Commission has reviewed all the wholesale roaming agreements filed on the record of the current proceeding and has found that the rates included in these agreements varied widely. The Commission **concludes** that this variation in rates constitutes discrimination and/or preference within the meaning of the Act.

26. Further, the Commission notes that RCP has entered into exclusive wholesale roaming agreements with certain new entrants but not with other mobile wireless carriers. The Commission **concludes** that the inclusion of exclusivity clauses in RCP's wholesale roaming agreements with certain new entrants constitutes discrimination and/or preference within the meaning of the Act.

Phase 2: Unjust/undue nature of discrimination/preference

27. Discrimination or preference in and of itself is not contrary to the Act; the discrimination must be unjust or the preference undue. Given the time and cost required to build out mobile wireless networks, if new entrants are to compete effectively with national wireless carriers that have broad network coverage, they must enter into wholesale roaming agreements with those carriers in order to provide national mobile wireless coverage to their retail customers. This situation could create a significant imbalance in bargaining positions between national wireless carriers and smaller mobile wireless carriers, including new entrants.

28. Following the AWS auction, new entrants had no choice but to enter into wholesale roaming agreements with RCP because, given the technology involved, RCP had the only national network available in Canada on which new entrants' customers could roam.

29. The Commission notes that the rates that RCP charged certain new entrants were significantly higher than the rates it charged many large U.S.-based mobile wireless carriers and other Canadian mobile wireless carriers, particularly with respect to wholesale mobile wireless data roaming services. The Commission recognizes that factors such as reciprocity, timing of the agreement, geographic coverage offered to the roaming partner, and traffic volume would explain some differences in the wholesale roaming rates that RCP charged other carriers. However, the Commission considers that these factors do not justify the magnitude of those differences.

30. With respect to exclusivity, based on the record of this proceeding, exclusivity clauses are not common in current wholesale roaming agreements. The Commission considers that the inclusion of exclusivity clauses in RCP's agreements with certain new entrants was a result of RCP's stronger bargaining position. These clauses have prevented mobile wireless carriers from being able to negotiate more favourable rates, terms, and conditions with other mobile wireless carriers that have put in place compatible networks.

31. In light of the above, the Commission **finds** that, contrary to subsection 27(2) of the Act, RCP engaged in unjust discrimination and undue preference with respect to (i) the wholesale mobile wireless roaming rates it charged certain new entrants for voice, data and text services, and (ii) the imposition of exclusivity clauses in its wholesale roaming agreements with certain new entrants.

Appropriate remedy

32. Several of the new entrants asked that an interim remedy be put in place, until the conclusion of the second wireless proceeding, to protect new entrants against irreparable harm. They asked that interim wholesale mobile wireless roaming rates be set at retail rates for access to a national wireless carrier's network. Several parties, including the new entrants, Lynx, and some of the other interveners, submitted that a permanent remedy should take the form of a regulated wholesale tariff or rate cap.

33. The Bell companies and TCC argued that if the Commission finds that a carrier has unjustly discriminated against another carrier or conferred an undue preference on itself in a wholesale roaming agreement, that finding cannot be attributed to any other carrier and the remedy should be limited to that agreement only.

34. The regional wireless carriers argued that universally applied caps regarding wholesale mobile wireless roaming rates would significantly disadvantage them, as the national wireless carriers would be able to access their networks at rates that are not sufficient to support ongoing investment in rural and remote communities.

35. PIAC submitted that any wholesale roaming framework should apply universally to all wireless carriers to ensure fairness, certainty, and predictability, and that the Commission should engage in ongoing oversight of wholesale roaming agreements.

Commission's analysis and determinations

36. Section 27.1 of the Act,[8] which came into force during the course of this proceeding, establishes caps for all Canadian mobile wireless carriers on wholesale mobile wireless roaming rates for voice, data and text services based on the retail rates for those services. The Commission is responsible for enforcing this section.

37. The Commission considers that the implementation of section 27.1 of the Act reduces the risk of future unjust discrimination with respect to wholesale mobile wireless roaming rates. It also provides most new entrants with relief that is similar to the interim remedy they proposed. Therefore, the Commission **concludes** that, for the

[8] 27.1(1) The amount charged during a year by a Canadian carrier to a second Canadian carrier for roaming services with respect to the transmission of all domestic wireless voice calls and the domestic portion of all international wireless voice calls shall not exceed the amount determined by the formula A/B where A is the first Canadian carrier's total retail revenues from the provision of wireless voice call services to its Canadian subscribers, for calls both originating and terminating in Canada, for the preceding year; and B is the number of minutes provided for those calls for the preceding year.

(2) The amount charged during a year by a Canadian carrier to a second Canadian carrier for roaming services with respect to the transmission of wireless data in Canada shall not exceed the amount determined by the formula A/B where A is the first Canadian carrier's total retail revenues from the provision of wireless data services in Canada to its Canadian subscribers for the preceding year; and B is the number of megabytes provided for those data services for the preceding year.

(3) The amount charged during a year by a Canadian carrier to a second Canadian carrier for roaming services with respect to the transmission of all domestic wireless text messages and the domestic portion of all international wireless text messages shall not exceed the amount determined by the formula A/B where A is the first Canadian carrier's total retail revenues from the provision of wireless text message services to its Canadian subscribers, for text messages both originating and terminating in Canada, for the preceding year; and B is the number of those text messages for the preceding year.

(4) The Canadian carrier shall not charge the second Canadian carrier any other amount in relation to the provision of the roaming services referred to in subsections (1) to (3).

(5) The amount established by the Commission that a Canadian carrier can charge to a second Canadian carrier for roaming services prevails over an amount determined under any of subsections (1) to (3) to the extent of any inconsistency.

purposes of this proceeding, it will not put in place a remedy for unjust discrimination with respect to wholesale mobile wireless roaming rates.

38. With respect to exclusivity provisions in wholesale roaming agreements, the Commission considers that to address the finding of unjust discrimination and undue preference with respect to RCP, it is necessary and appropriate to prohibit such provisions in RCP's agreements with other mobile wireless carriers. Further, to ensure that other carriers do not engage in such behaviour, the Commission considers it necessary and appropriate to prohibit exclusivity provisions in all wholesale roaming agreements between Canadian mobile wireless carriers. In the Commission's view, this prohibition will also promote wholesale competition in the mobile wireless industry in Canada.

39. Accordingly, pursuant to section 24 of the Act, the Commission **determines** that the offering and provision of roaming services by Canadian mobile wireless carriers is subject to the condition that such carriers are prohibited from applying exclusivity provisions in wholesale roaming agreements with other Canadian mobile wireless carriers. Exclusivity clauses in current wholesale roaming agreements between Canadian carriers are therefore rendered inapplicable as of the date of this decision.

Other issues

40. The Commission notes that there were claims of unjust discrimination or undue preference with respect to other terms and conditions in wholesale roaming agreements, such as seamless roaming. Several parties also suggested regulating wholesale mobile wireless roaming rates.

41. Since these issues are under consideration in the second wireless proceeding, the Commission considers that it would be more appropriate to address them in that proceeding. In particular, in that proceeding, the Commission is exploring the possibility of reasserting its jurisdiction to apply certain provisions of the Act that are currently forborne. The Commission notes that if it were to reassert its jurisdiction with respect to rate regulation and establish rates for wholesale mobile wireless roaming services, these rates would prevail over the caps set by section 27.1 of the Act.[9]

Consistency with the Policy Direction

42. The Commission considers that the determination made in this decision with respect to exclusivity is consistent with the Policy Direction[10] for the reasons set out below.

43. The Policy Direction states that the Commission, in exercising its powers and performing its duties under the Act, shall implement the policy objectives set out in

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[9] Ibid.

[10] *Order Issuing a Direction to the CRTC on Implementing the Canadian Telecommunications Policy Objectives*, P.C. 2006-1534, 14 December 2006

section 7 of the Act, in accordance with paragraphs 1(*a*), (*b*), and (*c*) of the Policy Direction.

44. The regulatory measure under consideration in this decision relates to terms for wholesale roaming agreements. Therefore, subparagraphs 1(*a*)(i) and (ii) and subparagraphs 1(*b*)(i), (ii), and (iv) of the Policy Direction apply to the Commission's determination in this decision.

45. In compliance with subparagraph 1(*b*)(i) of the Policy Direction, the Commission considers that the policy objectives set out in paragraphs 7(*b*), (*c*), (*f*), and (*h*)[11] of the Act are advanced by the regulatory measure established in this decision.

46. Consistent with subparagraphs 1(*a*)(i) and (ii) of the Policy Direction, the Commission considers that prohibiting exclusive wholesale roaming agreements is efficient and proportionate to its purpose, and interferes with the operation of market forces to the minimum extent necessary to meet the policy objectives cited above. As noted above, the Commission also considers that prohibiting exclusive wholesale roaming agreements will promote wholesale competition in the mobile wireless industry.

47. Consistent with subparagraph 1(*b*)(ii) of the Policy Direction, the Commission considers that the prohibition of exclusive wholesale roaming agreements will not deter economically efficient competitive entry into the market nor promote economically inefficient entry.

48. Consistent with subparagraph 1(*b*)(iv) of the Policy Direction, the Commission considers that its determination, as it relates to network interconnection arrangements or regimes for access to networks, is technologically and competitively neutral and does not artificially favour either Canadian carriers or resellers.

Secretary General

Related documents

- *Review of wholesale mobile wireless services*, Telecom Notice of Consultation CRTC 2014-76, 20 February 2014, as amended by Telecom Notice of Consultation CRTC 2014-76-1, 25 April 2014

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[11] 7(*b*) to render reliable and affordable telecommunications services of high quality accessible to Canadians in both urban and rural areas in all regions of Canada;

(*c*) to enhance the efficiency and competitiveness, at the national and international levels, of Canadian telecommunications;

(*f*) to foster increased reliance on market forces for the provision of telecommunications services and to ensure that regulation, where required, is efficient and effective; and

(*h*) to respond to the economic and social requirements of users of telecommunications services.

- *Wholesale mobile wireless roaming in Canada – Unjust discrimination/undue preference*, Telecom Notice of Consultation CRTC 2013-685, 12 December 2013

Telecom Order CRTC 2017-312

PDF version

Ottawa, 29 August 2017

File numbers: Bell Canada Tariff Notices 7522, 7522A, 7524, 7524A, and 7534; Cogeco Tariff Notices 56 and 57; RCCI Tariff Notice 48; and Videotron Tariff Notice 53

Interim rates for disaggregated wholesale high-speed access services in Ontario and Quebec

The Commission determines that disaggregated wholesale high-speed access (HSA) services should be made available, on an interim basis, by Bell Canada, Cogeco, RCCI, and Videotron to competitors in Ontario and Quebec, and sets out the interim rates for these services. The availability of disaggregated wholesale HSA services will enable competitors to become more innovative by giving them a greater degree of control over their service offerings to Canadians, including access to fibre-to-the-premises facilities.

Introduction

1. The Commission regulates wholesale high-speed access (HSA) services provided by the large cable and telephone companies (collectively, the wholesale HSA service providers). Competitors[1] can use these services to provide their own retail Internet services and other services.

2. In Telecom Regulatory Policy 2015-326, the Commission mandated the implementation of a disaggregated wholesale HSA service consisting of only an access component, and imposed an obligation on certain carriers in Ontario and Quebec to provide the service. When implemented, the obligation to provide a disaggregated wholesale HSA service would replace the obligation to provide an aggregated wholesale HSA service, which includes both access and transport components. The Commission stated that this change would be subject to a transition plan. The disaggregated wholesale HSA service was to be made available on a central office (CO) or head-end basis, and only when a competitor actually obtained the service at the CO or head-end. In addition to requiring the provision of end-customer access over existing copper and hybrid fibre coaxial (HFC) facilities, the Commission mandated access over fibre-to-the-premises (FTTP) facilities.

3. As a result of its determinations, the Commission directed Cogeco Communications Inc. (Cogeco); Quebecor Media Inc., on behalf of Videotron G.P. (Videotron); and

[1] For the purpose of this order, "competitors" are the customers of wholesale HSA service providers. Competitors purchase access to wholesale HSA services to provide or resell telecommunications services to their own end-users.

Rogers Communications Canada Inc. (RCCI) [collectively, the cable carriers],[2] as well as Bell Canada, to file configurations for their proposed disaggregated wholesale HSA services for their Ontario and Quebec serving territories.

4. The Commission reviewed the companies' proposals and, in Telecom Decision 2016-379, it established guidelines for acceptable configurations and directed the companies to file proposed rates and associated Phase II cost studies for their disaggregated wholesale HSA services that reflected the Commission's directives. Bell Canada was also directed to file rates and associated Phase II cost studies for an external meet-me point for competitor interconnection to its disaggregated wholesale HSA service, similar to the meet-me point provided by the cable carriers.[3]

Applications

5. The Commission received tariff applications from Bell Canada, Cogeco, RCCI, and Videotron, dated 9 January 2017, along with supporting cost studies for both fibre-to-the-node (FTTN)-based and FTTP-based disaggregated wholesale HSA services.

6. As part of their applications, the cable carriers filed proposed capacity rates per 50 megabits per second (Mbps) and access rates for their FTTN-based disaggregated wholesale HSA services. Cogeco and RCCI also filed proposed access rates for their FTTP-based disaggregated wholesale HSA services that rely on radio frequency over glass (RFoG) technology. In addition, the cable carriers proposed to apply their existing aggregated wholesale HSA service charges to corresponding activities associated with their disaggregated wholesale HSA services.

7. Bell Canada filed proposed capacity rates per 50 Mbps and access rates for the company's FTTN- and FTTP-based disaggregated wholesale HSA services with supporting cost studies. Similar to the cable carriers, Bell Canada proposed to apply its existing aggregated wholesale HSA service charges to some of the corresponding activities associated with its disaggregated wholesale HSA service. Bell Canada also proposed modified service charges for FTTN access and capacity rates per 50 Mbps, along with several new service charges.

8. On 31 January 2017, Bell Canada filed a tariff application and a supporting cost study for the provision of a meet-me point for competitors at a given CO, including proposed service charges.

9. On 28 February 2017, Cogeco submitted a separate tariff application to establish access rates for a new Ethernet passive optical network (EPON)-based FTTP service offering.

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[2] At the time, Cogeco Communications Inc. was known as Cogeco Cable Inc., and Rogers Communications Canada Inc. was known as Rogers Communications Partnership.

[3] Bell Canada filed a Part 1 application with the Commission, dated 2 December 2016, to review the requirement to provide a meet-me point. This application is currently under consideration.

10. Bell Canada filed updates to the cost studies for its disaggregated wholesale HSA service, as well cost studies in support of revised rates for its aggregated wholesale HSA service, on 20 March 2017. These studies included multiple scenarios to reflect the impact of different assumptions for both types of wholesale HSA services.

11. On 21 April 2017, Bell Canada filed a tariff application with supporting cost studies for a bonded FTTN access for its disaggregated wholesale HSA service.

12. The intervention process is ongoing. The public records of these proceedings can be found on the Commission's website at www.crtc.gc.ca or by using the file numbers provided above.

Issues

13. To enable the timely introduction of disaggregated wholesale HSA services, the Commission considers that it may be appropriate to make the services available to competitors on an interim basis while the in-depth review to establish final rates is carried out.

14. Accordingly, the Commission has identified the following issues to be addressed in this order:

    - Should disaggregated wholesale HSA services be made available on an interim basis?
    - If so, are the rates proposed by Bell Canada and the cable carriers based on reasonable costs?
    - If the proposed rates are not based on reasonable costs, what adjustments should be made?

Should disaggregated wholesale HSA services be made available on an interim basis?

15. In Telecom Regulatory Policy 2015-326, the Commission stated that the availability of disaggregated wholesale HSA services would enable competitors to become more innovative by giving them a greater degree of control over their service offerings. Moreover, such services could encourage competitor investment in alternative transport facilities, thereby serving to develop a more robust telecommunications system.

16. In addition, disaggregated wholesale HSA services would enable competitors to access end-users served by FTTP facilities.

17. The unavailability of FTTP access is a concern for competitors. Competitors have recently requested relief regarding FTTP access for the time period in which disaggregated wholesale HSA services are not available. For example, in Telecom Decision 2016-446, the Commission directed RCCI to make FTTP access available through its aggregated wholesale HSA service to TekSavvy Solutions Inc. and other

competitors at a residential complex where RCCI had deployed FTTP and had removed its existing HFC network.

18. The availability of interim rates would provide competitors with the ability to use disaggregated wholesale HSA services (including FTTP access) and the opportunity to more effectively compete prior to the finalization of the rates, to the benefit of Canadians.

19. In light of the above, the Commission determines that disaggregated wholesale HSA services should be made available on an interim basis.

Are the rates proposed by Bell Canada and the cable carriers based on reasonable costs?

Positions of parties

20. Bell Canada and the cable carriers proposed rates that are generally based on the associated Phase II costs[4] plus a specified markup.

21. Bell Canada proposed to use an alternative costing approach to develop its capacity rate per 50 Mbps, rather than using the costing methodology outlined in its Regulatory Economic Studies Manual (the Manual). Bell Canada provided one set of cost studies based on its alternative costing approach and a second set of cost studies based on Phase II costing principles. Further, it provided rationale to support its alternative costing approach.

22. In addition, Bell Canada and the cable carriers proposed deviations from past Commission determinations regarding the annual capital unit cost change assumption[5] and various working fill factors (WFFs)[6] of equipment. Each company provided rationale for its proposed deviations.

23. Bell Canada further proposed an FTTN access rate for its disaggregated (and aggregated) wholesale HSA services that did not incorporate several assumptions that the Commission applied in Telecom Regulatory Policy 2011-703 when setting FTTN access rates for the company's existing aggregated wholesale HSA service (assumptions that have been maintained in the current interim FTTN access rates for

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[4] Phase II costs reflect the costs of the prospective incremental resources used to provide a service, consistent with the costing methodologies and assumptions set out in the incumbent local exchange carriers' approved Manuals. Phase II costing principles were set out in Telecom Decision 79-16 and amended in subsequent Commission decisions.

[5] The annual capital unit cost change assumption reflects technological advancements, whereby suppliers are able to meet rising demands from traffic growth by increasing equipment capacity at a lower cost per unit.

[6] The WFF is a measure of the ultimate utilization of a shared facility and is used to recognize the non-working capacity (spare units, units required for maintenance [i.e. administrative] functions, etc.) of the shared facility, and to apportion the cost of non-working capacity to the per-unit cost of the working capacity. A lower WFF will result in higher costs.

its aggregated wholesale HSA service). Bell Canada also proposed certain service charges for disaggregated wholesale FTTN access that differ from the corresponding charges in place for aggregated wholesale FTTN access.

Commission's analysis and determinations

24. The Commission has reviewed the costing approaches and assumptions proposed by Bell Canada and the cable carriers in developing their rates for disaggregated wholesale HSA services and has completed a preliminary review of the evidence submitted in their respective applications in support of their deviations from either the Phase II costing methodology or previous Commission determinations. Given that the arguments in support of the deviations have not been subject to a thorough review that includes comments from parties and interrogatories, the Commission considers that it would be premature to set interim rates that incorporate the proposed deviations.

25. As noted by Bell Canada,[7] the FTTN access component is the same for both aggregated and disaggregated wholesale HSA services. Since the assumptions that Bell Canada included in its proposed FTTN access rate for its disaggregated wholesale HSA service differ from those applied in past decisions by the Commission and have not been subject to a thorough review, the Commission considers that it would also be premature to incorporate such assumptions in setting interim FTTN access rates for Bell Canada's disaggregated wholesale HSA service.

26. In addition, the Commission has found several errors in spreadsheet cost models that affect the disaggregated wholesale HSA service rates proposed by some of the cable carriers, which should be corrected.

27. In light of the above, the Commission considers that Bell Canada's and the cable carriers' proposed costs, for the purpose of setting interim rates, are not reasonable. The Commission further considers that interim rates should rely on established Phase II costing methodology and past Commission determinations.

If the proposed rates are not based on reasonable costs, what adjustments should be made?

28. The Commission considers that a number of adjustments related to the following are required to ensure that the interim rates reflect more reasonable underlying costs:

- costing methodology;
- previous Commission determinations;
- Bell Canada-specific determinations related to the access component; and
- cost model errors.

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[7] See Bell Canada Tariff Notice 7522, Attachment 1, paragraph 43.

Costing methodology

Background

29. Each large incumbent local exchange carrier's (ILEC)[8] Manual states that the capacity cost method is to be used to estimate the unit cost for shared facilities. The capacity cost method determines the per-unit cost by dividing the installed first cost[9] of the shared facilities by its maximum capacity and then dividing this ratio by the appropriate WFF. In addition, the unit cost included in a cost study is to reflect the cost of growth technology, i.e. the technology the company will deploy going forward.

Positions of parties

30. Bell Canada submitted that its preferred approach for estimating monthly capacity rates per 50 Mbps was to use a costing approach called "explicit costing" instead of the capacity costing approach outlined in the Manual. Bell Canada described its explicit costing approach as a fundamental tool to properly estimate causal costs, and described the capacity costing approach as an outdated methodology that was introduced some 40 years ago as an approximation to explicit costing. Bell Canada further submitted that capacity costing is only applicable when the network is stable and evolving slowly and that, since these conditions are not met today, capacity costing is not as accurate as explicit costing and will not lead to just and reasonable rates.

31. Bell Canada submitted separate sets of cost studies and associated monthly capacity rates per 50 Mbps, with one set based on the explicit costing approach and the other set based on the capacity costing approach.

32. Cogeco proposed an approach in its cost study that did not uniformly apply growth technology in the estimation of its capital expenditures.

Commission's analysis and determinations

33. The Commission has reviewed Bell Canada's explicit costing approach in conjunction with the Manual and previous instances in which Bell Canada has used an explicit costing approach, and considers that the proposed approach requires further review. Accordingly, for interim rate-setting purposes, the Commission has used Bell Canada's cost studies that use the capacity costing approach.

34. With regard to Cogeco's approach, Phase II costing methodology is clear in that the capital expenditures included in a regulatory economic study are to reflect growth technology. Accordingly, the Commission has made appropriate adjustments.

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[8] "Large ILECs" refers to Bell Aliant Regional Communications, Limited Partnership; Bell Canada; Bell MTS; Saskatchewan Telecommunications; and TELUS Communications Company.

[9] This represents the incremental capital cost of the next unit of demand. This cost is always calculated using "cost new" and "growth technology."

Previous Commission determinations

Positions of parties

35. Bell Canada (in its alternative proposal for monthly capacity rates per 50 Mbps that were calculated using the capacity costing approach) and the cable carriers proposed to calculate the unit cost of shared equipment using WFFs that are lower than those approved in Appendix V, table 9 of the Manual, or in Telecom Decision 2006-77. In support of its proposed WFFs, Bell Canada provided measurements of the percentage of equipment ports in use for different speed ports in its edge and core network, along with samples of measurements of peak traffic on the active ports. The cable carriers provided evidence, in the form of a report prepared by CableLabs,[10] to support their proposed WFFs.

36. Bell Canada and the cable carriers proposed to apply annual capital unit cost changes that were different from the -26.4% figure established in Telecom Decision 2016-117 to their traffic-driven equipment. The cable carriers submitted that they agreed with TELUS Communications Company's (TCC) submission in its Tariff Notice 512 filing, wherein TCC submitted that *Routers Report: Five-Year Forecast: 2011-2015* by the Dell'Oro Group (the 2011 Dell'Oro Report), which was used to set the -26.4% figure, was out of date, and that a more recent report was available (the 2016 Dell'Oro Report). The cable carriers supported TCC's position that the appropriate annual capital unit cost change assumption of -16.8% for data aggregation and switching equipment is more appropriate, based on the information contained in the 2016 Dell'Oro Report. The cable carriers proposed to use an annual capital unit cost change of -17%. In a similar vein, Bell Canada proposed an annual capital unit cost change of -15.7% based on a calculation using data from the updated report.

Commission's analysis and determinations

37. The Commission considers that the evidence noted above requires further review. Accordingly, for interim rate-setting purposes, the Commission has applied

- WFFs approved in Appendix V, table 9 of the Manual, or used in determinations set out in Telecom Decision 2006-77, as appropriate, to each company's shared equipment; and

- the annual capital unit cost change of -26.4% established in Telecom Decision 2016-117 to each company's traffic-driven equipment.

Bell Canada-specific determinations related to the access component

Umbilical fibre costs

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[10] *Cable Broadband Network Architecture and Capacity Planning: Working Fill Factor*, jointly filed on 9 January 2017 by Bragg Communications Incorporated, operating as Eastlink; Cogeco; RCCI; Shaw Cablesystems G.P.; and Videotron.

Positions of parties

38. Bell Canada proposed to recover umbilical fibre costs for both its FTTN- and FTTP-based disaggregated wholesale HSA service in its monthly capacity rate per 50 Mbps. Bell Canada submitted that these components are usage-sensitive and should therefore be recovered in the monthly capacity rate rather than the monthly access rates.

Commission's analysis and determinations

39. For the aggregated wholesale HSA service, the umbilical fibre costs for the FTTN-based service are currently being recovered through Bell Canada's FTTN access rates, which were made final in Telecom Regulatory Policy 2011-703, modified in Telecom Decision 2013-73, and made interim in Telecom Decision 2016-117. Since the FTTN access component for the aggregated wholesale HSA service is the same as the one for the disaggregated wholesale HSA service, it would be appropriate to apply the current FTTN access rate for the aggregated wholesale HSA service to the FTTN access for the disaggregated wholesale HSA service on an interim basis.

40. Since the Commission has approved an interim bonded FTTN access rate for Bell Canada's aggregated wholesale HSA service that includes the same assumption,[11] it would also be appropriate to apply the assumption to the bonded FTTN access rate for the company's disaggregated wholesale HSA service.

41. The Commission considers that the corresponding umbilical fibre component for FTTP access has a high capacity and is unlikely to be usage sensitive. Therefore, on an interim basis, it would be appropriate to associate the umbilical fibre costs with the FTTP access rate rather than the monthly capacity rate per 50 Mbps.

42. With the above approach, inclusion of all or a portion of the umbilical fibre costs in the disaggregated wholesale HSA monthly capacity rate per 50 Mbps may lead to over-recovery of these costs. Accordingly, for the interim rates, umbilical fibre costs should be removed from Bell Canada's monthly capacity rate per 50 Mbps.

43. The Commission will review Bell Canada's proposed transfer of umbilical fibre costs from the access rates to the monthly capacity rates for both aggregated and disaggregated wholesale HSA services during the process to establish final rates.

Removal of labour cost constraint

Positions of parties

44. Bell Canada proposed an FTTN access rate for its disaggregated wholesale HSA service that did not incorporate a Commission cost adjustment made in

[11] See Telecom Order 2017-261.

Telecom Regulatory Policy 2011-703 that caps the labour cost included in the digital subscriber line access multiplexer (DSLAM) costs at 40% of total DSLAM costs.

Commission's analysis and determinations

45. Given this inconsistency with the Commission's determination, for interim rates, it would be appropriate to include the cost constraint in the FTTN access rate for Bell Canada's disaggregated wholesale HSA service. Since the Commission has approved an interim bonded FTTN access rate for the aggregated wholesale HSA service that includes the cost constraint, it would be appropriate to apply the cost constraint to the bonded FTTN access rate for the disaggregated wholesale HSA service. Bell Canada's proposal will be reviewed during the process to establish final rates.

FTTN access service charges

Positions of parties

46. Bell Canada filed proposed FTTN access service charges for its disaggregated wholesale HSA service consisting of installation charges and charges for speed changes. These charges differ from the corresponding interim-approved FTTN access service charges for its aggregated wholesale HSA service.

Commission's analysis and determinations

47. In the Commission's ongoing proceeding to determine final rates for aggregated wholesale HSA service, Bell Canada did not file proposed new rates for the above-noted service charges for wholesale FTTN access, even though FTTN access for both the aggregated and disaggregated wholesale HSA services would require the same treatment for installation and speed changes. For the interim rates, it would be appropriate to apply the service charges that were approved for FTTN access for the aggregated wholesale HSA service to FTTN access for the disaggregated wholesale HSA service. The Commission will review Bell Canada's proposal during the process to establish final rates.

Cost model errors

48. The Commission notes that, in its review of the cost models filed in confidence by the companies, it found spreadsheet errors related to RCCI's estimation of capital expenditures for certain equipment and the vintage of certain data used by Videotron. The Commission has therefore made corrections that are reflected in the interim approved rates.

Conclusion

49. In light of the above, the Commission **approves on an interim basis** Bell Canada's and the cable carriers' proposed rates, subject to the revisions set out in Appendix 1 to this order. The approved rates include access rates for FTTN- and FTTP-based disaggregated wholesale HSA services, capacity rates per 50 Mbps, and associated

service charges for Bell Canada and the cable carriers, as well as rates for Bell Canada's meet-me point. Any rates proposed in the companies' tariff notices that are not listed in Appendix 1 are approved on an interim basis without changes. Explanations of the Commission's adjustments are summarized in Appendix 2.

50. The Commission **directs** Bell Canada, Cogeco, RCCI, and Videotron to issue revised tariff pages by **8 September 2017** reflecting the determinations set out in this order.[12]

Secretary General

Related documents

- *Bell Canada – Introduction of Bonded Access service*, Telecom Order CRTC 2017-261, 21 July 2017
- *TekSavvy Solutions Inc. – Application regarding transitional access to aggregated wholesale high-speed access service*, Telecom Decision CRTC 2016-446, 9 November 2016
- *Follow-up to Telecom Regulatory Policy 2015-326 – Implementation of a disaggregated wholesale high-speed access service, including over fibre-to-the-premises access facilities*, Telecom Decision CRTC 2016-379, 20 September 2016
- *Review of costing inputs and the application process for wholesale high-speed access services*, Telecom Decision CRTC 2016-117, 31 March 2016
- *Review of wholesale wireline services and associated policies*, Telecom Regulatory Policy CRTC 2015-326, 22 July 2015; as amended by Telecom Regulatory Policy CRTC 2015-326-1, 9 October 2015
- *Canadian Network Operators Consortium Inc. – Application to review and vary Telecom Regulatory Policies 2011-703 and 2011-704*, Telecom Decision CRTC 2013-73, 21 February 2013
- *Billing practices for wholesale residential high-speed access services*, Telecom Regulatory Policy CRTC 2011-703, 15 November 2011; as amended by Telecom Regulatory Policy CRTC 2011-703-1, 22 December 2011
- *Cogeco, Rogers, Shaw, and Videotron – Third-party Internet access service rates*, Telecom Decision CRTC 2006-77, 21 December 2006
- *Inquiry into Telecommunications Carriers' Costing and Accounting Procedures – Phase II: Information Requirements for New Service Tariff Filings*, Telecom Decision CRTC 79-16, 28 August 1979

[12] Revised tariff pages can be submitted to the Commission without a description page or a request for approval; a tariff application is not required.

Appendix 1 to Telecom Order CRTC 2017-312

Interim approved rates for disaggregated wholesale HSA services

Table 1(a): Interim approved monthly capacity rates per 50 Mbps

Company	Bell Canada	Cogeco	RCCI	Videotron
Rate	$15.04	$161.56	$143.99	$126.91

Table 1(b): Interim approved monthly FTTN access rates

Company	Speed	Rate
Bell Canada (non-bonded)	All	$25.62
Bell Canada (bonded)	All	$52.32
Cogeco	0-6 Mbps	$14.00
	7-15 Mbps	$15.64
	16-40 Mbps	$21.86
	41-60 Mbps	$32.48
	61-120 Mbps	$52.51
	121-250 Mbps	$61.41
RCCI	0-15 Mbps	$21.71
	16-30 Mbps	$24.52
	31-60 Mbps	$26.50
	61-100 Mbps	$28.88
	101-249 Mbps	$40.77
	250-499 Mbps	$54.05
	500-749 Mbps	$61.54
	750-1024 Mbps	$76.93
Videotron	0-5 Mbps	$17.57
	6-10 Mbps	$19.61
	11-30 Mbps	$23.10
	31-60 Mbps	$30.57
	61-120 Mbps	$35.88

	121-200 Mbps	$39.63
	201-500 Mbps	$56.89
	501-1000 Mbps	$75.81

Table 1(c): Interim approved monthly FTTP access rates

Company	Speed	Rate
Bell Canada (FTTP)	All	$121.79
Cogeco (EPON)	All	$172.43
Cogeco (RFoG)	0-6 Mbps	$43.24
	7-15 Mbps	$46.02
	16-40Mbps	$49.37
	41-60 Mbps	$56.90
	61-120 Mbps	$66.70
	121-250 Mbps	$72.28
RCCI (RFoG)	0-15 Mbps	$27.21
	16-30 Mbps	$30.24
	31-60 Mbps	$32.37
	61-100 Mbps	$34.93
	101-249 Mbps	$47.74
	250-499 Mbps	$62.03
	500-749 Mbps	$70.11
	750-1024 Mbps	$86.68

Table 1(d): Bell Canada – Interim approved access service charges

Item	Rate
Disaggregated wholesale HSA non-bonded FTTN access installation charge	$90.65
Disaggregated wholesale HSA bonded FTTN access installation charge	$167.84
Speed change service charge, per disaggregated HSA access • **With a premises visit**	$90.65

Appendix 2 to Telecom Order CRTC 2017-312

Rationale for Commission rate adjustments

Table 2(a): Bell Canada

Monthly capacity rate per 50 Mbps

Area requiring adjustment	Commission adjustment	Rationale for adjustment
Costing methodology	Used capacity costing instead of explicit costing	Bell Canada proposed to use an explicit costing approach to estimate capacity rates. Capacity costing rather than explicit costing is the Commission’s accepted approach for the estimation of costs. Evidence submitted to deviate from the use of capacity costing will be fully reviewed during the process to set final rates.
Switch and router costs	Applied a WFF of 80% to switch and router equipment	Bell Canada, in its alternative capacity costing approach, applied WFFs that are lower than the WFFs in Appendix V, table 9 of the Manual. Evidence submitted to deviate from approved WFFs will be fully reviewed during the process to set final rates.
Switch and router costs	Applied an annual capital unit cost change of -26.4% to switch and router costs	Bell Canada applied an annual capital unit cost change of -15.7% to switch and router costs instead of -26.4%, which was established in Telecom Decision 2016-117. Evidence submitted to deviate from the determination in Telecom Decision 2016-117 will be fully reviewed during the process to set final rates.

Umbilical fibre	Excluded umbilical fibre (FTTN and FTTP) costs from the monthly capacity rate	Bell Canada treated umbilical fibre for both FTTN and FTTP access as usage-sensitive equipment and included the costs in the monthly capacity rate. FTTN umbilical fibre costs are currently recovered through the FTTN access rate – an assumption that the Commission applied when it set rates for FTTN access for the aggregated service. As discussed in the “Monthly access rate” section below, for interim rate purposes, the umbilical fibre for both FTTN and FTTP is to be associated with the access component. Inclusion of these costs in the monthly capacity rate will lead to over-recovery of these costs. Evidence submitted to deviate from this approach will be fully reviewed during the process to set final rates.

Monthly access rate

Area requiring adjustment	Commission adjustment	Rationale for adjustment
Umbilical fibre	Included appropriate umbilical fibre costs in FTTN and FTTP access rates	Bell Canada excluded umbilical fibre from the access rate for FTTN and FTTP. FTTN umbilical fibre costs are currently recovered through the FTTN access rate – an assumption that the Commission applied when it set rates for FTTN access for the aggregated service. Given the capacity of the FTTP umbilical fibre, the same assumption is to apply to FTTP access. Evidence submitted to deviate from this approach will be fully reviewed during the process to set final rates.

Cap on DSLAM labour costs	Applied a 40% cap on DSLAM labour costs for FTTN access rates	Bell Canada did not include the Commission-applied labour cap of 40% of the DSLAM costs in its estimation of FTTN access rates. Given that the cap is in place for existing FTTN access rates, it is appropriate to maintain it for these rates. Evidence submitted to deviate from this approach will be fully reviewed during the process to set final rates.

Table 2(b): Cogeco

Monthly capacity rate per 50 Mbps and access rates

Area requiring adjustment	Commission adjustment	Rationale for adjustment
Node segmentation and Converged Cable Access Platform (CCAP) capital costs	Adjusted node segmentation and CCAP capital costs to reflect the appropriate WFFs	Cogeco estimated its node segmentation costs using WFFs that are lower than those used in the Telecom Decision 2006-77 cost determinations. Evidence submitted to deviate from the determinations made in Telecom Decision 2006-77 will be fully reviewed during the process to set final rates. Cogeco estimated its CCAP capital costs using WFFs that are lower than those in Appendix V, table 9 of the Manual. Evidence submitted to deviate from the determination made in Appendix V, table 9 will be fully reviewed during the process to set final rates.

Monthly capacity rate per 50 Mbps

Area requiring adjustment	Commission adjustment	Rationale for adjustment
CCAP capital costs	Applied an annual capital unit cost change of -26.4% to CCAP capital costs	Cogeco applied an annual capital unit cost change of -17% to CCAP capital costs instead of -26.4%, which was established in Telecom Decision 2016-117. Evidence submitted to deviate from the determination in Telecom Decision 2016-117 will be fully reviewed during the process to set final rates.

Growth technology	Adjusted costs to appropriately reflect growth technology	Cogeco did not uniformly apply growth technology in the estimation of its capital expenditures in its cost study. As per the Manual, growth technology should be included in the cost study.

Table 2(c): RCCI

Monthly capacity rate per 50 Mbps and access rates

Area requiring adjustment	Commission adjustment	Rationale for adjustment
Node segmentation capital costs	Adjusted node segmentation capital costs to reflect the appropriate WFFs	RCCI estimated its node segmentation costs using WFFs that are lower than the WFFs used in the Telecom Decision 2006-77 cost determinations. Evidence submitted to deviate from the determinations made in Telecom Decision 2006-77 will be fully reviewed during the process to set final rates.

Monthly capacity rate per 50 Mbps

Area requiring adjustment	Commission adjustment	Rationale for adjustment
Router and CCAP capital costs	Applied an annual capital unit cost change of -26.4% to point of interconnection (POI) router and CCAP capital costs	RCCI applied an annual capital unit cost change of -17% to POI router and CCAP capital costs instead of -26.4%, which was established in Telecom Decision 2016-117. Evidence submitted to deviate from the determination in Telecom Decision 2016-117 will be fully reviewed during the process to set final rates.
Router and CCAP capital costs	Adjusted router and CCAP capital costs to reflect the appropriate WFFs	RCCI estimated its router and CCAP capital costs based on WFFs that are lower than those provided in Appendix V, table 9 of the Manual. Evidence submitted to deviate from the determination in Appendix V, table 9 will be fully reviewed during the process to set final rates.
Spreadsheet error	Corrected calculation error	RCCI incorrectly calculated the capital expenditures for certain equipment

Table 2(d): Videotron

Monthly capacity rate per 50 Mbps

Area requiring adjustment	Commission adjustment	Rationale for adjustment
Node segmentation and CCAP capital costs	Adjusted node segmentation and CCAP capital costs to reflect the appropriate WFFs	Videotron estimated its node segmentation costs based on WFFs that are lower than those used in the Telecom Decision 2006-77 cost determinations. Evidence submitted to deviate from the determinations in Telecom Decision 2006-77 will be fully reviewed during the process to set final rates. Videotron estimated its CCAP capital costs based on WFFs that are lower than those in Appendix V, table 9 of the Manual. Evidence provided to deviate from the determination in Appendix V, table 9 will be fully reviewed during the process to set final rates.
CCAP capital costs	Applied an annual capital unit cost change of -26.4% to CCAP capital costs	Videotron applied an annual capital unit cost change of -17% to CCAP capital costs instead of -26.4%, which was established in Telecom Decision 2016-117. Evidence submitted to deviate from the determination in Telecom Decision 2016-117 will be fully reviewed during the process to set final rates.
Spreadsheet error	Corrected spreadsheet error	Videotron referenced incorrect vintage of certain data in its calculations

2008 SCC 53
Supreme Court of Canada

F.H. v. McDougall

2008 CarswellBC 2041, 2008 CarswellBC 2042, 2008 SCC 53, [2008] 11 W.W.R. 414, [2008] 3 S.C.R. 41, [2008] A.C.S. No. 54, [2008] S.C.J. No. 54, 169 A.C.W.S. (3d) 346, 260 B.C.A.C. 74, 297 D.L.R. (4th) 193, 380 N.R. 82, 439 W.A.C. 74, 60 C.C.L.T. (3d) 1, 61 C.R. (6th) 1, 61 C.P.C. (6th) 1, 83 B.C.L.R. (4th) 1, J.E. 2008-1864

F.H. (Appellant) and Ian Hugh McDougall (Respondent)

F.H. (Appellant) and The Order of the Oblates of Mary Immaculate in the Province of British Columbia (Respondent)

F.H. (Appellant) and Her Majesty The Queen in Right of Canada as represented by the Minister of Indian Affairs and Northern Development (Respondent)

McLachlin C.J.C., LeBel, Deschamps, Fish, Abella, Charron, Rothstein JJ.

Heard: May 15, 2008
Judgment: October 2, 2008 [*]
Docket: 32085

Proceedings: reversing *C. (R.) v. McDougall* (2007), 2007 CarswellBC 723, 2007 BCCA 212, 41 C.P.C. (6th) 213, 68 B.C.L.R. (4th) 203, (sub nom. *F.H. v. McDougall)* 396 W.A.C. 222, [2007] 9 W.W.R. 256, (sub nom. *F.H. v. McDougall)* 239 B.C.A.C. 222 (B.C. C.A.)**Proceedings: reversing in part *C. (R.) v. McDougall* (2005), 2005 BCSC 1518, 2005 CarswellBC 2578 (B.C. S.C.)**

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***Rothstein J.*:**

1 The Supreme Court of British Columbia found in a civil action that the respondent, Ian Hugh McDougall, a supervisor at the Sechelt Indian Residential School, had sexually assaulted the appellant, F.H., while he was a student during the 1968-69 school year. A majority of the British Columbia Court of Appeal allowed the respondent's appeal in part, and reversed the decision of the trial judge. I would allow the appeal to this Court and restore the judgment of the trial judge.

I. Facts

2 The Sechelt Indian Residential School was established in 1904 in British Columbia. It was funded by the Canadian government and operated by the Oblates of Mary Immaculate. F.H. was a resident student at the school from September 1966 to March 1967 and again from September 1968 to June 1974. Ian Hugh McDougall was an Oblate Brother until 1970 and was the junior and intermediate boys' supervisor at the school from 1965 to 1969.

3 The school building had three stories. Dormitories for junior and senior boys were located on the top floor. A supervisors' washroom was also located on the top floor and was accessible through a washroom for the boys. The intermediate boys' dormitory was on the second floor. McDougall had a room in the corner of that dormitory.

4 F.H. claims to have been sexually assaulted by McDougall in the supervisors' washroom when he was approximately ten years of age. At trial, he testified that McDougall sexually abused him on four occasions. The trial judge set out his evidence of these incidents at paras. 34-38 of her reasons:

> As to the first occasion, F.H. had been in the dormitory with others. The defendant asked four boys to go upstairs to the main washroom where they were to wait before going to the supervisors' washroom for an examination. F.H. was the last to go into the washroom to be examined. When he went in, he was asked to remove his pyjamas and while facing the defendant, he was checked from head to toe. His penis was fondled. The defendant then turned him around, asked him to bend over and put his finger in his anus. He removed his clothing, grabbed F.H. around the waist, pulled him onto his lap and raped him. The defendant had put the cover of the toilet down and was using it as a seat. After the defendant ejaculated, he told the plaintiff to put on his pyjamas and leave the room.
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> F.H. was shocked. He did not cry or scream, nor did he say anything. When he went to the main communal washroom, he could see that he was bleeding. The next morning, he noticed blood in his pyjamas. He went downstairs to the boys' washroom and changed. The bloody pyjamas were rinsed and placed in his locker.
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> The second incident was approximately two weeks after the first. F.H. was in the dormitory getting ready for bed when the defendant asked him to go to the supervisors' washroom so he could do an examination. There were no other boys present. F.H. was asked to remove his pyjamas and again, he was raped. He went to the communal washroom to clean himself up. In the morning, he realized that his pyjamas were bloody. As it was laundry day, he threw his pyjamas in the laundry bin with the sheets.
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> The third incident occurred approximately one month later. F.H. testified that once again he was asked to go to the supervisors' washroom, remove his pyjamas and turn around. Again, the defendant grabbed him by the waist and raped him. He was bleeding, but could not recall whether there was blood on his pyjamas.
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> The fourth incident occurred approximately one month after the third. As he was getting ready for bed, the defendant grabbed him by the shoulder and took him upstairs to the supervisors' washroom. Another rape occurred.

(2005 BCSC 1518 (B.C. S.C.))

5 F.H. did not tell anyone about the assaults until approximately the year 2000. He and his wife were having marital difficulties. She had learned of his extra-marital affair. He testified that because of the problems in his marriage he felt he had to tell his wife about his childhood experience. At his wife's recommendation, he sought counselling.

6 F.H. commenced his action against the respondents on December 7, 2000, approximately 31 years after the alleged sexual assaults. In British Columbia there is no limitation period applicable to a cause of action based on sexual assault and the action may be brought at any time (see *Limitation Act*, R.S.B.C. 1996, c. 266, s. 3(4)(1)).

II. Judgments Below

A. British Columbia Supreme Court, 2005 BCSC 1518 (B.C. S.C.)

7 F.H.'s action was joined with the action of R.C., another former resident of the school who made similar claims against the same parties. The parties agreed to have a trial on the following discrete issues of fact (para. 1):

1) Was either plaintiff physically or sexually abused while he attended the school?

2) If the plaintiff was abused

a) by whom was he abused?

b) when did the abuse occur? and

c) what are the particulars of the abuse?

8 The trial judge, Gill J., began her reasons by noting that the answer to the questions agreed to by the parties depended on findings as to credibility and reliability. Few issues of law were raised. She referred to *Francis v. Canada (Attorney General)*, [2002] B.C.J. No. 436, 2002 BCSC 325 (B.C. S.C.), in which the court stated that in cases involving serious allegations and grave consequences, the civil standard of proof that is "commensurate with the occasion" applied (para. 4).

9 The trial judge then went on to review the testimony of each plaintiff, McDougall and others who worked at the school or were former students. McDougall denied the allegations of sexual abuse and testified that he could not recall ever strapping F.H. He also denied ever conducting physical examinations of the boys and gave evidence that boys were not taken into the supervisors' washroom.

10 In determining whether F.H. was sexually assaulted, the trial judge dealt with the arguments of the defense that F.H.'s evidence was neither reliable nor credible. Gill J. rejected the defense position that F.H.'s inability to respond to certain questions should lead to an adverse conclusion regarding the reliability of his evidence. She found F.H.'s testimony credible while acknowledging that the commission of the assaults in the manner described by F.H. would have carried with it a risk of detection. Gill J. also rejected the contention of defense counsel that F.H.'s motive to lie must weigh heavily against his credibility. Rather she agreed with counsel for F.H. that the circumstances surrounding his disclosure were not suggestive of concoction.

11 The trial judge pointed out areas of consistency and inconsistency between F.H.'s testimony and that of the other students at the school. She also noted that there were significant discrepancies in the evidence given by F.H. as to the frequency of the abuse. At trial, F.H. said there were four incidents. On previous occasions, he said the abuse occurred every two weeks or ten days. Despite these inconsistencies, the trial judge concluded F.H. was a credible witness and stated that his evidence about "the nature of the assaults, the location and the times they occurred" had been consistent (para. 112). She concluded that F.H. had been sexually abused by McDougall, the sexual assaults being four incidents of anal intercourse committed during the 1968-69 school year.

12 In relation to the issue of physical abuse, the trial judge limited herself to deciding whether the plaintiffs had proved that they were strapped while at school. To answer this question, the trial judge reviewed the evidence of McDougall and the testimony of another Brother employed at the school as well as the testimony of several of F.H.'s fellow students. She concluded that strapping was a common form of discipline and that it was not used only in response to serious infractions. She concluded that F.H. was strapped by McDougall an undetermined number of times while at the school.

13 With respect to the claims made by R.C., the trial judge found that he had not proven that he had been sexually assaulted, but found that he had been strapped by a person other than McDougall.

B. British Columbia Court of Appeal (2007), 68 B.C.L.R. (4th) 203, 2007 BCCA 212 (B.C. C.A.)

14 The decision of the Court of Appeal was delivered by Rowles J.A., with Southin J.A. concurring. Ryan J.A. dissented.

(1) Reasons of Rowles J.A.

15 Rowles J.A. concluded that McDougall' s appeal from that part of the order finding that he had sexually assaulted F.H. should be allowed; however his appeal from that part of the order finding that he had strapped F.H. should be dismissed.

16 Rowles J.A. found that it was obvious that the trial judge was aware of the case authorities that have considered the standard of proof to be applied in cases where allegations of morally blameworthy conduct have been made, i.e. proof that is "commensurate with the occasion". However, in her view, the trial judge was bound to consider the serious inconsistencies in the evidence of F.H. in determining whether the alleged sexual assaults had been proven to the standard "commensurate with the allegation". She found that the trial judge did not scrutinize the evidence in the manner required and thereby erred in law.

17 In allowing the appeal in respect of the sexual assaults alleged by F.H., Rowles J.A. was of the opinion that in view of the state of the evidence on that issue, no practical purpose would be served by ordering a new trial.

(2) Concurring Reasons of Southin J.A.

18 In her concurring reasons, Southin J.A. discussed the "troubling aspect" of the case — "how, in a civil case, is the evidence to be evaluated when it is oath against oath, and what is the relationship of the evaluation of the evidence to the burden of proof?" (para. 84).

19 Southin J.A. held that it was of central importance that the gravity of the allegations be forefront in the trier of fact's approach to the evidence. It was not enough, in her view, to choose the testimony of the plaintiff over that of the defendant. Instead, "[t]o choose one over the other... requires... an articulated reason founded in evidence other than that of the plaintiff (para. 106). Moreover, Southin J.A. found that Cory J.'s rejection in *R. v. W. (D.)*, [1991] 1 S.C.R. 742 (S.C.C.), of the "either/or" approach to evaluating evidence of the Crown and the accused as to the conduct of the accused in criminal cases also applied to civil cases.

20 In the end, she could not find in the trial judge's reasons a "legally acceptable articulated reason for accepting the plaintiff's evidence and rejecting the defendants' evidence" (para. 112).

(3) Dissenting Reasons of Ryan J.A.

21 While sharing the concerns of the majority about "the perils of assigning liability in cases where the events have occurred so long ago", Ryan J.A. disagreed with the conclusion that the trial judge did not apply the proper standard of proof to her assessment of the evidence (para. 115).

22 Ryan J.A. noted that the trial judge set out the test — a standard of proof commensurate with the occasion — early in her reasons. "Having set out the proper test, we must assume that she properly applied it, unless her reasons demonstrate otherwise" (para. 116).

23 In the view of Ryan J.A., alleging that the trial judge misapplied the standard of proof to her assessment of the evidence was to say that the trial judge erred in her findings of fact. To overturn the trial judge's findings of fact, the appellate court must find that the trial judge made a manifest error, ignored conclusive or relevant evidence or drew unreasonable conclusions from it.

24 Ryan J.A. was of the view that the trial judge had made no such error. The trial judge had acknowledged the most troubling aspect of F.H.'s testimony — that it was not consistent with earlier descriptions of the abuse — and decided that at its core, the testimony was consistent and truthful. The inconsistencies were not overlooked by the trial judge.

25 Having found no error in the reasons for judgment, Ryan J.A. was of the view that the Court of Appeal should have deferred to the conclusions of the trial judge. Accordingly, she would have dismissed the appeal.

III. Analysis

A. The Standard of Proof

(1) Canadian Jurisprudence

26 Much has been written as judges have attempted to reconcile the tension between the civil standard of proof on a balance of probabilities and cases in which allegations made against a defendant are particularly grave. Such cases include allegations of fraud, professional misconduct, and criminal conduct, particularly sexual assault against minors. As explained by L. R. Rothstein, R. A. Centa, and E. Adams, in "Balancing Probabilities: The Overlooked Complexity of the Civil Standard of Proof in *Special Lectures of the Law Society of Upper Canada 2003: The Law of Evidence* (2003), 455, at p. 456:

> ...These types of allegations are considered unique because they carry a moral stigma that will continue to have an impact on the individual after the completion of the civil case.

27 Courts in British Columbia have tended to follow the approach of Lord Denning in *Bater v. Bater*, [1950] 2 All E.R. 458 (Eng. C.A.). Lord Denning was of the view that within the civil standard of proof on a balance of probabilities "there may be degrees of probability within that standard" (p. 459), depending upon the subject matter. He stated at p. 459:

> It does not adopt so high a degree as a criminal court, even when it is considering a charge of a criminal nature, but still it does require a degree of probability which is commensurate with the occasion.

28 In the present case the trial judge referred to *Francis v. Canada (Attorney General)*, at para. 154, in which Neilson J. stated:

> The court is justified in imposing a higher degree of probability which is "commensurate with the occasion"....

29 In the constitutional context, Dickson C.J. adopted the *Bater* approach in *R. v. Oakes*, [1986] 1 S.C.R. 103 (S.C.C.). In his view a "very high degree of probability" required that the evidence be cogent and persuasive and make clear the consequences of the decision one way or the other. He wrote at p. 138:

> Having regard to the fact that s. 1 is being invoked for the purpose of justifying a violation of the constitutional rights and freedoms the *Charter* was designed to protect, a very high degree of probability will be, in the words of Lord Denning, "commensurate with the occasion". Where evidence is required in order to prove the constituent elements of a s. 1 inquiry and this will generally be the case, it should be cogent and persuasive and make clear to the Court the consequences of imposing or not imposing the limit.

30 However, a "shifting standard" of probability has not been universally accepted. In *Continental Insurance Co. v. Dalton Cartage Co.*, [1982] 1 S.C.R. 164 (S.C.C.), Laskin C.J. rejected a "shifting standard". Rather, to take account of the seriousness of the allegation, he was of the view that a trial judge should scrutinize the evidence with "greater care". At pp. 169-71 he stated:

> Where there is an allegation of conduct that is morally blameworthy or that could have a criminal or penal aspect and the allegation is made in civil litigation, the relevant burden of proof remains proof on a balance of probabilities....
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> . . . . .
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> There is necessarily a matter of judgment involved in weighing evidence that goes to the burden of proof, and a trial judge is justified in scrutinizing evidence with greater care if there are serious allegations to be established by the proof that is offered.
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> . . . . .
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> I do not regard such an approach (the *Bater* approach) as a departure from a standard of proof based on a balance of probabilities nor as supporting a shifting standard. The question in all civil cases is what evidence with what weight that is accorded to it will move the court to conclude that proof on a balance of probabilities has been established.

31 In Ontario Professional Discipline cases, the balance of probabilities requires that proof be "clear and convincing and based upon cogent evidence" (see *Heath v. College of Physicians & Surgeons (Ontario)* (1997), 6 Admin. L.R. (3d) 304 (Ont. Div. Ct.), at para. 53).

(2) Recent United Kingdom Jurisprudence

32 In the United Kingdom some decisions have indicated that depending upon the seriousness of the matters involved, even in civil cases, the criminal standard of proof should apply. In *R. (on the application of McCann) v. Manchester Crown Court* (2002), [2003] 1 A.C. 787 (U.K. H.L.), Lord Steyn said at para. 37:

> ... I agree that, given the seriousness of matters involved, at least some reference to the heightened civil standard would usually be necessary: *In re H (Minors) (Sexual Abuse: Standard of Proof)*, [1996] A.C. 563, 586 D-H, per Lord Nicholls of Birkenhead. For essentially practical reasons, the Recorder of Manchester decided to apply the criminal standard. The

Court of Appeal said that would usually be the right course to adopt. Lord Bingham of Cornhill has observed that the heightened civil standard and the criminal standard are virtually indistinguishable. I do not disagree with any of these views. But in my view pragmatism dictates that the task of magistrates should be made more straightforward by ruling that they must in all cases under section 1 apply the criminal standard.

33 Yet another consideration, that of "inherent probability or improbability of an event" was discussed by Lord Nicholls in *H., Re* (1995), [1996] A.C. 563 (Eng. H.L.), at p. 586:

> ... the inherent probability or improbability of an event is itself a matter to be taken into account when weighing the probabilities and deciding whether, on balance, the event occurred. The more improbable the event, the stronger must be the evidence that it did occur before, on the balance of probability, its occurrence will be established.

34 Most recently in *B (Children), Re*, [2008] 3 W.L.R. 1 (U.K. H.L.), a June 11, 2008 decision, the U.K. House of Lords again canvassed the issue of standard of proof. Subsequent to the hearing of the appeal, Mr. Southey, counsel for the Attorney General of Canada, with no objection from other counsel, brought this case to the attention of the Court.

35 Lord Hoffman addressed the "confusion" in the United Kingdom courts over this issue. He stated at para. 5:

> Some confusion has however been caused by dicta which suggest that the standard of proof may vary with the gravity of the misconduct alleged or even the seriousness of the consequences for the person concerned. The cases in which such statements have been made fall into three categories. First, there are cases in which the court has for one purpose classified the proceedings as civil (for example, for the purposes of article 6 of the European Convention for the Protection of Human Rights and Fundamental Freedoms) but nevertheless thought that, because of the serious consequences of the proceedings, the criminal standard of proof or something like it should be applied. Secondly, there are cases in which it has been observed that when some event is inherently improbable, strong evidence may be needed to persuade a tribunal that it more probably happened than not. Thirdly, there are cases in which judges are simply confused about whether they are talking about the standard of proof or about the role of inherent probabilities in deciding whether the burden of proving a fact to a given standard has been discharged.

36 The unanimous conclusion of the House of Lords was that there is only one civil standard of proof. At para. 13, Lord Hoffman states:

> ... I think that the time has come to say, once and for all, that there is only one civil standard of proof and that is proof that the fact in issue more probably occurred than not.

However, Lord Hoffman did not disapprove of application of the criminal standard depending upon the issue involved. Following his very clear statement that there is only one civil standard of proof, he somewhat enigmatically wrote, still in para. 13:

> ... I do not intend to disapprove any of the cases in what I have called the first category, but I agree with the observation of Lord Steyn in *McCann's* case, at p. 812, that clarity would be greatly enhanced if the courts said simply that although the proceedings were civil, the nature of the particular issue involved made it appropriate to apply the criminal standard.

37 Lord Hoffman went on to express the view that taking account of inherent probabilities was not a rule of law. At para. 15 he stated:

> I wish to lay some stress upon the words I have italicised ["to whatever extent is appropriate in the particular case"]. Lord Nicholls [*In re H*] was not laying down any rule of law. There is only one rule of law, namely that the occurrence of the fact in issue must be proved to have been more probable than not. Common sense, not law, requires that in deciding this question, regard should be had, to whatever extent appropriate, to inherent probabilities.

38 *B (Children), Re* is a child case under the United Kingdom *Children Act 1989*. While her comments on standard of proof are confined to the 1989 Act, Baroness Hale explained that neither the seriousness of the allegation nor the seriousness of

the consequences should make any difference to the standard of proof to be applied in determining the facts. At paras. 70-72, she stated:

> My Lords, for that reason I would go further and announce loud and clear that the standard of proof in finding the facts necessary to establish the threshold under section 31 (2) or the welfare considerations in section 1 of the 1989 Act is the simple balance of probabilities, neither more nor less. Neither the seriousness of the allegation nor the seriousness of the consequences should make any difference to the standard of proof to be applied in determining the facts. The inherent probabilities are simply something to be taken into account, where relevant, in deciding where the truth lies.
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> As to the seriousness of the consequences, they are serious either way. A child may find her relationship with her family seriously disrupted; or she may find herself still at risk of suffering serious harm. A parent may find his relationship with his child seriously disrupted; or he may find himself still at liberty to maltreat this or other children in the future.
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> As to the seriousness of the allegation, there is no logical or necessary connection between seriousness and probability. Some seriously harmful behaviour, such as murder, is sufficiently rare to be inherently improbable in most circumstances. Even then there are circumstances, such as a body with its throat cut and no weapon to hand, where it is not at all improbable. Other seriously harmful behaviour, such as alcohol or drug abuse, is regrettably all too common and not at all improbable.

(3) Summary of Various Approaches

39 I summarize the various approaches in civil cases where criminal or morally blameworthy conduct is alleged as I understand them:

(1) The criminal standard of proof applies in civil cases depending upon the seriousness of the allegation;

(2) An intermediate standard of proof between the civil standard and the criminal standard commensurate with the occasion applies to civil cases;

(3) No heightened standard of proof applies in civil cases, but the evidence must be scrutinized with greater care where the allegation is serious;

(4) No heightened standard of proof applies in civil cases, but evidence must be clear, convincing and cogent; and

(5) No heightened standard of proof applies in civil cases, but the more improbable the event, the stronger the evidence is needed to meet the balance of probabilities test.

(4) The Approach Canadian Courts Should Now Adopt

40 Like the House of Lords, I think it is time to say, once and for all in Canada, that there is only one civil standard of proof at common law and that is proof on a balance of probabilities. Of course, context is all important and a judge should not be unmindful, where appropriate, of inherent probabilities or improbabilities or the seriousness of the allegations or consequences. However, these considerations do not change the standard of proof. I am of the respectful opinion that the alternatives I have listed above should be rejected for the reasons that follow.

41 Since *Hanes v. Wawanesa Mutual Insurance Co.*, [1963] S.C.R. 154 (S.C.C.), at pp. 158-64, it has been clear that the criminal standard is not to be applied to civil cases in Canada. The criminal standard of proof beyond a reasonable doubt is linked to the presumption of innocence in criminal trials. The burden of proof always remains with the prosecution. As explained by Cory J. in *R. v. Lifchus*, [1997] 3 S.C.R. 320 (S.C.C.), at para. 27:

> First, it must be made clear to the jury that the standard of proof beyond a reasonable doubt is vitally important since it is inextricably linked to that basic premise which is fundamental to all criminal trials: the presumption of innocence. The two concepts are forever as closely linked as Romeo with Juliet or Oberon with Titania and they must be presented together as a unit. If the presumption of innocence is the golden thread of criminal justice, then proof beyond a reasonable doubt

> is the silver and these two threads are forever intertwined in the fabric of criminal law. Jurors must be reminded that the burden of proving beyond a reasonable doubt that the accused committed the crime rests with the prosecution throughout the trial and never shifts to the accused.

42 By contrast, in civil cases, there is no presumption of innocence. As explained by J. Sopinka, S. N. Lederman and A. W. Bryant, *The Law of Evidence* (2nd ed. 1999), at p. 154:

> ... Since society is indifferent to whether the plaintiff or the defendant wins a particular civil suit, it is unnecessary to protect against an erroneous result by requiring a standard of proof higher than a balance of probabilities.

It is true that there may be serious consequences to a finding of liability in a civil case that continue past the end of the case. However, the civil case does not involve the government's power to penalize or take away the liberty of the individual.

43 An intermediate standard of proof presents practical problems. As expressed by L. Rothstein et al., at p. 466:

> As well, suggesting that the standard of proof is "higher" than the "mere balance of probabilities" leads one inevitably to inquire what percentage of probability must be met? This is unhelpful because while the concept of "51% probability", or "more likely than not" can be understood by decision-makers, the concept of 60% or 70% probability cannot.

44 Put another way, it would seem incongruous for a judge to conclude that it was more likely than not that an event occurred, but not sufficiently likely to some unspecified standard and therefore that it did not occur. As Lord Hoffman explained in *B (Children), Re* at para. 2:

> If a legal rule requires a fact to be proved (a "fact in issue"), a judge or jury must decide whether or not it happened. There is no room for a finding that it might have happened. The law operates a binary system in which the only values are zero and one. The fact either happened or it did not. If the tribunal is left in doubt, the doubt is resolved by a rule that one party or the other carries the burden of proof. If the party who bears the burden of proof fails to discharge it, a value of zero is returned and the fact is treated as not having happened. If he does discharge it, a value of one is returned and the fact is treated as having happened.

In my view, the only practical way in which to reach a factual conclusion in a civil case is to decide whether it is more likely than not that the event occurred.

45 To suggest that depending upon the seriousness, the evidence in the civil case must be scrutinized with greater care implies that in less serious cases the evidence need not be scrutinized with such care. I think it is inappropriate to say that there are legally recognized different levels of scrutiny of the evidence depending upon the seriousness of the case. There is only one legal rule and that is that in all cases, evidence must be scrutinized with care by the trial judge.

46 Similarly, evidence must always be sufficiently clear, convincing and cogent to satisfy the balance of probabilities test. But again, there is no objective standard to measure sufficiency. In serious cases, like the present, judges may be faced with evidence of events that are alleged to have occurred many years before, where there is little other evidence than that of the plaintiff and defendant. As difficult as the task may be, the judge must make a decision. If a responsible judge finds for the plaintiff, it must be accepted that the evidence was sufficiently clear, convincing and cogent to that judge that the plaintiff satisfied the balance of probabilities test.

47 Finally there may be cases in which there is an inherent improbability that an event occurred. Inherent improbability will always depend upon the circumstances. As Baroness Hale stated in *B (Children), Re* at para. 72:

> ... Consider the famous example of the animal seen in Regent's Park. If it is seen outside the zoo on a stretch of greensward regularly used for walking dogs, then of course it is more likely to be a dog than a lion. If it is seen in the zoo next to the lions' enclosure when the door is open, then it may well be more likely to be a lion than a dog.

48 Some alleged events may be highly improbable. Others less so. There can be no rule as to when and to what extent inherent improbability must be taken into account by a trial judge. As Lord Hoffman observed at para. 15 of *B (Children), Re*:

> ... Common sense, not law, requires that in deciding this question, regard should be had, to whatever extent appropriate, to inherent probabilities.

It will be for the trial judge to decide to what extent, if any, the circumstances suggest that an allegation is inherently improbable and where appropriate, that may be taken into account in the assessment of whether the evidence establishes that it is more likely than not that the event occurred. However, there can be no rule of law imposing such a formula.

(5) Conclusion on Standard of Proof

49 In the result, I would reaffirm that in civil cases there is only one standard of proof and that is proof on a balance of probabilities. In all civil cases, the trial judge must scrutinize the relevant evidence with care to determine whether it is more likely than not that an alleged event occurred.

50 I turn now to the issues particular to this case.

B. The Concerns of the Court of Appeal Respecting Inconsistency in the Evidence of F.H.

51 The level of scrutiny required in cases of sexual assault was central to the analysis of the Court of Appeal. According to Rowles J.A. at para. 72, one of the issues was "whether the trial judge, in light of the standard of proof that had to be applied in a case such as this, failed to consider the problems or troublesome aspects of [F.H.]'s evidence". The "troublesome aspects" of F.H.'s evidence related to, amongst others, inconsistencies as to the frequency of the alleged sexual assaults as between F.H.'s evidence on discovery and at trial, as well as to an inconsistency between the original statement of claim alleging attempted anal intercourse and the evidence given at trial of actual penetration.

52 In the absence of support from the surrounding circumstances, when considering the evidence of F.H. on its own, the majority of the Court of Appeal concluded that the trial judge had failed to consider whether the facts had been proven "to the standard commensurate with the allegation" and had failed to "[s]crutinize the evidence in the manner required and thereby erred in law" (para. 79).

53 As I have explained, there is only one civil standard of proof — proof on a balance of probabilities. Although understandable in view of the state of the jurisprudence at the time of its decision, the Court of Appeal was in error in holding the trial judge to a higher standard. While that conclusion is sufficient to decide this appeal, nonetheless, I think it is important for future guidance to make some further comments on the approach of the majority of the Court of Appeal.

54 Rowles J.A. was correct that failure by a trial judge to apply the correct standard of proof in assessing evidence would constitute an error of law. The question is how such failure may be apparent in the reasons of a trial judge. Obviously in the remote example of a trial judge expressly stating an incorrect standard of proof, it will be presumed that the incorrect standard was applied. Where the trial judge expressly states the correct standard of proof, it will be presumed that it was applied. Where the trial judge does not express a particular standard of proof, it will also be presumed that the correct standard was applied:

> Trial judges are presumed to know the law with which they work day in and day out.
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> (*R. v. B. (R.H.)*, [1994] 1 S.C.R. 656 (S.C.C.), at p. 664, *per* McLachlin J. (as she then was)).

Whether the correct standard was expressly stated or not, the presumption of correct application will apply unless it can be demonstrated by the analysis conducted that the incorrect standard was applied. However, in determining whether the correct standard has indeed been applied, an appellate court must take care not to substitute its own view of the facts for that of the trial judge.

55 An appellate court is only permitted to interfere with factual findings when "the trial judge [has] shown to have committed a palpable and overriding error or made findings of fact that are clearly wrong, unreasonable or unsupported by the evidence" (*L. (H.) v. Canada (Attorney General)*, [2005] 1 S.C.R. 401, 2005 SCC 25 (S.C.C.), at para. 4 (emphasis deleted), *per* Fish J.). Rowles J.A. correctly acknowledged as much (para. 27). She also recognized that where there is some evidence to support an inference drawn by the trial judge, an appellate court will be hard pressed to find a palpable and overriding error. Indeed, she quoted the now well-known words to this effect in the judgment of Iacobucci and Major JJ. in *Housen v. Nikolaisen*, [2002] 2 S.C.R. 235, 2002 SCC 33 (S.C.C.), at para. 27 of her reasons (para. 22 of *Housen*).

56 Rowles J.A. was satisfied that the trial judge was aware of the standard of proof that had heretofore been applied in cases of moral blameworthiness. At para. 35 of her reasons she stated:

> ... From her reasons it is obvious that the judge was aware of the case authorities that have considered the standard of proof to be applied in cases where allegations of morally blameworthy conduct have been made.

That should have satisfied the Court of Appeal that the trial judge understood and applied the standard of proof they thought to be applicable to this case.

C. The Inconsistency in the Evidence of F.H.

57 At para. 5 of her reasons, the trial judge had regard for the judgment of Rowles J.A. in *R. v. B. (R.W.)* (1993), 24 B.C.A.C. 1 (B.C. C.A.), at paras. 28-29, dealing with the reliability and credibility of witnesses in the case of inconsistencies and an absence of supporting evidence. Although *R. v. B. (R.W.)* was a criminal case, I, like the trial judge, think the words of Rowles J.A. are apt for the purposes of this case:

> In this case there were a number of inconsistencies in the complainant's own evidence and a number of inconsistencies between the complainant's evidence and the testimony of other witnesses. While it is true that minor inconsistencies may not diminish the credibility of a witness unduly, a series of inconsistencies may become quite significant and cause the trier of fact to have a reasonable doubt about the reliability of the witness' evidence. There is no rule as to when, in the face of inconsistency, such doubt may arise but at the least the trier of fact should look to the totality of the inconsistencies in order to assess whether the witness' evidence is reliable. This is particularly so when there is no supporting evidence on the central issue, which was the case here. [para. 29]

58 As Rowles J.A. found in the context of the criminal standard of proof, where proof is on a balance of probabilities there is likewise no rule as to when inconsistencies in the evidence of a plaintiff will cause a trial judge to conclude that the plaintiff's evidence is not credible or reliable. The trial judge should not consider the plaintiff's evidence in isolation, but must look at the totality of the evidence to assess the impact of the inconsistencies in that evidence on questions of credibility and reliability pertaining to the core issue in the case.

59 It is apparent from her reasons that the trial judge recognized the obligation upon her to have regard for the inconsistencies in the evidence of F.H. and to consider them in light of the totality of the evidence to the extent that was possible. While she did not deal with every inconsistency, as she explained at para. 100, she did address in a general way the arguments put forward by the defence.

60 The trial judge specifically dealt with some of what the Court of Appeal identified as the troublesome aspects of F.H.'s evidence. For example, Rowles J.A. stated at para. 77, that F.H.'s evidence with respect to inspections in the supervisors' washroom was not consistent with the testimony of other witnesses:

> ... There was no corroborative evidence from the witnesses who had been students at the School of other boys having lined up and being examined by McDougall in the supervisor's washroom so as to lend support to the respondent's recollection of events. In fact, the defense evidence was to the opposite effect, that is, the boys did not line up outside the staff washroom for any reason or at any time.

61 However, Gill J. dealt with the washroom inspections as well as the inconsistent recollection of the witnesses regarding these inspections. She also made a finding of fact that inspections were performed and were routine at the school. At para. 106 of her reasons she stated:

> It was argued that the evidence of F.H. was not consistent with the evidence of others. No inspections were done in the supervisors' washroom or in the way that F.H. described. I agree that no other witness described inspections being done in the supervisors' washroom. However, evidence about inspections was given by defence witnesses. I have already referred to the evidence of Mr. Paul. I accept that inspections were done in the manner he described. The boys were sometimes inspected on shower days and supervisors regularly checked to ensure that they had washed themselves thoroughly. Admittedly, Mr. Paul did not say that the defendant had conducted such examinations, but he described the inspections as a routine of the school. In fact, Mr. Paul's evidence is not consistent with the evidence of the defendant, who stated that the only examination of the boys was for head lice and it was done by the nurse.

62 In this passage of her reasons, the trial judge dealt with the inconsistency between the evidence of F.H. and other witnesses. She also considered McDougall's testimony in light of other evidence given by witnesses for the defence. From the evidence of Mr. Paul she concluded that examinations were routinely carried out. She found that Mr. Paul's evidence about examinations was not consistent with that of McDougall who had testified that examinations were only for head lice and were carried out by the nurse. The necessary inference is that she found McDougall not to be credible on this issue.

63 The majority of the Court of Appeal was also concerned with the testimony of F.H., that each time he was sexually assaulted by McDougall, he would go upstairs from his dorm to the supervisors' washroom. At para. 77 of her reasons, Rowles J.A. stated:

> However, [F.H.] was a junior boy rather than an intermediate one at the relevant time and his dorm would have been on the top floor. Based on the evidence of where the boys slept, [McDougall] could not have taken [F.H.] "upstairs" from his dorm.

Counsel for F.H. points out that in his evidence at trial, F.H. testified that he was an intermediate boy when the sexual assaults occurred and that as an intermediate boy he would have to go upstairs to the supervisors' washroom. Although there was contradictory evidence, there was evidence upon which F.H. could have been believed.

64 It is true that Gill J. did not deal with F.H.'s inconsistency as to the frequency of the inspections inside the supervisors' washroom as identified by Rowles J.A. at para. 75:

> The respondent also told Ms. Stone that the young boys regularly lined up outside the staff washroom, which they referred to as the "examination room", every second week in order to be examined. At trial he testified this lining up only happened the first time he was sexually assaulted. Again, this is a substantial change in the respondent's recounting of events.

Nor did Gill J. specifically address the change in the allegations of attempted anal intercourse and genital fondling in the original statement of claim and the evidence of F.H. at trial of actual penetration. Rowles J.A. stated at para. 76:

> The respondent's original statement of claim only alleged attempted anal intercourse and genital fondling. There was no allegation about the appellant actually inserting his finger in F.H.'s anus or having forced anal intercourse. The respondent's evidence at trial was of actual penetration. As the trial judge found, the respondent acknowledged that he had reviewed the statement of claim, including the paragraphs which particularized the alleged assaults, and that he was aware of the difference between actually doing something and attempting to do something.

65 However, at paras. 46 and 48 of her reasons, Gill J. had recounted these inconsistencies as raised in cross-examination. Her reasons indicate she was aware of the inconsistencies.

66 As for the inconsistency relating to the frequency of the sexual assaults, Rowles J.A. stated at para. 73:

> At his examination for discovery the respondent said that the sexual assaults took place "weekly", "frequently", and "every ten days or so" over the entire time he was at the School. The respondent admitted at trial that he had said on discovery

> that he had told the counsellor, Ms. Nellie Stone, that the sexual assaults by the appellant had taken place over the entire time he was at the School, while he was between the ages of eight and fourteen years. At trial, the respondent testified that the sexual assaults occurred on only four occasions over a period of two-and-a-half months.
>
> [Emphasis added.]

67 Counsel for F.H. points out that F.H.'s evidence was that he was subjected to physical and sexual abuse while he was at the residential school perpetrated by more than one person, that the question to which he was responding mixed both sexual and physical abuse and that the majority of the Court of Appeal wrongly narrowed F.H.'s statement only to assaults perpetrated by McDougall. Counsel says that F.H. was commenting on all of the physical and sexual abuse he experienced at the school which involved more than McDougall and took place over his six years of attendance.

68 The Court of Appeal appears to have interpreted his evidence on discovery that he was sexually assaulted by McDougall over the entire time he was at the school, while in his evidence at trial it was only four times over two and a half months. Although the evidence is not without doubt, it is open to be interpreted in the way counsel for F.H. asserts and that there was no inconsistency between F.H.'s evidence on discovery and at trial.

69 As to the frequency of the alleged sexual assaults by McDougall, the trial judge did not ignore inconsistencies in the evidence of F.H. In spite of the inconsistencies, she found him to be credible. At para. 112 of her reasons, she stated:

> There are, however, some inconsistencies in the evidence of F.H. As the defence has also argued, his evidence about the frequency of the abuse has not been consistent and there are differences between what he admittedly told Ms. Stone, what he said at his examination for discovery and his evidence at trial. At trial, he said there were four incidents. On previous occasions, he said that this occurred every two weeks or ten days. That is a difference of significance. However, his evidence about the nature of the assaults, the location and the times they occurred has been consistent. Despite differences about frequency, it is my view that F.H. was a credible witness.

70 The trial judge was not obliged to find that F.H. was not credible or that his evidence at trial was unreliable because of inconsistency between his trial evidence and the evidence he gave on prior occasions. Where a trial judge demonstrates that she is alive to the inconsistencies but still concludes that the witness was nonetheless credible, in the absence of palpable and overriding error, there is no basis for interference by the appellate court.

71 All of this is not to say that the concerns expressed by Rowles J.A. were unfounded. There are troubling aspects of F.H.'s evidence. However, the trial judge was not oblivious to the inconsistencies in his evidence. The events occurred more than 30 years before the trial. Where the trial judge refers to the inconsistencies and deals expressly with a number of them, it must be assumed that she took them into account in assessing the balance of probabilities. Notwithstanding its own misgivings, it was not for the Court of Appeal to second guess the trial judge in the absence of finding a palpable and overriding error.

72 With respect, I cannot interpret the reasons of the majority of the Court of Appeal other than that it disagreed with the trial judge's credibility assessment of F.H. in light of the inconsistencies in his evidence and the lack of support from the surrounding circumstances. Assessing credibility is clearly in the bailiwick of the trial judge and thus heightened deference must be accorded to the trial judge on matters of credibility. As explained by Bastarache and Abella JJ. in *R. c. Gagnon*, [2006] 1 S.C.R. 621, 2006 SCC 17 (S.C.C.), at para. 20:

> Assessing credibility is not a science. It is very difficult for a trial judge to articulate with precision the complex intermingling of impressions that emerge after watching and listening to witnesses and attempting to reconcile the various versions of events. That is why this Court decided, most recently in *H.L.*, that in the absence of a palpable and overriding error by the trial judge, his or her perceptions should be respected.

73 As stated above, an appellate court is only permitted to intervene when "the trial judge is shown to have committed a palpable and overriding error or made findings of fact that are clearly wrong, unreasonable or unsupported by the evidence" (*L. (H.)*, at para. 4 (emphasis deleted)). The Court of Appeal made no such finding. With respect, in finding that the trial judge

failed to scrutinize F.H.'s evidence in the manner required by law, it incorrectly substituted its credibility assessment for that of the trial judge.

D. Palpable and Overriding Error

74 Notwithstanding that the Court of Appeal made no finding of palpable and overriding error, the Attorney General of Canada submits that the trial judge did indeed make such an error. This argument is based entirely on the inconsistencies in the evidence of F.H. The Attorney General says that in light of these inconsistencies, the trial judge was clearly wrong in finding F.H. credible.

75 I do not minimize the inconsistencies in F.H.'s testimony. They are certainly relevant to an assessment of his credibility. Nonetheless, the trial judge was convinced, despite the inconsistencies, that F.H. was credible and that the four sexual assaults alleged to have been committed by McDougall did occur. From her reasons, it appears that the trial judge's decision on the credibility of the witnesses was made in the context of the evidence as a whole. She considered the layout of the school and the fact that the manner in which F.H. described the assaults as taking place would have carried with it the risk of detection. She also considered whether F.H.'s evidence about inspections taking place in the supervisors' washroom and the availability of sheets and pyjamas was consistent with evidence of other witnesses. She acknowledged that F.H. had a motive to lie to save his marriage and decided that the circumstances surrounding disclosure were not suggestive of concoction. She also factored into her analysis the demeanor of F.H.: that "[he] was not a witness who gave detailed answers, often responding simply with a yes or no, nor did he volunteer much information" (para. 110), and that "[w]hen [he] testified, he displayed no emotion but it was clear that he had few, if any, good memories of the school" (para. 113).

76 In the end, believing the testimony of one witness and not the other is a matter of judgment. In light of the inconsistencies in F.H.'s testimony with respect to the frequency of the sexual assaults, it is easy to see how another trial judge may not have found F.H. to be a credible witness. However, Gill J. found him to be credible. It is important to bear in mind that the evidence in this case was of matters occurring over thirty years earlier when F.H. was approximately ten years of age. As a matter of policy, the British Columbia legislature has eliminated the limitation period for claims of sexual assault. This was a policy choice for that legislative assembly. Nonetheless, it must be recognized that the task of trial judges assessing evidence in such cases is very difficult indeed. However, that does not open the door to an appellate court, being removed from the testimony and not seeing the witnesses, to reassess the credibility of the witnesses.

E. Corroboration

77 The reasons of the majority of the Court of Appeal may be read as requiring, as a matter of law, that in cases of oath against oath in the context of sexual assault allegations, that a sexual assault victim must provide some independent corroborating evidence. At para. 77 of her reasons, Rowles J.A. observed:

> There was no corroborative evidence from the witnesses who had been students at the School of other boys having lined up and being examined by McDougall in the supervisor's washroom so as to lend support to [F.H.]'s recollection of events.

At para. 79 she stated:

> ... No support for [F.H.]'s testimony could be drawn from the surrounding circumstances.

78 In her concurring reasons at para. 106, Southin J.A. stated:

> ... To choose one over the other in cases of oath against oath requires, in my opinion, an articulated reason founded in evidence other than that of the plaintiff.

79 The impression these passages may leave is that there is a legal requirement of corroboration in civil cases in which sexual assault is alleged. In an abundance of caution and to provide guidance for the future, I make the following comments.

80 Corroborative evidence is always helpful and does strengthen the evidence of the party relying on it as I believe Rowles J.A. was implying in her comments. However, it is not a legal requirement and indeed may not be available, especially where the alleged incidents took place decades earlier. Incidents of sexual assault normally occur in private.

81 Requiring corroboration would elevate the evidentiary requirement in a civil case above that in a criminal case. Modern criminal law has rejected the previous common law and later statutory requirement that allegations of sexual assault be corroborated in order to lead to a conviction (see *Criminal Code*, R.S.C. 1970, c. C-34, s. 139(1), mandating the need for corroboration and its subsequent amendments removing this requirement (*Act to amend the Criminal Code in relation to sexual offences and other offences against the person and to amend certain other Acts in relation thereto or in consequence thereof*, S.C. 1980-81-82-83, c. 125), as well as the current *Criminal Code*, R.S.C. 1985, c. C-46, s. 274, stipulating that no corroboration is required for convictions in sexual assault cases). Trial judges faced with allegations of sexual assault may find that they are required to make a decision on the basis of whether they believe the plaintiff or the defendant and as difficult as that may be, they are required to assess the evidence and make their determination without imposing a legal requirement for corroboration.

F. Is W. (D.) Applicable in Civil Cases in Which Credibility is in Issue?

82 At paras. 107, 108 and 110 of her reasons, Southin J.A. stated:

> It is not enough for the judge to say that I find the plaintiff credible and since he is credible the defendant must be lying.
>
> What I have said so far is, to me, no more than an application to civil cases of *R. v. W. (D.)*, [1991] 1 S.C.R. 742.
>
> . . . . .
>
> I see no logical reason why the rejection of "either/or" in criminal cases is not applicable in civil cases where the allegation is of crime, albeit that the burden of proof on the proponent is not beyond reasonable doubt but on the balance of probabilities.

83 *W. (D.)* was a decision by this Court in which Cory J., at pp. 757-58, established a three-step charge to the jury to help the jury assess conflicting evidence between the victim and the accused in cases of criminal prosecutions of sexual assaults:

> First, if you believe the evidence of the accused, obviously you must acquit.
>
> Second, if you do not believe the testimony of the accused but you are left in reasonable doubt by it, you must acquit.
>
> Third, even if you are not left in doubt by the evidence of the accused, you must ask yourself whether, on the basis of the evidence which you do accept, you are convinced beyond a reasonable doubt by that evidence of the guilt of the accused.

84 These charges to the jury are not sacrosanct but were merely put in place as guideposts to the meaning of reasonable doubt, as recently explained by Binnie J. in *R. v. S. (J.H.)*, [2008] 2 S.C.R. 152, 2008 SCC 30 (S.C.C.), at paras. 9 and 13:

> ... Essentially, *W. (D.)* simply unpacks for the benefit of the lay jury what reasonable doubt means in the context of evaluating conflicting testimonial accounts. It alerts the jury to the "credibility contest" error. It teaches that trial judges are required to impress on the jury that the burden never shifts from the Crown to prove every element of the offence beyond a reasonable doubt.
>
> . . . . .
>
> In *R. v. Avetysan*, [2000] 2 S.C.R. 745, 2000 SCC 56, Major J. for the majority pointed out that in any case where credibility is important "[t]he question is really whether, in substance, the trial judge's instructions left the jury with the impression that it had to choose between the two versions of events" (para. 19). The main point is that lack of credibility on the part of the accused does not equate to proof of his or her guilt beyond a reasonable doubt.

85 The *W. (D.)* steps were developed as an aid to the determination of reasonable doubt in the criminal law context where a jury is faced with conflicting testimonial accounts. Lack of credibility on the part of an accused is not proof of guilt beyond a reasonable doubt.

86 However, in civil cases in which there is conflicting testimony, the judge is deciding whether a fact occurred on a balance of probabilities. In such cases, provided the judge has not ignored evidence, finding the evidence of one party credible may well be conclusive of the result because that evidence is inconsistent with that of the other party. In such cases, believing one party will mean explicitly or implicitly that the other party was not believed on the important issue in the case. That may be especially true where a plaintiff makes allegations that are altogether denied by the defendant as in this case. *W. (D.)* is not an appropriate tool for evaluating evidence on the balance of probabilities in civil cases.

G. Did the Trial Judge Ignore the Evidence of McDougall?

87 In an argument related to *W. (D.)*, the Attorney General of Canada says at para. 44 of its factum, that "[s]imply believing the testimony of one witness, without assessing the evidence of the other witness, marginalizes that other witness" since he has no way of knowing whether he was disbelieved or simply ignored.

88 The Attorney General bases his argument on the well-known passage in *Faryna v. Chorny* (1951), [1952] 2 D.L.R. 354 (B.C. C.A.), which concludes at p. 357:

> ... a Court of Appeal must be satisfied that the trial Judge's finding of credibility is based not on one element only to the exclusion of others, but is based on all the elements by which it can he tested in the particular case.

89 Thus, the Attorney General contends, at para. 47 of its factum, that:

> ... In a civil proceeding alleging a sexual assault, if the trier of fact accepts the plaintiff's evidence and simply ignores the defendant's evidence, that conclusion would breach the requirement described in *Faryna*, that every element of the evidence must be considered.

90 I agree that it would be an error for the trial judge to ignore the evidence of the defendant and simply concentrate on the evidence submitted by the plaintiff. But that is not the case here.

91 The trial judge described the testimony given by McDougall with respect to his vocational beliefs, his subsequent marriage, his role at the school, the routine at the school, the laundry procedure and his denials as to having sexually assaulted either R.C. or F.H.. She also dealt with the defense arguments with respect to the credibility and reliability of the testimony of R.C. and F.H. regarding the sexual assaults. Indeed, she found that R.C. did not prove he was sexually assaulted by McDougall.

92 In determining whether McDougall had ever strapped R.C. or F.H., she summarized McDougall's evidence as follows at para. 131:

> As stated, it was the defendant's evidence that during his years at the school, he administered the strap to only five or six intermediate boys. He did so as punishment for behavior such as fighting or swearing. It was always to the hand and was always done in the dorm. He denied the evidence of Mr. Jeffries that he had frequently disciplined him for the reasons Mr. Jeffries described. He denied going to his grandmother's home or mocking him about wanting to visit his grandmother. He denied the evidence of F.H.

93 She also highlighted a contradiction in McDougall's testimony at para. 135:

> It is also my view that the defendant minimized his use of the strap as a form of discipline. Further, while he testified that no child was ever strapped in his room, when testifying about one specific incident, he said that he brought the boy "upstairs to my room and I administered the strap three times to his right hand".

Although McDougall later "corrected himself to say that he had strapped the boy in the dorm and not in his room, it was open to the trial judge to believe his first statement and not his "correction".

94 And as earlier discussed, at para. 106 of her reasons, she pointed out inconsistency between the evidence of McDougall and one of the defence witnesses, Mr. Paul, on the issue of routine physical inspections of the students.

95 At para. 66 of her reasons for the majority of the Court of Appeal, Rowles J.A. stated:

> From the reasons the trial judge gave for finding that the appellant had strapped the respondent, one can infer that the judge did not accept the appellant's evidence on that issue. Disbelief of a witness's evidence on one issue may well taint the witness's evidence on other issues, but an unfavourable credibility finding against a witness does not, of itself, constitute evidence that can be used to prove a fact in issue.

96 I agree with Rowles J.A. However, the trial judge's unfavourable credibility findings with respect to McDougall's strapping evidence together with her belief in Paul's evidence in preference to that of McDougall with respect to routine physical inspections, indicates that she did not ignore McDougall's evidence or marginalize him. She simply believed F.H. on essential matters rather than McDougall.

H. Were the Reasons of the Trial Judge Adequate?

97 The Attorney General alleges that the reasons of the trial judge are inadequate. The same argument was not accepted by the Court of Appeal. At para. 61, Rowles J.A. stated:

> Generally speaking, if a judge's reasons reveal the path the judge took to reach a conclusion on the matter in dispute, the reasons are adequate for the purposes of appellate review. To succeed in an argument that the trial judge did not give adequate reasons, an appellant does not have to demonstrate that there is a flaw in the reasoning that lead to the result. In this case, the judge's reasons are adequate to show how she arrived at her conclusion that the respondent had been sexually assaulted.

Where the Court of Appeal expresses itself as being satisfied that it can discern why the trial judge arrived at her conclusion, a party faces a serious obstacle to convince this court that the reasons are nonetheless inadequate.

98 The meaning of adequacy of reasons is explained in *R. v. Sheppard*, [2002] 1 S.C.R. 869, 2002 SCC 26 (S.C.C.). In *R. v. Walker*, [2008] 2 S.C.R. 245, 2008 SCC 34 (S.C.C.), Binnie J. summarized the duty to give adequate reasons:

> (1) To justify and explain the result;
>
> (2) To tell the losing party why he or she lost;
>
> (3) To provide for informed consideration of the grounds of appeal; and
>
> (4) To satisfy the public that justice has been done.

99 However, an appeal court cannot intervene merely because it believes the trial judge did a poor job of expressing herself. Nor, is a failure to give adequate reasons a free standing basis for appeal. At para. 20 of *Walker*, Binnie J. states:

> Equally, however, *Sheppard* holds that "[t]he appellate court is not given the power to intervene simply because it thinks the trial court did a poor job of expressing itself (para. 26). Reasons are sufficient if they are responsive to the case's live issues and the parties' key arguments. Their sufficiency should be measured not in the abstract, but as they respond to the substance of what was in issue.... The duty to give reasons "should be given a functional and purposeful interpretation" and the failure to live up to the duty does not provide "a free-standing right of appeal" or "in itself confe[r] entitlement to appellate intervention" (para. 53).

100 An unsuccessful party may well be dissatisfied with the reasons of a trial judge, especially where he or she was not believed. Where findings of credibility must be made, it must be recognized that it may be very difficult for the trial judge to put into words the process by which the decision is arrived at (see *R. c. Gagnon*). But that does not make the reasons inadequate. In

R. v. M. (R.E.), 2008 SCC 51 (S.C.C.), released at the same time as this decision, McLachlin C J. has explained that credibility findings may involve factors that are difficult to verbalize:

> While it is useful for a judge to attempt to articulate the reasons for believing a witness and disbelieving another in general or on a particular point, the fact remains that the exercise may not be purely intellectual and may involve factors that are difficult to verbalize. Furthermore, embellishing why a particular witness's evidence is rejected may involve the judge in saying unflattering things about the witness; judges may wish to spare the accused who takes the stand to deny the crime, for example, the indignity of not only rejecting his evidence in convicting him, but adding negative comments about his demeanor. In short, assessing credibility is a difficult and delicate matter, that does not always lend itself to precise and complete verbalization. [para. 49]

Nor are reasons inadequate because in hindsight, it may be possible to say that the reasons were not as clear and comprehensive as they might have been.

101 Rowles J.A. found that the reasons of the trial judge showed why she arrived at her conclusion that F.H. had been sexually assaulted by McDougall. I agree with her that the reasons of the trial judge were adequate.

IV. Conclusion

102 I am of the respectful opinion that the majority of the Court of Appeal erred in reversing the decision of the trial judge. The appeal should be allowed with costs. The decision of the Court of Appeal of British Columbia should be set aside and the decision of the trial judge restored.

Appeal allowed.

Pourvoi accueilli.

Footnotes

* A corrigendum issued by the court on November 4, 2008 has been incorporated herein.

246 F.3d 708
United States Court of Appeals,
District of Columbia Circuit.

FEDERAL TRADE COMMISSION, Appellant,
v.
H.J. HEINZ CO. and Milnot Holding Corporation, Appellees.

No. 00–5362
|
Argued Feb. 12, 2001.
|
Decided April 27, 2001.

Synopsis

Federal Trade Commission (FTC) brought suit under Clayton Act, seeking to prevent merger of second and third largest manufacturers of jarred baby food. The United States District Court for the District of Columbia, James Robertson, J., denied FTC's motion for preliminary injunction, and FTC appealed. The Court of Appeals, Karen LeCraft Henderson, Circuit Judge, held that: (1) FTC established prima facie case that merger would be anticompetitive, and (2) manufacturers failed to rebut presumption created by prima facie case.

Reversed and remanded.

***710 **366** Appeal from the United States District Court for the District of Columbia (No. 00cv01688).

Attorneys and Law Firms

Debra A. Valentine, General Counsel, Federal Trade Commission, argued the cause for the appellant. John F. Daly, Assistant General Counsel, Richard G. Parker, Director, and Richard B. Dagen, David A. Balto and David C. Shonka, Attorneys, Federal Trade Commission, were on brief.

Edward P. Henneberry argued the cause for the appellees. W. Bradford Reynolds, Marc G. Schildkraut, Kenneth W. Starr, and Mark L. Kovner were on brief.

J. Joseph Curran, Jr., Attorney General, and Ellen S. Cooper, Assistant Attorney General, State of Maryland; Bruce M. Botelho, Attorney General, State of Alaska; Janet Napolitano, Attorney General, State of Arizona; Mark Pryor, Attorney General, State of Arkansas; Bill Lockyer, Attorney General, and Peter Siggins, Chief Deputy Attorney General, State of California; Ken Salazar, Attorney General, State of Colorado; Richard Blumenthal, Attorney General and Steven Rutstein, Assistant Attorney General, State of Connecticut; Robert R. Rigsby, Corporation Counsel, Charles L. Reischel, Deputy Corporation Counsel, and Bennett Rushkoff, Senior Counsel, District of Columbia; Robert A. Butterworth, Attorney General, State of Florida; Earl I. Anzai, Attorney General, State of Hawaii; Alan G. Lance, Attorney General, State of Idaho; James E. Ryan, Attorney General, State of Illinois; Karen M. Freeman–Wilson, Attorney General, State of Indiana; Thomas J. Miller, Attorney General, State of Iowa; Carla J. Stovall, Attorney General, State of Kansas; Richard P. Ieyoub, Attorney General, State of Louisiana; Jennifer Granholm, Attorney General, and Thomas L. Casey, Solicitor General, State of Michigan; Julie Ralston Aoki, Assistant Attorney General, State of Minnesota; Mike Moore, Attorney General, State of Mississippi; Frankie Sue Del Papa, Attorney General, State of Nevada; Philip T. McLaughlin, Attorney General, State of New Hampshire; Eliot Spitzer, Attorney General, State of New York; Michael F. Easley, Attorney General, and K.D. Sturgis, Assistant Attorney General, State of North Carolina; Herbert D. Soll, Attorney General, Commonwealth of the Northern Mariana Islands; Betty D. Montgomery, Attorney General, State of Ohio; ***711 **367** W.A. Drew Edmondson, Attorney General, State of Oklahoma; Angel E. Rotger–Sabat, Attorney General, Commonwealth of Puerto Rico; Mark Barnett, Attorney General, State of South Dakota; John Cornyn, Attorney General, State of Texas; Jan Graham, Attorney General, State of Utah; William H. Sorrell, Attorney General, State of Vermont; Mark L. Earley, Attorney General, Commonwealth of Virginia; Christine O. Gregoire, Attorney General, State of Washington; Darrell V. McGraw, Jr., Attorney General, and Douglas L. Davis, Assistant Attorney General, State of West Virginia; James E. Doyle, Attorney General, and Kevin J. O'Connor, State of Wisconsin; and Gay Woodhouse, Attorney General, State of Wyoming; were on brief for The Thirty–Six Amici Curiae in support of the appellant.

James H. Skiles and Jan Amundson were on brief for Grocery Manufacturers of America, Inc. et al., Amici Curiae in support of the appellees.

C. Boyden Gray, William J. Kolasky, Jeffrey D. Ayer and Robert H. Bork were on brief for Citizens for a Sound Economy Foundation, Amicus Curiae, in support of the appellees.

Before: HENDERSON, RANDOLPH and GARLAND, Circuit Judges.

Opinion for the court filed by Circuit Judge HENDERSON.

Opinion

KAREN LeCRAFT HENDERSON, Circuit Judge.

On February 28, 2000 H.J. Heinz Company (Heinz) and Milnot Holding Corporation (Beech–Nut) entered into a merger agreement. The Federal Trade Commission (Commission or FTC) sought a preliminary injunction pursuant to section 13(b) of the Federal Trade Commission Act (FTCA), 15 U.S.C. § 53(b), to enjoin the consummation of the merger. The injunction was sought in aid of an FTC administrative proceeding which was subsequently instituted by complaint to challenge the merger as violative of, *inter alia,* section 7 of the Clayton Act, 15 U.S.C. § 18. The district court denied the preliminary injunction and the FTC appealed to this court. For the reasons set forth below, we reverse the district court and remand for entry of a preliminary injunction against Heinz and Beech–Nut.

I. Background

Four million infants in the United States consume 80 million cases of jarred baby food annually, representing a domestic market of $865 million to $1 billion.[1] *FTC v. H.J. Heinz, Co.,* 116 F.Supp.2d 190, 192 (D.D.C.2000). The baby food market is dominated by three firms, Gerber Products Company (Gerber), Heinz and Beech–Nut. Gerber, the industry leader, enjoys a 65 per cent market share while Heinz and Beech–Nut come in second and third, with a 17.4 per cent and a 15.4 per cent share respectively. *Id*. The district court found that Gerber enjoys unparalleled brand recognition with a brand loyalty greater than any other product sold in the United States. *Id*. at 193. Gerber's products are found in over 90 per cent of all American supermarkets.[2]

By contrast, Heinz is sold in approximately 40 per cent of all supermarkets. Its sales are nationwide but concentrated ***712 **368** in northern New England, the Southeast and Deep South and the Midwest. *Id*. at 194. Despite its second-place domestic market share, Heinz is the largest producer of baby food in the world with $1 billion in sales worldwide. Its domestic baby food products with annual net sales of $103 million are manufactured at its Pittsburgh, Pennsylvania plant, which was updated in 1991 at a cost of $120 million. *Id*. at 192–93. The plant operates at 40 per cent of its production capacity and produces 12 million cases of baby food annually. Its baby food line includes about 130 SKUs (stock keeping units), that is, product varieties (*e.g.,* strained carrots, apple sauce, etc.). Heinz lacks Gerber's brand recognition; it markets itself as a "value brand" with a shelf price several cents below Gerber's. *Id*. at 193.

Beech–Nut has a market share (15.4%) comparable to that of Heinz (17.4%), with $138.7 million in annual sales of baby food, of which 72 per cent is jarred baby food. Its jarred baby food line consists of 128 SKUs. Beech–Nut manufactures all of its baby food in Canajoharie, New York at a manufacturing plant that was built in 1907 and began manufacturing baby food in 1931. Beech–Nut maintains price parity with Gerber, selling at about one penny less. It markets its product as a premium brand. *Id*. Consumers generally view its product as comparable in quality to Gerber's. *Id*. Beech–Nut is carried in approximately 45 per cent of all grocery stores. Although its sales are nationwide, they are concentrated in New York, New Jersey, California and Florida.[3] *Id*. at 194.

At the wholesale level Heinz and Beech–Nut both make lump-sum payments called "fixed trade spending" (also known as "slotting fees" or "pay-to-stay" arrangements) to grocery stores to obtain shelf placement. *Id.* at 197. Gerber, with its strong name recognition and brand loyalty, does not make such pay-to-stay payments. The other type of wholesale trade spending is "variable trade spending," which typically consists of manufacturers' discounts and allowances to supermarkets to create retail price differentials that entice the consumer to purchase their product instead of a competitor's. *Id*.

Under the terms of their merger agreement, Heinz would acquire 100 per cent of Beech–Nut's voting securities for $185 million. Accordingly, they filed a Premerger Notification and Report Form with the FTC and the United States Department of Justice pursuant to the Hart–Scott–Rodino Antitrust Improvement Act of 1976, 15 U.S.C. § 18a.[4] On July 7, 2000 the FTC authorized this action for a preliminary injunction under section 13(b) of the FTCA and, on July 14, 2000, it filed a complaint and motion for preliminary injunction. The district court conducted a five-day hearing in late August and early September and heard final arguments on September 21, 2000. The record before the district court consisted of 1,267 exhibits, including 150 demonstrative exhibits, 32 depositions and 41 affidavits. ***713** ****369** In addition, eleven witnesses testified. On October 18, 2000 the district court denied preliminary injunctive relief. The court concluded that it was "more probable than not that consummation of the Heinz/Beech–Nut merger will actually increase competition in jarred baby food in the United States." *H.J. Heinz,* 116 F.Supp.2d at 200. The FTC appealed and sought injunctive relief pending appeal, which this court granted on November 8, 2000. On November 22, 2000 the FTC filed an administrative complaint against Heinz and Beech–Nut, charging that the proposed merger violates section 5 of the FTCA and, if consummated, would violate section 7 of the Clayton Act. *In the Matter of H. J. Heinz,* Docket No. 9295 (filed Nov. 22, 2000).

II. Analysis

A. *Standard of Review*

We review a district court order denying preliminary injunctive relief for abuse of discretion, *National Wildlife Fed'n v. Burford,* 835 F.2d 305, 319 (D.C.Cir.1987), and will set aside the court's factual findings only if they are "clearly erroneous." Fed.R.Civ.P. 52(a); *United States v. Marine Bancorporation, Inc.,* 418 U.S. 602, 615 n. 13, 94 S.Ct. 2856, 41 L.Ed.2d 978 (1974). If our review of the district court order "reveals that it rests on an erroneous premise as to the pertinent law, however, we must examine the decision in light of the legal principles we believe proper and sound." *Ambach v. Bell,* 686 F.2d 974, 979 (D.C.Cir.1982). We apply *de novo* review to the district court's conclusions of law. *See FTC v. National Tea Co.,* 603 F.2d 694, 696–98 (8th Cir.1979) (reviewing *de novo* proper standard of proof under section 13(b) of FTCA); *cf. FTC v. Warner Communications Inc.,* 742 F.2d 1156, 1160 (9th Cir.1984) (per curiam) (finding as matter of law district court applied incorrect standard for section 7 violation). In deciding whether to grant preliminary injunctive relief under section 13(b), the court evaluates whether it is in the public interest to enjoin the proposed merger. *See* 15 U.S.C. § 53(b).

B. *Section 7 of the Clayton Act*

Section 7 of the Clayton Act prohibits acquisitions, including mergers, "where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly." 15 U.S.C. § 18; *see United States v. Philadelphia Nat'l Bank,* 374 U.S. 321, 355, 83 S.Ct. 1715, 10 L.Ed.2d 915 (1963) ("The statutory test is whether the effect of the merger 'may be substantially to lessen competition' 'in any line of commerce in any section of the country.' "). The "Congress used the words '*may* be substantially to lessen competition' (emphasis supplied), to indicate that its concern was with probabilities, not certainties." *Brown Shoe Co. v. United States,* 370 U.S. 294, 323, 82 S.Ct. 1502, 8 L.Ed.2d 510 (1962) (emphasis original); *see* S.Rep. No. 1775, at 6 (1950), U.S.Code Cong. & Admin. News at 4293, 4298 ("The use of these words ["may be"] means that the bill, if enacted, would not apply to the mere possibility but only to the reasonable probability of the pr[o]scribed effect...."). "Merger enforcement, like other areas of antitrust, is directed at market power. It shares with the law of monopolization a degree of schizophrenia: an aversion to potent power that heightens risk of abuse; and tolerance of that degree of power required to attain economic benefits." Lawrence A. Sullivan & Warren S. Grimes, *The Law of Antitrust* § 9.1, at 511 (2000). The Congress has empowered the FTC, *inter alia,* to weed out those mergers whose effect "may be substantially to lessen competition" from those that enhance competition. *See* H.R.Rep. No. 1142, at 18–19 (1914). ***714** ****370** In section 13(b) of the FTCA, the Congress provided a mechanism whereby the FTC may seek preliminary injunctive relief preventing the merging parties from consummating the merger until the Commission has had an opportunity to investigate and, if necessary, adjudicate the matter.

C. *Section 13(b) of the Federal Trade Commission Act*

"Whenever the Commission has reason to believe that a corporation is violating, or is about to violate, Section 7 of the Clayton Act, the FTC may seek a preliminary injunction to prevent a merger pending the Commission's administrative adjudication of the merger's legality." *FTC v. Staples, Inc.,* 970 F.Supp. 1066, 1070 (D.D.C.1997); *see* 15 U.S.C. § 53(b). Section 13(b) provides for the grant of a preliminary injunction where such action would be in the public interest—as determined by a weighing of the equities and a consideration of the Commission's likelihood of success on the merits. 15 U.S.C. § 53(b).[5] The Congress intended this standard to depart from what it regarded as the then-traditional equity standard, which it characterized as requiring the plaintiff to show: (1) irreparable damage, (2) probability of success on the merits and (3) a balance of equities favoring the plaintiff. H.R.Rep. No. 93–624, at 31 (1971). The Congress determined that the traditional standard was not "appropriate for the implementation of a

Federal statute by an independent regulatory agency where the standards of the public interest measure the propriety and the need for injunctive relief." *Id*. "The courts had evolved an approach to cases in which government agencies, acting to enforce a federal statute, sought interim relief. The agency, in such cases, was not held to the high thresholds applicable where private parties seek interim restraining orders." *FTC v. Weyerhaeuser Co.,* 665 F.2d 1072, 1082 (D.C.Cir.1981); *see FTC v. Exxon Corp.,* 636 F.2d 1336, 1343 (D.C.Cir.1980) ("In enacting [Section 13(b)], Congress further demonstrated its concern that injunctive relief be broadly available to the FTC by incorporating a unique 'public interest' standard in 15 U.S.C. § 53(b), rather than the more stringent, traditional 'equity' standard for injunctive relief."). The FTC is not required to *establish* that the proposed merger would in fact violate section 7 of the Clayton Act. *Staples,* 970 F.Supp. at 1071; *see FTC v. Food Town Stores, Inc.,* 539 F.2d 1339, 1342 (4th Cir.1976) ("The district court is not authorized to determine whether the antitrust laws have been or are about to be violated. That adjudicatory function is vested in the FTC in the first instance."). We now consider the FTC's likelihood of success and weigh the equities. *Accord FTC v. Freeman Hosp.,* 69 F.3d 260, 267 (8th Cir.1995); *FTC v. University Health, Inc.,* 938 F.2d 1206, 1217 (11th Cir.1991); *Warner Communications,* 742 F.2d at 1160.

1. Likelihood of Success

To determine likelihood of success on the merits we measure the probability that, after an administrative hearing on the merits, the Commission will succeed in proving that the effect of the Heinz/Beech–Nut merger "may be substantially to lessen competition, or to tend to create a monopoly" in violation of section 7 of the Clayton Act. 15 U.S.C. § 18. This court and others have suggested that the standard for likelihood of success on the merits is met if the FTC "has raised questions going to the merits so serious, substantial, ***715 **371** difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC in the first instance and ultimately by the Court of Appeals." *FTC v. Beatrice Foods Co.,* 587 F.2d 1225, 1229 (D.C.Cir.1978) (Appendix to Statement of MacKinnon & Robb, JJ.)[6]; *Staples,* 970 F.Supp. at 1071; *Warner Communications,* 742 F.2d at 1162 (quoting *National Tea,* 603 F.2d at 698); *see University Health,* 938 F.2d at 1218. This specific standard was articulated by the court below, *see H.J. Heinz,* 116 F.Supp.2d at 194, and it is a standard to which the appellees have not objected.

In *United States v. Baker Hughes Inc.,* 908 F.2d 981, 982–83 (D.C.Cir.1990), we explained the analytical approach by which the government establishes a section 7 violation. First the government must show that the merger would produce "a firm controlling an undue percentage share of the relevant market, and [would] result[ ] in a significant increase in the concentration of firms in that market." *Philadelphia Nat'l Bank,* 374 U.S. at 363, 83 S.Ct. 1715. Such a showing establishes a "presumption" that the merger will substantially lessen competition. *See Baker Hughes,* 908 F.2d at 982. To rebut the presumption, the defendants must produce evidence that "show [s] that the market-share statistics [give] an inaccurate account of the [merger's] probable effects on competition" in the relevant market. *United States v. Citizens & S. Nat'l Bank,* 422 U.S. 86, 120, 95 S.Ct. 2099, 45 L.Ed.2d 41 (1975).[7] "If the defendant successfully rebuts the presumption [of illegality], the burden of producing additional evidence of anticompetitive effect shifts to the government, and merges with the ultimate burden of persuasion, which remains with the government at all times." *Baker Hughes Inc.,* 908 F.2d at 983; *see also Kaiser Aluminum,* 652 F.2d at 1340 & n. 12. Although *Baker Hughes* was decided at the merits stage as opposed to the preliminary injunctive relief stage, we can nonetheless use its analytical approach in evaluating the Commission's showing of likelihood of success. Accordingly, we look at the FTC's prima facie case and the defendants' rebuttal evidence.

a. Prima Facie Case

Merger law "rests upon the theory that, where rivals are few, firms will be able to coordinate their behavior, either by overt collusion or implicit understanding, in order to restrict output and achieve profits above competitive levels." *FTC v. PPG Indus.,* 798 F.2d 1500, 1503 (D.C.Cir.1986).[8] Increases in concentration above certain levels are thought to "raise[ ] a likelihood of 'interdependent anticompetitive ***716 **372** conduct.' " *Id.* (quoting *General Dynamics,* 415 U.S. at 497, 94 S.Ct. 1186); *see FTC v. Elders Grain,* 868 F.2d 901, 905 (7th Cir.1989). Market concentration, or the lack thereof, is often measured by the Herfindahl–Hirschmann Index (HHI). *See Staples,* 970 F.Supp. at 1081 n. 12.[9]

Sufficiently large HHI figures establish the FTC's prima facie case that a merger is anti-competitive. *See Baker Hughes,* 908 F.2d at 982–83 & n. 3; *PPG,* 798 F.2d at 1503. The district court found that the pre-merger HHI "score for the baby food industry is 4775"—indicative of a highly concentrated industry.[10] *H.J. Heinz,* 116 F.Supp.2d at 196; *see PPG,* 798 F.2d at 1503; Horizontal Merger Guidelines, *supra,* § 1.51. The merger of Heinz and Beech–Nut will increase the HHI by 510 points. This creates, by a wide margin, a presumption that the merger will lessen competition in the domestic jarred baby food market. *See* Horizontal Merger Guidelines, *supra,* § 1.51 (stating that HHI increase of more than 100 points, where post-merger HHI exceeds 1800, is "presumed ... likely to create or enhance market power or facilitate its exercise"); *see also Baker Hughes,* 908 F.2d at 982–83 & n. 3; *PPG,* 798 F.2d at 1503.[11] Here, ***717 **373** the FTC's market concentration statistics[12] are bolstered by the indisputable fact that the merger will eliminate competition between the two merging parties at the wholesale level, where they are currently the only competitors for what the district court described as the " second position on the supermarket shelves." *H.J. Heinz,* 116 F.Supp.2d at 196. Heinz's own documents recognize the wholesale competition and anticipate that the merger will end it. JA 2680; *see also* JA 2185. Indeed, those documents disclose that Heinz considered three options to end the vigorous wholesale competition with Beech–Nut: two involved innovative measures while the third entailed the acquisition of Beech–Nut. JA 2184. Heinz chose the third, and least pro-competitive, of the options.

Finally, the anticompetitive effect of the merger is further enhanced by high barriers to market entry.[13] The district court found that there had been no significant entries in the baby food market in decades and that new entry was "difficult and improbable." *H.J. Heinz,* 116 F.Supp.2d at 196. This finding largely eliminates the possibility that the reduced competition caused by the merger will be ameliorated by new competition from outsiders and further strengthens the FTC's case. *See University Health,* 938 F.2d at 1219 & n. 26.

As far as we can determine, no court has ever approved a merger to duopoly under similar circumstances.

***718 **374** b. Rebuttal Arguments

In response to the FTC's prima facie showing, the appellees make three rebuttal arguments, which the district court accepted in reaching its conclusion that the merger was not likely to lessen competition substantially. For the reasons discussed below, these arguments fail and thus were not a proper basis for denying the FTC injunctive relief.

1. Extent of Pre–Merger Competition

The appellees first contend, and the district court agreed, that Heinz and Beech–Nut do not really compete against each other at the retail level. Consumers do not regard the products of the two companies as substitutes, the appellees claim, and generally only one of the two brands is available on any given store's shelves. Hence, they argue, there is little competitive loss from the merger.

This argument has a number of flaws which render clearly erroneous the court's finding that Heinz and Beech–Nut have not engaged in significant pre-merger competition. First, in accepting the appellees' argument that Heinz and Beech–Nut do not compete, the district court failed to address the record evidence that the two do in fact price against each other, *see, e.g.,* 8/31/2000 Tr. 247–48, and that, where both are present in the same areas,[14] they depress each other's prices as well as those of Gerber even though they are virtually never all found in the same store. *See, e.g.,* 8/30/2000 Tr. 147–48, 172; PX 531 at ¶ 8; PX 481 at ¶ 12; PX 479 at ¶ ¶ 6–7; PX 478 at ¶ 6; DX 14 at RP–110. This evidence undermines the district court's factual finding.

Second, the district court's finding is inconsistent with its conclusion that there is a single, national market for jarred baby food in the United States. The Supreme Court has explained that "[t]he outer boundaries of a product market are determined by the reasonable interchangeability of use [by consumers] or the cross-elasticity of demand between the product itself and substitutes for it." *Brown Shoe,* 370 U.S. at 325, 82 S.Ct. 1502; *see also United States v. E.I. du Pont de Nemours & Co.,* 351 U.S. 377, 395, 76 S.Ct. 994, 100 L.Ed. 1264 (1956).[15] The definition of product market thus "focuses solely on demand substitution factors," *i.e.,* that consumers regard the products as substitutes. Horizontal Merger Guidelines, *supra,* § 1.0; Sullivan & Grimes, *supra,* § 11.2b1, at 579. By defining the relevant product market generically as jarred baby food, the district court concluded that in areas where Heinz's and Beech–Nut's products are both sold, consumers will switch between them in response to a "small but significant and nontransitory increase in price (SSNIP)." Horizontal Merger Guidelines, *supra,* § 1.11; *H.J. Heinz,* 116 F.Supp.2d at 195. The district court never explained this inherent inconsistency in its logic nor could counsel for the appellees explain it at oral argument.

Third, and perhaps most important, the court's conclusion concerning pre-merger competition does not take into account the indisputable fact that the merger will eliminate competition at the wholesale level between the only two competitors for the ****375 *719** "second shelf" position. Competition between Heinz and Beech–Nut to gain accounts at the wholesale level is fierce with each contest concluding in a winner-take-all result. JA 2680. The district court regarded this loss of competition as irrelevant because the FTC did not establish to its satisfaction that wholesale competition ultimately benefitted consumers through lower retail prices. The district court concluded that fixed trade spending did not affect consumer prices and that "the FTC's assertion that the proposed merger will affect variable trade spending levels and consumer prices is ... at best, inconclusive."[16] *H.J. Heinz,* 116 F.Supp.2d at 197. Although the court noted the FTC's examples of consumer benefit through couponing initiatives, the court held that it was "impossible to conclude with any certainty that the consumer benefit from such couponing initiatives would be lost in the merger." *Id.*

In rejecting the FTC's argument regarding the loss of wholesale competition, the court committed two legal errors. First, as the appellees conceded at oral argument, no court has ever held that a reduction in competition for wholesale purchasers is not relevant unless the plaintiff can prove impact at the consumer level. Oral Arg. Tr. at 22, 28; *see Hospital Corp. of Am. v. FTC,* 807 F.2d 1381, 1389 (7th Cir.1986) ("Section 7 does not require proof that a merger or other acquisition has caused higher prices in the affected market. All that is necessary is that the merger create an appreciable danger of [collusive practices] in the future. A predictive judgment, necessarily probabilistic and judgmental rather than demonstrable, is called for.") (citation omitted). Second, it is, in any event, not the FTC's burden to prove such an impact with "certainty." To the contrary, the antitrust laws assume that a retailer faced with an increase in the cost of one of its inventory items "will try so far as competition allows to pass that cost on to its customers in the form of a higher price for its product." *In re Brand Name Prescription Drugs Antitrust Litig.,* 123 F.3d 599, 605 (7th Cir.1997), *reh'g and suggestion for reh'g en banc denied* (Oct. 8, 1997). Section 7 is, after all, concerned with *probabilities,* not certainties. *United States v. El Paso Natural Gas Co.,* 376 U.S. 651, 658, 84 S.Ct. 1044, 12 L.Ed.2d 12 (1964); *Brown Shoe,* 370 U.S. at 323, 82 S.Ct. 1502; *Baker Hughes,* 908 F.2d at 984.[17]

***720 **376** 2. Post–Merger Efficiencies

The appellees' second attempt to rebut the FTC's prima facie showing is their contention that the anticompetitive effects of the merger will be offset by efficiencies resulting from the union of the two companies, efficiencies which they assert will be used to compete more effectively against Gerber. It is true that a merger's primary benefit to the economy is its potential to generate efficiencies. *See generally* 4A Phillip E. Areeda, Herbert Hovenkamp & John L. Solow, *Antitrust Law* ¶ 970 at 22–25 (1998). As the Merger Guidelines now recognize, efficiencies "can enhance the merged firm's ability and incentive to compete, which may result in lower prices, improved quality, or new products." Horizontal Merger Guidelines, *supra,* § 4.

Although the Supreme Court has not sanctioned the use of the efficiencies defense in a section 7 case, *see Procter & Gamble Co.,* 386 U.S. at 580, 87 S.Ct. 1224,[18] the trend among lower courts is to recognize the defense. *See, e.g., FTC v. Tenet Health Care Corp.,* 186 F.3d 1045, 1054 (8th Cir.1999), *reh'g and reh'g en banc denied* (Oct. 6.1999); *University Health,* 938 F.2d at 1222; *FTC v. Cardinal Health, Inc.,* 12 F.Supp.2d 34, 61 (D.D.C.1998); *Staples,* 970 F.Supp. at 1088–89; *see also* ABA Antitrust Section, *Mergers and Acquisitions: Understanding the Antitrust Issues* 152 (2000) ("The majority of courts have considered efficiencies as a means to rebut the government's prima facie case that a merger will lead to restricted output or increased prices. These courts, however, generally have found inadequate proof of efficiencies to sustain a rebuttal of the government's case."). In 1997 the Department of Justice and the FTC revised their Horizontal Merger Guidelines to recognize that "mergers have the potential to generate significant efficiencies by permitting a better utilization of existing assets, enabling the combined firm to achieve lower costs in producing a given quantity and quality than either firm could have achieved without the proposed transaction." Horizontal Merger Guidelines, *supra,* § 4.

Nevertheless, the high market concentration levels present in this case require, in rebuttal, proof of extraordinary efficiencies, which the appellees failed to supply. *See University Health,* 938 F.2d at 1223 ("[A] defendant who seeks to overcome a presumption that a proposed acquisition would substantially lessen competition must demonstrate that the intended acquisition would result in significant economies and that these economies ultimately would benefit competition and, hence, consumers."); Horizontal Merger

Guidelines, *supra,* § 4 (stating that "[e]fficiencies almost never justify a merger to monopoly or near-monopoly"); 4A Areeda, *et al., Antitrust Law* ¶ 971f, at 44 (requiring "extraordinary" efficiencies where the "HHI is well above 1800 and the HHI increase is ***721 **377** well above 100"). Moreover, given the high concentration levels, the court must undertake a rigorous analysis of the kinds of efficiencies being urged by the parties in order to ensure that those "efficiencies" represent more than mere speculation and promises about post-merger behavior. The district court did not undertake that analysis here.

In support of its conclusion that post-merger efficiencies will outweigh the merger's anticompetitive effects, the district court found that the consolidation of baby food production in Heinz's under-utilized Pittsburgh plant "will achieve substantial cost savings in salaries and operating costs." *H.J. Heinz,* 116 F.Supp.2d at 199. The court also credited the appellees' promise of improved product quality as a result of recipe consolidation.[19] The only cost reduction the court quantified as a percentage of pre-merger costs, however, was the so called "variable conversion cost": the cost of processing the volume of baby food now processed by Beech–Nut. The court accepted the appellees' claim that this cost would be reduced by 43% if the Beech–Nut production were shifted to Heinz's plant, *see* JA 4619, a reduction the appellees' expert characterized as "extraordinary."

The district court's analysis falls short of the findings necessary for a successful efficiencies defense in the circumstances of this case. We mention only three of the most important deficiencies here. First, "variable conversion cost" is only a percentage of the total variable manufacturing cost. A large percentage reduction in only a small portion of the company's overall variable manufacturing cost does not necessarily translate into a significant cost advantage to the merger. Thus, for cost reduction to be relevant, we must at least consider the percentage of Beech–Nut's total variable manufacturing cost that would be reduced as a consequence of the merger. At oral argument, the appellees' counsel agreed. Oral Arg. Tr. at 43. This correction immediately cuts the asserted efficiency gain in half since, according to the appellees' evidence, using total variable manufacturing cost as the measure cuts the cost savings from 43% to 22.3%. *See* JA 4620.

Second, the percentage reduction in *Beech-Nut's* cost is still not the relevant figure. After the merger, the two entities will be combined, and to determine whether the merged entity will be a significantly more efficient competitor, cost reductions must be measured across the new entity's combined production—not just across the pre-merger output of Beech–Nut. *See* 4A Areeda, *et al., supra,* ¶ 976d at 93–94. The district court, however, did not consider the cost reduction over the merged firm's combined output. At oral argument the appellees' counsel was unable to suggest a formula that could be used for determining that cost reduction. *See* Oral Arg. Tr. at 45–47.

Finally, and as the district court recognized, the asserted efficiencies must be "merger-specific" to be cognizable as a defense.[20] ***722 **378** *H.J. Heinz,* 116 F.Supp.2d at 198–99; *see* Horizontal Merger Guidelines, *supra,* § 4; 4A Areeda, *et al., supra,* ¶ 973, at 49–62. That is, they must be efficiencies that cannot be achieved by either company alone because, if they can, the merger's asserted benefits can be achieved without the concomitant loss of a competitor. *See generally* 4A Areeda, *et al., supra,* ¶ 973. Yet the district court never explained why Heinz could not achieve the kind of efficiencies urged without merger. As noted, the principal merger benefit asserted for Heinz is the acquisition of Beech–Nut's better recipes, which will allegedly make its product more attractive and permit expanded sales at prices lower than those charged by Beech–Nut, which produces at an inefficient plant. Yet, neither the district court nor the appellees addressed the question whether Heinz could obtain the benefit of better recipes by investing more money in product development and promotion—say, by an amount less than the amount Heinz would spend to acquire Beech–Nut. At oral argument, Heinz's counsel agreed that the taste of Heinz's products was not so bad that no amount of money could improve the brand's consumer appeal. Oral Arg. Tr. at 54. That being the case, the question is how much Heinz would have to spend to make its product equivalent to the Beech–Nut product and hence whether Heinz could achieve the efficiencies of merger without eliminating Beech–Nut as a competitor. The district court, however, undertook no inquiry in this regard. In short, the district court failed to make the kind of factual determinations necessary to render the appellees' efficiency defense sufficiently concrete to offset the FTC's prima facie showing.

3. Innovation

The appellees claim next that the merger is required to enable Heinz to innovate, and thus to improve its competitive position against Gerber. Heinz and Beech–Nut asserted, and the district court found, that without the merger the two firms are unable to launch new products to compete with Gerber because they lack a sufficient shelf presence or ACV. *See* *H.J. Heinz,* 116 F.Supp.2d at 199–200. This kind of defense is often a speculative proposition. *See* 4A Areeda, *et al., supra,* ¶ 975g (noting "truly formidable" proof problems in determining innovation economies). In this case, given the old-economy nature of the industry as well as Heinz's position as the world's largest baby food manufacturer, it is a particularly difficult defense to prove. The court below accepted the appellees' argument principally on the basis of their expert's testimony that new product launches are cost-effective only when a firm's ACV is 70% or greater (Heinz's is presently 40%; Beech–Nut's is 45%). ***723 **379** That testimony, in turn, was based on a graph that plotted revenue against ACV. According to the expert, the graph showed that only four out of 27 new products launched in 1995 had been successful—all for companies with an ACV of 70% or greater.

The chart, however, does not establish this proposition and the court's consequent finding that the merger is necessary for innovation is thus unsupported and clearly erroneous. All the chart plotted was revenue against ACV and hence all it showed was the unsurprising fact that the greater a company's ACV, the greater the revenue it received. Because the graph did not plot the profitability (or any measure of "cost-effectiveness"), there is no way to know whether the expert's claim—that a 70% ACV is required for a launch to be "successful" in an economic sense—is true.[21] Moreover, the number of data points on the chart were few; they were limited to launches in a single year; and they involved launches of all new grocery products rather than of baby food alone. Assessing such data's statistical significance in establishing the proposition at issue, *i.e.,* the necessity of 70% ACV penetration, is thus highly speculative. The district court did not even address the question of the data's statistical significance and the appellees' counsel could offer no help at oral argument. *See* Oral Arg. Tr. at 39 ("I'm not aware of the statistical significance of the underlying study.").[22] In the absence of reliable and significant evidence that the merger will permit innovation that otherwise could not be accomplished, the district court had no basis to conclude that the FTC's showing was rebutted by an innovation defense.

Moreover, Heinz's insistence on a 70–plus ACV before it brings a new product to market may be largely to persuade the court to recognize promotional economies as a defense. Heinz argues that to profitably launch a new product, it must have nationwide market penetration to recoup the money spent on advertising and promotion. It wants to spread advertising costs out among as many product units as possible, thereby lowering the advertising cost per unit. It does not want to "waste" promotional expenditures in markets where its products are not on the shelf or where they are on only a few shelves. For example, in a metropolitan area in which Heinz has a 75 per cent ACV, every dollar spent on advertising is two or three times more "effective" than in a market in which it has only a 25 per cent ACV. As one authority notes, however, "[t]he case for recognizing a defense based on promotional economies is relatively weak." 4A Areeda, *et al., supra,* ¶ 975f, at 77. The district court accepted Heinz's claim that it could not introduce new products without at least a 70 per cent ACV because it would ***724 **380** be unable to adequately diffuse its advertising and promotional expenditures. But the court failed to determine whether substantial promotional scale economies exist now and, if they do, whether Heinz and Beech–Nut "for that reason operate at a substantial competitive disadvantage in the market or markets in which they sell" or whether there are effective alternatives to merger by which the disadvantage can be overcome. *Id.* at ¶ 975f2, at 78.

4. Structural Barriers to Collusion

In a footnote the district court dismissed the likelihood of collusion derived from the FTC's market concentration data. "[S]tructural market barriers to collusion" in the retail market for jarred baby food, the court said, rebut the normal presumption that increases in concentration will increase the likelihood of tacit collusion. *H.J. Heinz,* 116 F.Supp.2d at 198 n. 7. The court's sole citation, however, was to testimony by the appellees' expert, Jonathan B. Baker, a former Director of the Bureau of Economics at the FTC, who testified that in order to coordinate successfully, firms must solve "cartel problems" such as reaching a consensus on price and market share and deterring each other from deviating from that consensus by either lowering price or increasing production. He opined that after the merger the merged entity would want to expand its market share at Gerber's expense, thereby decreasing the likelihood of consensus on price and market share. 9/8/2000 Tr. 1010–1013. In his report, Baker elaborated on his theory, explaining that the efficiencies created by the merger will give the merged firm the ability and incentive to take on Gerber in price and product improvements. DX 617. He also predicted that policing and monitoring of any agreement would be more difficult than it is now, due in part to a time lag in the ability of one firm to detect price cuts by another. But the district court made no finding that any of these "cartel problems" are so much greater in the baby food industry than in other industries that they rebut the normal presumption. In fact, Baker's testimony about "time lag" is refuted by the record which reflects that supermarket prices are available from industry-wide scanner data within 4–8 weeks. *See* DX 617 at ¶ 86 (report of appellees' expert Jonathan Baker); *see also* Oral Arg. Tr. at 30 (statement by appellees' counsel that nothing in record reflects time lag is greater in baby food industry than in other industries). His testimony is further undermined by the record evidence of past price leadership in the baby food industry.[23]

The combination of a concentrated market and barriers to entry is a recipe for price coordination. *See University Health,* 938 F.2d at 1218 n. 24 ("Significant market concentration makes it 'easier for firms in the market to collude, expressly or tacitly, and thereby force price above or farther above the competitive level.' " (citation omitted)). "[W]here rivals are few, firms will be able to coordinate their behavior, ***725** ****381** either by overt collusion or implicit understanding, in order to restrict output and achieve profits above competitive levels." *PPG,* 798 F.2d at 1503. The creation of a durable duopoly affords both the opportunity and incentive for both firms to coordinate to increase prices. The district court recognized this when it questioned Baker on whether the merged entity will, up to a point, expand its market share but "then [with Gerber will] find a nice equilibrium and they'll all get along together." 9/8/2000 Tr. 1014. Tacit coordination

> is feared by antitrust policy even more than express collusion, for tacit coordination, even when observed, cannot easily be controlled directly by the antitrust laws. It is a central object of merger policy to obstruct the creation or reinforcement by merger of such oligopolistic market structures in which tacit coordination can occur.

4 Phillip E. Areeda, Herbert Hovenkamp & John L. Solow, *Antitrust Law* ¶ 901b2, at 9 (rev. ed.1998). Because the district court failed to specify any "structural market barriers to collusion" that are unique to the baby food industry, its conclusion that the ordinary presumption of collusion in a merger to duopoly was rebutted is clearly erroneous.[24]

* * *

Although we recognize that, post-hearing, the FTC may accept the rebuttal arguments proffered by the appellees, including their efficiencies defense, and permit the merger to proceed, we conclude that the FTC succeeded in "rais[ing] questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC." *Warner Communications,* 742 F.2d at 1162. The FTC demonstrated that the merger to duopoly will increase the concentration in an already highly concentrated market; that entry barriers in the market make it unlikely that any anticompetitive effects will be avoided; that pre-merger competition is vigorous at the wholesale level nationwide and present at the retail level in some metropolitan areas; and that post-merger competition may be lessened substantially. These substantial questions have not been sufficiently answered by the appellees. As we said in *Baker Hughes,* "[t]he more compelling the prima facie case, the more evidence the defendant must present to rebut it successfully." 908 F.2d at 991. In concluding that the FTC failed to make the requisite showing, the district court erred in a number of respects. Regarding the contention of lack of pre-merger competition, it made a clearly erroneous factual finding and misunderstood the law with respect to the import of competition at the wholesale level. Regarding the proffered efficiencies defense, the court failed to make the kind of factual findings required to render that defense sufficiently concrete to rebut the government's prima facie showing. Finally, as to the contention that the merger is necessary for innovation, the court clearly erred in relying on evidence that does not support its conclusion. Because the district court incorrectly assessed the merits of the appellees' rebuttal arguments, it improperly discounted the FTC's showing of likelihood of success.

***726** ****382** 2. Weighing of the Equities

Although the FTC's showing of likelihood of success creates a presumption in favor of preliminary injunctive relief, we must still weigh the equities in order to decide whether enjoining the merger would be in the public interest. 15 U.S.C. § 53(b); *see PPG,* 798 F.2d at 1507; *Weyerhaeuser,* 665 F.2d at 1081–83. The principal public equity weighing in favor of issuance of preliminary injunctive relief is the public interest in effective enforcement of the antitrust laws. *University Health,* 938 F.2d at 1225. The Congress specifically had this public equity consideration in mind when it enacted section 13(b). *See Food Town Stores,* 539 F.2d at 1346 (Congress enacted section 13(b) to preserve status quo until FTC can perform its function). The district court found, and there is no dispute, that if the merger were allowed to proceed, subsequent administrative and judicial proceedings on the merits "will not matter" because Beech–Nut's manufacturing facility "will be closed, the Beech–Nut distribution channels will be closed, the new label and recipes will be in place, and it will be impossible as a practical matter to undo the transaction." *H.J. Heinz,* 116 F.Supp.2d at 201. Hence, if the merger were ultimately found to violate the Clayton Act, it would be impossible to recreate pre-merger competition. *See Warner Communications,* 742 F.2d at 1165 ("A denial of a preliminary injunction would preclude effective relief if the Commission ultimately prevails and divestiture is ordered."). Section 13(b) itself embodies congressional recognition of the fact that divestiture is an inadequate and unsatisfactory remedy in a merger case, 119 Cong. Rec. 36612 (1973), a point that has been emphasized by the United States Supreme Court. *See, e.g., FTC v. Dean Foods Co.,* 384 U.S. 597, 606 n. 5, 86 S.Ct. 1738, 16 L.Ed.2d 802 (1966) ("Administrative experience shows that the Commission's inability to unscramble merged assets frequently prevents entry of an effective order of divestiture.").

On the other side of the ledger, the appellees claim that the injunction would deny consumers the procompetitive advantages of the merger. *See FTC v. Pharmtech Research, Inc.,* 576 F.Supp. 294, 299 (D.D.C.1983) (explaining that public equities include "beneficial economic effects and procompetitive advantages for consumers"). The district court found that if the merger were preliminarily enjoined, the injury to competition would also be irreversible, that is, the merger would be abandoned and could not be consummated if ultimately found lawful. By contrast to its first finding, however, for the latter conclusion the court relied not on the facts of this case but on our statement in *Exxon* that—as a general matter—temporarily blocking a tender offer is likely to end an attempted acquisition, "as a result of the short life-span of most tender offers." *Id*. (quoting *Exxon,* 636 F.2d at 1343). In their brief in this court, the appellees offer nothing more to support the finding that the merger would never be consummated were an injunction to issue. Indeed, they devote only a single sentence, without any citation, to the point. The district court's finding that an injunction would "kill this merger" is thus not a factual finding supported by record evidence. This case does not involve a short-lived tender offer as did the case cited by the court for its "kill the merger" conclusion. The appellees acknowledge that there is no alternative buyer for Beech–Nut and the court found that it is not a failing company but rather a "profitable and ongoing enterprise." *H.J. Heinz,* 116 F.Supp.2d at 201 n. 9. If the merger makes economic sense now, the appellees have offered no reason why it would not do so later. Moreover, Beech–Nut's principal assets of value to Heinz are, assertedly, its recipes and brand ***727 **383** name. Nothing in the record leads us to believe that both will not still exist when the FTC completes its work. It may be that Beech–Nut will have to sell its recipes to Heinz at a lower price than the price of today's merger. But that is at best a "private" equity which does not affect our analysis of the impact on the market of the two options now before us and which has not in any event been urged by the appellees.[25] *See id*.

In sum, weighing of the equities favors the FTC. If the merger is ultimately found to violate section 7 of the Clayton Act, it will be too late to preserve competition if no preliminary injunction has issued. On the other hand, if the merger is found not to lessen competition substantially, the efficiencies that the appellees urge can be reclaimed by a renewed transaction. Our conclusion with respect to the equities necessarily lightens the burden on the FTC to show likelihood of success on the merits, a burden which the FTC has met here.

III. Conclusion

It is important to emphasize the posture of this case. We do not decide whether the FTC will ultimately prove its case or whether the defendants' claimed efficiencies will carry the day.[26] Our task is to review the district court's order to determine whether, under section 13(b), preliminary injunctive relief would be in the public interest. We have considered the FTC's likelihood of success on the merits. We have weighed the equities. We conclude that the FTC has raised serious and substantial questions. We also conclude that the public equities weigh in favor of preliminary injunctive relief and therefore that a preliminary injunction would be in the public interest. Accordingly, we reverse the district court's denial of preliminary injunctive relief and remand the case for entry of a preliminary injunction pursuant to section 13(b) of the Federal Trade Commission Act.

So ordered.

All Citations

246 F.3d 708, 345 U.S.App.D.C. 364, 2001-1 Trade Cases P 73,243

Footnotes

1 The facts as set forth herein are based on the district court's factual findings and the record material submitted by the parties.

2 Product volume in retail stores throughout the country is measured by the product's All Commodity Volume (ACV). Gerber's near 100 per cent ACV is impressive because virtually all supermarkets stock at most two brands of baby food. In at least one area of the country as many as 80 per cent of supermarket retailers stock only Gerber.

3 Although Heinz and Beech–Nut introduced evidence showing that in areas that account for 80% of Beech–Nut sales, Heinz has a market share of about 2% and in areas that account for about 72% of Heinz sales, Beech–Nut's share is about 4%, the FTC introduced evidence that Heinz and Beech–Nut are locked in an intense battle at the wholesale level to gain (and maintain) position as the second brand on retail shelves.

4 Section 18a requires pre-merger notification for a merger in which either the acquiring or the acquired firm has total net sales or assets of at least $10 million and the other firm has annual sales or total assets of at least $100 million. The acquirer must have at least 15 per cent or $15 million worth of the target firm's voting securities or assets. 15 U.S.C. § 18a(a). Filers must disclose specific financial and market data and pay a filing fee.

5 Section 13(b) of the FTCA provides that "[u]pon a proper showing that, weighing the equities and considering the Commission's likelihood of ultimate success, such action would be in the public interest, ... a preliminary injunction may be granted." 15 U.S.C. § 53(b).

6 In *Beatrice Foods,* two members of the court, writing separately from a denial of *en banc* review, included the quoted language from an unpublished judgment and memorandum issued earlier in the litigation.

7 To rebut the defendants may rely on "[n]onstatistical evidence which casts doubt on the persuasive quality of the statistics to predict future anticompetitive consequences" such as "ease of entry into the market, the trend of the market either toward or away from concentration, and the continuation of active price competition." *Kaiser Aluminum & Chem. Corp. v. FTC,* 652 F.2d 1324, 1341 (7th Cir.1981). In addition, the defendants may demonstrate unique economic circumstances that undermine the predictive value of the government's statistics. *See United States v. General Dynamics Corp.,* 415 U.S. 486, 506–10, 94 S.Ct. 1186, 39 L.Ed.2d 530 (1974) (fundamental changes in structure of coal market made market concentration statistics inaccurate predictors of anticompetitive effect); *see also University Health,* 938 F.2d at 1218.

8 A "horizontal merger" involves firms selling the same or similar products in a common geographical market.

9 "The FTC and the Department of Justice, as well as most economists, consider the measure superior to such cruder measures as the four-or eight-firm concentration ratios which merely sum up the market shares of the largest four or eight firms." *PPG,* 798 F.2d at 1503. The Department of Justice and the FTC rely on the HHI in evaluating proposed horizontal mergers. *See* United States Dep't of Justice & Federal Trade Comm'n, *Horizontal Merger Guidelines* §§ 1.5, 1.51 (1992), as revised (1997). The HHI is calculated by totaling the squares of the market shares of every firm in the relevant market. For example, a market with ten firms having market shares of 20%, 17%, 13%, 12%, 10%, 10%, 8%, 5%, 3% and 2% has an HHI of 1304 ($20^2 + 17^2 + 13^2 + 12^2 + 10^2 + 10^2 + 8^2 + 5^2 + 3^2 + 2^2$). If the firms with 13% and 5% market shares were to merge, the HHI would increase by 130 points, expressed by the formula 2ab, which is derived from $(a+b)^2$ or $a^2 + 2ab + b^2$. Under the Merger Guidelines a market with a postmerger HHI above 1800 is considered "highly concentrated" and mergers that increase the HHI in such a market by over 50 points "potentially raise significant competitive concerns." *Id.* at § 1.51. Mergers "producing an increase in the HHI of more than 100 points [in such markets] are [presumed] likely to create or enhance market power or facilitate its exercise." *Id*. Although the Merger Guidelines are not binding on the court, they provide "a useful illustration of the application of the HHI." *PPG,* 798 F.2d at 1503 n. 4.

10 To determine the HHI score the district court first had to define the relevant market. The court defined the product market as jarred baby food and the geographic market as the United States. *H.J. Heinz,* 116 F.Supp.2d at 195. The parties do not challenge the court's definition.

11 The FTC argues that this finding alone—that it is certain to establish a prima facie case—entitles it to preliminary injunctive relief under *PPG.* We disagree with the Commission's reading of *PPG*. In *PPG,* the Commission appealed the district court's denial of its request for a preliminary injunction to prevent PPG Industries, the world's largest producer of glass aircraft transparencies, from acquiring Swedlow, Inc., the world's largest manufacturer of acrylic aircraft transparencies. 798 F.2d at 1502. After defining the relevant market and determining market share, the district court found that the merger would significantly increase the concentration in an already highly concentrated market. It also "found high market-entry barriers that would prolong high market concentration." *Id*. at 1503. On appeal, this court stated: "There is no doubt that the pre-and post-acquisition HHI's and market shares found in this case entitle the Commission to some preliminary relief." *Id.* This statement came, however, in the context of a case in which the appellants offered no rebuttal (other than the observation of rapid and continuing technological changes in the industry) to the presumption generated by the market concentration data on which the FTC based its prima facie showing. *Id*. at 1506. The court then noted the rule established in *Weyerhaeuser* that the FTC is entitled to a "presumption in favor of a preliminary injunction when [it] establishes a strong likelihood of success on the merits." *Id*. at 1507.

12 The Supreme Court has cautioned that statistics reflecting market share and concentration, while of great significance, are not conclusive indicators of anticompetitive effects. *See General Dynamics,* 415 U.S. at 498, 94 S.Ct. 1186; *Brown Shoe,* 370 U.S. at 322 n. 38, 82 S.Ct. 1502 ("Statistics reflecting the shares of the market controlled by the industry leaders and the parties to the merger are, of course, the primary index of market power; but only a further examination of the particular market—its structure, history and probable future—can provide the appropriate setting for judging the probable anticompetitive effect of the merger."). In *General Dynamics* the Supreme Court held that the market share statistics the government used to seek divestiture of the merged firm were insufficient because, in failing to take into account the acquired firm's long-term contractual commitments (coal contracts), the statistics overestimated the acquired firm's ability to compete in the relevant market in the future. *General Dynamics,* 415 U.S. at 500–504, 94 S.Ct. 1186.

13 Barriers to entry are important in evaluating whether market concentration statistics accurately reflect the pre- and likely postmerger competitive picture. *Cf. Baker Hughes,* 908 F.2d at 987. If entry barriers are low, the threat of outside entry can significantly alter the anticompetitive effects of the merger by deterring the remaining entities from colluding or exercising market power. *See United States v. Falstaff Brewing Corp.,* 410 U.S. 526, 532–33, 93 S.Ct. 1096, 35 L.Ed.2d 475 (1973); *Baker Hughes,* 908 F.2d at 987 ("In the absence of significant barriers, a company probably cannot maintain supracompetitive pricing for any length of time."); Horizontal Merger Guidelines, *supra,* § 3.0 ("A merger is not likely to create or enhance market power or to facilitate its exercise, if entry into the market is so easy that market participants, after the merger, either collectively or unilaterally could not profitably maintain a price increase above premerger levels."). Low barriers to entry enable a potential competitor to deter anticompetitive behavior by firms within the market simply by its ability to enter the market. *FTC v. Procter & Gamble Co.,* 386 U.S. 568, 581, 87 S.Ct. 1224, 18 L.Ed.2d 303 (1967) ("It is clear that the existence of Procter at the edge of the industry exerted considerable influence on the market."). Existing firms know that if they collude or exercise market power to charge supracompetitive prices, entry by firms currently not competing in the market becomes likely, thereby increasing the pressure on them to act competitively. *See Baker Hughes,* 908 F.2d at 988; *Byars v. Bluff City News Co.,* 609 F.2d 843, 851 n. 19 (6th Cir.1979).

14 There are at least ten metropolitan areas in which Heinz and Beech–Nut both have more than a 10 per cent market share and their combined share exceeds 35 per cent. PX 781 at Ex. 1B.

15 Interchangeability of use and cross-elasticity of demand look to the availability of products that are similar in nature or use and the degree to which buyers are willing to substitute those similar products for one another. *See E.I. du Pont de Nemours,* 351 U.S. at 393, 76 S.Ct. 994.

16 Fixed trade spending consists of "slotting fees," "pay-to-stay" arrangements, new store allowances and other payments to retailers in exchange for shelf space and desired product display. *H.J. Heinz,* 116 F.Supp.2d at 197. Variable trade spending includes payments to retailers tied to sales volume and intended to insure a specific sales volume and lower shelf price. *Id*.

17 Although the merger's effects on the wholesale market for baby food are important to a determination of whether the merger is likely to reduce competition in the baby food market overall, we reject the FTC's argument here that the "wholesale competition" between Heinz and Beech–Nut is an entirely distinct "line of commerce" within the meaning of

section 7 of the Clayton Act such that it must be analyzed independently from "retail competition." The Congress amended section 7 in 1950 "to make the measure of anticompetitive acquisitions the extent to which they lessened competition 'in any line of commerce,' rather than the extent to which they lessened competition 'between' the two companies." *Citizen Publishing Co. v. United States,* 394 U.S. 131, 137 n. 3, 89 S.Ct. 927, 22 L.Ed.2d 148 (1969). Courts interpret "line of commerce" as synonymous with the relevant product market. *See* *General Dynamics,* 415 U.S. at 510, 94 S.Ct. 1186; *Falstaff Brewing,* 410 U.S. at 531–32, 93 S.Ct. 1096. The district court defined only one market—jarred baby food sold throughout the line of commerce in the United States. Thus, the proper "line of commerce" for analysis in this case is the *overall* market for jarred baby food, which includes both retail and wholesale levels. At this point in the proceedings, the wholesale market cannot be separated out for analysis without regard to the merger's effect on other levels of competition.

18 In *Procter & Gamble Co.,* 386 U.S. at 580, 87 S.Ct. 1224, the Supreme Court stated that "[p]ossible economies cannot be used as a defense to illegality" in section 7 merger cases. The issue is, however, not a closed book. *See* *Staples,* 970 F.Supp. at 1088 (collecting cases). Areeda and Turner explain that "[i]n interpreting the *Clorox* language, moreover, observe that the court referred only to 'possible' economies and to economies that 'may' result from mergers that lessen competition. To reject an economies defense based on mere possibilities does not mean that one should reject such a defense based on more convincing proof." 4 Phillip Areeda & Donald Turner, *Antitrust Law* ¶ 941b, at 154 (1980). They conclude that "[t]he Court's brief and unelaborated language [in *Clorox*] cannot reasonably be taken as a definitive disposition of so important and complex an issue as the role of economies in analyzing legality of a merger." *Id.*

19 In addition, the district court described Heinz's distribution network as much more efficient than Beech–Nut's. *H.J. Heinz,* 116 F.Supp.2d at 199. It failed to find, however, a significant diseconomy of scale in distribution from which either Heinz or Beech–Nut suffers. 4A Areeda, *et al., supra,* ¶ 975e1, at 73. In other words, although Beech–Nut has an inefficient distribution system, it can make that system more efficient without merger. Heinz's own efficient distribution network illustrates that a firm the size of Beech–Nut does not need to merge in order to attain an efficient distribution system.

20 The Horizontal Merger Guidelines explain that "merging firms must substantiate efficiency claims so that the Agency can verify by reasonable means the likelihood and magnitude of each asserted efficiency, how and when each would be achieved (and any costs of doing so), how each would enhance the merged firm's ability and incentive to compete, and why each would be merger-specific. Efficiency claims will not be considered if they are vague or speculative or otherwise cannot be verified by reasonable means." Horizontal Merger Guidelines, *supra,* § 4. Regarding the types of efficiencies asserted here, the Guidelines state:

> The Agency has found that certain types of efficiencies are more likely to be cognizable and substantial than others. For example, efficiencies resulting from shifting production among facilities formerly owned separately, which enable the merging firms to reduce the marginal cost of production, are more likely to be susceptible to verification, merger-specific, and substantial, and are less likely to result from anticompetitive reductions in output. Other efficiencies, such as those relating to research and development, are potentially substantial but are generally less susceptible to verification and may be the result of anticompetitive output reductions. Yet others, such as those relating to procurement, management, or capital cost are less likely to be merger-specific or substantial, or may not be cognizable for other reasons.

Id.

21 For example, a 5 cent piece of bubble gum introduced with a 90% ACV could appear as a failure on the graph because of low revenue but nonetheless be profitable. On the other hand, a high priced grocery product introduced with the same ACV could generate a lot of revenue (and thus appear as a "success" on the graph) yet be unprofitable.

22 The graph evidence is also not useful unless we know the "sunk" costs in bringing the product to market and the manufacturer's fixed and variable costs in producing the product. Sunk costs are costs that have already been incurred such as research and development and promotional expenses, including brand name development. *See* Henry N. Butler, *Economic Analysis for Lawyers* 935 (1998). Fixed costs refer to those expenses that do not vary with output and will be incurred as long as the firm continues in business. Variable costs are those that change with the rate of output such as wages paid to workers and payments for raw materials. *See id*. at 920, 936; E. Thomas Sullivan & Jeffrey L. Harrison, *Understanding Antitrust and its Economic Implications* 19–21 (3d ed.1998).

23 In an oligopolistic market characterized by few producers, price leadership occurs when firms engage in interdependent pricing, setting their prices at a profit-maximizing, supracompetitive level by recognizing their shared economic interests with respect to price and output decisions. *See Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 227, 113 S.Ct. 2578, 125 L.Ed.2d 168 (1993); *see also* Jesse W. Markham, *The Nature and Significance of Price Leadership,* 41 Amer. Econ. Rev. 891 (1951); Richard A. Posner, *Oligopoly and the Antitrust Laws: A Suggested Approach,* 21 Stan. L.Rev. 1562, 1582 (1969); Donald Arthur Washburn, *Price Leadership,* 64 Va. L.Rev. 691, 693–697 (1978). In a duopoly, a market with only two competitors, supracompetitive pricing at monopolistic levels is a danger. *See* Edward Hastings Chamberlin, *The Theory of Monopolistic Competition: A Re-orientation of the Theory of Value* 46–55 (8th ed.1962).

24 Contrary to the appellees' claims, nothing in *Baker Hughes* suggests otherwise. In that case, the sophisticated nature of the purchasers of the industry's product and the "volatile and shifting" nature of each firm's market share rendered the HHI figures an unreliable measure of concentration. *See* 908 F.2d at 986–87. No such circumstances exist in this case.

25 The district court noted that "[t]he parties have not stressed private equities" but the court nonetheless considered them. It concluded that while "the corporate interests of Heinz and Milnot and especially the interests of Dearborn Capital Partners LP, which presumably acquired Milnot through a leveraged buyout with the purpose and intent of selling its interest at a profit" were important to the private parties, they should not affect the outcome of the proceeding. *H.J. Heinz,* 116 F.Supp.2d at 200 n. 9. We agree. "While it is proper to consider private equities in deciding whether to enjoin a particular transaction, we must afford such concerns little weight, lest we undermine section 13(b)'s purpose of protecting the 'public-at-large, rather than the individual private competitors.' " *University Health,* 938 F.2d at 1225 (citation omitted); *cf. Weyerhaeuser,* 665 F.2d at 1083 ("Private equities do not outweigh effective enforcement of the antitrust laws. When the Commission demonstrates a likelihood of ultimate success, a countershowing of private equities alone would not suffice to justify denial of a preliminary injunction barring the merger.").

26 "The most difficult mergers to assess may be those that combine both negative and positive effects: creating market power that increases the risk of oligopolistic pricing while at the same time creating efficiencies that reduce production or marketing costs." Sullivan & Grimes, *supra,* § 9.1, at 511.

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341 F.Supp.3d 27
United States District Court, District of Columbia.

FEDERAL TRADE COMMISSION, Plaintiff,
v.
WILH. WILHELMSEN HOLDING ASA, Wilhelmsen Maritime Services AS, Resolute Fund II, L.P., Drew Marine Intermediate B.V., and Drew Marine Group, Inc., Defendants.

Civil Action No. 18-cv-00414-TSC
|
Filed October 1, 2018

Synopsis

Background: Federal Trade Commission (FTC) brought action seeking a preliminary injunction to block a proposed merger between two large providers of marine water treatment chemicals and related services.

Holdings: The District Court, Tanya S. Chutkan, J., held that:

supply of marine water treatment (MWT) products and services, including boiler water treatment (BWT) chemicals, cooling water treatment (CWT) chemicals, and associated products and services, to global fleets, constituted a relevant antitrust market;

FTC made out a prima facie case of anticompetitiveness;

providers failed to meet their burden to establish that entry to the market would be appropriately timely, likely, and sufficient to deter or counteract the competitive effects of the merger;

evidence of buyer power was insufficient to rebut the FTC's prima facie case of anticompetitiveness;

providers failed to carry their burden to demonstrate the verifiability of their claimed efficiencies that would result from providers' merger, to rebut FTC's prima facie case of anticompetitiveness; and

equities favored issuance of a preliminary injunction blocking proposed merger.

Motion granted.

Attorneys and Law Firms

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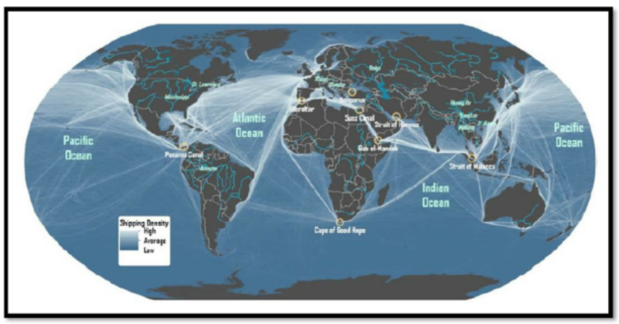
MEMORANDUM OPINION

Tanya S. Chutkan, District Judge

The Federal Trade Commission ("FTC") has moved for a preliminary injunction to block a proposed merger between defendants Wilhelmsen Maritime Services AS ("WMS"), Wilhelmsen Ship Services ("WSS") (collectively "Wilhelmsen"), and The Resolute Fund II, L.P., Drew Marine Intermediate II B.V., and Drew Marine Group, Inc. (collectively "Drew"), two large providers of marine water treatment chemicals and related services. The FTC objects to the merger on the grounds that Defendants are each other's closest and only realistic competition for supplying these chemicals and services on a global scale, and the merger threatens to reduce or eliminate tangible consumer benefits resulting from market competition. Having considered the evidence presented through live testimony, as well as extensive pleadings, exhibits, and other submissions, the court hereby GRANTS the motion for preliminary injunction.

I. BACKGROUND

This case is about the likely impact of a proposed merger in the international maritime industry—an industry on which much of the global economy, including intercontinental trade, large-scale transport of raw materials, and the import/export of foodstuffs and manufactured goods, depends. *See* PX90033 at 001; PX90034 at 001 (noting that "[i]nternational shipping transports more than 80 percent of global trade ***40** to peoples and communities all over the world," and that "[s]hipping is the most efficient and cost-effective method of international transportation for most goods"). By at least one estimate, the worldwide shipping industry includes 50,000 merchant ships registered in over 150 nations. PX90033 at 001. The following map, originally sourced from the National Center for Ecological Analysis and Synthesis, depicts common global shipping routes and underscores the breadth and density of maritime industry activities:



PX10126 at 023. While international merchant ships includes many types of vessels, all of them—and especially large ones—require regular maintenance to ensure continuous performance at operational levels. Companies like Wilhelmsen and Drew provide an array of products and services designed to ensure the continued operational performance of all types of maritime vessels. *See* PX10126 at 008–009 (noting that "VPP [vessel performance products] applications are necessary to maintain financial and operational efficiency of vessels," and that such products "are required by all commercial shipping vessel classes," which include container ships, bulk ships, cruise ships, military ships, tankers, cargo ships, and even offshore oil and gas rigs). Defendants sell maritime customers several categories of products, including cleaning chemicals, fuel treatment chemicals, welding gases, refrigerants, and, critically, water treatment chemicals. Am. Compl. ¶ 29; Ans. ¶ 29. The products at issue in this case are consumable water treatment products and related services, a category that includes products and services for the chemical treatment of boiler water, cooling water, water production, waste water, ballast water, and potable water. DX-1161 at 0019.

Marine vessels use water resources for a number of applications, including drinking, showering, cleaning, pools, spas, and—critically—for boiler and cooling systems. JX-0149 at 003. Depending on the type of ship, a boiler is necessary either as a constituent part of the main propulsion system or as part of an auxiliary system on which the propulsion system relies. PX90030 at 001. In auxiliary systems, the boiler primarily serves to generate steam to support ship functions in vessels running on marine diesel engines or diesel electric propulsion. PX90030 at 001. Examples include preventing Heavy Fuel Oil ("HFO")—a highly viscous substance—from falling below the temperature at which it is useable, heating HFO to ensure fluidity immediately before use in the engine, and for use in purifiers, ***41** booster modules, and other applications. PX90030 at 002–005. Cooling water systems reduce excess heat produced by the working machinery of a vessel's engine. PX90032 at 001. Essentially, cooling water systems circulate water through the engine to remove heat and reduce the likelihood of engine failure. Fry Hrg. Tr. at 943: 17–24 ("If you don't maintain the cooling water side, then you're relying on the oil side of the house to take up and remove that heat from the engine. And what happens is, if you don't cool the cylinders down, the oil starts breaking down. When the oil starts breaking down, then you get metal-to-metal contact inside the piston and the rings, and then you have an engine failure, and usually ... under those circumstances you have a crank case explosion as well.").

Marine water treatment chemicals "are all the chemicals associated with the maritime operation of ships"—including boiler chemistry, diesel chemistry, central cooling water, and evaporators. Fry Hrg. Tr. at 936: 11–12. After measuring the pH, conductivity, temperature, and oxidation-reduction potential of the water with specialized testing equipment, ship engineers inject these chemicals into the boiler and engine cooling systems through specialized dosing equipment optimized for high-pressure/low-volume or low-pressure/high-volume applications. Fry Hrg. Tr. at 945: 10–12; JX-0135 at 005; PX90014 at 003–004. Once injected, water treatment chemicals ensure the performance and reliability of marine boiler and engine cooling systems by: (1) removing excess oxygen from the systems, (2) allowing fine-tuned control of boiler water, cooling water, and feedwater pH; and (3) preventing the leaching and circulation of harmful metals. *See* Fry Hrg. Tr. at 937: 1–21; *see also* JX-0135 at 002. In each of these applications, the chemicals operate to reduce or eliminate the incidence of scale, corrosion, and oxygen formation within boiler, feedwater, and engine cooling systems, as well as the risk of engine overheating with respect to cooling systems specifically. Fry Hrg. Tr. at

937: 1–6; JX-0135 at 003; Fry Hrg. Tr. at 943: 12–14 ("Q. And why do vessels use engine cooling water chemicals? A. To control the amount of corrosion and erosion within the cooling channels of the engine itself.").

Although marine water treatment chemicals "only account for a small fraction of the cost of managing a ship," PX80014 ¶ 3, failure to treat the water resources in boiler and engine cooling systems comes with significant consequences, including breakdown or catastrophic failure. *See, e.g.*, Thompson Hrg. Tr. at 259: 18–24 ("Q. What happens if a boiler develops corrosion? A. [I]t could potentially damage the boiler. It may require significant servicing or even replacement"); JX-0135 at 002 ("Deviating from recommended pH and phosphate control limits can lead to caustic corrosion and result in catastrophic failure of the boiler system."); Fry Hrg. Tr. at 942: 24–25–943:4, 17–24 (describing how failure to treat high pressure boiler water could cause a ruptured pipe and boiler explosion, and how failure to treat cooling water could cause engine failure or explosion). System failure requires costly repairs and unscheduled downtime that translates to lost business and profits for shipping companies. JX-0149 at 003 ("Water treatment is as much about asset protection as it is about maintaining efficiency. The consequences of not using the right treatments can be costly, resulting in unscheduled downtime, or in the worst cases catastrophic, leading to total breakdown of equipment"); PX90014 at 003; Thompson Hrg. Tr. at 259:21–24 (noting that due to the size of the boilers involved, replacement would likely require cutting a hole in the hull and removing the boiler in ***42** pieces). Maritime companies therefore regard a consistent and effective marine water treatment program as critical to maintaining an operational fleet of ships. *See, e.g.*, PX80014 ¶¶ 3, 5, 7 (describing the importance of water treatment chemicals to ship operations, the need for consistency and dependability in chemical products, and the preference for companies offering total packages of chemical products and related services); Medina Hrg. Tr. at 167: 8–10 ("[C]onstancy in the chemical makeup of [marine water treatment chemical] products is crucial to the maintenance of our equipment.").

Consistent with customer demand for reliable water treatment chemical programs, suppliers of water treatment chemicals focus their business strategy on providing more than the chemicals themselves. They supply a "total solution"—a program that includes chemical products, test kits, technical expertise and support, and access to a global network with the ability to quickly and reliably provide product on demand, wherever a vessel is located, and whatever its specific needs may be. JX-0231 at 154 ("Manufacturer/supplier should be able to ... [s]upply a total solution rather than just the product"); [redacted] uses the phrase 'total solution' here, can you explain what that phrase means. A. It typically means the service that would come with the product, or even identifying what would be the best product for that application. So the total package would be not just a product but the service associated with the use, or identifying the right use of the right product for that application."); [redacted] (noting that when Drew enrolls a new customer in its water treatment program it offers recommendations on how to use specific water treatment chemicals, how to test water in boiler and cooling systems, and how to properly dose the chemicals); Medina Hrg. Tr. at 170:7–171:25 (discussing various services provided by marine chemical suppliers); *see also, e.g.*, Thompson Hrg. Tr. at 279:9–281:22 (describing the specific products and services covered under contract with marine chemical supplier). Defendants—whose business is described in more detail below—provide such programs.

Defendant Drew Marine Group, Inc. is a subsidiary of defendant Drew Marine Intermediate II B.V., which is owned by defendant The Resolute Fund II, L.P., a private equity fund managed by The Jordan Company. Am. Compl. ¶ 24. Drew was originally established in 1928, and has grown over the ensuing years into a company with a global infrastructure. Am. Compl. ¶ 24; DX-1161 at 0006, 0010. As Drew Marine representatives put it at a management presentation on February 15, 2017, "Drew Marine's strength is in delivering technical support in specialty chemicals." DX-1161 at 0019. Accordingly, roughly [redacted]% of Drew's revenue is traceable to "Water Treatment Solutions," a category that includes an array of products and services related to the chemical treatment of boiler water, cooling water, water production, waste water, ballast water, and potable water. DX-1161 at 0019. Drew maintains a "sales, service and logistics network that spans 47 countries, with stocking locations in nearly 100 distribution facilities that in turn supply [an estimated] 1000 ports and customers worldwide." PX10126 at 017.

Defendant Wilhelmsen Maritime Services AS is a wholly owned subsidiary of defendant Wilh. Wilhelmsen Holding ASA, a publicly traded corporation headquartered in Norway. Am. Compl. ¶ 23. Wilhelmsen Ship Services (WSS) is a division of WMS that focuses on supplying marine customers with a number of products and services, including water treatment chemicals and associated equipment for boiler water, cooling water, water production, ***43** and pool water. PX61000 ¶¶ 51, 53; PX90046; PX90047; PX90050; PX90063. Wilhelmsen—the parent company—was founded as a shipping business in 1861. PX61000 ¶ 51. WSS was founded in 1968. Since then, WSS has developed into "the largest maritime services network in the world," capable of delivering "in 125 countries ... [and] supporting [its] non-stop operations in 2,200 port locations across the globe." PX20172 at 006. Marine chemicals account for [redacted]% of WSS's total revenues. PX20137 at 0010.

Pursuant to a Share Purchase Agreement dated April 27, 2017, WMS proposed to acquire 100% of Drew's voting securities for approximately $400 million. Am. Compl. ¶ 25. The FTC then conducted a ten-month investigation, after which it "found reason to believe that the proposed Acquisition violates Section 7 of the Clayton Act and Section 5 of the FTC Act." Mem. Supp. Prelim. Inj. 12 ("Mot."). The FTC initiated an administrative action alleging a violation of the above statutes, and the merits trial in that action is scheduled to begin on July 24, 2018. Mot. at 2. The FTC also filed the instant motion for a preliminary injunction under Section 13(b) of the FTC Act, to preserve the status quo pre-merger during the pendency of the administrative proceeding. Mot. at 12–13.

An evidentiary hearing on the motion for preliminary injunction began on May 29, 2018 and concluded on June 19, 2018. The court heard testimony from fifteen fact witnesses—either live or via video deposition—and three expert witnesses. Plaintiff and Defendants each submitted proposed findings of fact and conclusions of law on June 25, 2018, along with a combined 4,186 exhibits.

II. LEGAL STANDARDS

A. Section 7 of the Clayton Act

Section 7 of the Clayton Act prevents mergers or acquisitions where "the effect ... may be substantially to lessen competition, or to tend to create a monopoly" in "any line of commerce or in any activity affecting commerce in any section of the country." 15 U.S.C. § 18. As the Supreme Court has noted, Section 7 concerns "probabilities, not certainties," *Brown Shoe Co. v. United States*, 370 U.S. 294, 323, 82 S.Ct. 1502, 8 L.Ed.2d 510 (1962), and thus the FTC need not demonstrate certainty that a proposed merger will produce anticompetitive effects—only that a "substantial lessening of competition will be 'sufficiently probable and imminent' to warrant relief." *FTC v. Arch Coal, Inc.*, 329 F.Supp.2d 109, 115 (D.D.C. 2004) (citing *United States v. Marine Bancorporation*, 418 U.S. 602, 618, 94 S.Ct. 2856, 41 L.Ed.2d 978 (1974)).

B. Section 13(b) Standard for Preliminary Injunction

Section 13(b) of the Federal Trade Commission Act empowers the Federal Trade Commission to seek preliminary injunctive relief in order to prevent a merger until it can adjudicate the merger's legality in an administrative proceeding, provided the agency has "reason to believe" that the merger will violate the antitrust laws. 15 U.S.C. § 53(b); *see also FTC v. CCC Holdings Inc.*, 605 F.Supp.2d 26, 35 (D.D.C. 2009); *FTC v. H.J. Heinz Co.*, 246 F.3d 708, 714 (D.C. Cir. 2001). Section 13(b) provides that an injunction may issue "[u]pon a proper showing that, weighing the equities and considering the Commission's likelihood of ultimate success, such action would be in the public interest." 15 U.S.C. § 53(b). As the D.C. Circuit noted in *Heinz*, the omission of any irreparable harm element evinces Congress's intention "to depart from what it regarded as the ... traditional equity standard" that applies to traditional requests for preliminary ***44** relief. *Heinz*, 246 F.3d at 714; *see also FTC v. Exxon Corp.*, 636 F.2d 1336, 1343 (1980) ("In enacting [15 U.S.C. § 53(b)], Congress ... demonstrated its concern that injunctive relief be broadly available to the FTC by incorporating a unique 'public interest' standard ... rather than the more stringent, traditional 'equity' standard for injunctive relief.").

Under Section 13(b), the district court balances the FTC's likelihood of success against the equities on a sliding scale. *FTC v. Whole Foods Mkt., Inc.*, 548 F.3d 1028, 1035 (D.C. Cir. 2008) (Brown, J.) (citing *H.J. Heinz Co.*, 246 F.3d at 727). Since Congress's particular "public equity consideration in enacting Section 13(b) was 'the public interest in effective enforcement of the antitrust laws,' " a showing of "private equities" alone will not suffice to overcome a showing of likelihood of success, and the equities often favor the FTC. *Id.* Moreover, "[t]he FTC is not required to *establish* that the proposed merger would in fact violate section 7 of the Clayton Act" in a Section 13(b) proceeding. *FTC v. Sysco Corp.*, 113 F.Supp.3d 1, 22 (D.D.C. 2015) (quoting *Heinz*, 246 F.3d at 714). Instead, "to demonstrate the likelihood of success on the merits, 'the government need only show that there is a reasonable probability that the challenged transaction will substantially impair competition." *Id.* (quoting *FTC v. Staples*, 970 F.Supp. 1066, 1072 (D.D.C. 1997)). Thus, the trial court's role in a Section 13(b) proceeding is to "measure the probability that, after an administrative hearing on the merits, the Commission will succeed in proving that the effect of the [proposed] merger 'may be substantially to lessen competition, or to tend to create a monopoly in violation of section 7 of the Clayton Act.' " *Id.* (quoting *Heinz*, 246 F.3d at 714). The FTC satisfies this standard where it "rais[es] questions going to the merits so serious, substantial, difficult[,] and doubtful as to make them fair ground for thorough investigation." *Whole Foods*, 548 F.3d at 1035 (Brown, J.) (quoting *Heinz*, 246 F.3d at 714–15); *see also Sysco*, 113 F.Supp.3d at 22. Nevertheless, a preliminary injunction in this context remains "an extraordinarily drastic remedy," *Exxon*, 636 F.2d at 1343 (quoting *Medical Society v. Toia*, 560 F.2d 535, 538 (2d Cir. 1977)), especially since "as a result of the short life-span of most tender offers, the issuance of a preliminary injunction blocking an acquisition or merger may prevent the transaction from ever being consummated." *Id.*

C. *Baker Hughes* Burden-Shifting Framework

Courts in this Circuit apply the burden-shifting framework set out in *United States v. Baker Hughes Inc.*, 908 F.2d 981, 991 (D.C. Cir. 1990), to assess whether a proposed merger violates Section 7 of the Clayton Act. Under that framework, the FTC bears the initial burden to prove that a proposed merger would result in "undue concentration in the market for a particular product in a particular geographic area." *Id.* at 982; *see also Heinz*, 246 F.3d at 715 (quoting *United States v. Phila. Nat'l Bank*, 374 U.S. 321, 363, 83 S.Ct. 1715, 10 L.Ed.2d 915 (1963)); *United States v. Anthem, Inc.*, 236 F.Supp.3d 171, 192 (D.D.C. 2017). Such a showing entitles the FTC to a presumption that the merger will substantially lessen competition. *Baker Hughes*, 908 F.2d at 982 (citing *United States v. Citizens & Southern Nat'l Bank*, 422 U.S. 86, 120–22, 95 S.Ct. 2099, 45 L.Ed.2d 41 (1975)); *Arch Coal*, 329 F.Supp.2d at 115–17, *appeal dismissed*, No. 04-5291, 2004 WL 2066879 (D.C. Cir. Sept. 15, 2004). Defendants are then entitled to rebut the presumption by presenting evidence that " 'show[s] that the market-share statistics ***45** [give] an inaccurate account of the [merger's] probable effects' on competition in the relevant market." *Heinz*, 246 F.3d at 715 (quoting *Citizens & Southern Nat'l Bank*, 422 U.S. at 120, 95 S.Ct. 2099). Where defendants successfully rebut the presumption of illegality, "the burden of producing additional evidence of anticompetitive effect shifts to the government, and merges with the ultimate burden of persuasion, which remains with the government at all times." *Baker Hughes*, 908 F.2d at 983; *see also Heinz,* 246 F.3d at 715.

III. DISCUSSION

A. Likelihood of Success on the Merits

1. Prima Facie Case

Given that "the ultimate determination of the legality of a merger involves an assessment of the new firm's market power ... and the prima facie case concerns market concentration," *Anthem*, 236 F.Supp.3d at 193 (D.D.C. 2017), it is appropriate to begin a merger analysis by defining the "relevant product and geographic boundaries of the market[ ] in question." *FTC v. Cardinal Health, Inc.*, 12 F.Supp.2d 34, 45 (D.D.C. 1998); *see also id.* ("[d]efining the relevant market is critical in an antitrust case because the legality of the proposed mergers in question almost always depends upon the market power of the parties involved."); *Marine Bancorporation*, 418 U.S. at 618, 94 S.Ct. 2856 (describing market definition as a "necessary predicate" to evaluating the legality of a merger under Section 7). The "relevant market has two components: (1) the relevant product market and (2) the relevant geographic market." *CCC Holdings Inc.*, 605 F.Supp.2d at 37; *see also Arch Coal*, 329 F.Supp.2d at 117. In this case, there is no dispute regarding the relevant geographic market—the parties agree it is global. Nevo Hrg. Tr. at 564:18–565:8; Israel Hrg. Tr. at 1456:21–23. Thus, the court now turns to determining the bounds of the relevant product market.

a. Relevant Product Market

1. LEGAL STANDARD

The Supreme Court has long maintained that "[t]he outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and the substitutes for it." *Brown Shoe Co.*, 370 U.S. at 325, 82 S.Ct. 1502. Accordingly, the touchstone is demand substitution —"[m]arket definition focuses ... on customers' ability and willingness to substitute away from one product to another in response to a price increase or a corresponding non-price change such as reduction in product quality or service." 2010 Merger Guidelines § 4. The key question is "whether there are other products offered to consumers which are similar in character or use to the product or products in question, as well as how far buyers will go to substitute one commodity for another." *Staples*, 970 F.Supp. at 1074 (citing *United States* *v. E.I. du Pont de Nemours and Co.*, 351 U.S. 377, 393, 76 S.Ct. 994, 100 L.Ed. 1264 (1956)); *see also* *United States v. H & R Block*, 833 F.Supp.2d 36, 51 (D.D.C. 2011). Where "one product is a reasonable substitute for the other, it is to be included in the same relevant product market even though the products themselves are not the same." *Cardinal Health*, 12 F.Supp.2d at 46.

Whether a product is a reasonable substitute for another depends on two factors: (a) the extent to which "buyers view similar products as substitutes" and thus "can substitute the use of one for the other" (i.e., functional interchangeability), *Sysco*, 113 F.Supp.3d at 25; *Arch Coal*, 329 F.Supp.2d at 119; and (b) the extent to ***46** which variations in the price of one product—an increase, for example—affects demand for another (i.e., cross-elasticity of demand). *See, e.g.,* *Cardinal Health*, 12 F.Supp.2d at 46 ("a product is construed to be a 'reasonable substitute' for another when the demand for it increases in response to an increase in the price for the other."). Thus, the boundaries of the relevant market lie where the reasonable alternatives for substitution—based on use or price—end. "The relevant market consists of all the products that the Defendants' customers view as substitutes to those supplied by the Defendants" *id.*, "even though the products themselves are not entirely the same." *Sysco*, 113 F.Supp.3d at 25.

Broad markets sometimes include relevant submarkets that themselves may "constitute product markets for antitrust purposes." *Whole Foods*, 548 F.3d at 1037–38 (Brown, J.) (quoting *Brown Shoe*, 370 U.S. at 325, 82 S.Ct. 1502). A firm need not "be included in the relevant product market for antitrust purposes" just because "it may be termed a competitor in the overall marketplace." *H & R Block*, 833 F.Supp.2d at 51 (quoting *Staples*, 970 F.Supp. at 1075); *see also* *Sysco*, 113 F.Supp.3d at 26 ("[F]or example, fruit can be bought from both a grocery store and a fruit stand, but no one would reasonably assert that buying all of one's groceries from a fruit stand is a reasonable substitute for buying from a grocery store"). Moreover, "the 'product' that comprises the market need not be a discrete good for sale," *Sysco*, 113 F.Supp.3d at 26, but can be a "cluster of products ... and services," *Phila. Nat'l Bank*, 374 U.S. at 356, 83 S.Ct. 1715, as long as the combination of "a number of different products or services" into "a single market ... reflects commercial realities." *United States v. Grinnell Corp.*, 384 U.S. 563, 572, 86 S.Ct. 1698, 16 L.Ed.2d 778 (1966); *Sysco*, 113 F.Supp.3d at 26 ("[W]hat is relevant for consideration here is not any particular food item sold or delivered by Defendants, but the full panoply of products and services offered by them that customers recognize as 'broadline distribution.' "). Such a "cluster market" can even "allow items that are not substitutes for each other to be clustered together in one antitrust market for analytical convenience." *FTC v. Staples, Inc. (Staples II)*, 190 F.Supp.3d 100, 117 (D.D.C. 2016) (finding a cluster market of consumable office supplies justified because "market shares and competitive conditions are likely to be similar for the distribution of pens to large customers and the distribution of binder clips to large customers."); *see also* *ProMedica Health Sys., Inc. v. FTC*, 749 F.3d 559, 565–68 (6th Cir. 2014) (describing the appropriateness of clustering multiple types of hospital services for the purposes of analytical convenience where competitive conditions were similar).

Lastly, antitrust markets can be based on targeted customers. Section 4.1.4 of the Merger Guidelines—described by the court in *Sysco* as providing "[t]he clearest articulation of [a targeted customer] approach to product market definition"—states that "[i]f a hypothetical monopolist could profitably target a subset of customers for price increases, the Agencies may identify relevant markets defined around those targeted customers, to whom a hypothetical monopolist would profitably and separately impose at least a [small but significant and non-transitory increase in price]." Merger Guidelines § 4.1.4; *Sysco*, 113 F.Supp.3d at 27. In other words, a targeted customer market may exist when "[a] price increase for targeted customers may be profitable even if a price increase for all customers would not be profitable because too many other customers would ***47** substitute away." Merger Guidelines § 3. Thus, "[d]efining a market around a targeted consumer ... requires finding that sellers could 'profitably target a subset of customers for price increases,' " which in turn demands that there be "differentiated pricing and limited arbitrage." *Staples II*, 190 F.Supp.3d at 117–18.

Courts employ two main analytical approaches in order to determine whether the boundaries of a relevant product market are "drawn narrowly to exclude any other product to which, within reasonable variations in price, only a limited number of buyers will turn." *United States v. Aetna, Inc.*, 240 F.Supp.3d 1, 20 (D.D.C. 2017) (quoting *Times-Picayune Publ'g Co. v. United States*, 345 U.S. 594, 612 n.31, 73 S.Ct. 872, 97 L.Ed. 1277 (1953)). These include the hypothetical monopolist test, the application of which is frequently the subject of "testimony from experts in the field of economics," and the "practical indicia" described by the Supreme Court in *Brown Shoe*. *Sysco*, 113 F.Supp.3d at 27.

Hypothetical Monopolist Test

In determining the bounds of a relevant market, courts often opt "to ask hypothetically whether it would be profitable to have a monopoly over a given set of substitutable products .... If so, those products may constitute a relevant market." *H & R Block*, 833 F.Supp.2d at 51–52; *see also* 5C Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law (hereinafter, "Areeda & Hovenkamp"), ¶ 530a, at 237 (4th ed. 2014) ("[A] market can be seen as the array of producers of substitute products that could control price if united in a hypothetical cartel or as a hypothetical monopoly."). This hypothetical inquiry is referred to by courts and in the merger guidelines as the hypothetical monopolist test. *See Sysco*, 113 F.Supp.3d at 27; Merger Guidelines § 4.1.1. The test essentially asks whether a "hypothetical profit-maximizing firm, not subject to price regulation, that was the only present and future seller of those products ... likely would impose at least a small but significant and non-transitory increase in price ("SSNIP") on at least one product in the market, including at least one product sold by one of the merging firms." Merger Guidelines § 4.1.1. A SSNIP is usually defined as five percent or more. *Id.*

The Brown Shoe Practical Indicia

Courts also determine the boundaries of a relevant product market by examining "such practical indicia as industry or public recognition of the [relevant market] as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors." *Whole Foods*, 548 F.3d at 1037–38 (Brown, J.) (quoting *Brown Shoe*, 370 U.S. at 325, 82 S.Ct. 1502). The *Brown Shoe* " 'practical indicia' of market boundaries may be viewed as evidentiary proxies for proof of substitutability and cross-elasticities of supply and demand." *H & R Block*, 833 F.Supp.2d at 51 (quoting *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 218 (D.C. Cir. 1986)).

2. ANALYSIS

The FTC defines the relevant product market here as "the supply of marine water treatment ("MWT") products and services to Global Fleet customers," where MWT products and services include "[t]he supply of BWT chemicals, CWT chemicals, and associated products and services." Plaintiff's Proposed Findings of Fact and Conclusions of Law ("PFF") ¶¶ 7, 17, ECF No. 81-2. This definition depends on at least three premises: (1) that there are no functional substitutes for the supply of ***48** boiler water treatment ("BWT") products and services or cooling water treatment ("CWT") products and services, (2) that it is appropriate to cluster BWT products and services and CWT products and services into one antitrust market for analytical convenience (while excluding other water treatment products), and (3) that it is appropriate to define the relevant market around "Global Fleets" as a distinct set of targeted customers. *See* PFF ¶¶ 17–44.

As an initial matter, the court finds that there are no reasonable substitutes for BWT or CWT products and services. These products and services have unique purposes—preserving the functionality of boilers and engines—and no party has pointed to any chemical or group of chemicals, or associated services, that could replace the critical functions that such products perform. In other words, it is possible to regard BWT products and services and CWT products and services as two *separate* product markets (e.g., the market for BWT and the market for CWT), insofar as none of the products grouped in either category have any reasonable substitutes that can perform the same functions.[1] Thus, the disputed threshold issues are (1) whether the markets for BWT and CWT can be clustered together in the manner proposed by the FTC, and (2) whether that cluster market can be further defined around the FTC's preferred set of targeted customers.

i. BWT and CWT as a Cluster Market

Defendants, supported by their expert, Dr. Mark A. Israel, advance two primary arguments against the FTC's proposed cluster market: that the market is overinclusive and underinclusive. Mem. Supp. Opp'n to Mot. at 23, ECF No. 50-2. They argue that the market is overinclusive insofar as it combines two categories of product—BWT and CWT—that are not reasonably interchangeable, meaning that combining them does not accurately reflect commercial realities and conflicts with the notion that product market definition depends on substitutability. ECF No. 50-2 at 24; DX-0060 ¶¶ 66–67. Defendants also argue that the proposed market is underinclusive because it is inappropriate for the FTC to consider BWT and CWT in the same market without also including the other water treatment and marine products typically sold alongside BWT and CWT, frequently in the same contract. ECF No. 50-2 at 25; DX-0060 ¶¶ 68–70. While Defendants acknowledge that these other products are not reasonable substitutes for BWT or CWT, they assert that neither are BWT and CWT reasonable substitutes for one another, such that with respect to products typically sold together, the FTC cannot include one product category that is not a reasonable substitute and then exclude others on that same ground. In other words, "the FTC cannot both lump BWTC and CWTC because they are part of the same sales and purchase process, but then also exclude all other products that are also part of that process." ECF No. 50-2 at 25–26.

The FTC responds first that Defendants' argument regarding overinclusiveness—based on the absence of interchangeability between BWT and CWT—fundamentally misapprehends the nature of a cluster market. According to the FTC, a cluster market does not aim to group ***49** together substitutable products, but rather groups non-substitutable products that face similar competitive conditions. Reply to Opp'n. to Mot. 5, ECF No. 56-2. The FTC argues that since both BWT and CWT products function to maintain operational equipment on marine vessels, both involve the same customers with the same need for global consistency, and both are distinguishable from products like cleaning chemicals, which do not require the same level of consistency. ECF No. 56-2 at 5–6. Moreover, the FTC argues that Defendants face the same set of competitors for both products, and therefore BWT and CWT face similar competitive conditions and can be appropriately clustered. ECF No. 56-2 at 5–6. As for Defendants' underinclusiveness argument, the FTC notes that clustering BWT and CWT with other marine products is inappropriate because those products do not share similar competitive conditions, despite the fact that customers negotiate for them at the same time as they negotiate for BWT and CWT. ECF No. 56-2 at 9–10.

The court concludes that the FTC's use of the cluster market approach is appropriate in this case.[2] Although BWT and CWT products are distinct products intended for distinct uses, they are also indisputably similar. Both are specially blended chemicals that are injected into water systems using special equipment, in order to prevent corrosion and erosion in critical systems. Thompson Hrg. Tr. at 259:18–24; Fry Hrg. Tr. at 943:13–14. While both products make up a "small fraction of the cost of managing a ship," PX80014 ¶ 3, the cost of system failure in the absence of these products is high. JX-0135 at 002. The fact that these products are low cost, highly critical, and heavily dependent on precise chemistry means that maritime companies strongly prefer consistency in their use, so as to avoid the risk of adverse chemical reaction and the resulting temporary or catastrophic system failure. Moreover, BWT and CWT products are frequently sold together as part of an overall management program that includes a number of additional product-related services. Deckman Hrg. Tr. at 475: 4–14. These similar characteristics matter because they factor into customers' decisions regarding the quantity of products they purchase, the timing of those purchases, as well as where they make their purchases. In other words, similar product characteristics—including function and risk—produce similar needs and constraints for shipping companies, which in turn affects supplier strategies and, accordingly, promotes similar competitive conditions across these product categories.[3]

***50** It follows from this point that products that do not share key characteristics do not produce similar needs or constraints for shipping companies, meaning that they give rise to different competitive conditions. The court finds that the FTC has carried its burden to demonstrate those differences. While BWT and CWT chemicals are both "water treatment chemicals"—a category that includes "chemicals for the treatment of evaporator water, ballast water, potable water, and pool/spa water or their related equipment," DFF ¶ 85—the evidence is clear that (1) sales of BWT and CWT are the driving force behind sales in the "water treatment chemicals" category,[4] and (2) other chemicals in that category, such as pool and spa chemicals, are easier to obtain from multiple suppliers. PX80006 ¶¶ 10, 27; Thompson Hrg. Tr. at 326:24-327:10. They also do not pose the same risks to a ship's critical systems, because they have no function related to those systems.

The same is true for the larger grouping of marine products. While Defendants correctly note that agreements for the sale of marine products to global fleets often include products in addition to BWT and CWT—such as tank cleaning chemicals, gases, or refrigerants, *see* Sarro Hrg. Tr. at 113 (noting that Teekay purchase agreements often include many different marine products, and that Teekay also purchases many products from WSS in addition to BWT and CWT); DX-1297 at 0013-0015 (listing products covered by purchase agreement)—the differences between these products and BWT/CWT are material. For example, tank cleaning products are less technically complex, do not pose the same operational risks, and are ordered on a short term, cleaning-by-cleaning basis, which makes it easier for shippers to switch suppliers. *See* Franzo Hrg. Tr. at 348:22–350:1–22 (describing the differences between tank cleaning and water treatment business and the difference in competitive conditions based on the characteristics of each product); JX-0254 ¶ 7 ("Different categories of chemicals require different levels of sophistication in chemistry. Water treatment chemicals are generally more sophisticated and harder to develop than other categories of marine chemicals."). Accordingly, tank cleaning presents a more lucrative business opportunity for smaller suppliers than does water ***51** treatment, where ships "really [do not] want to upset the apple cart by changing their products." Franzo Hrg. Tr. at 349:7–11; JX-0254 ¶ 3 (noting that tank cleaning is roughly 60% of [redacted] business, and that water treatment business is small in comparison); PX-80028 at ¶ 3 (describing water treatment chemicals as [redacted] "smallest product category" and tank cleaning chemicals as the largest). In other words, differences in product characteristics between BWT/CWT and other water treatment products lead to differences in maritime companies' sourcing decisions and are therefore connected to differences in competitive conditions.

Moreover, while the evidence suggests that companies tend to negotiate prices for multiple products at the same time, it also cuts against the notion that customers engage in one-stop shopping for all their marine products. *See* PX00004 at 010, 015 (noting that WSS and Drew customers do not typically "one-stop shop" and often "mix and match across suppliers"). In other words, framework agreements may set the price for several products from a particular supplier, but such agreements tend to be non-exclusive, leaving the door open to other, specific product purchases at individual ports. *See* PX-61002 at 041–042. Thus, an analytical approach that focuses on BWT and CWT to the exclusion of other marine products does not appear to fundamentally conflict with commercial reality, given that customers are empowered to make individualized product choices in different places and at different times.

For these reasons, the court concludes that FTC has appropriately clustered BWT and CWT products and services into one antitrust market for analytical convenience.

ii. "Global Fleets" as Targeted Customers

As defined by the FTC, "Global Fleets are fleets of 10 or more globally trading vessels—vessels above 1,000 gross tons in size that have traded at two ports that are at least 2,000 nautical miles apart in the preceding 12 months." Mot. Prelim. Inj. at 18, ECF No. 45-3. The FTC argues that it is appropriate to define the relevant product market around this group because "Global Fleets have distinct characteristics and requirements that limit customer choice, as compared to local or regional fleets," thus making them susceptible to price discrimination as a distinct customer group. ECF No. 45-3 at 19. In particular, the FTC points out that Global Fleet customers have "particular needs as it relates to centralized negotiation of contracts for delivery to geographically dispersed locations, product consistency, and product availability." ECF No. 45-3 at 19. The FTC also argues that Defendants have the ability to price discriminate because they "individually negotiate prices with each customer[,] and customers have a limited ability to arbitrage." ECF No. 45-3 at 19.

Defendants proffer several reasons why the "Global Fleets" distinction is not a meaningful way of segmenting customer groups. First, they contend that the definition of Global Fleets does not accord with commercial reality, given that neither WSS nor Drew use the FTC's definition of that term and less than half of WSS customers meet the Global Fleet criteria. ECF No. 50-2 at 26; DX-0060 ¶¶ 82, 85, 86. Defendants further argue that the Global Fleets construct is premised on arbitrary thresholds and accordingly produces variable and underinclusive results. Specifically, they allege that: (1) 43% of the vessels that WSS and Drew supply had trading patterns fitting the FTC's criteria in some fiscal quarters, but not in others, indicating ***52** that the boundaries of the Global Fleets construct are too permeable to be analytically helpful; and (2) the FTC's numerical cutoff—10 or more globally trading vessels—is arbitrary, and produces the following anomalous mismatches: (a) a quarter of the vessels in 23% of Global Fleets were not globally trading vessels, (b) 31% of the vessels in non-Global Fleets count as globally trading vessels, and (c) 20% of non-Global Fleets are comprised completely of globally trading vessels. ECF No. 50-2 at 27; *see also* DX-0060 ¶¶ 83–84 & Table 4. Defendants contend that including all vessels weighing 1,000 gross tons or more in the antitrust market would better accord with commercial realities.

The "Global Fleets" construct is meant to capture key aspects of the economic reality facing fleets with a significant number of globally trading vessels and which need access to the products and services that defendants provide. The construct purports to isolate a relevant subset of the market and measure how the result of a merger would affect customers within that subset. It follows that the construct is a useful way to discuss and predict economic conditions only if its key aspects correspond to elements of the existing marketplace that would make it possible to "profitably target a subset of customers for price increases" post-merger. *Sysco*, 113 F.Supp.3d at 38. The FTC, relying on the analysis of its economic expert, Dr. Aviv Nevo, has carried its burden to show that the construct is useful here.

a. Global Fleets Constitute a Distinct Customer Group with Distinct Needs

The FTC has adequately demonstrated that Global Fleets are a distinct group with distinct needs, as compared to the entire group of MWT customers. The distinction matters primarily because vessel trading patterns differ. Some vessels trade more globally than regionally or locally, meaning they travel further, visit more countries and ports in more varied locations, and spend less time in port. PX-61000 ¶ 103. Within the FTC's definition of Global Fleets as fleets including ten or more globally trading vessels, a vessel trading pattern that includes distances of more than 2,000 nautical miles is global, while regional patterns include distances of 500 and 2,000 nautical miles and local patterns include distances of less than 500 nautical miles. PX-61000 ¶ 105. The following data, reproduced from PX-61000 ¶ 110, illustrates the distinct travel patterns of local, regional, and globally trading vessels.

***53**

EXHIBIT 8

Number of unique ports, countries, and continents visited, by trading pattern, 2017

	Trading Pattern	5th Percentile	25th Percentile	Median	75th Percentile	95th Percentile
	Number of unique ports visited					
1.	Global	5	12	18	25	38
2.	Regional	2	5	10	19	41
3.	Local	1	2	3	4	9
	Number of unique countries visited					
4.	Global	3	6	10	13	19
5.	Regional	1	1	3	5	12
6.	Local	1	1	1	2	3
	Number of unique continents visited					
7.	Global	1	2	3	4	5
8.	Regional	1	1	1	2	3
9.	Local	1	1	1	1	1

Source: Vessel Characteristic Data; Vessel Movement Data

Notes: Globally, regionally, and locally trading vessels are vessels that traveled more than 0 nm within the calendar year to two locations that were more than 2,000 nm, between 500 nm and 2,000 nm, and less than 500 nm apart from each other, as the crow flies. I include only the 42,986 live and active vessels of 1,000 gt or higher in 2017 that are classified as either globally trading, regionally trading, or locally trading in 2017.

Importantly, neither the emphasis on vessels with global trading patterns nor the 2,000 nautical mile cutoff for defining a globally trading vessel are arbitrary parameters. Different trading patterns create different product needs that affect how customers weigh the value of consistent worldwide service potential at high levels of product quality. PX-61000 ¶ 111 ("Globally trading vessels tend to be larger, travel much greater distances, and visit more countries and multiple continents during the course of a year. Therefore, it should be expected that their preferences over the importance of high quality water treatment products and services that are consistently available differs from vessels with regional and local trading patterns); *see* Sarro Hrg. Tr. at 77:15–25 ("Q. When Teekay's vessels are operating on a spot charter, how predictable is where they're traveling to? A. Well, it's quite unpredictable, actually, because it's subject to market conditions. So whatever charter we pick up at the time—you know, that's what ends up happening. And it's on a per-voyage basis, is whatever it is ... would be where we're loading, and then we have to discharge.... Q. Do you know necessarily which port a spot charter will call in from month to month? A. No."); PX80002 at 003 ("Because we conduct much of our business as spot charters, we have limited ability to predict our vessels' trade routes, including what ports they will visit or when."). The industry itself recognizes that vessel trading patterns have commercial significance, as shown by the parties' own statements and internal documents. *See e.g.*, PX70006 (Grimholt IH Vol. 1 Tr.) at 164:23–167:15 (describing how WSS categorizes vessels as global when they "have traveled in excess of 2,000 nautical miles between the furthest points in a given twelve months," noting that such categorization "makes a difference [in] how [WSS] sell[s] and deliver[s]," and explaining how globally trading vessels "have different needs because they have vessels trading globally or further from their home ports, which means that our capability to serve them will be of more interest in a sales meeting than their local needs would be"); ***54** PX20388 at 005 (explaining that a potential sales model distinguishes between local, regional, and global trading patterns, and noting that the former two "don't necessarily correspond as well with our main competitive advantage which is our ability to provide standard products and services in virtually every port worldwide").[5] Notably, WSS collects data on which vessels traveled 2,000 nautical miles between furthest points in the last 12 months in order guide its sales strategy. *See* JX-0188 at 044–45.

The FTC's vessel size cutoff of 1,000 gross tons is also non-arbitrary and based on the parties' own conceptions of the market. The evidence shows that vessel size correlates with global trading pattern and, accordingly, with distinct product needs. *See* PX61000 ¶¶ 109, 111. In general, the larger the vessel, the more likely it is to trade globally. PX61000 ¶ 109. In keeping with this trend, internal documents show that Defendants focus their sales efforts on larger vessels and frame their business and competitive potential in terms of vessel size. *See* PX61000 ¶ 93; DX-1247_WSSFTC-0018878 at 11 (discussing categorization of vessels by weight for purposes of segmenting market and estimating market size); Grimholt Hrg. Tr. at 1236:10–16 (describing the total market in terms of sailing ships above 1,000 gross tons). Thus, combining the court's findings regarding trading pattern and vessel size, it follows that the FTC's definition of a globally trading vessel—vessels larger than 1,000 gross tons that have traveled 2,000 nautical miles between furthest points in the last 12 months—is both non-arbitrary and grounded in the ordinary course of business.

The evidence also shows that vessels are typically organized into fleets, containing varying numbers of globally trading vessels. *See* PX61000 ¶ 91. In order to measure the effect that a significant number of globally trading vessels would have on the water treatment needs of a fleet as a whole, Dr. Nevo organized the vessel-level raw data into fleets according to affiliation with unique owners or separate technical managers (“operators”). PX61000 ¶ 113. Dr. Nevo grouped vessels with the same operator into the same fleet, producing 9,407 unique “fleets” made up of varying numbers of vessels. PX61000 ¶¶ 113, 114; Nevo Hrg. Tr. at 586:6–20. He then defined “Global Fleets” as those having ten or more globally trading vessels, Nevo Hrg. Tr. at 586:21–587:6, and on the basis of that definition, identified 532 Global Fleets and calculated Defendants' market shares within the Global Fleets category. PX61000 ¶¶ 118, 123.

As noted above, Defendants objected to Dr. Nevo's definition of “ten or more globally trading vessels,” on the grounds that ten vessels is arbitrary and incongruent with commercial reality. While the court agrees that Dr. Nevo's choice of ten globally trading vessels was arbitrary in the sense that the number ten is not compelled by any specific market reality, the court disagrees that Dr. Nevo's construction is therefore meaningless. As the court understands it, Dr. Nevo's choice of ten globally trading vessels was not intended as an exact statement of the threshold number of globally trading vessels a fleet must have in order to manifest distinct product-related ***55** needs and preferences. Rather, Dr. Nevo chose ten as a starting point for developing a series of statistical estimates, the non-statistical implications of which support the appropriateness of regarding Global Fleets as a distinct customer group.

Dr. Nevo's fleet-level analysis took the following course: first, he inferred—after analyzing data and documentation used or created in the ordinary course of Defendants' business—that fleets with a significant number of globally trading vessels were likely to have distinct preferences that uniquely suit global suppliers. Nevo Hrg. Tr. at 587:7–19. Then, using the fleet data he compiled, Dr. Nevo sought to approximate what share of the fleet-level market would have those preferences. Because he did not know what threshold number of vessels would separate fleets with distinct preferences from those without, Dr. Nevo chose the number ten because of its roundness and simplicity. Nevo Hrg. Tr. at 587:20–22 (“So then, the question is, where's the cutoff. And I started with ten. Ten is a starting point.... [I]t's a round number. That's literally why we chose [it].”), 589:3–4 (“[I]'ll be the first to admit ... there's no hard rule as to why it was ten); *see also* *Staples II*, 190 F.Supp.3d at 118 n.10 (acknowledging and accepting expert's need to establish threshold cutoff for “practical analytical purposes”). After obtaining the results of that analysis, he ran trials to test the robustness of the results—that is, to measure how dependent his initial results were on his initial assumption of ten vessels. Nevo Hrg. Tr. at 589:1–590:11. Less dependency—i.e., more stability in the result—indicates the presence of a stable market reality that produces similar results despite variation in threshold numbers. *See* Nevo Hrg. Tr. at 596:20–597:19. Based on the initial trial, Dr. Nevo found that (1) Global Fleets accounted for most of all globally trading vessels—84% of vessels by tonnage and 71% by vessel count; (2) Global Fleets were mostly made up of globally trading vessels: 81.8% and 92.2% by count and tonnage; and (3) Global Fleets accounted for [redacted] and [redacted] of WSS's and Drew's respective MWT revenue. *See* Nevo Hrg. Tr. at 595:16–596:13; PX61000 ¶¶ 118, 161, 123. He also found that similar market share calculations held across four subsequent trials, two substituting five and then fifteen as the threshold numbers, one using ten but omitting any attempt to standardize the names of “operators” as they appeared in the raw data, and one only measuring sales to all globally trading vessels, without sorting those vessels into fleets (thus eliminating the need for any threshold number at all). PX61000 ¶ 123 n.234; Nevo Hrg. Tr. at 589:14–590:11. Notably, the specific percentages differ between each of these trials. PX61000 ¶ 123 n.234. That is because the point of the trials is not to establish that any particular set of percentages is the most accurate one, but rather to rely on the consistency across the range of percentages to illustrate that (1) there is a significant segment of the market—whatever the exact numbers—that focuses on global trading and therefore has needs and preferences that distinguish it from other customers; and (2) that segment accounts for a majority of Defendants' business. *See* PX61000 ¶¶ 119–21. In other words, the qualitative implications of the percentages do not change even if the percentages themselves shift somewhat across trials. *See* PX61000 ¶ 123 n.234 (noting that market share percentages “are not qualitatively sensitive to alternative definitions of ‘global fleets’ ”); Nevo Hrg. Tr. at 589:10–13 (“So ... I really tried to say, well, what happens if I define it as 5 and 15, or various other measures, to make sure that the end result, at least qualitatively, doesn't actually change."). The court ***56** considers these factual observations to be accurate and well supported, and therefore finds that the FTC has carried its burden to demonstrate that it is appropriate to consider Global Fleets a distinct customer group within the market for MWT products.

b. Price Discrimination Against Global Fleet Customers is Possible Post-Merger

The court finds that the FTC has carried its burden to demonstrate that price discrimination is possible post-merger because: (1) Global Fleets are a distinct group of customers with distinct needs; (2) negotiation with Global Fleets typically occurs on an individualized basis; and (3) documentation reveals that Defendants have contemplated pricing differentials based on size and trading pattern. As the court has already discussed the first factor, the discussion in this section focuses on the remaining two.

Defendants typically negotiate framework agreements with Global Fleets for the whole fleet or for a significant proportion of vessels. *See e.g.*, PX80006 ¶ 21 (describing fleet-level negotiations for the entire [redacted] fleet); JX-0277 ¶ 23 (describing same for Teekay). These negotiations are customer specific, and result in customer-specific pricing at ports relevant to the particular customer. *See* JX-0248 at 014 ("In negotiations, customers often focus on specific ports that they consider to be key in light of their trading patterns. They then negotiate a customer specific net price for the ports relevant to them."). JX-0240 at 011–014 (showing course of negotiation between [redacted] and Drew Marine). While there are general pricing trends—for instance, low volume ports tend to have higher pricing than high volume ports—ultimate prices are determined on a customer-by-customer basis. PX70000 (Cassaras (Drew) IH Tr. at 84:8–85:3, 87:7–10). While customers retain the freedom to purchase outside of framework agreements, they typically choose not to do so with products for which consistency is valued. Sarro Hrg. Tr. at 106:9–107:11 (noting that he prefers not to purchase outside contract when "it's really important that you have that product on board from that supplier," including BWT). This individualization makes the pricing for each Global Fleet opaque to the next, which in turn facilitates differential pricing.

Moreover, WSS internal documents expressly contemplate market segmentation for the purpose of price discrimination. An internal pricing presentation dated November 2014 notes the benefits of "value-based pricing," which allows WSS to "segment customer[s] based upon preferences." PX20381 at 003. The presentation also distinguishes local and global customers by their preference for suppliers with global reach, and then considers a price discrimination exemplar that distinguishes local and global customers, noting that global customers are willing to pay more for global reach and describing how "[v]alue based pricing identifies differences in customers' preferences and valuation of attributes, then identifies ways to make them pay different prices for virtually the same product/service." PX20381 at 003. The presentation also describes how "[a]greement discount levels will be built bottom up by applying indexes to multiple price discrimination levels," which include "segment" and "trading pattern" indexes, among other factors. PX20381 at 011.

In sum, based on (a) the lack of pricing transparency in a marketplace characterized by individualized negotiations, combined with (b) evidence that Global Fleets constitute a distinct segment of the market with distinct preferences, (c) evidence that WSS recognizes the potential benefits of price discrimination, and (d) the lack of ***57** any evidence suggesting arbitrage, the court concludes that price discrimination is possible post-merger.

iii. Hypothetical Monopolist Test

Having determined in the foregoing discussion the validity of the cluster market and targeted customer approaches in defining the relevant product market in this case, the court also finds that the *Brown Shoe* practical indicia support the FTC's candidate market, with regard to (1) a product's peculiar characteristics and uses, for which there are no reasonable substitutes; (2) industry recognition of the product market as a separate entity, as shown by ordinary course documents demonstrating a business focus on globally trading vessels; and (3) distinct customers with distinct needs who require (4) specialized vendors who provide both the products and value-added services. *Whole Foods*, 548 F.3d at 1037–38 (Brown, J.); *Brown Shoe*, 370 U.S. at 325, 82 S.Ct. 1502. The court now turns to an examination of expert evidence concerning the Hypothetical Monopolist Test ("HMT").

To model the course of a hypothetical monopolist, Dr. Nevo—the only economist to have performed the HMT in this case—conducted a critical loss analysis, which essentially calculates "the largest amount of sales that a monopolist can lose before a price increase becomes unprofitable." *FTC v. Swedish Match*, 131 F.Supp.2d 151, 160 (D.D.C. 2000). The test has three steps. First, Dr. Nevo calculated the critical loss threshold—that is, the point at which a hypothetical monopolist would lose too many customers for a SSNIP to be profitable. This step is purely mathematical—the critical loss threshold is the point at which increased profit margins resulting from an increase in price are offset by increased costs resulting from lost sales. Second, Dr. Nevo estimated the *actual* aggregate diversion ratio, which "represents the proportion of lost sales that are recaptured by all other firms in the proposed market as the result of a price increase ... [s]ince these lost sales are recaptured within the proposed market, they are not lost to the hypothetical monopolist." *H & R Block*, 833 F.Supp.2d at 63. The aggregate diversion is calculated with reference to suppliers to whom lost customers would potentially take their business. *Sysco*, 113 F.Supp.3d at 34. Third, Dr. Nevo compared aggregate diversion to critical loss, and if aggregate diversion exceeds critical loss, then a SSNIP would be profitable for a hypothetical monopolist. *Id.* (citing *Swedish Match*, 131 F.Supp.2d at 160).

Dr. Nevo used four kinds of data to calculate margins for different trials—estimates of gross margin for all water treatment products sold to all customers, WSS and Drew invoice data specific to BWT/CWT and Global Fleets, lowest gross margins by quarter, and variable cost margins based on accounting data specific to BWT/CWT and Global Fleets. For aggregate diversion, Dr. Nevo used three kinds of data —revenue information provided by marine suppliers, WSS salesforce data, and WSS and Drew win-loss data. PX61000 ¶ 227. After running multiple trials with varying inputs, including a SSNIP of 10% (in addition to the typical 5%), Dr. Nevo found that across all cases, the highest critical loss estimate was 17.5%, and the lowest aggregate diversion ratio estimate was 90%. PX61000 ¶¶ 232, 237; Nevo Hrg. Tr. at 903:14–904:4. In cross-examining Dr. Nevo and in closing arguments, Defendants challenged the basis for his estimates of margins and aggregate diversion, correctly noting that his BWT/CWT-specific estimates are drawn from broader data sets that include all water treatment products. Nevo Hrg. Tr. at 812:1–17. Nevertheless, Defendants' expert, Dr. Israel, presented nothing to suggest that the methodology Dr. Nevo employed in arriving ***58** at his estimates was flawed (apart from contesting the appropriateness of a cluster market analysis), and did not present any alternative calculations or HMT results. *See generally* DX-0060. Moreover, the gap between critical loss and aggregate diversion in every trial was so large as to ensure the stability of the HMT's qualitative result against any but the gravest of statistical errors. *See* PX61000 ¶¶ 232, 237. Further, that large gap is consistent with other, qualitative evidence regarding the role of ship chandlers and industrial suppliers in the product market.[6]

In sum, the court concludes that "the supply of MWT products and services"—including BWT chemicals, CWT chemicals, and associated products and services—to Global Fleets constitutes a relevant antitrust market.

a. Market Concentration, Probable Effects on Competition, and Prima Facie Case

1. LEGAL STANDARD

Having defined a relevant antitrust market, the court must "consider the likely effects of the proposed acquisition on competition within that market." *Swedish Match*, 131 F.Supp.2d at 166. At this juncture, the government must complete its prima facie case by showing that "the merger would produce 'a firm controlling an undue percentage share of the relevant market, and [would] result[ ] in a significant increase in the concentration of firms in that market.' " *Heinz*, 246 F.3d at 715 (quoting *Philadelphia Nat'l Bank*, 374 U.S. at 363, 83 S.Ct. 1715); *see also Baker Hughes*, 908 F.2d at 982. "Market concentration ... is often measured using the Herfindahl-Hirschmann Index ("HHI")." *Heinz*, 246 F.3d at 716; *Swedish Match*, 131 F.Supp.2d at 167 n.11. As the court explained in *Swedish Match*:

> "The HHI calculates market power [by] summing the squares of the individual market shares of all the firms in the market. The HHI takes into account the relative size and distribution of the firms in a market, increasing both as the number of firms in the market decreases and ***59** as the disparity in size among those firms increases."

Id. Sufficiently high HHI figures establish a *prima facie* case of anticompetitiveness. *H & R Block*, 833 F.Supp.2d at 71 (citing *Heinz*, 246 F.3d at 715 n.9). The merger guidelines consider markets with an HHI above 2500 to be "highly concentrated," and state that "[m]ergers resulting in highly concentrated markets that involve an increase in the HHI of more than 200 points will be presumed to be likely to enhance market power." Merger Guidelines § 5.3; *Heinz*, 246 F.3d at 715 (citing *Baker Hughes*, 908 F.2d at 982) (noting that significant increase in market concentration "establishes a ‘presumption’ that the merger will substantially lessen competition.”).

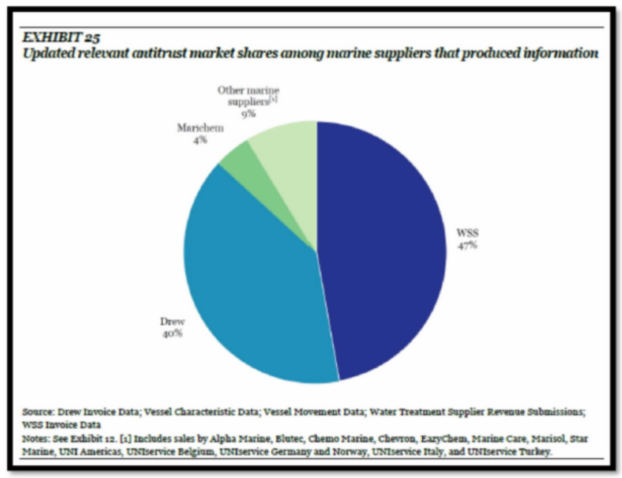
The FTC may also bolster its *prima facie* case by offering additional evidence. Relevant to this case, courts generally recognize that “a merger that eliminates head-to-head competition between close competitors can result in a substantial lessening of competition.” *Sysco*, 113 F.Supp.3d at 61. Where head-to-head competition between close competitors is an important feature of the relevant market, “[a] merger is likely to have unilateral anticompetitive effect if the acquiring firm will have the incentive to raise prices or reduce quality after the acquisition, independent of competitive responses from other firms.” *H & R Block*, 833 F.Supp.2d at 81; *see also* *Whole Foods*, 548 F.3d at 1043 (Tatel, J.) (citation omitted) (internal quotation marks omitted) (“[T]here can be little doubt that the acquisition of the second largest firm in the market by the largest firm in the market will tend to harm competition in that market.”).

2. ANALYSIS

i. Defendants Have High Market Shares and HHIs Predict High Concentration

Dr. Nevo calculated HHIs based on market share information from two sources—revenue information reported by Defendants and in sworn declarations of third-party suppliers, and information provided by WSS's Potential Sales Model (“PSM”).[7] PX61000 ¶¶ 250–51. Dr. Nevo claims that market shares based on revenue information are preferred because such information “actually reflect[s] the actual choices made by customers when choosing products.” Nevo Hrg. Tr. at 627:17–628:3. He calculated market size by (a) aggregating the revenues of all suppliers who provided information, and (b) assigning each supplier a share based on their revenue as a proportion of overall revenue. *See* PX61000 ¶¶ 252–56. The market share calculations indicated that Defendants are the two largest MWT suppliers by revenue. The following graph depicts the size of all marine water treatment suppliers who submitted revenue data.

[redacted] PX61002 ¶ 120, Ex. 12. Acknowledging that at least one supplier failed to submit revenue data, and to account for the possibility that other unknown suppliers exist. Dr. Nevo ran trials including revenue entries for five and ten unknown suppliers by assigning them revenue totals equal to the median for all non-party MWT suppliers. Nevo Hrg. Tr. at 628:8-17 (noting inclusion of all suppliers mentioned by Dr. Israel with exception of one, and including “dummy” suppliers). ***60** Dr. Nevo also ran trials assigning the “dummy” suppliers revenues equal to the *average* of all non-party MWT suppliers. PX61002 ¶ 271. Assuming five missing suppliers, and using the median value for “dummy” suppliers. Dr. Nevo calculated market shares at 46.1% for WSS and 38.7% for Drew (84.7% combined). PX61002 ¶ 271. Additional trials with different inputs produced combined shares between 78.7% and 82.8%. PX610021271 Ex. 26. The following graph depicts the result of Dr. Nevo's market share calculations, which correspond to his revenue calculations.[8]



PX61002 ¶ 270, Ex. 25. Based on these market shares, the post-merger HHI is 7,214, with an increase of 3,563, indicating extremely high market concentration and a very large increase in concentration. PX61002 ¶ 272, Ex. 27. Alternative trials based on the different formulations of the revenue and market share calculations revealed HHIs between 6,235 and 6,883, along with changes in HHIs between 3,075 and 3,399. PX61002 ¶ 272, Ex. 27.

Defendants' expert Dr. Israel challenged Dr. Nevo's analysis on a number of grounds. First, Dr. Israel questioned the appropriateness of applying the cluster market doctrine and focusing on Global Fleets, contending that BWT and CWT should be broken out separately and that the relevant market should include sales to all vessels. DX-0060 ¶¶ 109–10. Dr. Israel also suggested that Dr. Nevo's use of revenues as a metric to compute shares is ***61** problematic because it (a) relies on several estimates and assumptions to fill gaps in revenue data, (b) places more weight on larger vessels with more engines and boilers, rather than treating every vessel as an equal business opportunity, and (c) ignores the utility of treating sales of MWT chemicals as unit sales—corresponding to vessels—where one vessel makes one lower or higher-priced product choice and so constitutes one unit share. DX-0060 ¶¶ 112–114. Dr. Israel calculated market share based on sales to all vessels weighing 1,000 gross tons or more. DX-0060 ¶¶ 108, 111, 112, 115. He also employed a "single invoice" rule, whereby he assumed that any vessel with less than two invoices from the merging parties in 2017 was making a "one-off" purchase, which Dr. Israel took to mean that that vessel purchased most of its BWT or CWT products from other suppliers. DX-0060 ¶ 116. Dr. Israel separated BWT and CWT into individual market categories, and, applying the single invoice rule, computed Defendants' combined market share as 31% and 33%, resulting in HHIs that are substantially lower and below the Guidelines cutoff of 2500. DX-0060 ¶ 117.

The court credits Dr. Nevo's analysis. While it has already determined that both the cluster market approach and the focus on Global Fleets are appropriate, the court also disagrees with Dr. Israel for other reasons. For one, the court sees no justification for treating all vessels as constituting equal shares of the overall market for MWT. The core of the FTC's argument in this case—as borne out by the evidence—is that all vessels are *not* created equal. *See* Nevo Hrg. Tr. at 640:18–19 (noting that "not all vessels are created equal"). Where a vessel has more boilers and engines, it has greater MWT needs that comprise a correspondingly larger part of the market, making such vessels more valuable to suppliers. Conducting the analysis by using just the number of vessels obscures this fact, while using revenue data acknowledges that capturing the market for larger ships means capturing a larger part of the market for MWT. The court views this increased sensitivity to market reality as a strength of Dr. Nevo's revenue-based analysis, not a flaw. Moreover, while there is some imprecision inherent in estimating revenue shares for suppliers that did not produce revenue information, there appears to be only one known supplier—Vecom—that failed to produce such data. *See* PX61002 ¶ 271 Ex. 26. Dr. Nevo ran trials accounting for up to ten additional hypothetical suppliers with revenues matching the median and average of all non-party suppliers. *See* PX61002 ¶ 271 Ex. 26; PX61000 ¶ 263 Ex. 32. Defendants have pointed to no evidence suggesting that the absence of specific information about one missing supplier would change the data more substantially than ten additional suppliers with median or average revenues.[9] *See Sysco*, 113 F.Supp.3d at 54 ("The FTC need not present market shares and HHI estimates with the precision of a NASA scientist. The 'closest available approximation' often will do.") ***62** (quoting *FTC v. PPG Industries, Inc.*, 798 F.2d 1500, 1505 (1986)).

Moreover, Dr. Nevo explained in his reply report that, notwithstanding his conceptual misgivings, he did compute market shares and HHI using Dr. Israel's methodology. PX61002 ¶ 142. Disregarding the single-invoice rule and clustering BWT and CWT, Dr. Nevo's analysis yielded a combined market share across all vessels of 49.2% and lower bound HHI of 2,546 with change in HHI of 945. *See* PX61002 ¶¶ 141–42, Ex. 15 & 16. Dr. Nevo further explained at the evidentiary hearing and in his reply report that he performed multiple alternative HHI calculations using several of Defendants' preferred candidate markets. Nevo Hrg. Tr. at 637:24–640:6. These markets include supply of marine water treatment as a whole, BWT separately, CWT separately, and one market including all chemicals, gases, and refrigerants—all at the vessel level, regardless of trading pattern, and including only vessels weighing at least 1,000 gross tons. Nevo Hrg. Tr. at 637:24–640:6; PX61002 ¶¶ 104–12. The results in each case satisfied the Guidelines threshold for a structural presumption.[10] PX61002 ¶ 104 Ex. 8. In other words, here, as in *PPG* and *Sysco*, the FTC has presented "share calculations for 'every market the evidence suggests is remotely possible,' which yield[ed] results of similar magnitudes in market concentration." *Sysco*, 113 F.Supp.3d at 54 (quoting *PPG Industries*, 798 F.2d at 1506).

In sum, the court finds that based on Dr. Nevo's testimony and other evidence, the FTC has demonstrated that the proposed merger will significantly increase concentration in the market for supply of MWT products to Global Fleets. Thus, the FTC has made out a *prima facie* case and established a rebuttable presumption that the merger will substantially lessen competition in the aforementioned market.

ii. Ordinary Course Documentation and Customer Testimony Confirm Market Position and Suggest Competitive Effects From Elimination of Head-to-Head Competition

The notion that WSS and Drew are each other's primary competition in the relevant market is supported by a number of Defendants' own documents. For instance, in a January 2015 internal presentation on the strategic rationale for the merger, WSS acknowledged that "[t]he combined entity will be the unrivalled leader in maritime services in general and marine chemicals in particular." PX20329 at 48. Another WSS internal presentation titled "Global Strategy 2013-2017" described WSS as having "relatively high market shares within Marine Chemicals"—listing WSS as possessing slightly more than 50% market share in marine chemicals and describing Drew as having 25%. JX-0192 at 005. Furthermore, internal Drew documents acknowledge that ***63** "Drew Marine essentially has one global competitor —Wilh. Wilhemsen Holding ASA." JX-0055 at 027; *see also* JX-0053 at 024 (noting that "VPP segment is dominated by Drew Marine and the market's largest participant, Wilh. Wilhelmsen Holding ASA" and that "[r]emaining market [is] characterized by small regional/local suppliers, specializing in product sub-categories with limited product offerings, execution capabilities, and geographic reach."); JX-0048 at 006 (suggesting in strategic planning email that if Drew were to "[a]cquire WSS chemical business, take away [its] main competitor and win back this space fully for [Drew Marine], this could increase our ability to charge far better prices and win across all segments."); JX-0182 at 067 (noting that "WSS and DM hold majority of contract business for marine chemicals (in particular water treatment) due to long-term market participation and global presence."); JX-0096 at 054 (describing Drew Marine as "one of two global players in the performance chemicals market"). Moreover, the record includes multiple instances of serious competition between WSS and Drew, specifically on issues such as price and other non-price incentives.[11] *See Sysco*, 113 F.Supp.3d at 64–65.[12]

Customer testimony from Global Fleets further supports the notion that Defendants occupy the number one and number two market positions and that competition between them plays a key role in providing consumer benefits at the fleet level. *See, e.g.*, [redacted] (describing WSS and Drew as only viable options, describing how merger would leave fleet without alternatives, describing how negotiation with Vecom broke down over capability concerns); Sarro Hrg. Tr. at 93:24–99:9, 157:6–25 (describing WSS and Drew as only realistic options, and explaining how review process that originally included multiple suppliers was necessarily narrowed to WSS and Drew based on capability considerations); [redacted] (describing WSS and Drew as only credible options, explaining how other suppliers would be unable to meet fleet-level needs, and explaining that merger would leave fleet without options); *see also* PX400013 (same). The court agrees with Defendants that such testimony is not without its flaws—while many customers testified that they consider Drew and WSS to be the only proven suppliers capable of meeting their needs on a global basis, some also admitted that they have not undertaken any detailed investigation of other suppliers. ***64** *See, e.g.*, PX70028 106:14–18. It is also true that customer testimony alone is often considered a less reliable form of evidence in this context. *Arch Coal*, 329 F.Supp.2d at 145 (noting that "[i]n many contexts ... antitrust authorities do not accord great weight to the subjective views of customers in the market."). Nevertheless, in light of the extensive documentary and statistical evidence the FTC has presented in this case, it does not appear that the FTC is over-relying on customer input, and the fact that the documentary and statistical evidence aligns with customer testimony bolsters the reliability of the testimony.

iii. Quantitative Evidence Suggests Competitive Effects Based on High Market Shares and Elimination of Head-to-Head Competition

Dr. Nevo performed two additional studies to confirm that Defendants will have the incentive and ability to raise post-merger prices—the Gross Upward Pricing Pressure Index methodology ("GUPPI") and a merger simulation model.

A GUPPI analysis is essentially a bargaining framework that quantifies a firm's change in incentive to raise prices following a merger—i.e., the "upward pricing pressure." PX61000 ¶¶ 318–19. The model takes as a premise that, when WSS (or Drew) bids for business in the current market, higher prices increase the chance that customers will choose another supplier, and that given the closeness of competition between WSS and Drew, Drew (or WSS) will usually be the alternative supplier. PX61000 ¶ 317. In this model, the firm that chooses to raise or lower prices must balance the potential for increased profits at a higher price against the potential to lose profits but gain business at a lower price. PX61000 ¶ 317. The optimal price lies somewhere between these points. PX61000 ¶ 317. The model hypothesizes that without Drew or WSS as a check, the need for balancing disappears. PX61000 ¶ 317. The incentive to raise prices depends on the size of the fraction of diverting WSS customers that go to Drew (or vice versa) and the size of the margin that Drew or WSS earns. PX61000 ¶ 320. To estimate these variables, Dr. Nevo used a number of values drawn from market share estimates based on revenue data, market share estimates based on WSS's PSM tool, WSS salesforce data, and WSS win-loss data. PX61000 ¶ 321. For margins, Dr. Nevo used invoice data and variable cost margins. PX61000 ¶ 323. Dr. Nevo's results across multiple trials, accounting for variations of these inputs and calculated from the perspective of both Drew and WSS, produced percentages consistently over 20%, indicating strong incentives for post-merger price increase. Nevo Hrg. Tr. at 658:20–660:23.[13]

Dr. Nevo's merger simulation model aimed to quantify the effect that combining the first and second choice MWT suppliers would have on bargaining and prices in the relevant antitrust market. The model hypothesized that since customers needing supply are likely to solicit more than one bid and play the second-best supplier alternative off the first-best in order to secure better offers, a situation in which (a) the first and second-best merge, and (b) the third-best supplier (which will become second-best post-merger) represents a weak alternative relative to the merging parties, will tend to produce higher prices. Indeed, the weaker an option the third supplier represents relative to the merging parties, the more likely it is that customers will face higher prices. PX61000 ¶¶ 332–23; ***65** Nevo Hrg. Tr. at 663:22–665:5, 670:16–671:18. Using the same market share and margin estimates as in the GUPPI analysis, Dr. Nevo calculated estimated percentage price increases post-merger using eight scenarios involving all input combinations. Percentage increases across all sensitivities ranged from 13.6% to 53.1% ($6.7 million to $26 million in dollar increases), with ranges based on Dr. Nevo's preferred data of 29% to 46.6% (14.4 million to 23 million in dollar increases). PX61000 ¶ 339. Notably, the model did not predict the timing of price increases. As Dr. Nevo testified at the evidentiary hearing, such high price increases can be implemented over time, and in a market where it is typical for parties negotiating framework agreements to bargain over substantial discounts off list prices, price increases could simply involve reducing the amount of the discount in proportion to reduced negotiating leverage. Nevo Hrg. Tr. at 675:12–677:5.

Defendants argue that Dr. Nevo's models are flawed because they depend on unreliable data, specifically incomplete win-loss data and overbroad salesforce data. *See* Nevo Hrg. Tr. at 581:23–582:3 ("THE COURT: Dr. Nevo ... for this win-loss data ... what kind of numbers are we talking about in reaching these percentages? THE WITNESS: So these are very small numbers. I forget exactly.... But I think this is—it is very sparsely populated."), 722:11–723:8 (noting that salesforce and win-loss datasets are not specific to the market alleged). While the court agrees that there are some reliability issues with both the win-loss and salesforce data, the court disagrees that this flaw dooms the studies' significance, especially when, with respect to the merger simulation model in particular, the difference in market share between the merging parties and the third-best alternative so closely tracks the model's basic assumptions. Win-loss and salesforce data were the basis for market share estimates in only two of the scenarios in each analytical category (GUPPI and merger simulation), and did not form the basis of Dr. Nevo's preferred calculations. In all other trials, market shares were estimated using other data, and the results were stable across these variations. Moreover, even acknowledging the limited usefulness of certain data, calculations using that data can be considered as confirmatory, insofar as the results match the results of calculations that use more reliable data and accord with the inferences suggested by a larger body of evidence. *See Sysco*, 113 F.Supp.3d at 67 (finding merger simulation strengthened *prima facie* case despite imperfections in underlying data where result was qualitatively robust to other variations using more reliable data). Thus, the court concludes that Dr. Nevo's GUPPI analysis and merger simulation model strengthen the FTC's *prima facie* case that the proposed merger will substantially lessen competition in the relevant antitrust market.[14]

***66** *iv. Summary*

The FTC has made out a strong *prima facie* case of anticompetitive effects based on high market concentration and has bolstered that case with additional evidence that the merger would substantially lessen competition in the market for supply of MWT chemicals and services to Global Fleets.

2. Rebuttal

Given the court's conclusion that the FTC has met its burden to show a *prima facie* case, the burden now shifts to Defendants "to show that traditional economic theories of the competitive effects of market concentration are not an accurate indicator of the merger's probable effect on competition in [this] market or that the procompetitive effects of the merger are likely to outweigh any potential anticompetitive effects." *CCC Holdings*, 605 F.Supp.2d at 46. Typically, "the more 'compelling the [FTC's] prima facie case, the more evidence the defendant must present to rebut [the presumption] successfully." *Sysco*, 113 F.Supp.3d at 72 (quoting *Baker Hughes*, 908 F.2d at 991). Given that the FTC has made out a strong prima facie case, Defendants must make out a correspondingly strong rebuttal showing.

a. Barriers to Entry or Expansion

1. LEGAL STANDARD

A prima facie showing of anticompetitive effects associated with a merger can be rebutted by—among other factors—evidence that there are no significant entry barriers in the relevant market. *CCC Holdings*, 605 F.Supp.2d at 47. Indeed, the D.C. Circuit has recognized that "[t]he existence and significance of barriers to entry are frequently ... crucial considerations in a rebuttal analysis," given that "[i]n the absence of significant barriers, a company probably cannot maintain supracompetitive pricing for any length of time." *Baker Hughes*, 908 F.2d at 987. Accordingly, analysis of ease of entry—"the ability of other firms to respond to collusive pricing practices by entering to compete in the market," *Cardinal Health*, 12 F.Supp.2d at 54–55—is key to "evaluating whether market concentration statistics accurately reflect the pre- and likely post-merger competitive picture." *Heinz*, 246 F.3d at 717 n.13. "Low barriers to entry enable a potential competitor to deter anticompetitive behavior by firms within the market simply by its ability to enter the market." *Id.* (citing *FTC v. Procter & Gamble Co.*, 386 U.S. 568, 581, 87 S.Ct. 1224, 18 L.Ed.2d 303 (1967)). "In other words, entry is one way in which post-merger pricing practices can be forced back down to competitive levels." *CCC Holdings*, 605 F.Supp.2d at 47.

Nevertheless, "[t]he prospect of entry into the relevant market will alleviate concerns about adverse competitive effects only if such entry will deter or counteract any competitive effects of concern so the merger will not substantially harm customers." Merger Guidelines § 9. Thus, entry must be "timely, likely, and ***67** sufficient in its magnitude, character, and scope to deter or counteract the competitive effects of concern." *Id.*; *Cardinal Health*, 12 F.Supp.2d at 55. According to the Merger Guidelines, entry is timely when it is "rapid enough to make unprofitable overall the actions causing [competitive] effects and thus leading to entry," likely where it is profitable even "accounting for the assets, capabilities, and capital needed and the risks involved"—including sunk costs—and sufficient where the entering competitors provide products that "are ... close enough substitutes to the products offered by the merged firm to render a price increase ... unprofitable" and there are limited constraints on entrants' "competitive effectiveness," such that one firm can replicate the scale and strength of a merging firm, or one or more firms can operate without competitive disadvantage. Merger Guidelines § 9.1–9.3. In general, "[t]he relevant time frame for consideration ... is two to three years." *Staples II*, 190 F.Supp.3d at 133. The expansion of current competitors is regarded as "essentially equivalent to new entry," and is therefore evaluated according to the same criteria. *CCC Holdings*, 605 F.Supp.2d at 57; *Cardinal Health*, 12 F.Supp.2d at 55.

2. ANALYSIS

Defendants contend that there are no significant barriers to expansion by other firms already in the market as defined by the FTC, and that one or more of those firms will expand to provide a competitive counterbalance that will maintain prices at pre-merger levels. Defendants note that they are required only to show that "another competitor or group of competitors could fill Drew's current position in the market," DFF ¶ 280, examine a number of potential barriers, and argue that none of them prevent expansion in this case.

First, Defendants argue that "there is no meaningful limit on the supply of BWTC and CWTC," meaning that the FTC cannot argue that "current suppliers are capacity constrained." ECF No. 50-2 at 39. In particular, Defendants assert that the chemistry that guides formulation of MWT products is well known, and toll blenders—chemical companies that blend MWT chemicals for suppliers, including Drew—are not bound by exclusive agreements and could find another outlet for their products among other market participants. ECF No. 50-2 at 34; DFF ¶¶ 287–91. Second, Defendants argue that the need for a global distribution network does not constitute a significant barrier to entry because "there is nothing that prevents ... competitors from easily expanding their [distribution] networks in response to customer demand." ECF No. 50-2 at 40; DFF ¶¶ 298–300. Defendants emphasize that Drew outsources about two-thirds of its MWT business, [redacted] and engaging others such as Wrist—a large ship chandler—to make last-mile deliveries to vessels at distant ports, often far from warehouses (which are leased, rather than owned). DFF ¶¶ 301–03. Defendants also argue that the FTC has failed to identify any ports "where entry would be needed and would purportedly not occur." ECF No. 50-2 at 37; DFF ¶¶ 298, 301–14. Third, Defendants argue that the ability to offer technical services in conjunction with the delivery of chemical products poses no barrier. They point out that Drew offers only three kinds of technical services: (1) log sheet reporting, which involves periodically recording boiler and cooling testing results in proprietary software and collating data in a central location to ensure consistency over time; (2) initial training sessions, which involve providing new customers with written materials describing dosing and testing methods for Drew's products and conducting a presentation for onboard ***68** engineers; (3) on-board visits to customer vessels, during which Drew representatives answer shipboard engineers' questions, review the testing history, and make recommendations. Defendants note that Drew had 40–53 service engineers between January 2015 and June 2017, and contend that procuring engineers is not a sustainable entry barrier because an entrant can start with a smaller number and scale up over time. ECF No. 50-2 at 40–41; DFF ¶¶ 316–21. Fourth, Defendants argue that reputation and brand are not significant barriers to entry because Global Fleet customers are highly sophisticated, and are therefore unlikely to be influenced by branding. DFF ¶ 322. Defendants note that to the extent that some Global Fleet customers believe other suppliers are incapable of serving their needs, they are uninformed. DFF ¶ 326.

The court concludes that Defendants have not carried their burden to establish that entry will be appropriately timely, likely, and sufficient to deter or counteract the competitive effects of the merger. *See Cardinal Health*, 12 F.Supp.2d at 55. Defendants' contention that Drew's business—including its products, services, reputation, customer relationships, and distribution model—is simple and capable of replication in a short period of time is at odds with inferences drawn from the state of the current market and with documentary and testimonial evidence from customers and suppliers. It defies basic economic principles for a profitable market to be simultaneously characterized by (a) markedly high concentration and head-to-head competition between two dominant firms over a significant period of time, and (b) low barriers to entry and easily replicable business models. Where the latter is true, economic incentives to compete should ensure that the former is not. Low barriers signify economic opportunities, and as Defendants' own expert acknowledges, "[e]conomics teaches that firms will enter markets where there are opportunities to earn economic profits (profits above the competitive level) until those economic profits are pushed to zero." DX-0060 ¶ 224; Israel Hrg. Tr. at 1567:4–10, 1568:11–24. The FTC has presented strong evidence that the current market is highly concentrated and dominated by head-to-head competition between Drew and WSS, notwithstanding that a number of other suppliers have been present in the market for years. In other words, "the fact that the merging parties have been able to maintain high margins and market shares without witnessing notable entry and expansion" suggests that, contrary to Defendants' contentions, the market for supply of MWT products is characterized by significant barriers to entry. PX61002 at ¶ 244.

This perspective is borne out in documentary and testimonial evidence, which suggests that barriers to entry—especially global distribution networks, customer relationships and reputation, and customer retention rates—play a significant role in the merging parties' respective business models. Global presence in particular is consistently considered a distinguishing feature of Defendants' business that is capital intensive and difficult to replicate. *See* JX-0279 at 022 (Drew presentation describing one of its features as an "Established Global Presence with Significant Barriers to Entry," and further explaining that its "Expansive Global Logistics and Distribution Network Enables Swift Order Fulfillment and is Difficult and Costly to Replicate"); *see also* PX60008 (Drew) at 006 ("Q. Rough order, how long would it take and how much would it cost to replicate your global fulfillment network? A. It would take a vast investment to enter our market from a distribution perspective and even if they did that they would inevitably ***69** fail to gain any traction [because]: [(i)] brand reputation (quality, consistency and reliability); [(ii)] High cost of failure means customers are not going to swap supplier from a product they trust for essential compliance or maintenance products and services"); JX-0231 at 157 (consultant's internal presentation to WSS describes barriers to entry as "logistics, channel, market knowledge, and customer base"); PX20184 at 003 (internal assessment explaining that "[t]he business idea and the strategic role played by the company is to supply these products to vessels around the world ... through a truly global and seamless operation, meticulously designed for the global shipping community ... [t]he complexity of this operation is the major barrier to entry for competing manufacturers and suppliers, focusing their efforts towards larger, land based markets."). Indeed, other market participants have confirmed that expanding a distribution network to the size of Drew's would require significant capital investment. *See* Franzo Hrg. Tr. at 357: 13–358:4 ("Q. What would it take for UNI Americas to expand its distribution network to the size of Drew Marine's? A.... I mean, we would need financial backing to make that move ... Drew has built a tremendous company over 50 years ... they didn't do it overnight.... [I]t would take a financial influx of capital to do such a thing.").

Similarly, evidence indicates that prior customer relationships and reputation function as barriers in the MWT industry because customers are highly risk averse, leading them to favor known providers and avoid switching suppliers. *See* JX-0250 at 009 (consultant presentation of MWT analysis to WSS indicates that "[c]ustomer relationships are important to maintain sales and contract extensions," because "[w]ater treatment products has a lock-in effect, as the vessels cannot change water treatment supplier continuously, as it would defeat its purpose"); [redacted] (describing elimination of Marine Care from bidding process because "[t]he evaluation of the team was that the Marine Care bid had more risk to it. They didn't cover as many ports as we were seeking. They were an unknown supplier to us, so a lot more testing would be required to consider their chemicals."); Fry Hrg. Tr. at 962:11–23 (explaining that Military Sealift Command single sources its chemicals worldwide because "[c]ommonality of chemicals, commonality of training, commonality of test equipment" helps "prevent[ ] ... mistakes and ... minimize the risk to the ship itself.");[15] PX80000 (MSC Decl.) at ¶¶ 51–52 (noting that "[r]eputation cannot be understated given that even small discrepancies in the quality, availability, or service of marine chemicals could shorten the lifecycle of equipment or cause immediate failure," and that "if another company decided to make a concerted effort to replace Drew, it would take additional time for that company to earn the reputation for quality, service, and reliability that Drew and Wilhelmsen have developed over decades in the marine industry").

In sum, evidence relating to the foregoing barriers alone shows that here, as in *Sysco*, new entry and/or expansion are "capital intensive and demand[ ] a long time horizon"—capital to fund expansion of distribution network, and time to build relationships with customers and develop a high reputation for quality and reliability. 113 F.Supp.3d at 81. The evidence does not reveal any specific competitor or potential ***70** competitor with any plan to enter, and in fact suggests the opposite—that expansion is costly, and no smaller competitor or potential competitor intends to expand or reposition in order to make a bid for Global Fleet customers. *See, e.g.*, [redacted] ¶ 10 (noting that expansion is costly, on the order of $20,000–$30,000 in shipping per container of product on top of third-party fees, and that [redacted] has not expanded for water treatment chemicals in five years); [redacted] ¶ 8 (noting that [redacted] has no intention of entering the MWT business); [redacted] ¶ 6 (noting absence of expansion plans); *cf. Sysco*, 113 F.Supp.3d at 81 ("Based on their assessment that expansion would not be an economically viable strategy, regional distributors have said that they have no plans to expand or reposition in order to serve national customers."). Defendants may be correct that at some point in the future one or more smaller competitors will be in a position to replicate the competitive benefits that Drew's presence currently provides. Nevertheless, the record does not support the notion that any entry or credible threat thereof will be timely, likely, and sufficient to counteract the likely anticompetitive effects of this merger.

b. Power Buyers

1. LEGAL STANDARD

Courts have also noted that the existence of power buyers—sophisticated customers who retain strategies post-merger that "may constrain the ability of the merging parties to raise prices," Merger Guidelines § 8—is a factor that can serve to "rebut a prima facie case of anti-competitiveness." *Cardinal Health*, 12 F.Supp.2d at 59. However, "[t]he ability of large buyers to keep prices down ... depends on the alternatives these large buyers have available to them." *Sysco*, 113 F.Supp.3d at 48. Where mergers reduce alternatives—i.e., prevent the use of certain competitive strategies—"the power buyers' ability to constrain price and avoid price discrimination can be correspondingly diminished." *Id.* (citing Merger Guidelines § 8). Thus, the mere presence of power buyers "does not necessarily mean that a merger will not result in anti-competitive effects." *Cardinal Health*, 12 F.Supp.2d at 59. In assessing a power buyer argument, the court should "examine the choices available to powerful buyers and how those choices likely would change due to the merger," keeping in mind that "[n]ormally, a merger that eliminates a supplier whose presence contributed significantly to a buyer's negotiating leverage will harm that buyer." Merger Guidelines § 8. Finally, although the consideration of non-entry factors—including the existence of power buyers—is "relevant, and can even be dispositive, in a section 7 rebuttal analysis," *Baker Hughes*, 908 F.2d at 987, courts have not typically held "that power buyers alone enable a defendant to overcome the government's presumption of anticompetitiveness." *Cardinal Health*, 12 F.Supp.2d at 58; *Chicago Bridge & Iron Co. N.V. v. FTC*, 534 F.3d 410, 440 (5th Cir. 2008) ("[C]ourts have not considered the 'sophisticated customer' defense as itself independently adequate to rebut a *prima facie* case.").

2. ANALYSIS

Defendants argue that the FTC's Global Fleets construct focuses on the largest shipping companies—those most likely to have the power to constrain the merger's anticompetitive effects. In support of this contention, Defendants point out that customers tend to purchase other goods from suppliers, which permits them to discipline attempted BWT and CWT price increases by switching or credibly threatening to switch purchases of these other products to other suppliers or by negotiating price decreases on other products. ***71** ECF No. 50-2 at 45; DFF ¶¶ 246–249. Defendants further argue that customers could adapt purchases to another supplier's distribution network or shift part of their fleet to another competitor, since many vessels in Global Fleets do not avail themselves of all of Defendants' networks—instead visiting a subset of available ports and picking up MWT from an even smaller subset. DFF ¶¶ 250–253. Defendants also contend that Global Fleets could stockpile larger quantities of MWT products in order to shift purchases to major ports with lower costs, DFF ¶¶ 254–258; ECF No. 50-2 at 45–46, and that customers can partner with suppliers to sponsor entry or expansion to new ports.

The court is unpersuaded by Defendants' power buyer argument. The evidence is mixed—at best—regarding the effectiveness of each of the Defendants' suggested strategies. Although at least one witness suggested that customers could shift purchases of other products in more competitive markets to other suppliers, *see* Kelleher Hrg. Tr. at 536:6–20, there is, as Dr. Nevo noted, little empirical basis for the notion that this strategy—already available to large customers—would yield any additional benefits beyond those customers currently enjoy. PX61002 ¶¶ 223, 232. Similarly, while testimony suggested that customers may be able to stockpile product and concentrate purchases in ports where products are cheaper, that same testimony suggests that storage space is often limited and that customers already do so. *See e.g.*, [redacted] (describing size of storage facilities onboard and efforts to ensure that product sourcing occurs efficiently); *see also* Fry Hrg. Tr. at 963:13–964:22 (describing space constraints due to safety regulations, number of different consumable products, and need to maximize revenue-generating space). Defendants have not identified any *new* strategy or alternative likely to emerge post-merger—instead, they have focused on strategies that are already part of the competitive landscape and which show no promise of becoming more effective. On the other hand, the FTC has shown that the merger will result in the loss of a proven strategy—the ability to leverage one large, global supplier against another—that appears to be the most effective price constraint in the consolidated MWT market. In other words, the FTC has established a reasonable probability that as a result of the merger, sophisticated buyers will have one less alternative strategy through which they can exercise power, and Defendants have not identified any equally or more effective buyer options to counteract that loss. Thus, the reduction of buyer alternatives means that "power buyers' ability to constrain price and avoid price discrimination can be correspondingly diminished," *Sysco*, 113 F.Supp.3d at 48, and evidence of buyer power is insufficient to rebut the FTC's prima facie case.

c. Efficiencies

1. LEGAL STANDARD

As the Merger Guidelines explain, "a primary benefit of mergers to the economy is their potential to generate significant efficiencies and thus enhance the merged firm's ability and incentive to compete, which may result in lower prices, improved quality, enhanced services, or new products." Merger Guidelines § 10. Though the Supreme Court has never recognized the so-called "efficiencies" defense in a Section 7 case, other courts and the Horizontal Merger Guidelines acknowledge that evidence of efficiencies may prove "relevant to the competitive effects analysis of the market required to determine whether the proposed transaction will substantially lessen competition," *Arch Coal*, 329 F.Supp.2d at 151, and accordingly that efficiencies produced by a merger can form part of a defendant's rebuttal of ***72** the FTC's prima facie case. *Sysco*, 113 F.Supp.3d at 81; *Heinz*, 246 F.3d at 720. This is true even though "[c]ourts have rarely, if ever, denied a preliminary injunction solely based on the likely efficiencies." *CCC Holdings*, 605 F.Supp.2d at 72.

Potential efficiencies require close judicial scrutiny—"the court must undertake a rigorous analysis of the kinds of efficiencies being urged by the parties in order to ensure that those 'efficiencies' represent more than mere speculation and promises about post-merger behavior," *Heinz*, 246 F.3d at 721, and a defendant must prove "extraordinary efficiencies" where market concentration levels are high. *Id.* at 720–21. An efficiencies analysis must demonstrate that the claimed efficiencies are (1) merger-specific, and (2) verifiable—meaning that efficiency claims "must represent a type of cost saving that could not be achieved without the merger and the estimate of the predicted saving must be reasonably verifiable by an independent party." *United States v. H & R Block, Inc.*, 833 F.Supp.2d 36, 89 (D.D.C. 2011); *see also Sysco*, 113 F.Supp.3d at 82. Moreover, "it is incumbent upon the merging firms to substantiate efficiency claims," as "much of the information relating to efficiencies is uniquely in the possession of the merging firms." Merger Guidelines § 10.

2. ANALYSIS

Defendants claim that the proposed merger will result in significant merger-specific efficiencies in the form of cost savings of [redacted] and that these efficiencies will be realized in four ways: (1) production cost reductions from eliminating duplicative product lines, (2) customer-facing cost reductions from eliminating duplicative account managers and customer service operations, (3) reductions from eliminating duplicative back-office and administrative costs, and (4) price reductions as part of a plan to address expected revenue dis-synergies, in order to compensate for the possibility of lost customers who oppose the merger.

The FTC engaged an expert, Dr. Dov Rothman, to evaluate whether Defendants had substantiated their estimated cost efficiencies, and whether such efficiencies were merger-specific. Dr. Rothman reviewed data and documentation from the merging parties, and the parties' consultants provided him with spreadsheets relevant to their claimed cost savings. Dr. Rothman concluded in his report and his testimony at the evidentiary hearing that the merging parties had failed to provide sufficient information for him to verify the likelihood and magnitude of the claimed cost savings. PX61001 at ¶ 10. In particular, Dr. Rothman found that the alleged cost savings in each of the categories were based on a series of significant assumptions—percentage reductions in cost, percentage increases in productivity, or assumed cost/product equivalencies—that were "doing all the work" in calculation of the estimates. Rothman Hrg. Tr. at 1035:5–6. Dr. Rothman further pointed out that Wilhelmsen failed to provide any information that would have allowed him to confirm whether those assumptions are reasonable. *See, e.g.*, Rothman Hrg. Tr. at 1039:19–1040:5 ("So what Wilhelmsen has provided here, it's provided a description of the process by which these cost savings were estimated. So it's explained that it had functional teams and Cardo Partners go around and identify and assess areas of duplicative overlap. And Wilhelmsen has ... provided information that describes the output of the analysis. What Wilhelmsen hasn't provided is information about the analysis itself. And I think there's an important distinction between describing the process of estimating cost savings and ***73** describing the actual analysis, the assumptions that go into that analysis.").

In response to these criticisms, Defendants note that WSS has a history of acquiring companies that produce MWT chemicals—specifically Unitor and Nalfleet—that demonstrates that WSS has previously achieved the cost savings it projected. Defendants also note that the efficiency estimates went through many rounds of internal vetting, DFF ¶¶ 352, 354, 357, 358, and rely on the testimony and report of Dr. Israel, who contended that the estimates are verifiable insofar as WSS identified the potential bases for cost savings, performed its own vetting and due diligence, and has a track record of realizing projected cost savings. DX-0060 ¶¶ 287, 290, 298.

The court finds that Defendants have failed to carry their burden to demonstrate the verifiability of their claimed efficiencies. In reaching this decision, the court stresses that the determinative issue is neither the presence of assumptions nor the absence of completely precise estimates. Instead, the critical issue is that because the bases for the assumptions Dr. Rothman identified and their role in the efficiencies analysis is unclear, the reasonableness of those assumptions, along with the ultimate determinations of likelihood and magnitude, cannot be verified with any degree of rigor. *Heinz*, 246 F.3d at 721 ("[G]iven the high concentration levels, the court must undertake a *rigorous* analysis of the kinds of efficiencies being urged by the parties in order to ensure that those 'efficiencies' represent more than mere speculation and promises about post-merger behavior.") (emphasis added); *see also id.* (scrutinizing quantitative basis for claimed efficiencies). Nor can reference to the merging parties' past practices, managerial expertise and incentives, or internal verification processes serve to substantiate any efficiencies. The court cannot substitute Defendants' assessments and projections for independent verification. *H & R Block*, 833 F.Supp.2d at 91 ("While reliance on the estimation and judgment of experienced executives about costs may be perfectly sensible as a business matter, the lack of a verifiable method of factual analysis resulting in the cost estimates renders them not cognizable by the Court. If this were not so, then the efficiencies defense might well swallow the whole of Section 7 of the Clayton Act because management would be able to present large efficiencies based on its own judgment and the Court would be hard pressed to find otherwise."). The court concludes that Defendants have failed to provide enough information about their estimated efficiencies to render them "reasonably verifiable by an independent party." *Id.* at 89. Given this conclusion, the court need not address the question of merger-specificity.

B. Weighing the Equities

Notwithstanding the court's determination on the likelihood of success on the merits, the court must still "weigh the equities in order to decide whether enjoining the merger would be in the public interest." *Heinz*, 246 F.3d at 726. The interests at issue are "(i) the public interest in effectively enforcing antitrust law and (ii) the public interest in ensuring that the FTC has the ability to order effective relief if it succeeds at the merits trial." *Sysco*, 113 F.Supp.3d at 86; *see also* *Heinz*, 246 F.3d at 726 ("The principal public equity weighing in favor of issuance of preliminary injunctive relief is the public interest in effective enforcement of the antitrust laws."). The FTC notes that absent a preliminary injunction, Defendants can combine assets and operations such that it is administratively difficult to restore competition to its pre-merger state. *Heinz*, 246 F.3d at 726 ("Section 13(b) ***74** itself embodies congressional recognition of the fact that divestiture is an inadequate and unsatisfactory remedy in a merger case."). On the other hand, Defendants note that if this court issues a preliminary injunction, they will abandon the transaction rather than continue with the administrative proceeding—meaning that the efficiencies that they have identified will be lost, along with their potential benefits to consumers. *See* *Arch Coal*, 329 F.Supp.2d at 160 (taking abandonment of the transaction into account in weighing the equities).

Given the court's finding that Defendants' claimed efficiencies cannot be independently verified, the court cannot conclude on this record that those efficiencies outweigh the potential harm to the public resulting from further consolidation in the MWT industry. Moreover, although the court recognizes the time, resources, and effort that Defendants have put into planning this transaction, the parties' stated intention to abandon the transaction prior to the merits proceeding is a private equity, and cannot on its own overcome the public equities that favor the FTC. *Heinz*, 246 F.3d at 727; *Sysco*, 113 F.Supp.3d at 87.

IV. CONCLUSION

The court finds on the basis of the entire record that the FTC has carried its burden to show a "reasonable probability" that the proposed merger between Drew and WSS would harm competition in the market for supply of MWT products and services to Global Fleets. The FTC has "raised questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC in the first instance and ultimately by the Court of Appeals," *Heinz*, 246 F.3d at 714–15 (quoting *FTC v. Beatrice Foods Co.*, 587 F.2d 1225, 1229 (D.C. Cir. 1978)), and Defendants have offered insufficient evidence to rebut the FTC's showing of likely harm. Moreover, the equities favor issuance of a preliminary injunction. Accordingly, the FTC's Motion for Preliminary Injunction will be GRANTED. An appropriate order accompanies this memorandum opinion.

All Citations

341 F.Supp.3d 27, 2018-2 Trade Cases P 80,509

Footnotes

1 Defendants essentially concede this narrow point in their Memorandum in Opposition to Plaintiff's Motion for Preliminary Injunction, which acknowledges that "a market could be the Kmarket for the sale of boiler water treatment chemicals." ECF No. 50-2 at 2; *see also* ECF No. 50-2 at 28 (describing the appropriateness of separate BWT and CWT product markets).

2 Defendants' argument regarding the lack of interchangeability between BWT and CWT—i.e., the alleged product market's "overinclusiveness"—is at odds with the concept of a cluster market as a doctrine that "allow[s] items that are not substitutes for each other to be clustered together in one antitrust market for analytical convenience." *Staples II*, 190 F.Supp.3d at 117.

3 The FTC also notes that for both BWT and CWT, "Defendants have similar market shares, earn similar margins, and face a nearly identical set of competitors," PFF ¶ 12, and the margins and revenue shares are higher than for other marine products. PX-61002 ¶¶ 84, 85. To be sure, competitive conditions for BWT and CWT are not identical. Defendants have noted that while engine manufacturers approve specific brands of CWT chemicals for use in their engines, DX-2599 at 0007, boiler manufacturers do not maintain any such list. DX-0060 ¶ 67. Moreover, there is at least one supplier of CWT chemicals that does not supply BWT chemicals. DX-0060 ¶ 67. Nevertheless, the law on cluster markets requires only *similarity* in competitive conditions—not indistinguishability. *See* *Staples II*, 190 F.Supp.3d at 117.

4

Table 2:
The Parties' Sales of Water Treatment Products by Type
2017

	WSS		Drew	
Product	**Sales**	**Shares**	**Sales**	**Shares**
Boiler water treatment chemicals	[redacted]			
Cooling water treatment chemicals				
Boiler and cooling water treatment equipment				
Water production treatment chemicals				
Pool & spa treatment chemicals				
Other water testing and dosing equipment				
Other water treatment chemicals				
Total				

Source: Parties' invoice data

Notes: Sales to all vessels and sales to non-vessels are included. Drew's fixed fee revenues are excluded. For additional methodology details, please refer to Appendix 1.

The table above, taken from DX-0060 at 0018, indicates that BWT and CWT products account for [redacted] and [redacted] of WSS and Drew's “water treatment products” revenue, respectively, All other chemicals in the category together account for only [redacted] and [redacted] of water treatment products revenue.

5 Although WSS President and CEO Bjoerge Grimholt testified that trading pattern was not used internally for sales purposes, Grimholt Hrg. Tr. at 1224:24–25, this assertion is at odds with internal WSS documents explicitly using trading patterns to track sales and define market segments for sales purposes, *see, e.g.*, JX-0188 at 044–45, and with Grimholt's deposition testimony explaining the relationship between the two. PX70006 (Grimholt IH Vol. 1 Tr.) at 164:23–167:15.

6 Defendants argue that industrial suppliers and ship chandlers should be included as sellers in the relevant market, insofar as they sell some MWT chemicals to marine customers. The court disagrees. The evidence establishes that industrial suppliers focus most of their business on providing water treatment for industrial use on land, and have very limited involvement in the marine market. *See, e.g.*, Lange Hrg. Tr. at 1141:1–9 (noting that Nalco (owned by Ecolab) does not promote itself to the marine business), 1143:2–17 (describing total of [redacted] in annual sales to marine industry, [redacted] of which is to WSS); JX-0283 at 001 (explaining that [redacted] “deals with water treatment chemicals for manufacturing industry sector on ‘land,’ ” that only [redacted] deals with water treatment for the marine sector, and that it only sells to a distributor in Japan). Additionally, Defendants have not shown that the small number of marine sales attributable to industrial suppliers includes the range of additional services that comprise the “total solution” that WSS and Drew provide. *Cf. Sysco*, 113 F.Supp.3d at 26 (“[F]or example, fruit can be bought from both a grocery store and a fruit stand, but no one would reasonably assert that buying all of one's groceries from a fruit stand is a reasonable substitute for buying from a grocery store.”). Defendants have also produced no evidence to suggest that ship chandlers —marine retailers that stock a wide range of consumable goods in warehouses near ports—provide that solution. The same is true of testing equipment manufacturers. These observations are consistent with the HMT results, which suggest that neither industrial suppliers nor ship chandlers would be considered viable substitutes by any significant group of customers in the event of a price increase. To the extent that Defendants suggest that ship chandlers or other companies could easily reorganize to supply a total MWT solution that argument relates to ease of entry into the market, not to current market conditions.

7 Though Dr. Nevo believes that the PSM tends to overestimate the size of the market and accordingly understate market concentration, he found that the results of his calculations using the PSM do not qualitatively differ from those obtained using revenue information from MWT suppliers. PX61000 ¶ 251.

8 Defendants contend that the revenue information upon which Dr. Nevo relied is “unverified” because he made no effort to verify the accuracy of the information with the submitting parties. Hrg. Tr. at 1877:10-12. The court notes however that much of the revenue information was included in declarations given under penalty of perjury, and although some was provided in email communications with the FTC, Defendants have not proffered any specific reason to doubt the information's accuracy.

9 The court does however have concerns about Dr. Israel's “single invoice” rule. In an effort to exclude “one-off” purchasers, that rule excludes any vessel with only a single invoice in 2017, regardless of how much was purchased in that invoice and regardless of the timing of purchases from year to year. Thus, if a vessel were to purchase multiple times from Defendants in 2015 and 2016, but only once in 2017, the single invoice rule would treat that vessel as a non-loyal customer that bought its total supply of MWT elsewhere—ignoring the quantity it did buy from Defendants during 2017, and discounting

the possibility that the vessel stocked up on supplies for the relevant time period, or experienced downtime, or did not need to purchase again during that year for some other reason.

10 The complete results of these trials are presented in Dr. Nevo's reply report at PX61002 ¶ 104 Ex. 8. The relevant HHI statistics are summarized in the chart below:

Alternative Market Definition	Post-merger HHI	Change in HHI	Presumptively Unlawful?
Supply of marine water treatment to all vessels	6,991	3,399	Yes
Supply of boiler water treatment to all vessels	5,899	2,861	Yes
Supply of cooling system water treatment to all vessels	4,779	2,189	Yes
Supply of marine chemicals, gases, and refrigerants to all vessels	6,274	2,630	Yes

PFF ¶ 65.

11 *See, e.g.*, [redacted] (describing process of pitting WSS and Drew against one another, resulting in lower prices); Knowles Hrg. Tr. at 1426:23–1427:6 (describing how Drew won [redacted] business through competitive pricing against WSS); PX20063 (internal WSS email describing “aggressive offer from Drew” leading to increase in cost savings for Global Fleet customer); PX10346 at 002 (describing multiple non-price benefits afforded by Drew to Global Fleet customer in an effort to win business from WSS).

12 Defendants argue that current market pricing is inconsistent with the notion that they exercise market power. This is because the generally low cost of MWT (as a function of vessel operating cost) relative to the importance of the products should incentivize suppliers to charge higher prices to realize maximum value. Defendants argue that the fact that suppliers have not done so indicates that the products must exist in a competitive environment—not a highly concentrated (and therefore noncompetitive) one. Israel Hrg. Tr. at 1500:8–1501:17. However, the court does not understand the FTC to contend that the current market is noncompetitive—rather, the FTC contends that the market *is* competitive, and that the continued competitiveness of the market depends on aggressive competition between the two existing global suppliers with high market shares. A head-to-head competition theory is not inconsistent with the presence of lower prices in the current market.

13 Dr. Nevo's calculations did not rely on the salesforce data for the Drew GUPPI because that data was unavailable. Nevo Hrg. Tr. at 660:15–16.

14 The court also acknowledges the vessel-level “switching” study performed by Dr. Israel, which investigated head-to-head competition by examining what happens when vessels stop buying MWT from one of the merging parties, in order to find out whether the vessels “switch” to the other merging party or go elsewhere. Essentially, Dr. Israel used sales data to focus on vessels weighing 1,000 gross tons or more that purchase from one of the merging parties in one year but not the next year (or years, in some formulations). If that vessel disappeared from the invoice data for one party, and did not show up in the invoice data for the other within the relevant time period, Dr. Israel counted it as a “loss.” Dr. Israel's results indicated that most vessels that switch from one merging party do not typically switch to the other. DX-0060 at ¶ 124 & Appendix 3.

Dr. Israel's study does not factor heavily in the court's calculus for several reasons: (1) the study does not appear to address the effect of the transaction on fleet-level bargaining over framework agreements, unlike Dr. Nevo's studies; (2) it employs the single-invoice rule, which this court has already found to be problematic in note 9, *supra*; (3) it assumes that vessel absences from sales data for a given period mean that another supplier is serving its needs, but provides no data to support that assumption (while the FTC has come forward with some evidence to show that the assumption is false or true in only a small number of cases that do not relate to competitive considerations, *see, e.g.*, PX70025 (Sarro Dep. Tr. at 116:12–23); PX40031 at 001)).

15 Defendants' contention that customers who believe that there are no other MWT suppliers capable of serving their needs are uninformed is itself indicative of the importance of reputation in the industry—if reputation were less important, it is unlikely that a sophisticated customer would fail to investigate potentially cheaper alternatives.

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1982 CarswellBC 230
Supreme Court of Canada

R. v. Abbey

1982 CarswellBC 230, 1982 CarswellBC 740, 1982 J.E. 762, [1982] 2 S.C.R. 24, [1982] B.C.W.L.D. 2107, [1982] S.C.J. No. 59, [1983] 1 W.W.R. 251, 138 D.L.R. (3d) 202, 29 C.R. (3d) 193, 39 B.C.L.R. 201, 43 N.R. 30, 68 C.C.C. (2d) 394, 8 W.C.B. 81, J.E. 82-762

R. v. ABBEY

Laskin C.J.C., Martland, Ritchie, Dickson, Beetz, Estey, McIntyre, Chouinard and Lamer JJ.

Heard: December 16, 1981
Judgment: July 22, 1982
Docket: 16589

Counsel: *E. G. Ewaschuk, Q.C.*, and *S. D. Frankel*, for the Crown.
J. Wood, for respondent.

The judgment of the court was delivered by *Dickson J.*:

1 Robert Mark Abbey was tried by a judge sitting alone on two charges: (i) importing cocaine into Canada; and (ii) unlawful possession of cocaine for the purpose of trafficking. His sole defence was that he was insane at the material time. The trial judge gave effect to that defence. He found Abbey not guilty on account of insanity, and the Court of Appeal of British Columbia dismissed a Crown appeal [21 C.R. (3d) 63, 29 B.C.L.R. 212, 60 C.C.C. (2d) 49]. The matter has now, by leave, reached this court.

I

The Facts and History of the Case

2 The facts surrounding the commission of the offence are not in dispute. Pursuant to s. 582 of the Criminal Code, R.S.C. 1970, c. C-34, Abbey admitted, amongst others, the following facts alleged against him, for the purpose of dispensing with proof. On Sunday, 13th May 1979, Abbey arrived at the Vancouver International Airport on C.P. Air flight 421 from Lima, Peru. He entered Canada carrying a brown shoulder bag containing two clear plastic bags, the contents of which weighed 5.5 ounces and were analyzed to be approximately 50 per cent pure cocaine. After disembarkation, Abbey proceeded directly to the Canada Customs primary counter, where he presented his passport and a signed customs declaration. He then obtained his suitcase from a baggage carousel and proceeded to the customs secondary counter. Abbey placed the suitcase and shoulder bag on the counter. The customs inspector looked into the shoulder bag and observed a camera case and underneath it two plastic bags of white powder, the cocaine. The following conversation ensued between the customs inspector, Jung, and Abbey:

> JUNG [holding the two plastic bags of white powder]: What is it?
>
> ABBEY: You got me.
>
> JUNG: What is it?
>
> ABBEY: It's coke.

R.C.M.P. Constable Giesbrecht arrived on the scene:

CONSTABLE GIESBRECHT [indicating the brown shoulder bag]: What's in here?

ABBEY: Naturally, cocaine.

CONSTABLE GIESBRECHT: How much?

ABBEY: 130 to 150 grams.

CONSTABLE GIESBRECHT: You need not say anything, however, anything you do say may be given in evidence. You understand this? ... What's the white powder?

ABBEY: Cocaine.

CONSTABLE GIESBRECHT: You brought the cocaine into the country?

ABBEY: Yes.

CONSTABLE GIESBRECHT [indicating the brown shoulder bag]: Did you bring this suitcase into the country?

ABBEY: Yes.

Later in the day Abbey gave the police a signed statement in which he said that in the last two weeks of April 1979, while still in Canada, he had received $900 from three individuals on the express understanding that he would purchase 13 grams of cocaine for them in Peru. The two plastic bags contained 158.7 grams of cocaine, the "street value" of which was $76,320 if cut to 13 per cent purity, or $18,150 if sold uncut, by the ounce. It was a profit venture. In his statement to police, which was submitted in evidence, Abbey was asked if there was anything he would like to say with respect to the importation of cocaine. He replied:

It was just there. I've been down there many times, and when you see it for five dollars — I was going to school and the Philippines, and it was the perfect way to have a perfect year. I can't believe I did it.

3 As I have said, the only defence raised was s. 16(2) of the Criminal Code: insanity. Section 16 of the Code reads:

16.(1) No person shall be convicted of an offence in respect of an act or omission on his part while he was insane.

(2) For the purposes of this section a person is insane when he is in a state of natural imbecility or has disease of the mind to an extent that renders him incapable of appreciating the nature and quality of an act or omission or of knowing that an act or omission is wrong.

(3) A person who has specific delusions, but is in other respects sane, shall not be acquitted on the ground of insanity unless the delusions caused him to believe in the existence of a state of things that, if it existed, would have justified or excused his act or omission.

(4) Every one shall, until the contrary is proved, be presumed to be and to have been sane.

4 As witnesses, the Crown called the customs inspectors and R.C.M.P. officers who searched and questioned Abbey at the airport. They said that Abbey appeared "normal" in their dealings with him. Abbey did not testify. The defence called only one witness, Dr. Vallance, a psychiatrist. In rebuttal the Crown called another psychiatrist, Dr. Eaves. No other witnesses gave testimony.

5 Dr. Vallance testified that he first saw Abbey approximately ten weeks after the commission of the offence. Dr. Vallance's testimony was based on his interviews with Abbey, his interviews with Abbey's mother, his review of a medical report prepared by another pyschiatrist, and his discussions with other doctors who were involved in treating Abbey. In particular, Dr. Vallance relied on Abbey's description of the events surrounding his trip to South America as indicative of his mental state at the material

time. Dr. Vallance's opinion was that Abbey, at all material times, was suffering from a disease of the mind, a manic illness, known as "hypomania". While Abbey appreciated that he was bringing cocaine into Canada and knew that what he was doing was wrong, he believed that, if caught, he would not be punished. Dr. Vallance said:

> He had a considerable disturbance of mood. He had delusional ideas. He had hallucinatory experiences. It's difficult under circumstances like that to fully appreciate what you are doing, particularly when the feelings and delusional ideas are tangled up with what you are doing. If you feel that you are, for some delusional idea, inordinately powerful or safe, then that impairs good judgment. I am sure he had some appreciation of what he was doing.

6 Dr. Vallance further testified that, while Abbey was not rendered totally incapable of appreciating the nature and quality of his acts by reason of the disease of mind from which he suffered, there was a degree of impairment of judgment. He had the feeling that he was being looked after by some outside force that was feeding him strength, and that no harm would come to him, and even if he did get caught it did not matter, because somehow he would be looked after. Dr. Vallance made reference to Abbey's delusional belief that he was committed to a particular path of action which he could not change, and his further delusional idea, while in Lima, Peru, that he had "astro-travelled" back to Vancouver already, and that in getting on the plane in Lima to fly home he was simply having the body follow where the "rest" had already gone.

7 Dr. Eaves, in rebuttal, was of the opinion that the disease of the mind experienced by Abbey, hypomania, would "not be substantially enough to render him incapable of appreciating the nature and quality of his actions or of knowing that his actions were wrong".

8 The trial judge found that Abbey suffered from a disease of the mind. This was common ground. Both doctors agreed, however, that Abbey knew what was doing and he knew that it was wrong. They disagreed on their assessment of the degree of Abbey's capability as of 13th May 1979. The judge found that disease of the mind incapacitated his ability to appreciate the nature and quality of his acts to the degree required to meet the test of s. 16(2). More particularly, Abbey did not "appreciate" the consequences of punishment associated with the commission of the offence. After referring to the decision of this court in *Cooper v. R.*, [1980] 1 S.C.R. 1149, 13 C.R. (3d) 97, 18 C.R. (3d) 138, 51 C.C.C. (2d) 129, 110 D.L.R. (3d) 46, 31 N.R. 234, the trial judge did find that Abbey "had the capacity to appreciate the nature of his acts of importing and possessing the cocaine". He continued:

> As I understand the evidence and the submissions of counsel, the accused had the capacity to appreciate the nature of the act of importing and of possessing the cocaine. He also had the capacity to appreciate the immediate consequences of those acts, that is to say, that they were illegal, that he should not commit them overtly, that if he succeeded he must then deliver some of the cocaine to his friends who gave him the money for it and find someone through another friend who would buy the rest at a large profit to himself. He had the capability, in that sense, of analyzing the knowledge of what he was about, and he — in using the word "analyzing" I adopt the definition given by Estey J. in the Supreme Court of Canada decision *R. v. Barnier*, [1980] 1 S.C.R. 1124, 13 C.R. (3d) 129, 19 C.R. (3d) 371, [1980] 2 W.W.R. 659, 51 C.C.C. (2d) 193, 109 D.L.R. (3d) 257, 31 N.R. 273.

9 The trial judge, however, did not stop there. He went on to consider:

> ... whether the law requires that an accused also be able to appreciate, in the sense of which I have read from Estey J.'s decision, the consequences that may be personal to him, that is to say, the consequence of punishment.

10 In finding Abbey not guilty by reason of insanity, the judge concluded that:

> ... one who, like Abbey, suffers from the delusion that he is protected from punishment by some mysterious external force which comes to him as described in the evidence of Dr. Vallance has his ability to appreciate the nature and quality of his acts incapacitated to the degree required to meet the test of s. 16(2). He is, by disease of the mind, deprived of the ability to assess an important consequence of his act. He is deprived of the effect of the penal sanctions ...

11 The Crown appealed, contending that the trial judge had erred in law in directing himself to the law applicable to the defence of insanity. The appeal was dismissed.

12 The Crown has now appealed to this court, on the grounds raised in the British Columbia Court of Appeal:

13 (1) The trial judge erred in holding that a person who, by reason of a disease of the mind, does not "appreciate" the personal penal consequences of his actions is insane within the meaning of s. 16(2) of the Criminal Code.

14 (2) The trial judge erred in giving effect to a defence of "irresistible impulse".

15 (3) The trial judge misdirected himself with respect to the use which could be made of "hearsay" evidence introduced during the testimony of the psychiatrists who were called as witnesses.

II

Consequences

The first arm of s. 16(2)

16 The question raised in the first ground of appeal is therefore whether "appreciation of the nature and quality of an act" is limited to appreciation of the physical consequences of the act or also includes appreciation of the penal consequences to the accused, Taggart J.A., speaking for the Court of Appeal, said that *Cooper v. R.*, supra, and *R. v. Barnier*, supra, made it clear that there is a distinction between "know" and "appreciate" and that the words "appreciate the nature and quality of his acts" connote more than a mere knowledge of the physical nature of the acts being committed. With respect, I agree. The British Columbia court failed, however, to deal with the question of what it is that an accused must fail to "appreciate" before he can be found to be legally insane. The court simply accepted the trial judge's conclusion that somebody who, because of a disease of the mind, has the delusion that he is protected from punishment by some mysterious external force is incapacitated from appreciating the nature and quality of his acts.

17 The defence of insanity in s. 16(2) of the Criminal Code has received lengthy consideration by this court in several recent judgments: *Cooper v. R.*, supra; *R. v. Barnier*, supra; and, most recently, *Kjeldsen v. R.*, 24 C.R. (3d) 289, 28 C.R. (3d) 81, [1982] 1 W.W.R. 577, 17 Alta. L.R. (2d) 97, 64 C.C.C. (2d) 161, 131 D.L.R. (3d) 121, 34 A.R. 576, 39 N.R. 376. As stated in *Cooper v. R.*, s. 16(2) of the Criminal Code "does not set out a test of insanity but, rather the criteria to be taken into account in determining criminal responsibility" (at p. 1152). With some hesitation, the trial judge came to the conclusion that:

> ... one who, like Abbey, suffers from the delusion that he is protected from punishment by some mysterious external force which comes to him as described in the evidence of Dr. Vallance has his ability to appreciate the nature and quality of his acts incapacitated to the degree required to meet the test of s. 16(2). He is, by disease of the mind, deprived of the ability to assess an important consequence of his act. He is deprived of the effect of the penal sanctions in restraining him from the commission of a crime, its it should restrain us all.

18 With respect, the trial judge has confused the "ability to perceive the consequences, impact and results of a physical act" (*Cooper v. R.*, at p. 1162) with a belief, however unjustified, that the legal sanction imposed for the commission of the prohibited act, the "legal consequences", was somehow inapplicable to him. The delusion under which Abbey was supposedly labouring was that he would not get caught, or, if caught, would benefit from some undefined immunity to prosecution. Such a delusion by no means brings him under the first arm of the insanity test in s. 16(2) of the Criminal Code, as developed in the recent cases.

19 According to s. 16(2), a person is insane when he has a disease of the mind to an extent that renders him incapable of: (i) appreciating the nature and quality of an act; or (ii) knowing that an act is wrong. As the recent decisions dealing with s. 16(2) have noted, the wording in the Criminal Code is slightly different than in the English *M'Naghten* rules [*M'Naghten's Case* (1843), 10 Cl. & Fin. 200, 8 E.R. 718 (H.L.)], which are the inspiration for the section. The concern of the recent cases has

been to set the limits for the defence, limits which are broader than those in the *M'Naghten* rules. The *M'Naghten* rules, under what is termed the "first arm" of the test, require the accused to be incapable of *knowing* the nature and quality of his act. As has been pointed out by the commentators, a narrow literal interpretation of this test is such that "nobody is hardly ever really mad enough to be within it" (Bramwell B., quoted by G. A. Martin in "Insanity as a Defence" (1966), 8 Cr. L.Q. 240, at p. 243).

20 As the court said in *Cooper v. R.*, at p. 1161:

> To "know" the nature and quality of an act may mean merely to be aware of the physical act, while to "appreciate" may involve estimation and understanding of the consequences of that act. In the case of the appellant, as an example, in using his hands to choke the deceased, he may well have known the nature and quality of that physical act of choking. It is entirely different to suggest, however, that in performing the physical act of choking, he was able to appreciate its nature and quality in the sense of being aware that it could lead to or result in her death.

It is the use of the word "consequences" in this context which, unfortunately, led the trial judge astray. "Consequences" in *Cooper v. R., R. v. Barnier*, and *Kjeldsen* v. R., all supra, refer to the physical consequences of the act. All three cases were murder cases, violent crimes in which there was a victim who suffered the "consequences" of the accused's actions: *Cooper v. R.* at pp. 1162-63:

> The requirement, unique to Canada, is that of perception, an ability to perceive the consequences, impact, and results of a physical act. An accused may be aware of the physical character of his action (i.e., in choking) without necessarily having the capacity to appreciate that, in nature and quality, that act will result in the death of a human being. *This is simply a restatement, specific to the defence of insanity, of the principle that mens rea, or intention as to the consequences of an act, is a requisite element in the commission of a crime*. (The italics are mine.)

21 In *Schwartz v. R.*, [1977] 1 S.C.R. 673 at 700, 34 C.R.N.S. 138, 29 C.C.C. (2d) 1, 67 D.L.R. (3d) 716, 8 N.R. 585, Martland J. said:

> The *Codere* case [*R. v. Codere* (1916), 12 Cr. App. R. 21], in my opinion correctly, decided that "nature and quality" dealt with the physical character of the act. If, therefore, a person who has committed a crime did not, by reason of disease of the mind, know what he was doing, he is not to be convicted, because it really was not his act.

22 In *R. v. Codere*, Reading L.C.J. considered the application of the M'Naghten rules, and in particular the expression "nature and quality of the act" (pp. 26-27):

> It is said that "quality" is to be regarded as characterising the moral, as contrasted with the physical, aspect of the deed. The Court cannot agree with that view of the meaning of the words "nature and quality". The Court is of opinion that in using the language "nature and quality" the judges were only dealing with the physical character of the act, and were not intending to distinguish between the physical and moral aspects of the act. That is the law as it has been laid down by judges in many directions to juries, and as the Court understands it to be at the present time.

See also *R. v. Harrop*, 48 Man. R. 113, [1940] 3 W.W.R. 77, 74 C.C.C. 228 at 230, [1940] 4 D.L.R. 80 (C.A.); *R. v. Crook* (1979), 1 Sask. R. 273 at 303, leave to appeal to S.C.C. refused 5 Sask. R. 360n, 32 N.R. 444n.

23 Although there is some controversy in academic circles, I adopt the more traditional view espoused by Glanville Williams (Criminal Law, The General Part, 2nd ed. (1961), para. 166, at p. 525) that a delusion falling under the "first arm" of the insanity defence negatives an element of the crime, the mens rea. It may also, as Martin J.A. pointed out in *R. v. Rabey* (1977), 17 O.R. (2d) 1, 40 C.R.N.S. 46, 1 L.M.Q. 280, 37 C.C.C. (2d) 461, 79 D.L.R. (3d) 414 (C.A.), notwithstanding the existence of mens rea in the formal sense of intention, foresight, or knowledge with respect to the actus reus, exempt from liability if the criteria of insanity are met. As the court observed in *Cooper*, supra, the requirement that the accused be able to perceive the consequences of a physical act is a restatement, specific to the defence of insanity, of the principle of mens rea, or intention as to the consequences of an act, as a requisite element in the commission of a crime. The mental element must be proved with respect to all circumstances, and consequences, that form part of the actus reus. As the Crown in this case correctly points out,

"while punishment may be a *result* of the commission of a criminal act it is not an *element* of the crime ifself". A delusion which renders an accused "incapable of appreciating the nature and quality of his act" goes to the mens rea of the offence and brings into operation the "first arm" of s. 16(2): he is not guilty by reason of insanity. A delusion which renders an accused incapable of appreciating that the penal sanctions attaching to the commission of the crime are applicable to him does not go to the mens rea of the offence, does not render him incapable of appreciating the nature and quality of the act, and does not bring into operation the "first arm" of the insanity defence.

24 Abbey was charged with importing and trafficking in cocaine. There is no dispute as to the fact that he carried cocaine into the country. In his statement to police, it was his admitted intention to import cocaine for the purposes of trafficking. In other words, Abbey appreciated that the actus reus of each of the offences charged was being committed. Both the psychiatrist called for the defence and the psychiatrist who testified on behalf of the Crown stated that Abbey appreciated the nature and quality of his act. The judge erred, in my view, in going on to say that a failure to appreciate the penal sanctions ("consequences of punishment") brought the accused within the ambit of the "first arm" of the insanity defence of s. 16(2).

The second arm of s. 16(2)

25 Should the question of "personal penal consequences" be relevant at all, it is more appropriately discussed within the context of the second arm of s. 16(2), i.e., "knowing that an act is wrong". Glanville Williams in his Criminal Law, the General Part, at p. 478 says:

> It has been determined that this phrase ["nature and quality"] refers to the physical character of the act, not its legal quality; legal right and wrong are cared for by the second question [citing *R. v. Codere*, supra, at p. 27].

This court having decided in *Schwartz v. R.*, supra, that "wrong" means wrong according to law, and it being established that Abbey knew his act was "wrong", his inability to "appreciate" the penal consequences is really irrelevant to the question of legal insanity. There seems to be no doubt on the evidence, and on the judge's findings, that Abbey knew that he was doing an act forbidden by law.

26 With respect, the trial judge homogenized the first and second arms of s. 16(2), collapsing the one into the other in, for example, the following passage from his judgment:

> As I understand the evidence and the submissions of counsel, the accused had the capacity to appreciate the nature of the act of importing and of possessing the cocaine. He also had the capacity to appreciate the immediate consequences of those acts, that is to say, that they were illegal, that he should not commit them overtly ...

27 The second arm of s. 16(2) is concerned with cognitive capabilities, with knowledge, and not with appreciation of consequences. Section 16(2) speaks in terms of knowledge of wrongness, not appreciation of wrongness. One must, I think, draw a distinction between what might be termed "result" crimes and what might be termed "knowledge" crimes. In respect of the former it is correct to speak of appreciation of consequences. The capacity to appreciate the nature and quality of his act refers to the physical character of the act. It requires both an appreciation of the factors involved and sufficient mental capacity to measure and foresee the consequences of the conduct.

28 With respect, however, to the second arm of s. 16(2), knowledge that it is wrong, Martland J. set out the test in the *Schwartz* case, supra, at p. 701:

> In brief, it is my opinion that the effect of s. 16(2) is to provide protection to a person suffering from disease of the mind who has committed a crime if, in committing the crime, he did not appreciate what he was doing, or, if he did have that appreciation, he did not know that he was committing a crime.

29 In a note on *Schwartz v. R.*, "Section 16 and 'Wrong' "(1976), 18 Cr. L.Q. 413, Professor Mewett submits at p. 415 that the question that ought to be asked is "whether the accused, because of a disease of the mind (first hurdle) was rendered incapable (second hurdle) of knowing that his act was something that he ought not to do (third hurdle)" If he was capable of knowing

that an act was contrary to law, and that he ought not to do an act contrary to law, then, in the opinion of Professor Mewett, the defence should not apply.

30 When one is considering the legal aspects of a crime such as the importation of a narcotic the principal inquiry should be directed, not to appreciation of physical consequences, but to knowledge of wrongness. The trial judge said: "This man knew it was a crime, knew there was a penalty, but by delusion believed himself protected." Counsel for Abbey said in argument that he had to accept the fact that he could not bring Abbey's state of mind into the second half of s. 16(2). On these findings, in my opinion, the defence of insanity was not open to Abbey.

31 I agree with the submission of counsel for the Crown that s. 16(3) of the Code can be of no assistance to Abbey as his delusion could not in any way "justify" or "excuse" his actions. In any event, any defence which could be raised under subs. (3) could also be raised under subs. (2): see the McRuer Report [Report of the Royal Commission on the Law of Insanity as a Defence in Criminal Cases (1956)], p. 36.

32 I am of the view that the trial judge erred in law in holding that a person who, by reason of disease of the mind, does not "appreciate" the penal consequences of his actions is insane within the meaning of s. 16(2) of the Criminal Code.

III

Irresistible Impulse

33 The second ground of appeal is the submission that the trial judge erred in giving effect to a defence of "irresistible impulse". The submission rests upon the following passage from the judgment at trial, and in particular the words "he believed himself irrevocably committed":

> I must also note a second question, closely connected with the delusion I have already discussed. It involves the delusion which I find existed with Abbey and which also satisfies the test of s. 16(2) that while he was in Peru he thought he should not go through with the importing and possession of cocaine, but he believed himself irrevocably committed to it. That was not in the sense that, having arranged with his friends, he was bound to honour the arrangement, but in the sense that he was committed to a path of action which he was, by reason of a force acting upon him, powerless to change.

34 The Crown maintains that the trial judge found that this "second delusion", independently of any other delusions, rendered Abbey legally insane. Such a finding, the Crown contends, gives effect to a defence not recognized in Canadian law, that of irresistible impulse. What was said by Cartwright C.J.C. in *R. v. Borg*, [1969] S.C.R. 551, 7 C.R.N.S. 85, 68 W.W.R. 203, [1969] 4 C.C.C. 262, 6 D.L.R. (3d) 1, is cited in support of this proposition.

35 There is no issue here at all. Both the majority and minority opinions in *R. v. Borg* deny the existence of a defence, as such, of irresistible impulse. Both the majority and minority opinions in *Borg*, however, recognize that irresistible impulse may be a symptom or manifestation of a disease of the mind which may give rise to defence of insanity: Hall J. at p. 570:

> When an accused pleads insanity there is a sense in which it is true to say that irresistible impulse of itself is not a defence. However, there are two senses in which it is not true to say that irresistible impulse of itself is not a defence.
>
> There is no legal presumption of insanity merely from the existence of an irresistible impulse. If an accused presents no medical evidence of disease of the mind but merely pleads that he was acting under an irresistible impulse, a jury is not entitled to infer that the man was insane. In that sense irresistible impulse is not of itself a defence. However, if there is medical evidence of disease of the mind as there was here and yet the only symptoms of that disease of the mind are irresistible impulses, the jury may conclude that the accused is insane.

There is no error in the trial judgment in this respect. The trial judge did not give effect to an independent defence of irresistible impulse. His comments with respect to the "second delusion" were made in the context of his consideration of the insanity defence. He specifically rejected the existence of a defence of diminished responsibility in Canada.

36 I agree with the British Columbia Court of Appeal that the reasons of the trial judge should be understood in the sense that Abbey suffered from a disease of the mind which resulted in two delusions — the first was that some mysterious external force would protect him from punishment, the second was that he believed himself irrevocably committed to the course of action of importing cocaine — and that these delusions, taken together, rendered him incapable of appreciating the nature and quality of his acts. The trial judge did not equate the "delusion" with a defence of irresistible impulse and, that being the case, such authorities as *R. v. Borg*, supra, and *R. v. Creighton* (1908), 14 C.C.C. 349 (Ont. H.C.), and other authorities to a similar effect cited by Crown counsel have no application to the case at bar.

IV

Hearsay evidence

37 As a third ground of appeal, the Crown contends that the trial judge misdirected himself with respect to the use which could be made of hearsay evidence introduced during the testimony of the psychiatrists who were called as witnesses.

38 Dr. Vallance testified that during the course of his interviews Abbey told him of various delusions, visions, hallucinations and sensations which he had experienced in the six months preceding his arrest. Dr. Vallance also testified that Abbey had described certain symptoms of the disease to his mother several months prior to the commission of the offence. In his testimony, Dr. Vallance recounted several incidents of bizarre and unstable conduct by Abbey, both before his departure for Peru and during his stay. Abbey had told him, Dr. Vallance testified, that four days prior to his actual departure for Peru he had missed a flight and, in a rage, kicked in a window at Vancouver airport. Dr. Vallance was also told by Abbey of certain experiences in Peru:

> ... he could see lights and follow the lights and would interpret those phenomenon with ideas that there was some power outside of him that was communicating with him. he would do strange things, like run out into the fields. He was licking the wetness from trees.

The Crown submits that the trial judge accepted and treated as factual much of his hearsay evidence related by Dr. Vallance in the course of giving his opinion. The point is well taken.

39 A general principle of evidence is that all relevant evidence is admissible. The law of evidence, however, reposes on a few general principles, riddled by innumerable exceptions. Two major exceptions to this general principle are hearsay evidence and opinion evidence. There are also exceptions to the exceptions. "Expert witnesses may testify to their opinion on matters involving their expertise" (Cross on Evidence, 5th ed. (1979), at p. 20), and may also, incidentally, base their opinions upon hearsay.

40 A major difficulty encountered by counsel and the courts alike has been identifying hearsay. There exists a "superstitious awe ... about having any truck with evidence which involves A's telling the court what B said to him": Cross, "What should be done about the Rule Against Hearsay?", [1965] Crim. L. Rev. 68, at p. 82. Phipson on Evidence, 12th ed. (1976), 1980 supplement, para. 625, pp. 263-64, suggests three reasons for this:

> 1) Failure to appreciate that the hallmark of a hearsay statement is not only the nature and the source of the statement but also the purpose for which it is tendered.
>
> 2) The absence of any comprehensive judicial formulation of the rule — no doubt because "it is difficult to make any general statement about the law of hearsay which is entirely accurate".
>
> 3) The multiplicity of formulations found in textbooks upon the subject.

41 The main concern of the hearsay rule is the veracity of the statements made. The principal justification for the exclusion of hearsay evidence is the abhorrence to the common law of proof which is unsworn and has not been subjected to the trial by fire of cross-examination. Testimony under oath, and cross-examination, have been considered to be the best assurances of the truth of the statements of facts presented. Not all statements by a witness of that which he heard someone else say are, however,

necessarily hearsay. A felicitous formulation of the distinction between hearsay and non-hearsay evidence is found in the Privy Council decision in *Subramanian v. Pub. Prosecutor*, [1956] 1 W.L.R. 965 at 970:

> Evidence of a statement made to a witness by a person who is not himself called as a witness may or may not be hearsay. It is hearsay and inadmissible when the object of the evidence is to establish the truth of what is contained in the statement. It is not hearsay and is admissible when it is proposed to establish by the evidence, not the truth of the statement, but the fact that it was made.

42 What is sometimes loosely and erroneously referred to as "hearsay evidence" may in fact be "original evidence", as Cross terms it at p. 8:

> When a witness is asked to narrate another's statement for some purpose *other than that of inducing the court to accept it as true*, his evidence is said to be "original". Original evidence may therefore be defined as evidence of the fact that a statement was made, tendered without reference to the truth of anything alleged in the statement. (The italics are mine.)

Opinion evidence

43 Witnesses testify as to facts. The judge or jury draws inferences from the facts. "In the law of evidence 'opinion' means any inference from observed fact, and the law on the subject derives from the general rule that witnesses must speak only to that which was directly observed by them.": Cross on Evidence at p. 442. Where it is possible to separate fact from inference, the witness may testify only as to fact. It is not always possible, however, to do so, and the "law makes allowances for these borderline cases by permitting witnesses to state their opinion with regard to matters not calling for special knowledge whenever it would be virtually impossible for them to separate their inferences from the facts on which those inferences are based.": Cross at p. 442.

44 With respect to matters calling for special knowledge, an expert in the field may draw inferences and state his opinion. An expert's function is precisely this: to provide the judge and jury with a ready-made inference which the judge and jury, due to the technical nature of the facts, are unable to formulate. "An expert's opinion is admissible to furnish the Court with scientific information which is likely to be outside the experience and knowledge of a judge or jury. If on the proven facts a judge or jury can form their own conclusions without help, then the opinion of the expert is unnecessary.": *R. v. Turner*, [1975] Q.B. 834, 60 Cr. App. R. 80 at 83, [1975] 1 All E.R. 70, per Lawton L.J.

45 An expert witness, like any other witness, may testify as to the veracity of facts of which he has first-hand experience, but this is not the main purpose of his or her testimony. An expert is there to give an opinion. And the opinion more often than not will be based on second-hand evidence. This is especially true of the opinions of psychiatrists.

46 As stated by Fauteux J. in *Wilband v. R.*, [1967] S.C.R. 14 at 21, 2 C.R.N.S. 29, 60 W.W.R. 292, [1967] 2 C.C.C. 6:

> The value of a psychiatrist's opinion may be affected to the extent to which it may rest on second-hand source material; but that goes to the weight and not to the receivability in evidence of the opinion, which opinion is no evidence of the truth of the information but evidence of the opinion formed on the basis of that information.

47 In the *Wilband* case counsel for Wilband had attempted to have declared inadmissible as hearsay opinion evidence because it was based in part on prison records, material not proved in open court. Fauteux J. found that in fact the prison records were not relied upon to any significant extent by the psychiatrists in the formation of their opinion, but the decision does stand for the proposition that the second-hand nature of the basis of the opinion does not "contaminate" the opinion. This is consistent with the acceptance of expert evidence based, as it often is, upon hypothetical questions. For the judge or jury, the expert's opinion is a question of fact which may be accepted or rejected as seen fit. The opinion, even if uncontradicted, is not determinative of an issue.

48 Thus an expert opinion based on second-hand evidence is admissible, if relevant. The problem arose in *R. v. Dietrich*, [1970] 3 O.R. 725, 11 C.R.N.S. 22, 1 C.C.C. (2d) 49, leave to appeal to S.C.C. refused [1970] 3 O.R. 744n, 1 C.C.C. (2d) 68n, as to second-hand evidence which itself formed the basis of the opinion. Gale C.J.O. at p. 65 reached the conclusion that:

> Put shortly, if an expert is permitted to give his opinion, he ought to be permitted to give the circumstances upon which that opinion is based.

Testimony as to circumstances upon which the opinion is based is not introduced, and cannot be introduced, in order to establish the veracity of the second-hand evidence. It is thus not hearsay evidence. Jessup J.A. correctly stated the law in *R. v. Rosik*, [1971] 2 O.R. 47 at 84, 13 C.R.N.S. 129, 13 Cr. L.Q. 224, 2 C.C.C. (2d) 351, affirmed [1971] 2 O.R. 89n, 14 C.R.N.S. 400, 2 C.C.C. (2d) 393n (S.C.C.):

> In my view, a psychiatrist expressing an opinion as to a mental or emotional condition of an accused can relate in evidence, as Dr. Gray did, what he has been told by the accused *when such information is a basis of his opinion*. (The italics are mine.)

And at p. 85:

> The hearsay rule does not operate to exclude such evidence because it is not admitted to prove the fact of what the expert has been told: see *Wigmore on Evidence*, 3rd ed. [1940], vol. VI, s. 1720, p. 70, approved by Gale C.J.O. in the *Dietrich* case [supra]. The trial judge should have so instructed the jury and it would have been proper for him also to point out that there was no sworn evidence that the accused ingested drugs or consumed the quantity of alcohol integral to Dr. Gray's opinion ...

Jessup J.A.'s view was recently confirmed by this court in *Phillion v. R.*, [1978] 1 S.C.R. 18, 37 C.R.N.S. 363, 33 C.C.C. (2d) 535, 74 D.L.R. (3d) 136, 14 N.R. 371. After citing the excerpt from *Subramanian v. Pub. Prosecutor*, supra, which is quoted above with respect to hearsay evidence, Ritchie J. went on to say (p. 24):

> Statements made to psychiatrists and psychologists are sometimes admitted in criminal cases and when this is so it is because they have qualified as experts in diagnosing the behavioural symptoms of individuals and have formed an opinion which the trial judge deems to be relevant to the case, but the statements on which such opinions, are based are not admissible in proof of their truth but rather as indicating the basis upon which the medical opinion was formed in accordance with recognized professional procedures.

49 The danger, of course, in admitting such testimony is the ever-present possibility, here exemplified, that the judge or jury, without more, will accept the evidence as going to the truth of the facts stated in it. The danger is real, and lies at the heart of this case. Once such testimony is admitted, a careful charge to the jury or direction to himself by the judge is essential. The problem, however, as pointed out by Fauteux J. in *Wilband*, supra, resides not in the admissibility of the testimony but rather in the weight to be accorded to the opinion. Although admissible in the context of his opinion, to the extent that it is second-hand his testimony is not proof of the facts stated. Lawton L.J. in *Turner*, supra, spoke of this "elementary principle" which is "frequently overlooked" (p. 82):

> Thereupon the judge commented that the report contained "hearsay character evidence" which was inadmissible. He could have said that all the facts upon which the pyschiatrist based his opinion were hearsay save for those which he observed for himself during his examination of the appellant such as his appearance of depression and his becoming emotional when discussing the deceased girl and his own family. It is not for this Court to instruct psychiatrists how to draft their reports, but *those who call psychiatrists as witnesses should remember that the facts upon which they base their opinions must be proved by admissible evidence. This elementary principle is frequently overlooked*. (The italics are mine.)

50 In the present case Abbey did not testify. Dr. Vallance testified, in the course of his opinion, as to many events and experiences related to him during several interviews. This testimony, while admissible in the context of the opinion, was not in any way evidence of the factual basis of these events and experiences. The trial judge in his decision fell into the error of accepting, as evidence of these facts, testimony which, if taken to be evidence of their existence, would violate the hearsay

rule. There was no admissible evidence properly before the court with respect to: the delusions experienced by the accused; the accused having described the symptoms of his disease to his mother some six months prior to the commission of the offence; the accused having seen a psychiatrist before leaving for Peru; the accused's unstable conduct at the airport some days prior to leaving for Peru; or his bizarre behaviour in Peru.

51 In my view, the trial judge erred in law in treating as factual the hearsay evidence upon which the opinions of the psychiatrist were based.

52 Counsel for Abbey said that the passages in which the trial judge seemed to take symptoms as findings of fact were merely "unfortunate language". But it goes further than that. As Woods J.A. said in *R. v. Perras*, 20 C.R.N.S. 90, [1972] 5 W.W.R. 183, 8 C.C.C. (2d) 209 at 213, affirmed [1974] S.C.R. 659, 22 C.R.N.S. 160, [1973] 5 W.W.R. 275, 11 C.C.C. (2d) 449, 35 D.L.R. (3d) 596:

> The evidence of a physician stating what a patient told him about his symptoms is not evidence as to the existence of the symptoms. To accept it as such would be to infringe the rule against hearsay.

It was appropriate for the doctors to state the basis for their opinions and, in the course of doing so, to refer to what they were told not only by Abbey but by others, but it was error for the judge to accept as having been proved the facts upon which the doctors had relied in forming their opinions. While it is not questioned that medical experts are entitled to take into consideration all possible information in forming their opinions, this in no w ay removes from the party tendering such evidence the obligation of establishing, through properly admissible evidence, the factual basis on which such opinions are based. Before any weight can be given to an expert's opinion, the facts upon which the opinion is based must be found to exist.

V

Conclusion

53 Thus the trial judge erred in two respects. There was no admissible evidence of important facts regarding Abbey's conduct upon which the medical opinions were based. And the judge misconstrued the recent cases dealing with the interpretation of the insanity defence in s. 16(2). A failure to "appreciate" the penal sanctions attaching to an offence does not render the accused "incapable of appreciating the nature and quality" of his act so as to bring the insanity defence into play.

54 The appeal should be allowed. The judgments at trial and on appeal should be set aside, and a new trial ordered on both counts.

Appeal allowed; new trial ordered.

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R. v. Lavallee

1990 CarswellMan 198, 1990 CarswellMan 377, [1990] 1 S.C.R. 852, [1990] 4 W.W.R. 1, [1990] S.C.J. No. 36, 108 N.R. 321, 10 W.C.B. (2d) 101, 132 W.A.C. 243, 55 C.C.C. (3d) 97, 67 Man. R. (2d) 1, 76 C.R. (3d) 329, J.E. 90-735, EYB 1990-67181

LAVALLEE v. R.

Dickson C.J.C., Lamer, Wilson, L'Heureux-Dubé, Sopinka, Gonthier and McLachlin JJ.

Heard: October 31, 1989
Judgment: May 3, 1990
Docket: No. 21022

Counsel: *G.G. Brodsky, Q.C.*, and *S. Hoeppner*, for appellant.
J.G.B. Dangerfield, Q.C., for respondent.

***Wilson J. (Dickson C.J.C. Lamer, L'Heureux-Dubé, Gonthier* and *McLachlin JJ.* concurring):**

1 The narrow issue raised on this appeal [from 65 C.R. (3d) 387, 44 C.C.C. (3d) 113, 52 Man. R. (2d) 274] is the adequacy of a trial judge's instructions to the jury regarding expert evidence. The broader issue concerns the utility of expert evidence in assisting a jury confronted by a plea of self-defence to a murder charge by a common law wife who had been battered by the deceased.

1. The Facts

2 The appellant, who was 22 years old at the time, had been living with Kevin Rust for some three to four years. Their residence was the scene of a boisterous party on 30th August 1986. In the early hours of 31st August after most of the guests had departed the appellant and Rust had an argument in the upstairs bedroom which was used by the appellant. Rust was killed by a single shot in the back of the head from a .303 calibre rifle fired by the appellant as he was leaving the room.

3 The appellant did not testify but her statement made to police on the night of the shooting was put in evidence. Portions of it read as follows:

> Me and Wendy argued as usual and I ran in the house after Kevin pushed me. I was scared, I was really scared. I locked the door. Herb was downstairs with Joanne and I called for Herb but I was crying when I called him. I said, "Herb come up here please." Herb came up to the top of the stairs and I told him that Kevin was going to hit me actually beat on me again. Herb said he knew and that if I was his old lady things would be different, he gave me a hug. OK, we're friends, there's nothing between us. He said "Yeah, I know" and he went outside to talk to Kevin leaving the door unlocked. I went upstairs and hid in my closet from Kevin. I was so scared ... My window was open and I could hear Kevin asking questions about what I was doing and what I was saying. Next thing I know he was coming up the stairs for me. He came into my bedroom and said "Wench, where are you?" And he turned on my light and he said "Your purse is on the floor" and he kicked it. OK then he turned and he saw me in the closet. He wanted me to come out but I didn't want to come out because I was scared. I was so scared. [The officer who took the statement then testified that the appellant started to cry at this point and stopped after a minute or two.] He grabbed me by the arm right there. There's a bruise on my face also where he slapped me. He didn't slap me right then, first he yelled at me then he pushed me and I pushed him back and he hit me twice on the right hand side of my head. I was scared. All I thought about was all the other times he used to beat me, I was

scared, I was shaking as usual. The rest is a blank, all I remember is he gave me the gun and a shot was fired through my screen. This is all so fast. And then the guns were in another room and he loaded it the second shot and gave it to me. And I was going to shoot myself. I pointed it to myself, I was so upset. OK and then he went and I was sitting on the bed and he started going like this with his finger [the appellant made a shaking motion with an index finger] and said something like "You're my old lady and you do as you're told" or something like that. He said "wait till everybody leaves, you'll get it then" and he said something to the effect of "either you kill me or I'll get you" that was what it was. He kind of smiled and then he turned around. I shot him but I aimed out. I thought I aimed above him and a piece of his head went that way.

4 The relationship between the appellant and Rust was volatile and punctuated by frequent arguments and violence. They would apparently fight for two or three days at a time or several times a week. Considerable evidence was led at trial indicating that the appellant was frequently a victim of physical abuse at the hands of Rust. Between 1983 and 1986 the appellant made several trips to hospital for injuries including severe bruises, a fractured nose, multiple contusions and a black eye. One of the attending physicians, Dr. Dirks, testified that he disbelieved the appellant's explanation on one such occasion that she had sustained her injuries by falling from a horse.

5 A friend of the deceased, Robert Ezako, testified that he had witnessed several fights between the appellant and the deceased and that he had seen the appellant point a gun at the deceased twice and threaten to kill him if he ever touched her again. Under cross-examination Ezako admitted to seeing or hearing the deceased beat up the appellant on several occasions and, during the preliminary inquiry, described her screaming during one such incident like "a pig being butchered". He also saw the appellant with a black eye on one occasion and doubted that it was the result of an accident as she and the deceased stated at the time. Another acquaintance of the couple recalled seeing the appellant with a split lip.

6 At one point on the night of his death Rust chased the appellant outside the house and a mutual friend, Norman Kolish, testified that the appellant pleaded with Rust to "leave me alone" and sought Kolish's protection by trying to hide behind him. A neighbour overheard Rust and the appellant arguing and described the tone of the former as "argumentative" and the latter as"scared". Later, between the first and second gunshot, he testified that he could hear that "somebody was beating up somebody" and the screams were female. Another neighbour testified to hearing noises like gunshots and then a woman's voice sounding upset saying, "Fuck. He punched me in the face. He punched me in the face". He looked out the window and saw a woman matching the description of the appellant.

7 Three witnesses who attended the party testified to hearing sounds of yelling, pushing, shoving and thumping coming from upstairs prior to the gunshots. It is not disputed that two shots were fired by the appellant. The first one went through a window screen. It is not clear where Rust was at the time. The appellant in her statement says that he was upstairs, while another witness places him in the basement. The second shot was the fatal one. After the second shot was fired, the appellant was seen visibly shaken and upset and was heard to say, "Rooster [the deceased] was beating me so I shot him", and "You know how he treated me, you've got to help me". The arresting officer testified that en route to the police station the appellant made various comments in the police car, including "He said if I didn't kill him first he would kill me. I hope he lives. I really love him" and "He told me he was gonna kill me when everyone left".

8 The police officer who took the appellant's statement testified to seeing a red mark on her arm where she said the deceased had grabbed her. When the coroner who performed an autopsy on the deceased was shown pictures of the appellant (who had various bruises), he testified that it was "entirely possible" that bruises on the deceased's left hand were occasioned by an assault on the appellant. Another doctor noted an injury to the appellant's pinkie finger consistent with those sustained by the adoption of a defensive stance.

9 The expert evidence which forms the subject matter of the appeal came from Dr. Fred Shane, a psychiatrist with extensive professional experience in the treatment of battered wives. At the request of defence counsel Dr. Shane prepared a psychiatric assessment of the appellant. The substance of Dr. Shane's opinion was that the appellant had been terrorized by Rust to the point of feeling trapped, vulnerable, worthless and unable to escape the relationship despite the violence. At the same time, the continuing pattern of abuse put her life in danger. In Dr. Shane's opinion the appellant's shooting of the deceased was a final desperate act by a woman who sincerely believed that she would be killed that night:

> ... I think she felt, she felt in the final tragic moment that her life was on the line, that unless she defended herself, unless she reacted in a violent way that she would die. I mean he made it very explicit to her, from what she told me and from the information I have from the material that you forwarded to me, that she had, I think, to defend herself against his violence.

10 Dr. Shane stated that his opinion was based on four hours of formal interviews with the appellant, a police report of the incident (including the appellant's statement), hospital reports documenting eight of her visits to emergency departments between 1983 and 1985, and an interview with the appellant's mother. In the course of his testimony Dr. Shane related many things told to him by the appellant for which there was no admissible evidence. They were not in the appellant's statement to the police and she did not testify at trial. For example, Dr. Shane mentioned several episodes of abuse described by the appellant for which there were no hospital reports. He also related the appellant's disclosure to him that she had lied to doctors about the cause of her injuries. Dr. Shane testified that such fabrication was typical of battered women. The appellant also recounted to Dr. Shane occasions on which Rust would allegedly beat her, then beg her forgiveness and ply her with flowers and temporary displays of kindness. Dr. Shane was aware of the incidents described by Ezako about the appellant's pointing a gun at Rust on two occasions and explained it as "an issue for trying to defend herself. She was afraid that she would be assaulted". The appellant denied to Dr. Shane that she had homicidal fantasies about Rust and mentioned that she had smoked some marijuana on the night in question. These facts were related by Dr. Shane in the course of his testimony.

11 The appellant was acquitted by a jury but the verdict was overturned by a majority of the Manitoba Court of Appeal and the case sent back for retrial.

2. Lower Court Judgements

12

Manitoba Queen's Bench (Scott A.C.J.Q.B.)

13 After Dr. Shane testified and was cross-examined, Crown counsel brought an application to have the evidence of Dr. Shane withdrawn from the jury. The first reason he gave was that the jury was perfectly capable of deciding the issue on the admissible evidence and that expert evidence was therefore "unnecessary and superfluous". The second reason was that Dr. Shane's comment that he found the accused credible was "wholly improper" in light of her failure to testify as to the facts upon which Dr. Shane based his opinion. The trial judge denied the application stating that the Crown's concerns could be met through an appropriate charge to the jury:

> But I understand fully the concern that the Crown has at this time because a substantial chunk of the factual evidence that Dr. Shane relied on is simply not evidence in these proceedings and is not before the jury and my task, even with a very attentive jury such as this one, is going to be very difficult because of that fact.
>
> But I think, under the circumstances, that the better course of action and the more realistic one to follow is to deal with the fact that it is in evidence and to attempt to explain to the jury as adequately and as fully as I can the difference between what is evidence and what is not in evidence and the impact that that ought to have on the weight that they choose to attach to the opinion of Dr. Shane.

14 With respect to the appellant's out-of-court statements, the trial judge cautioned the jury that "as with the verbal testimony, you may accept all, part or none of the statements attributed to Lyn Lavallee and as with all evidence, the real question is whether the things reported to have been said are true". Later he introduced Dr. Shane's testimony as follows:

> As counsel put it yesterday, you cannot decide this case on things you didn't hear. You cannot decide this case on things the witnesses didn't see or hear.
>
> A somewhat different, though related, evidentiary caution has to be noted with respect to the expert opinion evidence of Dr. Shane. There were two matters in his evidence, two facts, two sources of information that he had reference to which are not

evidence in this case and that is the suggestion that people had been smoking marijuana at the party and the confirmatory evidence, as he called it, received from the mother of Lyn Lavallee. These are not matters in evidence before you.

For example, there is absolutely no evidence that anyone was smoking marijuana at this party and you must not consider that it took place. There is no evidence from the mother of the accused before you.

The extent to which this impacts on the weight of the opinion of Dr. Shane is a matter for you to decide. You must appraise the value of the resulting opinion in light of the fact that there is no evidence about these matters before you. In terms of the matters considered by Dr. Shane he is left, therefore, with the deceased's statement, some supplementary information from the police report and his interpretation of the hospital records.

If the premises upon which the information is substantially based has [sic] not been proven in evidence, it is up to you to conclude that it is not safe to attach a great deal of weight to the opinion. An opinion of an expert depends, to a large extent, on the validity of the facts assumed by the evidence by the expert.

If there are some errors and the factual assumptions aren't too important to the eventual opinion, that's one thing. If there are errors or matters not in evidence and those matters are substantial, in you [sic] view, in terms of the impact on the expert's opinion, then you will want to look at the value and weight of that opinion very carefully. It depends on how important you think the matters were that Dr. Shane relied on that are not in evidence. [emphasis added]

15 The trial judge then reviewed the evidence given by Dr. Shane regarding the appellant's emotional and mental state at the time of the killing. He reiterated Dr. Shane's opinion that the appellant's act was "a reflection of her catastrophic fear that she had to defend herself". He also drew attention to Dr. Shane's awareness that the appellant would occasionally be the aggressor despite her denial to him that she had homicidal fantasies:

[Dr. Shane] noted that at times Lyn Lavallee would be the aggressor from all of the underlying hostility. She couldn't leave psychologically because there were steel fences in her mind and she was tyrannized psychologically. She said she loved him and he felt that she did.

She denied to him thinking at any time of killing Kevin Rust. That is to say she did not entertain any homicidal fantasies and he felt that what she told him was reasonable.

It is the position of the Crown that Dr. Shane's opinion stands or falls on the veracity of Lyn Lavallee because he relied so heavily and extensively on what she told him and the evidence contained in the statement, Exhibit 16. That's for you to decide.

Undoubtably [sic] she was a very important source, if not the major source, of his information. Dr. Shane agreed that if what she told him was erroneous, he would have to reassess his position.

On cross-examination he reiterated that in his opinion her action was spontaneous to the moment to try to defend herself. The straw that broke the camel's back was the threat, "when the others leave you're going to get it", even though similar statements had been made to her on other occasions. According to what she told him, the accused felt compelled to shoot.

Based on the information he had in his interview, it was his opinion that the acts of the accused were impulsive and not premeditated. He disagreed with the Crown's suggestion that Lyn Lavallee took the opportunity when it presented itself.

He conceded that patients had, on occasion, lied and misled him in the past.

Manitoba Court of Appeal (Monnin C.J.M., Philp and Huband JJ.) (1988), 52 Man. R. (2d) 274

16 Writing for himself and Monnin C.J.M., Philp J.A. begins by observing, at p. 275, that there was "ample evidence for the jury to conclude that Rust abused the accused". He adds that it "was a reasonable inference for the jury to draw that the injuries resulted from Rust's violent and abusive behaviour, notwithstanding her explanations at the time to the contrary".

17 Turning to Dr. Shane's evidence, the majority comments that in the course of stating the factual basis of his opinions and conclusions, Dr. Shane referred to many facts, incidents and events which were not before the court in the form of admissible evidence. These included: the smoking of marijuana on the night of the shooting; the deterioration of the intimate relationship between the appellant and Rust (the appellant had told Shane that they were sleeping in separate bedrooms); a reference to an abortion the appellant had obtained, after which Rust allegedly threatened to tell her parents that she was a "baby killer"; incidents where Rust would allegedly beg forgiveness from the appellant after beating her up; the appellant's "incredible remorse" after killing Rust, and the appellant's denial to Dr. Shane that she harboured homicidal fantasies about Rust.

18 Philp J.A. then refers to the appellant's written statement to the police in which she professed her love for Rust and her hope that he would not die. At p. 277, he pointed out "discrepancies and conflicts in the narrative of events in the accused's statement, and the evidence of witnesses who testified at her trial", particularly with respect to the location of Rust when the first shot was fired. With respect to the accused's unsworn statement, he concludes at p. 278:

> ... in the circumstances of this case, where much of the factual basis for the plea of self-defence lay in the statement of the accused, the jury ought not to have been told to "give this evidence no more nor less weight than any other evidence heard by you"; that the frailties of such assertions should have been pointed out.
>
> The instructions of the trial judge to the jury with respect to the evidence of Dr. Shane are a more troubling matter. The problem presented by the accused's out of court statement and comments, in my view, comes to a head in that context.

19 Philp J.A. then turns to the judgment of Dickson J. (as he then was) in *R. v. Abbey*, [1982] 2 S.C.R. 24, [1983] 1 W.W.R. 251, 39 B.C.L.R. 201, 29 C.R. (3d) 193, 68 C.C.C. (2d) 394, 138 D.L.R. (3d) 202, 43 N.R. 30, a case from this court dealing with the admissibility of expert evidence and the use to which it can be put. After quoting from the judgment, Philp J.A. states at p. 279:

> Canadian authorities support the view that an expert can state to the court the basis for his opinion, and that it is desirable that he do so. In *Abbey*, Dickson, J., confirmed this approach and referred to the "obligation" of the party tendering evidence of the factual basis for the opinions of experts, to establish, "through properly admissible evidence, the factual basis on which such opinions are based". He cautioned: "Before any weight can be given to an expert's opinion, the facts upon which the opinion is based must be found to exist."

Referring back to the case at bar, Philp J.A. comments, at p. 279, that the record did not disclose "the full extent of these secondhand facts, or their importance in the formation of Dr. Shane's opinion; nor can one speculate what his opinion might have been had his inquiries been limited to the admissible evidence properly before the court".

20 In his assessment of the trial judge's charge to the jury, Philp J.A. remarks that the trial judge properly pointed out that there was no evidence about marijuana smoking on the night in question, nor was there any evidence before them from the mother of the appellant. Philp J.A. found this latter warning insufficient. While he considered the trial judge's general instructions regarding the weight that should be placed on expert evidence to be proper, he felt that they "did not go far enough in the circumstances of this case". He gives three reasons (at p. 280):

> Firstly, the comments, placed in juxtaposition to the trial judge's reference to the "two facts, two sources of information that (Dr. Shane) had reference to which are not evidence in this case ...", lose their impact. The jury may well have concluded that the trial judge's warning related only to Dr. Shane's reference to the marijuana, and to the "confirmatory evidence" of the accused's mother.
>
> Secondly, I think the trial judge was in error in telling the jury that the police report (presumably, the document referred to by Dr. Shane as the "police summary of the incident") was a matter left for Dr. Shane to consider. That document was not evidence before the court, nor do we know what facts it contained.
>
> Finally, although the trial judge did not refer to Dr. Shane's interviews with the accused (and her mother) when he told the jury what matters were left for Dr. Shane to consider, the conclusion that the jury was to ignore facts related in these

> interviews unless they were otherwise established by admissible evidence (and to weigh Dr. Shane's opinion accordingly) is dispelled by the trial judge's later references to these interviews.

Philp J.A. then quotes the passages from the trial judge's charge in which he reviewed Dr. Shane's admission that he would have to reassess his position if what the appellant had told him was not true. Philp J.A. also draws attention to the remark by the trial judge that the Crown emphasized that Shane's opinion would stand or fall on the appellant's veracity. In Philp J.A.'s views, these aspects of the trial judge's instructions were also deficient (at p. 281):

> With respect, those comments of the trial judge, so crucial to the plea of self-defence, amounted to a misdirection. The issue was not just the veracity of the accused (and at this point, a careful charge with respect to the accused's unsworn self-serving evidence would have been appropriate). The pivotal questions the jury had to decide were the extent to which Dr. Shane's opinion was based on facts not established by admissible evidence; and the weight to be accorded to his opinion.

Finally, Philp J.A. finds, at p. 281, that the trial judge's charge fell so short of the standard required in *Abbey* that a new trial was warranted:

> This was an unusual case. The accused shot Rust in the back of the head when he was leaving the bedroom. The accused says Rust loaded the rifle and handed it to her. Friends of the accused and Rust, including the couple who had planned to stay overnight, were present in another part of the residence. In these circumstances, absent the evidence of Dr. Shane, it is unlikely that the jury, properly instructed, would have accepted the accused's plea of self-defence. The accused did not testify, and the foundation for her plea of self-defence was, in the main, her unsworn exculpatory evidence and the hearsay evidence related by Dr. Shane. Because Dr. Shane relied upon facts not in evidence, including those related to him in his lengthy interviews with the accused, the factual basis for his opinion should have been detailed in his evidence.

Philp J.A. concludes by suggesting to the Crown that they proceed with a charge of manslaughter rather than second degree murder since a properly instructed jury would, in his opinion, be unlikely to convict the appellant of the latter offence.

21 Writing in dissent, Huband J.A. summarizes the basis of Dr. Shane's opinion that the appellant acted out of a genuine fear for her life. He acknowledges, at p. 282, that "self-defence in this context finds some support in the evidence presented to the jury".

22 Huband J.A. points out the conflict in the evidence about how the appellant obtained the gun and where Rust was when the first shot was fired. Noting the appellant's statement to the police about how frightened of the deceased she was, he states, at p. 282, that "the significance of the statement is that, if believed, it establishes some foundation for a psychiatric opinion that she acted out of fear for her own safety as a person who had been subjected to continuous abuse". Ezako's evidence confirms that Rust beat the appellant and that, although the appellant may have "often provoked" the arguments, she "invariably got the worst of it".

23 With respect to Dr. Shane's evidence, Huband J.A. remarks, at p. 283, that in addition to hospital records and the accused's statement to the police, Dr. Shane "had the advantage of speaking at length with the accused herself, and also with the mother of the accused, in formulating his opinion". In Huband J.A.'s view (at p. 283), the "learned trial judge was well aware of the need to give adequate warning to the jury as to the weight to be placed upon the testimony of Dr. Shane. It was quite obvious that Dr. Shane relied upon statements by the accused and her mother which were unsworn hearsay comments and not part of the evidence in the case".

24 Turning to this court's judgment in *Abbey*, Huband J.A. expresses the view, at p. 283, that the "learned trial judge followed the advice of the Supreme Court of Canada to the letter":

> The learned trial judge begins by making it clear to the jury that they could not rely on the opinion of Dr. Shane on matters where there was no supporting evidence. He chose a good example. In relating what the accused had told him Dr. Shane said that marijuana had been smoked at the party that evening. None of the witnesses who testified as to what occurred during the evening mentioned any involvement with marijuana. Nor is such an involvement indicated in the accused's

statement to the police. Dr. Shane's testimony constitutes no proof that marijuana was smoked, and to the extent that it became a factor in formulating his opinion, then his opinion must be discounted.

The learned trial judge also noted that while Dr. Shane referred to conversations with the accused's mother, no such evidence had been presented to the jury.

But the learned trial judge could not tell the jury to disregard Dr. Shane's report in its entirety. He was required to tell the jury, as he did, that there was some evidentiary support for Dr. Shane's opinion, — the accused's own statement and the hospital records. Indeed, if anything, I think the learned trial judge was unfair to the accused in not also mentioning the evidence of Mr. Ezako as constituting evidentiary foundation supporting Dr. Shane's opinion.

25 Huband J.A. finds that the trial judge specifically warned the jury that Dr. Shane's conversations with the accused and her mother extended beyond the evidence before the court when he told them that "it is not safe to attach a great deal of weight" to the opinion of an expert when the information on which it is predicated has not been proven in evidence. After quoting the relevant passage, Huband J.A. comments at p. 284:

I suppose one could argue that the learned trial judge should have said it is not safe to attach "any" weight to the opinion rather than it is not safe to attach "a great deal" of weight to the opinion. He could have said that an expert's opinion depends "totally" instead of "to a large extent" on the validity of the factual foundation upon which he has proceeded. In my view, however, the jury would fully comprehend the import of the learned trial judge's remarks. After the jury received its instruction and retired, counsel was invited to comment on the charge ... Crown counsel voiced no complaints ...

This accused was acquitted by a jury of her peers on the basis of self-defence, which might strike one as being somewhat fanciful. We should not, however, search out semantic excuses to order a new trial, at high public cost, in the belief that the jury should have been more skeptical and arrived at a different verdict.

3. Relevant Legislation

26 Criminal Code, R.S.C. 1985, c. C-46:

34. ...

(2) Everyone one who is unlawfully assaulted and who causes death or grievous bodily harm in repelling the assault is justified if

(*a*) he causes it under reasonable apprehension of death or grievous bodily harm from the violence with which the assault was originally made or with which the assailant pursues his purposes; and

(*b*) he believes, on reasonable grounds, that he cannot otherwise preserve himself from death or grievous bodily harm.

4. Issues on Appeal

27 It should be noted that two bases for ordering a new trial are implicit in the reasons of the majority of the Court of Appeal. In finding that "absent the evidence of Dr. Shane, it is unlikely that the jury, properly instructed, would have accepted the accused's plea of self-defence", the Court of Appeal suggests that the evidence of Dr. Shane ought to have been excluded entirely. The alternative ground for allowing the Crown's appeal was that Dr. Shane's testimony was properly admitted but the trial judge's instructions with respect to it were deficient. Thus, the issues before this court are as follows:

28 1. Did the majority of the Manitoba Court of Appeal err in concluding that the jury should have considered the plea of self-defence absent the expert evidence of Dr. Shane?

29 2. Did the majority of the Manitoba Court of Appeal err in holding that the trial judge's charge to the jury with respect to Dr. Shane's expert evidence did not meet the requirements set out by this court in*Abbey*, thus warranting a new trial?

5. Analysis

30

(i) Admissibility of Expert Evidence

31 In *Kelliher v. Smith*, [1931] S.C.R. 672 at 684, [1931] 4 D.L.R. 102 [Sask.], this court adopted the principle that in order for expert evidence to be admissible "the subject-matter of the inquiry must be such that or dinary people are unlikely to form a correct judgment about it, if unassisted by persons with special knowledge". More recently, this court addressed the admissibility of expert psychiatric evidence in criminal cases in *R. v. Abbey*, supra. At p. 42 of the unanimous judgment, Dickson J. (as he then was) stated the rule as follows:

> With respect to matters calling for special knowledge, an expert in the field may draw inferences and state his opinion. An expert's function is precisely this: to provide the judge and jury with a ready-made inference which the judge and jury, due to the technical nature of the facts, are unable to formulate. "An expert's opinion is admissible to furnish the Court with scientific information which is likely to be outside the experience and knowledge of a judge or jury. If on the proven facts a judge or jury can form their own conclusions without help, then the opinion of the expert is unnecessary" (*Turner* (1974), 60 Crim. App. R. 80, at p. 83, *per* Lawton L.J.).

See also *R. v. Béland*, [1987] 2 S.C.R. 398 at 415, 60 C.R. (3d) 1, 36 C.C.C. (3d) 481, 43 D.L.R. (4th) 641, 9 Q.A.C. 293, 79 N.R. 263, in which McIntyre J. speaks of an expert witness possessing "special knowledge and experience going beyond that of the trier of fact".

32 Where expert evidence is tendered in such fields as engineering or pathology, the paucity of the layperson's knowledge is uncontentious. The longstanding recognition that psychiatric or psychological testimony also falls within the realm of expert evidence is predicated on the realization that in some circumstances the average person may not have sufficient knowledge of or experience with human behaviour to draw an appropriate inference from the facts before him or her. An example may be found in *R. v. Lyons*, [1987] 2 S.C.R. 309, 61 C.R. (3d) 1, (sub nom. *L. v. R.)* 37 C.C.C. (3d) 1, 44 D.L.R. (4th) 193, 32 C.R.R. 41, 82 N.S.R. (2d) 271, 207 A.P.R. 271, 80 N.R. 161, in which this court approved the use of psychiatric testimony in dangerous offender applications. At p. 366, La Forest J. remarks that "psychiatric evidence is clearly relevant to the issue whether a person is likely to behave in a certain way and, indeed, is probably relatively superior in this regard to the evidence of other clinicians and lay persons".

33 The need for expert evidence in these areas can, however, be obfuscated by the belief that judges and juries are thoroughly knowledgeable about "human nature" and that no more is needed. They are, so to speak, their own experts on human behaviour. This, in effect, was the primary submission of the Crown to this court.

34 The bare facts of this case, which I think are amply supported by the evidence, are that the appellant was repeatedly abused by the deceased but did not leave him (although she twice pointed a gun at him), and ultimately shot him in the back of the head as he was leaving her room. The Crown submits that these facts disclose all the information a jury needs in order to decide whether or not the appellant acted in self-defence. I have no hesitation in rejecting the Crown's submission.

35 Expert evidence on the psychological effect of battering on wives and common law partners must, it seems to me, be both relevant and necessary in the context of the present case. How can the mental state of the appellant be appreciated without it? The average member of the public (or of the jury) can be forgiven for asking: Why would a woman put up with this kind of treatment? Why should she continue to live with such a man? How could she love a partner who beat her to the point of requiring hospitalization? We would expect the woman to pack her bags and go. Where is her self-respect? Why does she not cut loose and make a new life for herself? Such is the reaction of the average person confronted with the so-called "battered wife syndrome". We need help to understand it and help is available from trained professionals.

36 The gravity, indeed, the tragedy, of domestic violence can hardly be overstated. Greater media attention to this phenomenon in recent years has revealed both its prevalence and its horrific impact on women from all walks of life. Far from protecting women from it, the law historically sanctioned the abuse of women within marriage as an aspect of the husband's ownership of his wife and his "right" to chastise her. One need only recall the centuries old law that a man is entitled to beat his wife with a stick "no thicker than his thumb".

37 Laws do not spring out of a social vacuum. The notion that a man has a right to "discipline" his wife is deeply rooted in the history of our society. The woman's duty was to serve her husband and to stay in the marriage at all costs "till death do us part" and to accept as her due any "punishment" that was meted out for failing to please her husband. One consequence of this attitude was that "wife battering" was rarely spoken of, rarely reported, rarely prosecuted, and even more rarely punished. Long after society abandoned its formal approval of spousal abuse, tolerance of it continued and continues in some circles to this day.

38 Fortunately, there has been a growing awareness in recent years that no man has a right to abuse any woman under any circumstances. Legislative initiatives designed to educate police, judicial officers and the public, as well as more aggressive investigation and charging policies, all signal a concerted effort by the criminal justice system to take spouse abuse seriously. However, a woman who comes before a judge or jury with the claim that she has been battered and suggests that this may be a relevant factor in evaluating her subsequent actions still faces the prospect of being condemned by popular mythology about domestic violence. Either she was not as badly beaten as she claims or she would have left the man long ago. Or, if she was battered that severely, she must have stayed out of some masochistic enjoyment of it.

39 Expert testimony on the psychological effects of battering have been admitted in American courts in recent years. In *New Jersey v. Kelly*, 478 A. 2d 364 at 378 (1984), the New Jersey Supreme Court commended the value of expert testimony in these terms:

> It is aimed at an area where the purported common knowledge of the jury may be very much mistaken, an area where jurors' logic, drawn from their own experience, may lead to a wholly incorrect conclusion, an area where expert knowledge would enable the jurors to disregard their prior conclusions as being common myths rather than common knowledge.

40 The court concludes at p. 379 that the battering relationship is "subject to a large group of myths and stereotypes". As such, it is "beyond the ken of the average juror and thus is suitable for explanation through expert testimony". I share that view.

(ii) The Relevance of Expert Testimony to the Elements of Self-Defence

41 In my view, there are two elements of the defence under s. 34(2) of the Code which merit scrutiny for present purposes. The first is the temporal connection in s. 34(2)(*a*) between the apprehension of death or grievous bodily harm and the act allegedly taken in self-defence. Was the appellant "under reasonable apprehension of death or grievous bodily harm" from Rust as he was walking out of the room? The second is the assessment in s. 34(2)(*b*) of the magnitude of the force used by the accused. Was the accused's belief that she could not "otherwise preserve herself from death or grievous bodily harm" except by shooting the deceased based "on reasonable grounds"?

42 The feature common to both s. 34(2)(*a*) and s. 34(2)(*b*) is the imposition of an objective standard of reasonableness on the apprehension of death and the need to repel the assault with deadly force. In *Reilly v. R.*, [1984] 2 S.C.R. 396, 42 C.R. (3d) 154, 15 C.C.C. (3d) 1, 13 D.L.R. (4th) 161, 6 O.A.C. 88, 55 N.R. 274, this court considered the interaction of the objective and subjective components of s. 34(2) at p. 404:

> Subsection (2) of s. 34 places in issue the accused's state of mind at the time he caused death. The subsection can only afford protection to the accused if he apprehended death or grievous bodily harm from the assault he was repelling and if he believed he could not preserve himself from death or grievous bodily harm otherwise than by the force he used. Nonetheless, his apprehension must be a *reasonable* one and his belief must *be based upon reasonable and probable grounds*. The subsection requires that the jury consider, and be guided by, what they decide on the evidence was the

> accused's appreciation of the situation and his belief as to the reaction it required, so long as there exists an objectively verifiable basis for his perception.
>
> Since s. 34(2) places in issue the accused's perception of the attack upon him and the response required to meet it, the accused may still be found to have acted in self-defence even if he was mistaken in his perception. Reasonable and probable grounds must still exist for this mistaken perception in the sense that the mistake must have been one which an ordinary man using ordinary care could have made in the same circumstances.

43 If it strains credulity to imagine what the "ordinary man" would do in the position of a battered spouse, it is probably because men do not typically find themselves in that situation. Some women do, however. The definition of what is reasonable must be adapted to circumstances which are, by and large, foreign to the world inhabited by the hypothetical "reasonable man".

44 I find the case of *Washington v. Wanrow*, 559 P. 2d 548, 88 Wash. 2d 221 (1977), helpful in illustrating how the factor of gender can be germane to the assessment of what is reasonable. In *Wanrow* the Washington Supreme Court addressed the standard by which a jury ought to assess the reasonableness of the female appellant's use of a gun against an unarmed intruder. The court pointed out that the appellant had reason to believe that the intruder had molested her daughter in the past and was coming back for her son. The appellant was a 5 foot 4 inch woman with a broken leg. The assailant was 6 feet 2 inches and intoxicated. The court first observed, at p. 558, that "in our society women suffer from a conspicuous lack of access to training in and the means of developing those skills necessary to effectively repel a male assailant without resorting to the use of deadly weapons". Later it found that the trial judge erred in his instructions to the jury by creating the impression that the objective standard of reasonableness to be applied to the accused was that of an altercation between two men. At p. 559, the court makes the following remarks which I find apposite to the case before us:

> The respondent was entitled to have the jury consider her actions in the light of her own perceptions of the situation, including those perceptions which were the product of our nation's "long and unfortunate history of sex discrimination"... Until such time as the effects of that history are eradicated, care must be taken to assure that our self-defense instructions afford women the right to have their conduct judged in light of the individual physical handicaps which are the product of sex discrimination. To fail to do so is to deny the right of the individual woman involved to trial by the same rules which are applicable to male defendants.

I turn now to a consideration of the specific components of self-defence under s. 34(2) of the Criminal Code.

A. Reasonable apprehension of death

45 Section 34(2)(*a*) requires that an accused who intentionally causes death or grievous bodily harm in repelling an assault is justified if he or she does so "under reasonable apprehension of death or grievous bodily harm". In the present case, the assault precipitating the appellant's alleged defensive act was Rust's threat to kill her when everyone else had gone.

46 It will be observed that subsection 34(2)(*a*) does not actually stipulate that the accused apprehend *imminent* danger when he or she acts. Case law has, however, read that requirement into the defence: see *Reilly v. R.*, supra; *R. v. Baxter* (1975), 33 C.R.N.S. 22, 27 C.C.C. (2d) 96 (Ont. C.A.); *R. v. Bogue* (1976), 13 O.R. (2d) 272, 30 C.C.C. (2d) 403, 70 D.L.R. (3d) 603 (C.A.). The sense in which "imminent" is used conjures up the image of "an uplifted knife" or a pointed gun. The rationale for the imminence rule seems obvious. The law of self-defence is designed to ensure that the use of defensive force is really necessary. It justifies the act because the defender reasonably believed that he or she had no alternative but to take the attacker's life. If there is a significant time interval between the original unlawful assault and the accused's response, one tends to suspect that the accused was motivated by revenge rather than self-defence. In the paradigmatic case of a one-time bar room brawl between two men of equal size and strength, this interference makes sense. How can one feel endangered to the point of firing a gun at an unarmed man who utters a death threat, then turns his back and walks out of the room? One cannot be certain of the gravity of the threat or his capacity to carry it out. Besides, one can always take the opportunity to flee or to call the police. If he comes back and raises his fist, one can respond in kind if need be. These are the tacit assumptions that underlie the imminence rule.

47 All of these assumptions were brought to bear on the respondent in *R. v. Whynot* (1983), 37 C.R. (3d) 198, 9 C.C.C. (3d) 449, 61 N.S.R. (2d) 33, 133 A.P.R. 33 (C.A.) . The respondent Jane Stafford shot her sleeping common law husband as he lay passed out in his truck. The evidence at trial indicated that the deceased "dominated the household and exerted his authority by striking and slapping the various members and from time to time administering beatings to Jane Stafford and the others" (at p. 452). The respondent testified that the deceased threatened to kill all of the members of her family, one by one, if she tried to leave him. On the night in question he threatened to kill her son. After he passed out, the respondent got one of the many shotguns kept by her husband and shot him. The Nova Scotia Court of Appeal held that the trial judge erred in leaving s. 37 (preventing assault against oneself or anyone under one's protection) with the jury. The court stated at p. 464:

> I do not believe that the trial judge was justified in placing s. 37 of the *Code* before the jury any more than he would have been justified in giving them s. 34. Under s. 34 the assault must have been underway and unprovoked, and under s. 37 the assault must be such that it is necessary to defend the person assaulted by the use of force. No more force may be used than necessary to prevent the assault or the repetition of it. In my opinion, no person has the right in anticipation of an assault that may or may not happen, to apply force to prevent the imaginary assault.

48 The implication of the court's reasoning is that it is inherently unreasonable to apprehend death or grievous bodily harm unless and until the physical assault is actually in progress, at which point the victim can presumably gauge the requisite amount of force needed to repel the attack and act accordingly. In my view, expert testimony can cast doubt on these assumptions as they are applied in the context of a battered wife's efforts to repel an assault.

49 The situation of the appellant was not unlike that of Jane Stafford in the sense that she too was routinely beaten over the course of her relationship with the man she ultimately killed. According to the testimony of Dr. Shane, these assaults were not entirely random in their occurrence. The following exchange during direct examination elicited a discernible pattern to the abuse:

> Q. How did they react during the tension that preceded the beatings? How would her ...
>
> A. Well, typically before a beating there's usually some verbal interchange and there are threats and typically she would feel, you know, very threatened by him and for various reasons.
>
> He didn't like the way she dressed or if she — didn't like the way she handled money or she wasn't paying him enough attention or she was looking at other men, all sorts of reasons, and she would be defending herself, trying to placate him, which was typical, saying, you know, trying to calm him down, trying to soothe him, you know, so nothing violent would happen and sometimes it would work. You know, as people's experiences indicated or as people who write about this process, if you will, have indicated.
>
> But often, as reflected by what she has told me, and the information I have from other people, such as her mother, often it would fail and she would end up being beaten and assaulted.
>
> Q. And that would be followed by this forgiveness state?
>
> A. It typically would be followed by, you know, this make-up period.

Earlier in his testimony Dr. Shane explained how this "make-up" period would be characterized by contrite and affectionate behaviour by Rust:

> In this particular case she documented many times, after he would beat her, he would send her flowers and he would beg her for forgiveness and he would love her and then the relationship would come back to a sense of equilibrium, if you will ... But then, because of the nature of the personalities, it would occur again.

50 The cycle described by Dr. Shane conforms to the Walker Cycle Theory of Violence named for clinical psychologist, Dr. Lenore Walker, the pioneer researcher in the field of the battered wife syndrome. Dr. Shane acknowledged his debt to Dr. Walker in the course of establishing his credentials as an expert at trial. Dr. Walker first describes the cycle in the book The

Battered Woman (1979). In her 1984 book, The Battered Woman Syndrome, Dr. Walker reports the results of a study involving 400 battered women. Her research was designed to test empirically the theories expounded in her earlier book. At pp. 95-96 of The Battered Woman Syndrome she summarizes the Cycle Theory as follows:

> A second major theory that was tested in this project is the Walker Cycle Theory of Violence (Walker, 1979). This tension reduction theory states that there are three distinct phases associated in a recurring battering cycle: (1) tension building, (2) the acute battering incident, and (3) loving contrition. During the first phrase, there is a gradual escalation of tension displayed by discrete acts causing increased friction such as name-calling, other mean intentional behaviors, and/or physical abuse. The batterer expresses dissatisfaction and hostility but not in an extreme or maximally explosive form. The woman attempts to placate the batterer, doing what she thinks might please him, calm him down, or at least, what will not further aggravate him. She tries not to respond to his hostile actions and uses general anger reduction techniques. Often she succeeds for a little while which reinforces her unrealistic belief that she can control this man ...
>
> The tension continues to escalate and eventually she is unable to continue controlling his angry response pattern. "Exhausted from the constant stress, she usually withdraws from the batterer, fearing she will inadvertently set off an explosion. He begins to move more oppressively toward her as he observes her withdrawal. ... Tension between the two becomes unbearable" (Walker, 1979, p. 59). The second phase, the acute battering incident, becomes inevitable without intervention. Sometimes, she precipitates the inevitable explosion so as to control where and when it occurs, allowing her to take better precautions to minimize her injuries and pain.
>
> "Phase two is characterized by the uncontrollable discharge of the tensions that have built up during phase one" (p. 59). The batterer typically unleashes a barrage of verbal and physical aggression that can leave the woman severely shaken and injured. In fact, when injuries do occur it usually happens during this second phase. It is also the time police become involved, if they are called at all. The acute battering phase is concluded when the batterer stops, usually bringing with its cessation a sharp physiological reduction in tension. This in itself is naturally reinforcing. Violence often succeeds because it does work.
>
> In phase three which follows, the batterer may apologize profusely, try to assist his victim, show kindness and remorse, and shower her with gifts and/or promises. The batterer himself may believe at this point that he will never allow himself to be violent again. The woman wants to believe the batterer and, early in the relationship at least, may renew her hope in his ability to change. This third phase provides the positive reinforcement for remaining in the relationship, for the woman. In fact, our results showed that phase three could also be characterized by an absence of tension or violence, and no observable loving-contrition behaviour, and still be reinforcing for the woman.

51 Dr. Walker defines a battered woman as a woman who has gone through the battering cycle at least twice. As she explains in her introduction to The Battered Woman at p. xv, "Any woman may find herself in an abusive relationship with a man once. If it occurs a second time, and she remains in the situation, she is defined as a battered woman".

52 Given the relational context in which the violence occurs, the mental state of an accused at the critical moment she pulls the trigger cannot be understood except in terms of the cumulative effect of months or years of brutality. As Dr. Shane explained in his testimony, the deterioration of the relationship between the appellant and Rust in the period immediately preceding the killing led to feelings of escalating terror on the part of the appellant:

> But their relationship some weeks to months before was definitely escalating in terms of tension and in terms of the discordant quality about it. They were sleeping in separate bedrooms. Their intimate relationship was lacking and things were building and building and to a point, I think, where it built to that particular point where she couldn't — she felt so threatened and so overwhelmed that she had to — that she reacted in a violent way because of her fear of survival and also because, I think because of her, I guess, final sense that she was — that she had to defend herself and her own sense of violence towards this man who had really desecrated her and damaged her for so long.

53 Another aspect of the cyclical nature of the abuse is that it begets a degree of predictability to the violence that is absent in an isolated violent encounter between two strangers. This also means that it may in fact be possible for a battered spouse to accurately predict the onset of violence before the first blow is struck, even if an outsider to the relationship cannot. Indeed, it has been suggested that a battered woman's knowledge of her partner's violence is so heightened that she is able to anticipate the nature and extent (though not the onset) of the violence by his conduct beforehand. In her article "Potential Uses for Expert Testimony: Ideas Toward the Representation of Battered Women Who Kill" (1986), 9 Women's Rights Law Reporter 227, psychologist Julie Blackman describes this characteristic at p. 229:

> Repeated instances of violence enable battered women to develop a continuum along which they can "rate" the tolerability or survivability of episodes of their partner's violence. Thus, signs of unusual violence are detected. For battered women, this response to the ongoing violence of their situations is a survival skill. Research shows that battered women who kill experience remarkably severe and frequent violence relative to battered women who do not kill. They know what sorts of danger are familiar and which are novel. They have had myriad opportunities to develop and hone their perceptions of their partner's violence. And, importantly, they can say what made the final episode of violence different from the others: they can name the features of the last battering that enabled them to know that this episode would result in life-threatening action by the abuser.

At p. 236 Dr. Blackman relates the role of expert testimony in cases where a battered woman kills her batterer while he is sleeping (or not actively posing a threat to her) and pleads self-defence:

> Perhaps the single most important idea conveyed by expert testimony in such a case pertains to the notion that a battered woman, because of her extensive experience with her abuser's violence, can detect changes or signs of novelty in the pattern of normal violence that connote increased danger. Support for this assertion must come from the woman herself, in her spontaneous, self-initiated description of the events that precede her action against the abuser. Only then can testimony from an expert offer scientific support for the idea that such a danger detection process can occur and can be expected to be as accurate as the "reasonable man" standard would imply.

54 Of course, as Dr. Blackman points out, it is up to the jury to decide whether the distinction drawn between "typical" violence and the particular events the accused perceived as "life threatening" is compelling. According to the appellant's statement to police, Rust actually handed her a shotgun and warned her that if she did not kill him, he would kill her. I note in passing a remarkable observation made by Dr. Walker in her 1984 study, The Battered Woman Syndrome. Writing about 50 battered women she interviewed who had killed their partners, she comments at p. 40:

> Most of the time the women killed the men with a gun; usually one of several that belonged to him. *Many of the men actually dared or demanded the woman use the gun on him first, or else he said he'd kill her with it*. [emphasis added]

55 Where evidence exists that an accused is in a battering relationship, expert testimony can assist the jury in determining whether the accused had a "reasonable" apprehension of death when she acted by explaining the heightened sensitivity of a battered woman to her partner's acts. Without such testimony I am skeptical that the average fact-finder would be capable of appreciating why her subjective fear may have been reasonable in the context of the relationship. After all, the hypothetical "reasonable man" observing only the final incident may have been unlikely to recognize the batter's threat as potentially lethal. Using the case at bar as an example, the "reasonable man" might have thought, as the majority of the Court of Appeal seemed to, that it was unlikely that Rust would make good on his threat to kill the appellant that night because they had guests staying overnight.

56 The issue is not, however, what an outsider would have reasonably perceived but what the accused reasonably perceived, given her situation and her experience.

57 Even accepting that a battered woman may be uniquely sensitized to danger from her batterer, it may yet be contended that the law ought to require her to wait until the knife is uplifted, the gun pointed or the fist clenched before her apprehension is deemed reasonable. This would allegedly reduce the risk that the woman is mistaken in her fear, although the law does not

require her fear to be correct, only reasonable. In response to this contention, I need only point to the observation made by Huband J.A. that the evidence showed that when the appellant and Rust physically fought the appellant "invariably got the worst of it". I do not think it is an unwarranted generalization to say that due to their size, strength, socialization and lack of training, women are typically no match for men in hand-to-hand combat. The requirement imposed in *Whynot* that a battered woman wait until the physical assault is "underway" before her apprehensions can be validated in law would, in the words of an American court, be tantamount to sentencing her to "murder by installment": *New Mexico v. Gallegos*, 719 P. 2d 1268 at 1271, 104 N.M. 247 (C.A., 1986). I share the view expressed by M.J. Willoughby in "Rendering Each Woman Her Due: Can a Battered Woman Claim Self-Defense When She Kills Her Sleeping Batterer" (1989), 38 Kan. L. Rev. 169, at p. 184, that "society gains nothing, except perhaps the additional risk that the battered woman will herself be killed, because she must wait until her abusive husband instigates another battering episode before she can justifiably act".

B. Lack of alternatives to self-help

58 Subsection 34(2) requires an accused who pleads self-defence to believe "on reasonable grounds" that it is not possible to otherwise preserve him or herself from death or grievous bodily harm. The obvious question is if the violence was so intolerable, why did the appellant not leave her abuser long ago? This question does not really go to whether she had an alternative to killing the deceased at the critical moment. Rather, it plays on the popular myth already referred to that a woman who says she was battered yet stayed with her batterer was either not as badly beaten as she claimed or else she liked it. Nevertheless, to the extent that her failure to leave the abusive relationship earlier may be used in support of the proposition that she was free to leave at the final moment, expert testimony can provide useful insights. Dr. Shane attempted to explain in his testimony how and why, in the case at bar, the appellant remained with Rust:

> She had stayed in this relationship, I think, because of the strange, almost unbelievable, but yet it happens, relationship that sometimes develops between people who develop this very disturbed, I think, very disturbed quality of a relationship. Trying to understand it, I think, isn't always easy and there's been a lot written about it recently, in the recent years, in psychiatric literature. But basically it involves two people who are involved in what appears to be an attachment which may have sexual or romantic or affectionate overtones.
>
> And the one individual, and it's usually the women in our society, but there have been occasions where it's been reversed, but what happens is the spouse who becomes battered, if you will, stays in the relationship probably because of a number of reasons.
>
> One is that the spouse gets beaten so badly — so badly — that he or she loses the motivation to react and becomes helpless and becomes powerless. And it's also been shown sometimes, you know, in — not that you can compare animals to human beings, but in laboratories, what you do if you shock an animal, after a while it can't respond to a threat of its life. It becomes just helpless and lies there in an amotivational state, if you will, where it feels there's no power and there's no energy to do anything.
>
> So in a sense it happens in human beings as well. It's almost like a concentration camp, if you will. You get paralyzed with fear.
>
> The other thing that happens often in these types of relationships with human beings is that the person who beats or assaults, who batters, often tries — he makes up and begs for forgiveness. And this individual, who basically has a very disturbed or damaged self-esteem, all of a sudden feels that he or she — we'll use women in this case because it's so much more common — the spouse feels that she again can do the spouse a favour and it can make her feel needed and boost her self-esteem for a while and make her feel worthwhile and the spouse says he'll forgive her and whatnot.

59 Apparently, another manifestation of this victimization is a reluctance to disclose to others the fact or extent of the beatings. For example, the hospital records indicate that on each occasion the appellant attended the emergency department to be treated for various injuries she explained the cause of those injuries as accidental. Both in its address to the jury and in its written submissions before this court the Crown insisted that the appellant's injuries were as consistent with her explanations as with

being battered and, therefore, in the words of Crown counsel at trial, "the myth is, in this particular case, that Miss Lavallee was a battered spouse". In his testimony Dr. Shane testified that the appellant admitted to him that she lied to hospital staff and others about the cause of her injuries. In Dr. Shane's opinion this was consistent with her overall feeling of being trapped and helpless:

> ... she would never say that she'd been abused by the man with whom she was living and that usually happened because of this whole process. He would beg her. I mean she would tell me that on occasions he would beat her and then the police would be called by, I think, on one occasion a neighbour and he got down on his knees and he begged forgiveness and he loved her and he felt so terrible about it. And so this would be a typical scenario. Whenever she would go to the hospital, that he would attempt to, I think, attempt to have her forgive him and he would love her so much more.
>
> Again she would feel so needed and this would start the whole cycle over again.
>
> And he would also blackmail her on occasions. She had an abortion when she was in the early part of their relationship and he would blackmail her saying, "You know, I will tell your parents that you were a baby killer", et cetera.
>
> But basically the manner in which, I think, she would be prevented from telling the doctors or other people about the beatings was related to the fact that this whole process would repeat itself. He would want forgiveness and tell her he would love her and it would never happen again and she would feel grateful. She would feel a little loved. It would help her self-esteem again and she would feel a little safer for a while too. It would allow her to have a sense, a window of security for a period because she felt so trapped in this relationship.

60 The account given by Dr. Shane comports with that documented in the literature. Reference is often made to it as a condition of "learned helplessness", a phrase coined by Dr. Charles Seligman, the psychologist who first developed the theory by experimenting on animals in the manner described by Dr. Shane in his testimony. A related theory used to explain the failure of women to leave battering relationships is described by psychologist and lawyer Charles Patrick Ewing in his book, Battered Women Who Kill (1987). Ewing describes a phenomenon labelled "traumatic bonding" that has been observed between hostages and captors, battered children and their parents, concentration camp prisoners and guards, and batterers and their spouses. According to the research cited by Ewing, there are two features common to the social structure in each of these apparently diverse relationships. At pp. 19-20, he states:

> The first of these common features is an imbalance of power "wherein the maltreated person perceives himself or herself to be subjugated or dominated by the other". The less powerful person in the relationship — whether battered woman, hostage, abused child, cult follower, or prisoner — becomes extremely dependent upon, and may even come to identify with, the more powerful person. In many cases, the result of such dependency and identification is that the less powerful, subjugated persons become "more negative in their self-appraisal, more incapable of fending for themselves, and thus more in need of the high power person." As this "cycle of dependency and lowered self-esteem" is repeated over time, the less powerful person develops a "strong affective bond" to the more powerful person in the abusive relationship.
>
> The second feature common to the relationships between battered woman and batterer, hostage and captor, battered child and abusive parent, cult follower and leader, and prisoner and guard is the periodic nature of the abuse. In each relationship, the less powerful person is subjected to intermittent periods of abuse, which alternate with periods during which the more powerful, abusive person treats the less powerful person in a "more normal and acceptable fashion." ...
>
> Given the clear power differential between battered women and their batterers and the intermittent nature of physical and psychological abuse common to battering relationships, it seems fair to conclude ... that many battered women are psychologically unable to leave their batterers because they have developed a traumatic bond with them. [citations omitted]

This strong "affective bond" may be helpful in explaining not only why some battered women remain with their abusers but why they even profess to love them. Of course, as Dr. Ewing adds, environmental factors may also impair the woman's ability to leave — lack of job skills, the presence of children to care for, fear of retaliation by the man, etc., may each have a role to play in some cases.

61 This is not to say that in the course of a battering relationship a woman may never attempt to leave her partner or try to defend herself from assault. In The Battered Woman Syndrome Dr. Walker notes at p. 30 that women may sometimes "react to men's violence against them by striking back, but their actions are generally ineffective at hurting or stopping the men. They may be effective in controlling the level of the man's violence against them". In the case at bar Dr. Shane was aware that the appellant had pointed a gun at Rust in the past. In direct examination he stated:

> And what would also happen from time to time is that there would be moments where she would attempt to hit back to defend herself or she may take a weapon to defend herself in order to prevent herself from being harmed or even, when the underlying rage may accumulate, if you will, the feeling that she had to do something to him in order to survive, in order to defend herself.

62 The same psychological factors that account for a woman's inability to leave a battering relationship may also help to explain why she did not attempt to escape at the moment she perceived her life to be in danger. The following extract from Dr. Shane's testimony on direct examination elucidates this point:

> Q. Now, we understand from the evidence that on this night she went — I think you've already described it in your evidence — and hid in the closet?
>
> A. Yes.
>
> Q. Can you tell the jury why she, for instance, would stay in that house if she had this fear? Why wouldn't she so [sic] someplace else? Why would she have to hide in the closet in the same house?
>
> A. Well, I think this is a reflection of what I've been talking about, this ongoing psychological process, her own psychology and the relationship, that she felt trapped. There was no out for her, this learned helplessness, if you will, the fact that she felt paralyzed, she felt tyrannized. She felt, although there were obviously no steel fences around, keeping her in, there were steel fences in her mind which created for her an incredible barrier psychologically that prevented her from moving out. Although she had attempted on occasion, she came back in a magnetic sort of a way. And she felt also that she couldn't expect anything more. Not only this learned helplessness about being beaten, beaten, where her motivation is taken away, but her whole sense of herself. She felt this victim mentality, this concentration camp mentality if you will, where she could not see herself be in any other situation except being tyrannized, punished and crucified physically and psychologically.

63 I emphasize at this juncture that it is not for the jury to pass judgment on the fact that an accused battered woman stayed in the relationship. Still less is it entitled to conclude that she forfeited her right to self-defence for having done so. I would also point out that traditional self-defence doctrine does not require a person to retreat from her home instead of defending herself: *R. v. Antley*, [1964] 1 O.R. 545, 42 C.R. 384, [1964] 2 C.C.C. 142 (C.A.). A man's home may be his castle but it is also the woman's home even if it seems to her more like a prison in the circumstances.

64 If, after hearing the evidence (including the expert testimony), the jury is satisfied that the accused had a reasonable apprehension of death or grievous bodily harm and felt incapable of escape, it must ask itself what the "reasonable person" would do in such a situation. The situation of the battered woman as described by Dr. Shane strikes me as somewhat analogous to that of a hostage. If the captor tells her that he will kill her in three days time, is it potentially reasonable for her to seize an opportunity presented on the first day to kill the captor or must she wait until he makes the attempt on the third day? I think the question the jury must ask itself is whether, given the history, circumstances and perceptions of the appellant, her belief that she could not preserve herself from being killed by Rust that night except by killing him first was reasonable. To the extent that expert evidence can assist the jury in making that determination, I would find such testimony to be both relevant and necessary.

65 In light of the foregoing discussion, I would summarize as follows the principles upon which expert testimony is properly admitted in cases such as this:

66 1. Expert testimony is admissible to assist the fact-finder in drawing inferences in areas where the expert has relevant knowledge or experience beyond that of the layperson.

67 2. It is difficult for the layperson to comprehend the battered wife syndrome. It is commonly thought that battered women are not really beaten as badly as they claim, otherwise they would have left the relationship. Alternatively, some believe that women enjoy being beaten, that they have a masochist strain in them. Each of these stereotypes may adversely affect consideration of a battered woman's claim to have acted in self-defence in killing her mate.

68 3. Expert evidence can assist the jury in dispelling these myths.

69 4. Expert testimony relating to the ability of an accused to perceive danger from her mate may go to the issue of whether she "reasonably apprehended" death or grievous bodily harm on a particular occasion.

70 5. Expert testimony pertaining to why an accused remained in the battering relationship may be relevant in assessing the nature and extent of the alleged abuse.

71 6. By providing an explanation as to why an accused did not flee when she perceived her life to be in danger, expert testimony may also assist the jury in assessing the reasonableness of her belief that killing her batterer was the only way to save her own life.

72 Quite apart from Dr. Shane's testimony, there was ample evidence on which the trial judge could conclude that the appellant was battered repeatedly and brutally by Kevin Rust over the course of their relationship. The fact that she may have exhibited aggressive behaviour on occasion or tried (unsuccessfully) to leave does not detract from a finding of systematic and relentless abuse. In my view, the trial judge did not err in admitting Dr. Shane's expert testimony in order to assist the jury in determining whether the appellant had a reasonable apprehension of death or grievous bodily harm and believed on reasonable grounds that she had no alternative but to shoot Kevin Rust on the night in question.

73 Obviously the fact that the appellant was a battered woman does not entitle her to an acquittal. Battered women may well kill their partners other than in self-defence. The focus is not on who the woman is, but on what she did. In "The Meaning of Equality for Battered Women Who Kill Men in Self-Defense" (1985), 8 Harvard Women's L.J. 121, at p. 159, Phyllis Crocker makes the point succinctly:

> The issue in a self-defence trial is not whether the defendant is a battered woman, but whether she justifiably killed her husband. The defendant introduces testimony to offer the jury an explanation of reasonableness that is an alternative to the prosecution's stereotypic explanations. It is not intended to earn her the status of a battered woman, as if that would make her not guilty.

The trial judge, to his credit, articulated the same principle when introducing Dr. Shane's testimony in the course of his instructions to the jury. After referring to "the so-called battered spouse syndrome", he cautions:

> Let me say at the outset that I think it is better that we try not to attach labels to this. It doesn't matter what we call it. What is important is the evidence itself and how it impacts on the critical areas of the intent of the accused and the issue of self-defence.

74 Ultimately, it is up to the jury to decide whether, *in fact*, the accused's perceptions and actions were reasonable. Expert evidence does not and cannot usurp that function of the jury. The jury is not compelled to accept the opinions proffered by the expert about the effects of batter ing on the mental state of victims generally or on the mental state of the accused in particular. But fairness and the integrity of the trial process demand that the jury have the opportunity to hear them.

(iii) Adequacy of Trial Judge's Charge to the Jury

75 The second issue raised in this case is the adequacy of the trial judge's charge to the jury with respect to the expert evidence furnished by Dr. Shane. It appears that Dr. Shane relied on various sources in formulating his opinion — his series of interviews with the appellant, an interview with her mother, a police report of the incident (including information regarding her statement to the police), the hospital records documenting eight of her visits to emergency departments between 1983 and 1986. Neither the appellant nor her mother testified at trial. The contents of their statements to Dr. Shane were hearsay.

76 In *Abbey*, supra, this court addressed the bases upon which expert evidence that relies on hearsay is admissible. The accused in that case was charged with importing cocaine and his defence was insanity. The accused did not testify. A psychiatrist gave his opinion as to the sanity of the accused and, in the course of giving the basis for his conclusions, referred to incidents and hallucinations related to him by the accused for which there was no admissible evidence. The Crown submitted before this court that the trial judge "accepted and treated as factual much of this hearsay evidence" related to the psychiatrist. Dickson J. found that the point was "well taken". This was the preliminary finding on which the case was based and I think it is fair to say that the trial judge in the case at bar clearly did not make the same mistake as did the trial judge in*Abbey*. At pp. 44-46 of his judgment, Dickson J. articulated the hazards inherent in admitting expert testimony based on hearsay:

> The danger, of course, in admitting such testimony is the ever present possibility, here exemplified, that the judge or jury, without more, will accept that evidence as going to the truth of the facts stated in it. The danger is real and lies at the heart of this case. Once such testimony is admitted, a careful charge to the jury by the judge or direction to himself is essential. The problem, however, as pointed out by Fauteux J. in *Wilband* resides not in the admissibility of the testimony but rather the weight to be accorded to the opinion. Although admissible in the context of his opinion, to the extent that it is second-hand his testimony is not proof of the facts stated ... It was appropriate for the doctors to state the basis for their opinions and in the course of doing so, to refer to what they were told not only by Abbey but by others, but it was error for the judge to accept as having been proved the facts upon which the doctors had relied in forming their opinions. While it is not questioned that medical experts are entitled to take into consideration all possible information in forming their opinions, this in no way removes from the party tendering such evidence the obligation of establishing, through properly admissible evidence, the factual basis on which such opinions are based. Before any weight can be given to an expert's opinion, the facts upon which the opinion is based must be found to exist.

77 For present purposes I think the ratio of *Abbey* can be distilled into the following propositions:

78 1. An expert opinion is admissible if relevant, even if it is based on secondhand evidence.

79 2. This secondhand evidence (hearsay) is admissible to show the information on which the expert opinion is based, not as evidence going to the existence of the facts on which the opinion is based.

80 3. Where the psychiatric evidence is composed of hearsay evidence, the problem is the weight to be attributed to the opinion.

81 4. Before any weight can be given to an expert's opinion, the facts upon which the opinion is based must be found to exist.

82 In the case at bar the trial judge was clearly of the view that Dr. Shane's evidence was relevant. He would not have admitted it otherwise. As I stated above, in light of the evidence of the battering relationship which subsisted between the appellant and the deceased, the trial judge was correct in so doing.

83 With respect to the second point, the trial judge warned the jury generally that they could not "decide the case on the basis of things the witnesses did not see or hear", which would seem to include those matters which Dr. Shane neither saw nor heard. He then gave the marijuana smoking and the confirmatory evidence of the appellant's mother as two sources of information which were not evidence in the case. In my opinion, it would have been preferable if the trial judge had described the interview with the appellant as a source of inadmissible evidence, the marijuana smoking being an example of inadmissible evidence from that source. Nevertheless, I think the trial judge makes his meaning clear to the jury in the subsequent passage:

> In terms of the matters considered by Dr. Shane he is left, therefore, with the deceased's [sic — he means accused's] statement, some supplementary information from the police report and his interpretation of the hospital records.

The trial judge thus eliminates the interview with the appellant and his conversation with her mother as sources of admissible evidence. Elsewhere he reinforces the rule that the jury can only consider the admissible evidence. He refers to the hospital visits made by the appellant:

> Another evidentiary caution is necessary here. Mr. Brodsky, in his remarks, said, as he did in calling some of the evidence respecting hospital attendances that this is only a representative sample. He ought not to have said that. It is not evidence and must be completely disregarded by you. The only evidence before you are the eight attendances that you heard about and nothing else — eight attendances and nothing else.

84 The trial judge's instructions regarding the weight attributable to Dr. Shane's opinion also emphasize his distinction between admissible evidence and hearsay:

> *If the premises upon which the information is substantially based has not been proven in evidence, it is up to you to conclude that it is not safe to attach a great deal of weight to the opinion. An opinion of an expert depends, to a large extent, on the validity of the facts assumed by the evidence of the expert*.
>
> If there are some errors and the factual assumptions aren't too important to the eventual opinion, that's one thing. *If there are errors or matters not in evidence and those matters are substantial, in you [sic] view, in terms of the impact on the expert's opinion, then you will want to look at the value and weight of that expert's opinion very carefully*. It depends on how important you think the matters were that Dr. Shane relied on that are not in evidence. [emphasis added]

85 I agree with Huband J.A. that these instructions with respect to weight conform to this court's judgment in *Abbey*. The only complaint can be with the trial judge's attempt to distinguish admissible from inadmissible evidence. The trial judge was certainly not as clear as he might have been but I have no hesitation in finding that a retrial is not warranted on this account.

86 Given that Dr. Shane relied extensively on his interview with the appellant, the trial judge drew particular attention to the additional element of credibility that could affect the quality of Dr. Shane's opinion:

> It is the position of the Crown that Dr. Shane's opinion stands or falls on the veracity of Lyn Lavallee because he relied so heavily and extensively on what she told him and the evidence contained in the statement, Exhibit 16. That's for you to decide.

Later in the charge, he elaborates:

> Undoubtably [sic] she was a very important source, if not the major source, of his information. Dr. Shane agreed that if what she told him was erroneous, he would have to reassess his position.
>
> On cross-examination he reiterated that in his opinion her action was spontaneous to the moment to try to defend herself. The straw that broke the camel's back was the threat, "When the others leave you're going to get it", even though similar statements had been made to her on other occasions. According to what she told him, the accused felt compelled to shoot.
>
> Based on the information he had in the interview, it was his opinion that the acts of the accused were impulsive and not premeditated. He disagreed with the Crown's suggestion that Lyn Lavallee took the opportunity when it presented itself.
>
> He conceded that patients had, on occasion, lied and misled him in the past.

87 The fourth proposition I have extracted from *Abbey* is that there must be admissible evidence to support the facts on which the expert relies before any weight can be attributed to the opinion. The majority of the Manitoba Court of Appeal appears to

interpret this as a requirement that each and every fact relied upon by the expert must be independently proven and admitted into evidence before the entire opinion can be given any weight.

88 Dr. Shane referred in his testimony to various facts for which there was no admissible evidence. The information was elicited from his interviews with the appellant. It included the smoking of marijuana prior to the killing, the deterioration of the intimate relationship between the appellant and Rust, past episodes of physical and psychological abuse followed by intervals of contrition, the apparent denial of homicidal fantasies on the appellant's part, and her remorse after killing Rust.

89 If the majority of the Court of Appeal is suggesting that each of these specific facts must be proven in evidence before any weight could be given to Dr. Shane's opinion about the accused's mental state, I must respectfully disagree. *Abbey* does not, in my view, provide any authority for that proposition. The court's conclusion in that case was that the trial judge erred in treating as proven the facts upon which the psychiatrist relied in formulating his opinion. The solution was an appropriate charge to the jury, not an effective withdrawal of the evidence. In my view, as long as there is some admissible evidence to establish the foundation for the expert's opinion, the trial judge cannot subsequently instruct the jury to completely ignore the testimony. The judge must, of course, warn the jury that the more the expert relies on facts not proved in evidence the less weight the jury may attribute to the opinion.

90 On my reading of the record Dr. Shane had before him admissible evidence about the nature of the relationship between the appellant and Rust in the form of the appellant's statement to the police and the hospital records. In addition, there was substantial corroborative evidence provided at trial by Ezako, the emergency room doctor who testified to doubting the appellant's explanation of her injuries. There was also the evidence of the witnesses on the night of the shooting who testified to the appellant's frightened appearance, tone of voice, and conduct in dealing with Rust. The evidence pointed to the image of a woman who was brutally abused, who lied about the cause of her injuries, and who was incapable of leaving her abuser. As Huband J.A. comments in dissent, if the trial judge erred at all, he was probably remiss in not mentioning the corroborative evidence of Ezako as buttressing the evidentiary foundation on which Dr. Shane premised his opinion.

91 The majority of the Court of Appeal attached particular significance to the absence of admissible evidence on the question whether the appellant had homicidal fantasies about Rust. As I read the evidence the appellant's alleged denial of homicidal fantasies appeared to add little to Dr. Shane's overall opinion about her mental state on the night in question. Moreover, the evidence given by Ezako about her being an aggressor in the past and even pointing a gun at Rust were far more incriminating in terms of evincing a prior intent to kill than the presence or absence of homicidal fantasies. The gun pointing incidents were explained by Dr. Shane as not inconsistent with her victimized condition and not necessarily indicative of premeditation. Clearly, Dr. Shane's explanation was something the jury could evaluate in the context of all the evidence.

92 Where the factual basis of an expert's opinion is a melange of admissible and inadmissible evidence, the duty of the trial judge is to caution the jury that the weight attributable to the expert testimony is directly related to the amount and quality of admissible evidence on which it relies. The trial judge openly acknowledged to counsel the inherent difficulty in discharging such a duty in the case at bar. In my view, the trial judge performed his task adequately in this regard. A new trial is not warranted on the basis of the trial judge's charge to the jury.

93 I would accordingly allow the appeal, set aside the order of the Court of Appeal, and restore the acquittal.

***Sopinka J.*:**

94 I have read the reasons of my colleague, Justice Wilson, and I agree in the result that this appeal must be allowed. I find it necessary, however, to add a few words concerning the interpretation of this court's decision in *R. v. Abbey*, [1982] 2 S.C.R. 24, [1983] 1 W.W.R. 251, 39 B.C.L.R. 201, 29 C.R. (3d) 193, 68 C.C.C. (2d) 394, 138 D.L.R. (3d) 202, 43 N.R. 30.

95 *Abbey* has been roundly criticized: see, e.g., Schiff, Evidence in the Litigation Process, 3rd ed. (1988), vol. 1, at pp. 473-76; and Delisle, Evidence: Principles and Problems, 2nd ed. (1989), at pp. 477-79. The essence of the criticism is that *Abbey* sets out more restrictive conditions for the use of expert evidence than did previous decisions of this court (i.e., *St. John v. Irving Oil Co.*, [1966] S.C.R. 581, 52 M.P.R. 126, 58 D.L.R. (2d) 404; *Wilband v. R.*, [1967] S.C.R. 14, 60 W.W.R. 292, 2

C.R.N.S. 29, [1967] 2 C.C.C. 6; and *R. v. Lupien*, [1970] S.C.R. 263, 9 C.R.N.S. 165, 71 W.W.R. 110, 655, [1970] 2 C.C.C. 193, 9 D.L.R. (3d) 1). Upon reflection, it seems to me that the very special facts in *Abbey*, and the decision required on those facts, have contributed to the development of a principle concerning the admissibility and weight of expert opinion evidence that is self-contradictory. The contradiction is apparent in the four principles set out by Wilson J. in the present case, at p. 33, which I reproduce here for the sake of convenience:

> 1. An expert opinion is admissible if relevant, even if it is based on secondhand evidence.
>
> 2. This secondhand evidence (hearsay) is admissible to show the information on which the expert opinion is based, not as evidence going to the existence of the facts on which the opinion is based.
>
> 3. Where the psychiatric evidence is composed of hearsay evidence, the problem is the weight to be attributed to the opinion.
>
> 4. Before any weight can be given to an expert's opinion, the facts upon which the opinion is based must be found to exist.

96 The combined effect of Nos. 1, 3 and 4 is that an expert opinion relevant in the abstract to a material issue in a trial but based entirely on unproven hearsay (e.g., from the mouth of the accused, as in *Abbey*) is admissible but entitled to no weight whatsoever. The question that arises is how any evidence can be admissible and yet entitled to no weight. As one commentator has pointed out, an expert opinion based *entirely* on unproven hearsay must, if anything, be inadmissible by reason of irrelevance, since the facts underlying the expert opinion are the only connection between the opinion and the case: see Wardle, "*R. v. Abbey* and Psychiatric Opinion Evidence: Requiring the Accused to Testify" (1984), 17 Ottawa L. Rev. 116, at pp. 122-23.

97 The resolution of the contradiction inherent in *Abbey*, and the answer to the criticism *Abbey* has drawn, is to be found in the practical distinction between evidence that an expert obtains and acts upon within the scope of his or her expertise (as in *St. John*), and evidence that an expert obtains from a party to litigation touching a matter directly in issue (as in *Abbey*).

98 In the former instance, an expert arrives at an opinion on the basis of forms of inquiry and practice that are accepted means of decision within that expertise. A physician, for example, daily determines questions of immense importance on the basis of the observations of colleagues, often in the form of second or third hand hearsay. For a court to accord no weight to, or to exclude, this sort of professional judgment, arrived at in accordance with sound medical practices, would be to ignore the strong circumstantial guarantees of trustworthiness that surround it, and would be, in my view, contrary to the approach this court has taken to the analysis of hearsay evidence in general, exemplified in *Ares v. Venner*, [1970] S.C.R. 608, 73 W.W.R. 347, 12 C.R.N.S. 349, 14 D.L.R. (3d) 4. In *R. v. Jordan* (1984), 39 C.R. (3d) 50, 11 C.C.C. (3d) 565 (B.C.C.A.), a case concerning an expert's evaluation of the chemical composition of an alleged heroin specimen, Anderson J.A. held, and I respectfully agree, that *Abbey* does not apply in such circumstances. (See also *R. v. Zundel* (1987), 58 O.R. (2d) 129, 56 C.R. (3d) 1 at 52, 31 C.C.C. (3d) 97, 29 C.R.R. 349, 35 D.L.R. (4th) 338, 18 O.A.C. 161 (C.A.), where the court recognized an expert opinion based upon evidence "of a general nature which is widely used and acknowledged as reliable by experts in that field.")

99 Where, however, the information upon which an expert forms his or her opinion comes from the mouth of a party to the litigation, or from any other source that is inherently suspect, a court ought to require independent proof of that information. The lack of such proof will, consistent with *Abbey*, have a direct effect on the weight to be given to the opinion, perhaps to the vanishing point. But it must be recognized that it will only be very rarely that an expert's opinion is entirely based upon such information, with no independent proof of any of it. Where an expert's opinion is based in part upon suspect information and in part upon either admitted facts or facts sought to be proved, the matter is purely one of weight. In this respect, I agree with the statement of Wilson J. at p. 35, as applied to circumstances such as those in the present case:

> ... as long as there is some admissible evidence to establish the foundation for the expert's opinion, the trial judge cannot subsequently instruct the jury to completely ignore the testimony. The judge must, of course, warn the jury that the more the expert relies on facts not proved in evidence the less weight the jury may attribute to the opinion.

100 As Wilson J. holds, the trial judge's charge to the jury was adequate, and the appeal ought therefore to be allowed.

Appeal allowed.

2005 SCC 38, 2005 CSC 38
Supreme Court of Canada

Ryan v. Moore

2005 CarswellNfld 157, 2005 CarswellNfld 158, 2005 SCC 38, 2005 CSC 38, [2005] 2 S.C.R. 53, [2005] R.R.A. 694, [2005] S.C.J. No. 38, 139 A.C.W.S. (3d) 1089, 18 E.T.R. (3d) 163, 247 Nfld. & P.E.I.R. 286, 254 D.L.R. (4th) 1, 25 C.C.L.I. (4th) 1, 32 C.C.L.T. (3d) 1, 334 N.R. 355, 735 A.P.R. 286, J.E. 2005-1188, EYB 2005-91679

Cabot Insurance Company Limited and Rex Gilbert Moore, deceased, by his Administratix, Muriel Smith, Appellants v. Peter Ryan, Respondent

McLachlin C.J.C., Major, Bastarache, LeBel, Deschamps, Abella, Charron JJ.

Heard: December 7, 2004

Judgment: June 16, 2005 *

Docket: 29849

Proceedings: reversing in part *Ryan v. Moore* (2003), 2003 NLCA 19, 2003 CarswellNfld 109, 50 E.T.R. (2d) 8, 224 Nfld. & P.E.I.R. 181, 669 A.P.R. 181 (N.L. C.A.); reversing in part *Ryan v. Moore* (2001), 2001 CarswellNfld 277, 205 Nfld. & P.E.I.R. 211, 615 A.P.R. 211, 41 E.T.R. (2d) 287, 19 M.V.R. (4th) 120, 18 C.P.C. (5th) 95 (Nfld. T.D.)

Counsel: Sandra Chaytor, Jorge Segovia, for Appellants
Ian F. Kelly, Q.C., Gregory A. French, for Respondent

***Bastarache J.*:**

1 We are asked to decide whether or not a shortened limitation period under s. 5 of the *Survival of Actions Act*, R.S.N.L. 1990, c. S-32 (see Appendix A), applicable upon the death of one of the parties to an action, can be enforced against a party who had no knowledge of the death until after the limitation period had expired. The respondent, Peter Ryan ("Ryan"), argues that the answer should be no; he invoked in front of our Court and in the courts below a number of legal principles which I shall address: discoverability, confirmation, estoppel by convention and estoppel by representation. The issue of estoppel was raised for the first time by the Court of Appeal itself.

2 The discoverability rule dictates that a cause of action arises for purposes of a limitation period when the material facts on which it is based have been discovered or ought to have been discovered by the plaintiff by the exercise of reasonable diligence (*Central & Eastern Trust Co. v. Rafuse*, [1986] 2 S.C.R. 147 (S.C.C.), at p. 224).

3 Section 16(1) of the *Limitations Act*, S.N.L. 1995, c. L-16.1 (see Appendix A), prescribes that confirmation of a cause of action occurs when a person acknowledges the cause of action of another person or makes a payment in respect of that cause of action. Thus, at that moment, the limitation clock is restarted, and the time before the date of the confirmation will not be counted.

4 Estoppel by convention operates where the parties have agreed that certain facts are deemed to be true and to form the basis of the transaction into which they are about to enter (G. H. L. Fridman, *The Law of Contract in Canada* (4th ed. 1999), at p. 140, note 302). If they have acted upon the agreed assumption , then, as regards that transaction, each is estopped against the other from questioning the truth of the statement of facts so assumed if it would be unjust to allow one to go back on it (S. Bower, *The Law Relating to Estoppel by Representation* (4th ed. 2004), at pp. 7-8).

5 Estoppel by representation requires a positive representation made by the party whom it is sought to bind, with the intention that it shall be acted on by the party with whom he or she is dealing, the latter having so acted upon it as to make it inequitable

that the party making the representation should be permitted to dispute its truth, or do anything inconsistent with it (*Page v. Austin* (1884), 10 S.C.R. 132 (S.C.C.), at p. 164).

6 None of these doctrines can find application in the present case. I will address each of these doctrines and in most cases adopt the reasons of the Court of Appeal with mere comment. One legal concept requires more attention from this Court, given that it is being asked to develop a legal test with regard to its application: estoppel by convention.

I. Background

A. Facts

7 On November 27, 1997, three vehicles were involved in an accident. They were operated by the respondent, Ryan, the appellant, Rex Gilbert Moore, and a third party (not involved in this matter), David Crummey. Ryan decided to pursue a personal injury claim against Moore. He was unaware that, on December 26, 1998, Moore had died of causes unrelated to the accident. On February 16, 1999, Letters of Administration were granted to Moore's administratrix, Muriel Smith. On October 28, 1999, Ryan issued his statement of claim; it was within the two-year limitation period prescribed by the *Limitations Act*, but outside the applicable six-month limitation period from the granting of the letters of administration under the *Survival of Actions Act*. Ryan argues that the appellant is estopped from relying upon the shorter limitation period. Alternatively, he argues that the discoverability principle or the confirmation rule apply to extend this shorter limitation period.

8 As this case is centred on issues related to limitation periods, it is important to recollect the important events leading up to this litigation:

<u>November 27, 1997</u>	<u>The accident</u>
November 28, 1997	Cabot Insurance Co. ("Cabot Insurance") appoints adjuster Brian Lacey to look after the claim against its insured Moore. Ryan retains counsel who contacts the adjuster advising of his retainer and that Ryan, while his injuries are being assessed, will pursue his property damage claim directly with the adjuster.
December 1997 - December 1998	Cabot Insurance pays Ryan's property damage claim directly to him. Correspondence is exchanged between Ryan's counsel and the adjuster concerning Ryan's medical condition, the adjuster seeking documentation and updates on Ryan's condition, and the counsel providing the information requested. The counsel forwards Ryan's hospital chart to the adjuster, for which Cabot Insurance reimburses counsel the $40 fee.
<u>December 26, 1998</u>	<u>Moore dies at age 75 from causes unrelated to the accident</u>.
January 25, 1999	The adjuster writes to Ryan's counsel seeking medical information and reiterating that the insurer would pay a reasonable fee for a medical report. He refers to Moore as "Our Insured".
<u>February 16, 1999</u>	<u>Letters of Administration of the Estate of Rex Moore are granted to Muriel Smith</u>.
April 5, 1999	Ryan's counsel forwards to the adjuster an invoice for a medical report of Ryan's examination by an orthopaedic surgeon.
July 29, 1999	The adjuster forwards to Ryan's counsel a cheque for payment of the medical report. The cheque is payable to Dr. Landells. He refers to Moore as "Our Insured".
<u>August 16, 1999</u>	<u>Six months have passed since the grant of letters of administration of Moore's estate</u>.

October 28, 1999	The statement of claim is issued naming Rex Moore as defendant.
February 10, 2000	Ryan's counsel writes to the adjuster seeking payment for the cost of obtaining the chart from Ryan's family physician. He refers to Moore as "Your Insured"
March 2, 2000	Ryan's counsel writes to the adjuster requesting payment for the chart of another physician. He refers to Moore as "Your Insured".
May 18, 2000	The adjuster learns of Moore's death.
September 22, 2000	Ryan's counsel learns of Moore's death after attempting to serve the statement of claim.
October 24, 2000	Ryan's counsel suggests to Cabot Insurance's claims examiner, Valerie Moore, in a meeting (to discuss claims unrelated to this case) that there might be a problem with the limitation period.
November 9, 2000	Cabot Insurance refuses to settle Ryan's claim because the action is outside the limitation period.

9 Cabot Insurance applied to intervene in the proceedings and sought an order striking out the statement of claim for being out of time. It further claimed that the statement of claim naming a dead person as defendant was a nullity and was not capable of being amended. Ryan also filed an application to amend the statement of claim to describe the defendant as "Rex Moore, Deceased, by his administratrix, Muriel Smith".

B. Supreme Court of Newfoundland and Labrador ((2001), 205 Nfld. & P.E.I.R. 211 (Nfld. T.D.))

10 At the Supreme Court of Newfoundland and Labrador, Orsborn J. denied Cabot Insurance's application to have the action dismissed. First, he held that the discoverability rule did not apply to postpone the running of the *Survival of Actions Act* limitation period, since the fact of death was not an element of the cause of action and was not required to complete the cause of action (paras. 50-51). Second, Orsborn J. held that the confirmation provisions of s. 16 of the *Limitations Act* are not expressly confined to the limitation periods fixed by the *Limitations Act*. He saw no reason in principle why a cause of action continued under the *Survival of Actions Act* could not be confirmed and the limitation period fixed by that Act thus continued. He concluded that Cabot Insurance's payment for the medical report on July 29, 1999 constituted a confirmation of Ryan's cause of action. Since the action was commenced within six months of this payment, the proceeding was still within the short *Survival of Actions Act* limitation period and was not statute barred (paras. 52-63). Third, Orsborn J. concluded that in any event, on the facts of this case, the cause of action against Moore was not a cause of action to which the *Survival of Actions Act* applies. The *Survival of Actions Act* permits a cause of action to survive "for the benefit of or against" an estate (s. 2(b)). The *Survival of Actions Act* deals with the potential acquisition or dissipation of estate assets. However, in this case, Ryan's claim poses no risk to the assets of the estate. Instead, the risk lies on the insurer. Moore was a defendant in name only, and the real party to the action was the insurer. Thus, Ryan's cause of action was not extinguished on Moore's death (paras. 66-76). Fourth, Orsborn J. held that if Ryan's cause of action had not been confirmed and if the *Survival of Actions Act* was indeed applicable (which he held it was not), then the action would have been a nullity for being commenced outside the limitation period. However, as this was not the case, the plaintiff was not statute barred.

C. Court of Appeal of Newfoundland and Labrador ((2003), 224 Nfld. & P.E.I.R. 181, 2003 NLCA 19 (N.L. C.A.))

(1) Wells C.J. (for the majority)

11 The majority of the Court of Appeal allowed, in part, both the appeal and cross-appeal. The applications judge's order to permit the intervention of Cabot Insurance and the amendment of the statement of claim was affirmed. Wells C.J. held that the applications judge made no error in considering the existence of insurance in determining whether or not the action posed a financial risk to the estate. He nevertheless held that the applications judge erred in holding that the cause of action against Moore is a cause of action to which the *Survival of Actions Act* did not apply. The court explained that unless the *Survival of*

Actions Act applies, the action will be a nullity. The right to institute a tort action after death, or continue an action after death, derives from the statute. Without such a statute, this right does not otherwise exist.

12 The majority agreed with the applications judge that the discoverability rule does *not* apply to postpone the running of the limitation period under the *Survival of Actions Act*. Concluding that the limitation period in the statute runs from an event that occurs without regard to the injured party's knowledge, the majority deemed that allowing the application of the discoverability rule would disrupt the exception to the common law rule, the courts thereby intruding into the legislature's jurisdiction.

13 The majority disagreed with Orsborn J.'s holding that the confirmation provisions of the *Limitations Act* also apply to the limitation period under the *Survival of Actions Act*. Wells C.J. held that s. 16 of the *Limitations Act* provides confirmation of a cause of action and not of the right to commence it. The majority pointed out that the nature of the cause of action, or whether it is confirmed, is not relevant to the date of death or of grant of probate which triggers the limitation period created by the *Survival of Actions Act*. Confirmation did not arise in relation to the limitation period stemming from the *Limitations Act* because the statement of claim was issued within two years of the collision, i.e. within the prescribed delay.

14 Turning to the last issue, the majority held that Moore's estate and Cabot Insurance were barred by the principle of estoppel from relying on the fact of Moore's death and the granting of letters of administration. The particular form of estoppel invoked was estoppel by convention. Wells C.J., having reviewed Canadian and foreign authorities and decisions, concluded that estoppel by convention was established (para. 79). The majority held that detrimental reliance was not required. Consequently, Cabot Insurance and Moore were estopped from pleading that Moore died or that letters of administration were granted prior to May 2000 in order to invoke the shorter *Survival of Actions Act* limitation period. As a result, nullity could not be established and the statement of claim was amended to name the administratrix of Moore as defendant in the action.

(2) Cameron J.A. (dissenting)

15 In dissenting reasons, concurred in by Welsh J.A., Cameron J.A. disagreed with the estoppel analysis and held that it did not apply to the case at bar. After analysing case law and doctrine, she concluded that mutual misunderstanding (both parties assuming that Moore was alive) did not amount to a common assumption. The dissenting judges did not find that the letters sent by Cabot Insurance to Ryan's counsel referring to "Our Insured — Rex Moore" formed the basis on which the parties governed their conduct. The failure to commence the action within the *Survival of Actions Act*'s limitation period was *not* due to any arrangement between the parties, and consequently, there was no reliance on any convention. Therefore, this principle did not apply. Ryan's action was therefore time barred. The dissenting judges would have allowed the appeal.

II. Analysis

A. Discoverability

(1) Statutory Limitation Periods

16 The situation here is governed by two limitation periods: s. 5 of the *Limitations Act* (see Appendix A) and s. 5 of the *Survival of Actions Act*. The limitation period in s. 5 of the *Limitations Act* applies initially. Section 5 of the *Survival of Actions Act* superimposes itself on s. 5 at a later point of time, but does not eliminate it. This follows from the fact that the *Survival of Actions Act* does not create a new cause of action, as will be explained later.

17 Pursuant to s. 5 of the *Limitations Act*, a person can bring an action for damages in respect of injury based on contract or tort within two years of the date on which the right to do so arose. Ryan, by issuing a statement of claim on October 28, 1999, naming Rex Moore as the defendant, therefore, met the prescribed limitation period in the *Limitations Act*. Nevertheless, unknown to the parties, Rex Moore had died on December 26, 1998, altering the fact scenario.

18 As stated by the Court of Appeal, it is well known that at common law a personal action in tort is extinguished on the death of the victim or the wrongdoer: *actio personalis moritur cum persona* (see G. Mew, *The Law of Limitations* (2nd ed. 2004), at p. 253). Being unable to sue the estate of a deceased tortfeasor was particularly severe as it left injured survivors of motor

vehicle accidents without any means of recovery. This led legislatures to enact statutes to diminish the hardship of the common law rule. The *Fatal Accidents Act*, R.S.N.L. 1990, c. F-6, and the *Survival of Actions Act* were such statutes. Under the *Fatal Accident Act*, the estate of a person who died as a result of the accident, or the survivors of that person, are accorded the right to maintain an action for death by wrongful act. Also, pursuant to s. 2 of the *Survival of Actions Act*, (see Appendix A) an action vested in or existing against a person who has died can be maintained by or against the deceased person's estate. However, s. 5 of the *Survival of Actions Act* prohibits an action brought six months after letters of probate or administration of the estate of the deceased have been granted, and after the expiration of one year from the date of death. Hence, the provision is meant to keep the action "alive" for a specific period of time. The *Survival of Actions Act* imposes an additional limitation period. As eloquently affirmed by Orsborn J., the *Survival of Actions Act* does not create a cause of action. It grafts its provision onto an existing cause of action, one which is complete in all of its elements before the operation of the *Survival of Actions Act* (para. 45).

19 In the case at bar, the *Survival of Actions Act* has the effect of shortening the time period within which the action could be taken because "an action founded in tort may only be taken by or against the estate of a deceased person if it is commenced within that period of time that is common to both limitations periods": Wells C.J., at para. 37.

20 Ryan argues that the *Survival of Actions Act* contemplates that a cause of action can arise under the *Survival of Actions Act*. I fail to see how the expression "[c]auses of action under this Act" or "an action ... under this Act" found in ss. 8(1) and 5 respectively can be seen to indicate the *creation* of a new cause of action. The *Survival of Actions Act* expressly contemplates the *survival* of causes of action *existing* against a person who has died (s. 2). I take that to mean that the cause of action existed prior to the application of the *Survival of Actions Act*. The survival of a cause of action for a time and its creation are two different things.

(2) Discoverability: The Judge-Made Rule

21 The debate concerning the use of the discoverability principle in tort actions has been settled by this Court in *Nielsen v. Kamloops (City)*, [1984] 2 S.C.R. 2 (S.C.C.), *Central Trust* and *M. (K.) v. M. (H.)*, [1992] 3 S.C.R. 6 (S.C.C.).

22 The discoverability principle provides that "a cause of action arises for purposes of a limitation period when the material facts on which it is based have been discovered or ought to have been discovered by the plaintiff by the exercise of reasonable diligence": *Central Trust*, at p. 224. In some provinces, the discoverability rule has been codified by statute; in others, it has been deemed redundant because of other remedial provisions.

23 While discoverability has been qualified in the past as a "general rule" (*Central Trust*, at p. 224; *Peixeiro v. Haberman*, [1997] 3 S.C.R. 549 (S.C.C.), at para. 36), it must not be applied systematically without a thorough balancing of competing interests (*Peixeiro*, at para. 34). The rule is an interpretative tool for construing limitation statutes. I agree with the Manitoba Court of Appeal when it writes:

> In my opinion, the judge-made discoverability rule is nothing more than a rule of construction. Whenever a statute requires an action to be commenced within a specified time from the happening of a specific event, the statutory language must be construed. When time runs from "the accrual of the cause of action" or from some other event which can be construed as occurring only when the injured party has knowledge of the injury sustained, the judge-made discoverability rule applies. <u>But, when time runs from an event which clearly occurs without regard to the injured party's knowledge, the judge-made discoverability rule may not extend the period the legislature has prescribed</u>. [Emphasis added.]

(*Fehr v. Jacob* (1993), 14 C.C.L.T. (2d) 200 (Man. C.A.), at p. 206). See also *Peixeiro*, at para. 37; *Snow (Guardian ad litem of) v. Kashyap* (1995), 125 Nfld. & P.E.I.R. 182 (Nfld. C.A.).

24 Thus, the Court of Appeal of Newfoundland and Labrador is correct in stating that the rule is "generally" applicable where the commencement of the limitation period is related by the legislation to the arising or accrual of the cause of action. The law does not permit resort to the judge-made discoverability rule when the limitation period is explicitly linked by the governing legislation to a fixed event unrelated to the injured party's knowledge or the basis of the cause of action (see Mew, at p. 55).

(3) Discoverability Principle Does Not Apply to the Survival of Actions Act

25 Ryan submits that the discoverability rule applies to the limitation period contained in s. 5 of the *Survival of Actions Act*. He argues that the limitation period should not begin to run until he knew, or ought reasonably to have known, the material facts which determine (i) his cause of action under the *Survival of Actions Act* and (ii) the limitation period. In sum, Ryan claims that the death of Moore is integral to the cause of action and that the limitation period should not start to run until he knew that he had a cause of action against the estate of Rex Moore. The appellants submit that the discoverability rule does not apply to the *Survival of Actions Act* as it would transcend the logic of statutory interpretation and the scheme enacted by the legislature. In addition, they say that the rule does not apply where time runs from a fixed event.

26 Like the Court of Appeal, I am of the view that the appellants' position is correct. For ease of reference, I reproduce s. 5 of the *Survival of Actions Act*:

> **5.** An action shall not be brought under this Act unless proceedings are started within 6 months after letters of probate or administration of the estate of the deceased have been granted and proceedings shall not be started in an action under this Act after the expiration of 1 year after the date of death of the deceased.

27 Pursuant to the *Survival of Actions Act*, the limitation period is triggered by the death of the defendant or the granting by a court of the letters of administration or probate. The section is clear and explicit: time begins to run from one of these two specific events. The Act does not establish a relationship between these events and the injured party's knowledge. I agree with the appellants that knowledge is not a factor: the death or granting of the letters occurs regardless of the state of mind of the plaintiff. We face here a situation in respect of which, as recognized by this Court in *Peixeiro*, the judge-made discoverability rule does not apply to extend the period the legislature has prescribed. Thus, I agree with the Court of Appeal that by using a specific event as the starting point of the "limitation clock", the legislature was displacing the discoverability rule in all the situations to which the *Survival of Actions Act* applies.

28 A number of the appellate courts have dealt with the question of discoverability in the context of actions by or against estates of deceased persons. The appellants rely extensively on *Payne v. Brady* (1996), 140 D.L.R. (4th) 88 (Nfld. C.A.), leave to appeal refused, [1997] 2 S.C.R. xiii (S.C.C.). While the facts of that case are very similar to the present, it is not clear whether the Court of Appeal of Newfoundland and Labrador decided that the rule of discoverability did not apply because death is always a possibility or because the appellant Payne had ample time after she became aware of the death of Brady to commence her action. What is clear is the point advanced by O'Neill J.A.: the death of a prospective defendant and the possibility of a shortened period to commence an action is a reality that claimants and their counsel have to guard against: *Payne*, at p. 94.

29 The Nova Scotia Court of Appeal decision in *Burt v. LeLacheur* (2000), 189 D.L.R. (4th) 193 (N.S. C.A.), is invoked by the respondent. However, the reasoning of that case cannot be applied in the case at bar. In *Burt*, the Court of Appeal held that the discoverability rule applied to s. 10 of the *Fatal Injuries Act*, R.S.N.S. 1989, c. 163. The Nova Scotia Court of Appeal stated its position in the following manner (at p. 208):

> If the discoverability rule applies to a limitation period running from "when the damages were sustained" (*Peixeiro*) and from "the final determination of the action against the insured" (*Grenier*), I think it is not unreasonable to apply it to the period one year after the death so as to start time running only when the claimant knows or ought to know that the death might be a <u>wrongful</u> one. This, having in mind the statutory scheme of the *Fatal Injuries Act*, is no greater a stretch of the language than was made by the courts in *Peixeiro, Grenier* and other cases, all for the purpose of preventing a potential injustice.
>
> <u>We must avoid the accusation of usurping the role of the Legislature</u>, but in my opinion to apply the discoverability rule here is consistent with what has already been done before. <u>On the true consideration of s. 10 of the *Fatal Injuries Act*, time does not run simply from a fixed event, but from constituent elements of the cause of action created by the statute.</u> [Emphasis added.]

30 In *Burt*, the death of a person for which an action can be brought under the *Fatal Injuries Act* does not merely refer to the time of death as provided in the *Survival of Actions Act*, but to a "wrongful death". It is not an event totally unrelated to the accrual of the cause of action. Hence, the death of the person there is in fact a "constituent elemen[t] of the cause of action", contrary to the present case.

31 In my view, the case that best assists this Court in the present matter is the one giving rise to the Ontario Court of Appeal's decision in *Waschkowski v. Hopkinson Estate* (2000), 47 O.R. (3d) 370 (Ont. C.A.). The court had to determine the possible application of the discoverability rule to s. 38(3) of the *Trustee Act*, R.S.O. 1990, c. T.23, the statutory provision in Ontario permitting an action in tort by or against the estate of a deceased person and limiting the period during which such actions may be commenced. Abella J.A., as she then was, concluded, at para. 16, that the discoverability rule did not apply to the section since the state of actual or attributed knowledge of an injured person in a tort claim is not germane when a death has occurred. She explained at paras. 8-9:

> In s. 38(3) of the *Trustee Act*, the limitation period runs from a death. Unlike cases where the wording of the limitation period permits the time to run, for example, from "when the damage was sustained" (*Peixeiro*) or when the cause of action arose (*Kamloops*), there is no temporal elasticity possible when the pivotal event is the date of a death. Regardless of when the injuries occurred or matured into an actionable wrong, s. 38(3) of the *Trustee Act* prevents their transformation into a legal claim unless that claim is brought within two years of the death of the wrongdoer or the person wronged.
>
> The underlying policy considerations of this clear time limit are not difficult to understand. The draconian legal impact of the common law was that death terminated any possible redress for negligent conduct. On the other hand, there was a benefit to disposing of estate matters with finality. The legislative compromise in s. 38 of the *Trustee Act* was to open a two-year window, making access to a remedy available for a limited time without creating indefinite fiscal vulnerability for an estate. [Emphasis added.]

See also *Canadian Red Cross Society / Société Canadienne de la Croix-Rouge, Re*, [2003] O.J. No. 5669 (Ont. C.A.), and *Edwards v. Law Society of Upper Canada* (2000), 48 O.R. (3d) 321 (Ont. C.A.).

32 Ryan's cause of action arose prior to Moore's death and Ryan was well aware of his cause of action both before Moore's death and before the expiration of the *Survival of Actions Act* limitation period. In fact, the day following the accident, Ryan retained a solicitor to pursue a claim for damages against Moore for injuries alleged to have resulted from the accident. At that point, Ryan could have sued Moore as all the elements of his cause of action were known. He did not need to have knowledge of the death in question to prove his claim or issue and serve the statement of claim. Moore's subsequent death had no impact whatsoever on the accrual of Ryan's cause of action. Consequently, I agree with the conclusion of the applications judge, at para. 50:

> The fact of death is of no relevance to the cause of action in question. It is not an element of the cause of action and is not required to complete the cause of action. Whatever the nature of the cause of action, it is existing and complete before the *Survival of Actions Act* operates, in the case of a death, to maintain it and provide a limited time window within which it must be pursued. The fact of the death is irrelevant to the cause of action and serves only to provide a time from which the time within which to bring the action is to be calculated.

33 A further reason for the non-application of the discoverability rule is the evident impact such a rule would have on the distribution of assets to the beneficiaries. Without a time limit, an executor or an administrator would not feel free to distribute the assets of an estate until all reasonable possibilities of claim had been addressed. This would be cumbersome and unrealistic. "An estate should not be held to ransom interminably by the advancement of claims which are not proceeded with in a timely manner": *MacKenzie v. MacKenzie* (1992), 84 Man. R. (2d) 149 (Man. Q.B.), para. 18, cited in *J. (A.) v. Cairnie Estate* (1993), 105 D.L.R. (4th) 501 (Man. C.A.), p. 510.

34 The *Survival of Actions Act* is itself a legislative exception to a common law rule. Thus, it would displace the intention of the legislature to "stretch" the limitation period. Borrowing the words of Marshall J.A. in *Snow (Guardian ad litem of)*, at

para. 43, to apply the rule of construction of reasonable discoverability to such a provision would be tantamount to mounting a fiction transcending the limits of logical statutory interpretation. Hence, it would constitute an impermissible incursion into the legislative process.

(4) Special Circumstances

35 Ryan submits, as an alternative, that if the discoverability rule does not apply, the limitation period should be extended because of the "special circumstances" principle. He claims that, pursuant to this principle, fairness and justice require that an innocent plaintiff should not be deprived of compensation through no fault of his own. This argument was not invoked in front of the applications judge or the Court of Appeal, and is not supported by any evidence; under these circumstances, it is, in my view, without merit.

B. Confirmation

36 Ryan claims that the confirmation of the cause of action pursued under s. 16 of the *Limitations Act* applies to extend the limitation period contained in s. 5 of the *Survival of Actions Act*. He argues that the correspondence exchanged between Cabot Insurance's adjuster and his previous counsel, the payment made by Cabot Insurance for his property damage claim, as well as a payment of $500 to his previous counsel for a medical report, prove acknowledgment (as contemplated by the *Limitations Act*) and therefore confirmation.

37 The appellants submit that s. 16 of the *Limitations Act* does not apply to the *Survival of Actions Act*. They claim that any confirmation of the cause of action would have no effect on the *Survival of Actions Act* limitation period because the *Survival of Actions Act* does not create a cause of action but simply confers a right to pursue a claim notwithstanding the fact that one of the parties has died. Finally, they argue that there was no confirmation of the cause of action in this case as there was no admission of liability through the letters nor the payments made.

38 I agree with the appellants' position as accepted by the Court of Appeal.

39 The relevant portions of s.16 of the *Limitations Act* provide:

> **16.** (1) A confirmation of a cause of action occurs where a person
>
> (a) acknowledges that cause of action, right or title of another person; or
>
> (b) makes a payment in respect of that cause of action, right or title of another.
>
> (2) Where a person against whom an action lies confirms that cause of action, the time before the date of that confirmation shall not count when determining the limitation period for a person having the benefit of the confirmation against the person bound by that confirmation.
>
> (3) Subsection (2) applies only to a right of action where the confirmation is given before the expiration of the limitation period for that right of action.
>
> . . . . .
>
> (5) In order to be effective a confirmation must be in writing and signed by
>
> (a) the person against whom that cause of action lies; or
>
> (b) his or her agent
>
> and given to the person or agent of the person having the benefit of that cause of action.

40 When a person acknowledges the cause of action of another person or makes a payment in respect of that cause of action, a confirmation of that cause of action occurs. Consequently, the time accrued before the date of that confirmation shall not be

considered when determining the limitation period (s. 16(2)). Confirmation must, of course, be made prior to the expiration of the limitation period (s. 16(3)).

41 Section 16 can only apply to a limitation period which limits the time during which an action may be taken. Since the limitation period which arises under the *Survival of Actions Act* supersedes the first limitation period of the *Limitations Act*, and does not create or revive an action, but merely permits it to continue, s. 16 cannot apply to it as found by the Court of Appeal (para. 67).

42 Even if this were not the case, the facts here do not support a finding of confirmation on the part of the appellants. I will address this issue briefly as a matter of principle.

43 In order to establish confirmation, one of two events must be proven: 1) that the party acknowledged the cause of action; or 2) that there was a payment made in respect of the cause of action (see Mew, at p. 115).

44 The term "acknowledges" as used in s. 16(1)(a) of the *Limitations Act* has been described by Lord Denning in *Good v. Parry*, [1963] 2 All E.R. 59 (Eng. C.A.), at p. 61, as requiring an "admission". While care must be shown when applying English case law, as the English *Limitation Act*, 1939, 2 & 3 Geo. 6, c. 21, does not provide for the acknowledgment of the "cause of action" but the acknowledgment of the "claim", it is still persuasive authority for the present interpretation.

45 Thus, a party can only be held to have acknowledged the claim if that party has in effect admitted his or her liability to pay that which the claimant seeks to recover (see *Surrendra Overseas Ltd. v. Sri Lanka* (1976), [1977] 2 All E.R. 481 (Eng. Q.B.)). As the British Columbia Court of Appeal concluded in *Podovinikoff v. Montgomery* (1984), 14 D.L.R. (4th) 716 (B.C. C.A.), at p. 721, a person can acknowledge as a bare fact that someone has asserted (by making a claim) a cause of action against him, without acknowledging any liability. Simple acknowledgment of the "existence" of a cause of action is insufficient to meet the requirements of s. 16(1)(a). Acknowledgment must involve acknowledgment of some liability.

46 Consequently, the letters from the adjuster to Ryan's counsel (i.e., letters of November 18, 1998 and January 25, 1999) do not restart the clock as they do not constitute an admission of liability on the part of Cabot Insurance. These were obviously only requests for information and part of the normal investigation process. As submitted by the appellants, if mere investigation of claims were to constitute confirmation, then potential defendants, in order to protect limitation defence, would have no choice but to refuse to investigate until a statement of claim is issued. This would destroy the possibility of early settlements and lead to increased litigation and costs.

47 The same conclusion applies to the second way that confirmation can occur, through payment. Of importance is the fact that both payments mentioned by Ryan, payments for Ryan's medical chart and Dr. Landells' medical report, were not evidence of liability by Cabot Insurance; nor did they indemnify Ryan, at least in part, for damages caused by the accident. Thus, they cannot be payments in respect of the "cause of action". Ryan relies on the Newfoundland and Labrador Court of Appeal decision in *Wheaton v. Palmer* (2001), 205 Nfld. & P.E.I.R. 304 (Nfld. C.A.), for the proposition that a payment made to a physician, but sent to the plaintiff's solicitor will constitute confirmation. With respect, I am of the view that the Court of Appeal erred in this determination. I prefer the contrary position of the British Columbia Court of Appeal in *MacKay v. Lemley* (1997), 44 B.C.L.R. (3d) 382 (B.C. C.A.), at para. 21. Payment for a medical report with a cheque payable to a physician, but sent to the plaintiff's solicitor, does not constitute confirmation of the plaintiff's cause of action:

> The mere fact that the payment, although made payable to the doctor, was directed through the lawyer's office for forwarding does not, in my view, bring the payment into the express wording of the section. The payment here, as in *Germyn*, was intended to pay to the doctor. The doctor was not a person through whom the appellant could claim. This was not a reimbursement to anyone for having paid for the medical report but a direct payment to the doctor by [the Insurance Corporation of British Columbia].

48 The purpose for which these types of payments and correspondence are made is critical. In this case, they were not intended as admissions of liability, but only to promote investigation and early resolution of certain aspects of the claim.

C. Estoppel

49 Moore's estate and Cabot Insurance submit that the majority of the Court of Appeal erred when it concluded that they were estopped from relying on the fact of Moore's death and the granting of letters of administration, thus preventing them from arguing that Ryan's action was outside the *Survival of Actions Act* limitation period. They claim that neither estoppel by convention nor estoppel by representation applies to the facts of the present case. Ryan argues that the appellants are precluded or estopped from relying on the limitation period in the *Survival of Actions Act* because of the application of either of these two types of estoppel.

50 While the principle of estoppel is often referred to in connection with cases of waiver, election, abandonment, acquiescence and laches, in the context of commercial and contractual relationships, the case law in Canada on this subject is not as abundant as that in the United Kingdom. It is therefore useful for this Court to address the issue in some detail, especially where it has long been accepted that estoppels are to be received with caution and applied with care (see *Harper v. Cameron* (1893), 2 B.C.R. 365 (B.C. C.A.), at p. 383).

51 The state of the law of estoppel was articulated by Lord Denning in *Amalgamated Investment & Property Co. (In Liquidation) v. Texas Commerce International Bank Ltd.* (1981), [1982] Q.B. 84 (Eng. C.A.), at p. 122, as follows:

> The doctrine of estoppel is one of the most flexible and useful in the armoury of the law. But it has become overloaded with cases. That is why I have not gone through them all in this judgment. It has evolved during the last 150 years in a sequence of separate developments: proprietary estoppel, estoppel by representation of fact, estoppel by acquiescence, and promissory estoppel. At the same time it has been sought to be limited by a series of maxims: estoppel is only a rule of evidence, estoppel cannot give rise to a cause of action, estoppel cannot do away with the need for consideration, and so forth. All these can now be seen to merge into one general principle shorn of limitations. When the parties to a transaction proceed on the basis of an underlying assumption — either of fact or of law — whether due to misrepresentation or mistake makes no difference — on which they have conducted the dealings between them — neither of them will be allowed to go back on that assumption when it would be unfair or unjust to allow him to do so. If one of them does seek to go back on it, the courts will give the other such remedy as the equity of the case demands.

52 The jurisprudence discloses six types of estoppel: estoppel by representation of fact, proprietary estoppel, promissory estoppel, estoppel by convention, estoppel by deed and estoppel by negligence (see Bower, at pp. 3-9). I will examine here the ones at the centre of this dispute, estoppel by convention and estoppel by representation.

(1) Estoppel by Convention

(a) Definition and Principles

53 The origin of the doctrine of estoppel by convention can be traced to estoppel by deed for which sealing and delivery were essential, and for which the foundation of duty lay not in the agreement itself, or any reliance thereon, but in the formal solemnity of the deed, reflecting the concern of ancient jurisprudence with form as opposed to substance. The modern rule has evolved enormously (see Bower, at pp. 179-80; T. B. Dawson, "Estoppel and obligation: the modern role of estoppel by convention" (1989), 9 *L.S.* 16)

54 Spencer Bower defines the modern concept of estoppel by convention as follows (p. 180):

> An estoppel by convention, it is submitted, is an estoppel by representation of fact, a promissory estoppel or a proprietary estoppel, in which the relevant proposition is established, not by representation or promise by one party to another, but by mutual, express or implicit, assent. This form of estoppel is founded, not on a representation made by a representor and believed by a representee, but on an agreed statement of facts or law, the truth of which has been assumed, by convention of the parties, as a basis of their relationship. When the parties have so acted in their relationship upon the agreed assumption that the given state of facts or law is to be accepted between them as true, that it would be unfair on one for the other to

resile from the agreed assumption, then he will be entitled to relief against the other according to whether the estoppel is as to a matter of fact, or promissory, and/or proprietary.

55 S. Wilken, *Wilken and Villiers: The Law of Waiver, Variation and Estoppel* (2nd ed. 2002), at p. 223, affirms that estoppel by convention will occur where:

> (i) the parties have established, by their construction of their agreement or a common apprehension as to its legal effect, a convention basis;
>
> (ii) on that basis the parties have regulated their subsequent dealings;
>
> (iii) one party would suffer detriment if the other were to be permitted to resile from that convention.

See also *Chitty on Contracts* (29th ed. 2004), vol. 1, at p. 283.

56 The Court of Appeal of Newfoundland and Labrador, after a review of the case law in the United Kingdom and in Canada, formulated the following four elements which need to be proven (para. 79):

> (i) The evidence establishes an assumption in common between the parties as to a state of facts;
>
> (ii) The parties have adopted the common assumption as the conventional basis for a transaction into which they have entered;
>
> (iii) The dispute in respect of which the estoppel by convention is asserted arises out of that transaction; and,
>
> (iv) A detriment would flow to the party asserting the estoppel if the other party is permitted to resile from the assumed stated facts.

These requirements were accepted by the respondent.

57 The appellants submit that there are six requirements for the estoppel by convention. They cite as support the New Zealand Court of Appeal decision in *National Westminster Finance NZ Ltd. v. National Bank of NZ Ltd.*, [1996] 1 N.Z.L.R. 548 (New Zealand C.A.), at p. 550. In fact, they simply advocate a more detailed description of the requirements also found in other foreign cases.

58 The jurisprudence in the United Kingdom is indeed abundant in contrast to that in Canada (see, e.g., *India v. India Steamship Co. Ltd.*, [1998] 1 Lloyd's Rep. 1 (U.K. H.L.), at p. 10; *K. Lokumal & Sons (London) Ltd. v. Lotte Shipping Co. Pte. Ltd.*, [1985] 2 Lloyd's Rep. 28 (Eng. C.A.), at pp. 34-35; *Norwegian American Cruises A/S v. Paul Mundy Ltd.*, [1988] 2 Lloyd's Rep. 343 (Eng. C.A.), at pp. 349-53).

59 This Court is not bound by any of the above analytical frameworks. After having reviewed the jurisprudence in the United Kingdom and Canada as well as academic comments on the subject, I am of the view that the following criteria form the basis of the doctrine of estoppel by convention:

> 1) The parties' dealings must have been based on a shared assumption of fact or law: estoppel requires manifest representation by statement or conduct creating a mutual assumption. Nevertheless, estoppel can arise out of <u>silence</u> (impliedly).
>
> 2) A party must have conducted itself, i.e. acted, in reliance on such shared assumption, its actions resulting in a change of its legal position.
>
> 3) It must also be unjust or unfair to allow one of the parties to resile or depart from the common assumption. The party seeking to establish estoppel therefore has to prove that detriment will be suffered if the other party is allowed to resile from the assumption since there has been a change from the presumed position.

See Wilken, at pp. 227-28; *Canacemal Investment Inc. v. PCI Realty Corp.*, [1999] B.C.J. No. 2029 (B.C. S.C.), at para. 35; *Capro Investments Ltd. v. Tartan Development Corp.*, [1998] O.J. No. 1763 (Ont. Gen. Div.), at para. 31.

(b) Application of the Law

60 The majority of the Court of Appeal held that estoppel by convention applied in the circumstances of this case. It concluded that there was an assumption between the parties as to a state of facts, namely: that Moore was alive; that the parties adopted this assumption as the basis upon which their transactions relating to Ryan's claim were to be conducted; that the dispute in respect of which the estoppel was asserted arose out of the transactions between the parties in dealing with Ryan's claim; and that detriment would flow to Ryan if Moore's estate or the insurer were permitted to resile from the common assumption. As will be evidenced from the analysis below, I cannot agree with this conclusion.

(i) Assumption Shared and Communicated

61 The crucial requirement for estoppel by convention, which distinguishes it from the other types of estoppel, is that at the material time both parties must be of "a like mind" (*Troop v. Gibson*, [1986] 1 E.G.L.R. 1 (Eng. C.A.), at p. 5; *London Borough of Hillingdon v. Arc Ltd.*, [2000] E.W.J. No. 3278 (Eng. C.A.), at para. 49). The court must determine what state of affairs the parties have accepted, and decide whether there is sufficient certainty and clarity in the terms of the convention to give rise to any enforceable equity: *Troop*, at p. 6; see also *Baird Textile Holdings Ltd v. Marks & Spencer Plc*, [2002] 1 All E.R. (Comm) 737 (Eng. C.A.), at para. 84.

62 While it may not be necessary that the assumption by the party raising estoppel be created or encouraged by the estopped party, it must be shared in the sense that each is aware of the assumption of the other (*John v. George*, [1995] E.W.J. No. 4375 (Eng. C.A.), at para. 37). Mutual assent is what distinguishes the estoppel by convention from other types of estoppel (Bower, at p. 184). The courts have described communications complying with this requirement as "crossing the line". In *K. Lokumal & Sons (London) Ltd.*, at pp. 34-35, Kerr L.J. held that

> [a]ll estoppels must involve some statement or conduct by the party alleged to be estopped on which the alleged representee was entitled to rely and did rely. In this sense <u>all estoppels may be regarded as requiring some manifest representation which crosses the line between representor and representee, either by statement or conduct</u>. It may be an express statement or it may be implied from conduct, e.g. a failure by the alleged representor to react to something said or done by the alleged representee so as to imply a manifestation of assent which leads to an estoppel by silence or acquiescence. Similarly, in cases of so-called estoppels by convention, there must be some mutually manifest conduct by the parties which is based on a common but mistaken assumption....
>
> There cannot be any estoppel unless the alleged representor has said or done something, or failed to do something, with the result that — across the line between the parties — his action or inaction has produced some belief or expectation in the mind of the alleged representee, so that, depending on the circumstances, it would thereafter no longer be right to allow the alleged representor to resile by challenging the belief or expectation which he has engendered. To that extent at least, therefore, the alleged representor must be open to criticism. [Emphasis added.]

See also *Norwegian American Cruises A/S*, at p. 350. Thus, it is not enough that each of the two parties acts on an assumption not communicated to the other (*India*, at p. 10). Further, the estopped party must have, at the very least, communicated to the other that he or she is indeed sharing the other party's (ex *hypothesi*) mistaken assumption (*John*, at para. 81; Bower at p. 184).

63 In the present case, the record discloses fourteen letters exchanged by Ryan's counsel and the adjuster with respect to the respondent's personal injury claim (A.R., Vol. II, at pp. 150-70). However, none of these prove the existence of a common assumption. The letters lack clarity and certainty. The mere fact that communications occurred between the parties does not establish that they both assumed that Moore was alive. It is unlikely the question of whether Moore was alive or dead crossed the minds of either the appellants or the respondent. The fact that Ryan's counsel had originally diarized the claim as having a two-

year limitation period under the *Limitations Act* shows that he had not turned his mind to the possibility of a shorter limitation period under the *Survival of Actions Act*. Effectively, this Court is in the presence of mutual ignorance, not mutual assumption.

64 Ryan submits, and it was agreed by the Court of Appeal, that the subject line in the letters exchanged between his counsel and the adjuster which read "Your Insured: Rex Moore" or "Our Insured: Rex Moore" is self-explanatory and indicates an assumption by both parties, that Moore was alive. I strongly disagree. This is an unrealistic interpretation of the subject line in the letters. Such an expression can mean one thing only: the named insured under the automobile insurance policy was Rex Moore. The words are a mere identification of the file the undersigned is dealing with. The Court of Appeal erred by giving weight to the subject line of these letters, which, properly interpreted, provide no evidence of a mutual assumption that Moore was alive.

65 Nor did the fact that the parties were conferring without regard to the limitation period establish a shared assumption that the limitation defence would not be relied on. The letters contain limited and simple requests for details of the claim, and do not establish a convention between the parties (see *Hillingdon London Borough*, at paras. 57 and 60; *Seechurn v. Ace Insurance SA NV*, [2002] 2 Lloyd's Rep. 390 (Eng. C.A.), at p. 396). In fact, the matter did not proceed beyond the preliminary stage of investigating the merits of the personal injury claim. There were no negotiations or settlement discussions, no admission of liability, and no agreement to forego a possible limitation defence.

66 Even if one could conclude that there was a mutual assumption between the parties, I am of the view that it cannot realistically be asserted that the respondent communicated to the appellants that he indeed shared the mistaken assumption. In this regard, I agree with the dissenting members of the Court of Appeal when they affirm (at para. 108):

> It is true that both parties assumed Mr. Moore was alive. That, as noted above, is not sufficient to establish estoppel by convention. Prior to Mr. Moore's death, any reference to him implying he was alive was a reflection of the truth at that time. That cannot be said to be a communication which becomes the basis of a convention that they will proceed on the assumption that Mr. Moore is alive, even beyond his death. There is no direct or circumstantial evidence which would lead to such a conclusion. The question becomes: could any agreement have arisen after Mr. Moore's death? The two letters written by the adjuster after Mr. Moore's death were in error when they said "Our insured — Rex Moore" but there is no communication to the other party and acceptance that they are to govern their future conduct on that basis.

(ii) Detrimental Reliance

67 The appellants submit that detrimental reliance is a requirement that must be proven in order to find convention estoppel. I agree. The Court of Appeal erred in finding this condition fulfilled by simple proof that a detriment would flow to the party asserting the estoppel if the other party were permitted to resile from the assumed stated facts, without a finding of reliance.

68 The jurisprudence and academic comments support the requirement of detrimental reliance as lying at the heart of true estoppel (see Bower, at pp. 6 and 184; *John*, at para. 86; *Hillingdon London Borough; K. Lokumal & Sons (London) Ltd.*, at p. 35; *Litwin Construction (1973) Ltd. v. Kiss* (1988), 52 D.L.R. (4th) 459 (B.C. C.A.), at pp. 469-70; *Canacemal*, at paras. 33-35; *Vancouver City Savings Credit Union v. Norenger Development (Canada) Inc.*, [2002] B.C.J. No. 1417, 2002 BCSC 934 (B.C. S.C.), at para. 74; 32262 *32262 B.C. Ltd. v. Companions Restaurant Inc.* (1995), 17 B.L.R. (2d) 227 (B.C. S.C.), at pp. 235-36.

69 Detrimental reliance encompasses two distinct, but interrelated, concepts: reliance and detriment. The former requires a finding that the party seeking to establish the estoppel changed his or her course of conduct by acting or abstaining from acting in reliance upon the assumption, thereby altering his or her legal position. If the first step is met, the second requires a finding that, should the other party be allowed to abandon the assumption, detriment will be suffered by the estoppel raiser because of the change from his or her assumed position (see Wilken, at p. 228; *Grundt v. Great Boulder Property Gold Mines Ltd.* (1937), 59 C.L.R. 641 (Australia H.C.), at p. 674).

70 Returning to the case at bar, even if one were to assume the existence of a communicated common assumption between the parties, there is no evidence that the respondent relied on this assumption. The evidence suggests that the respondent never put his mind to the shorter *Survival of Actions Act* limitation period. First, Ryan's counsel diarized the matter as a two-year limitation period. Second, the issue of estoppel by convention was raised for the first time by the Court of Appeal itself and

was never discussed before the applications judge. Moreover, in the affidavit of Ryan's counsel, nowhere does he state that he believed that the adjuster intended him to act or refrain from acting in reliance on any agreement (A.R., Vol. II, at pp. 137-46). From the date of the accident, November 27, 1997, to the expiry of the *Survival of Actions Act* limitation period, August 16, 1999, there was never any discussion by the respondent of the limitation period. On October 24, 2000, when Ryan's counsel indicated for the first time to Cabot Insurance's claim examiner that there might be a problem with the limitation period, he did not refer to a mutual understanding that Moore was to be treated as being alive for the purposes of Ryan's claim, nor did he raise the existence of an agreement.

71 It was not open to Ryan's counsel to refrain from bringing an action against Rex Gilbert Moore based solely on the limited communications between counsel. The letters relied upon were limited to the collection of medical information and documentation about Ryan's alleged injuries — nothing more. I have already spoken about the subject line; one cannot disregard the fact that all negotiations/communications were also done on a "without prejudice" basis.

72 Consequently, I agree with the dissenting members of the Court of Appeal that the respondent not only did not rely on this alleged assumption, but his conduct does not show an intention to affect the legal relations between the parties. The record does not disclose that the respondent changed in any way his position on the basis of this alleged mutual assumption.

(iii) Detriment

73 Once the party seeking to establish estoppel shows that he acted on a shared assumption, he must prove detriment. For the plea to succeed, it must be unjust or unfair to allow a party to resile from the common assumption (Wilken, at p. 228). It is often said that the fact that there will have been a change from the presumed legal position will facilitate the establishment of detriment: "This is because there is an element of injustice inherent within the concept of the shared assumption — one party has acted unjustly in allowing the belief or expectation to 'cross the line' and arise in the other's mind": Wilken, at p. 228.

74 This final requirement of estoppel has been described as proving that it would be "unjust", "unconscionable" or "unfair" to permit a party to resile from the mutual assumption (see, e.g., Bower, at p. 181; *John; India; Norwegian American Cruises A/S*). However, it may be preferable to refrain from using "unconscionable", in order to avoid confusion with this last concept which has developed a special meaning in relation to inequality of bargaining power in the law of contracts (where we speak of unconscionable transactions, for instance) (see *Litwin Construction*, at p. 468).

75 In the case at bar, given that there was no shared assumption or reliance, the detriment criterion does not need to be addressed. I would note, however, that a detriment is not established by a reduced limitation period, as suggested by the respondent. Limitation periods and prescriptions, in the diverse areas of the law, have the similar effect and impact. The *Survival of Actions Act* has provided a benefit not available at common law; this benefit cannot legitimately be characterized as unfair and unjust.

(2) Estoppel by Representation

76 Where there is no shared assumption, as in the present case, there can be no estoppel by convention, no matter how unjust the other party's conduct may appear to be. However, in some circumstances, the party seeking to establish estoppel may be able to rely on estoppel by representation, an alternative here advocated by the respondent. The added difficulty in such a case is that an estoppel by representation cannot arise from silence unless a party is under a duty to speak. Silence or inaction will be considered a representation if a legal duty is owed by the representor to the representee to make a disclosure, or take steps, the omission of which is relied upon as creating an estoppel: see Wilken, at p. 227; Bower, at pp. 46-47.

77 Ryan submits that in the present case silence constituted a representation grounding estoppel because there was a duty to disclose relevant information as it would be unfair for the appellants to benefit from non-disclosure. I disagree. In the present case, there was no duty on the appellants, who were at the time only potential defendants, to advise Ryan of a limitation period, to assist him in the prosecution of the claim, or to advise him of the consequences of the death of one of the parties. There is no fiduciary or contractual relationship here (contrast with *Queen v. Cognos Inc.*, [1993] 1 S.C.R. 87 (S.C.C.)). The appellants had no duty to exercise reasonable care, nor to divulge any information.

78 Hence, there was no representation, no duty to speak, no intention to affect legal relations and no reliance in this case.

III. Conclusion

79 The legislature created an exception to the common law rule by enacting the *Survival of Actions Act*. It extended the rights of the parties to permit them to continue an action against a deceased. The relevant provision modifies the common law. It is not this Court's role to interfere with the scheme established by the legislature.

80 There are no reasons based on estoppel, or any other legal doctrine, to preclude Moore's estate or Cabot Insurance from relying on the *Survival of Actions Act* limitation period. Accordingly, I would allow the appeal on the issue of estoppel, affirm the decision of the Court of Appeal on the other issues, and strike the statement of claim, with costs throughout, at all levels of court.

Appeal allowed.

Pourvoi accueilli.

Appendix A

Limitations Act, S.N.L. 1995, c. L-16.1

[Limitation period 2 years]

5. Following the expiration of 2 years after the date on which the right to do so arose, a person shall not bring an action

(a) for damages in respect of injury to a person or property, including economic loss arising from the injury whether based on contract, tort or statutory duty;

. . . . .

[Confirmation]

16. (1) A confirmation of a cause of action occurs where a person

(a) acknowledges that cause of action, right or title of another person; or

(b) makes a payment in respect of that cause of action, right or title of another.

(2) Where a person against whom an action lies confirms that cause of action, the time before the date of that confirmation shall not count when determining the limitation period for a person having the benefit of the confirmation against the person bound by that confirmation.

(3) Subsection (2) applies only to a right of action where the confirmation is given before the expiration of the limitation period for that right of action.

. . . . .

(5) In order to be effective a confirmation must be in writing and signed by

(a) the person against whom that cause of action lies; or

(b) his or her agent

and given to the person or agent of the person having the benefit of that cause of action.

Survival of Actions Act, R.S.N.L. 1990, c. S-32

[Causes of action to survive]

2. Actions and causes of action

(a) vested in a person who has died; or

(b) existing against a person who has died,

shall survive for the benefit of or against his or her estate.

[Limitation of action]

5. An action shall not be brought under this Act unless proceedings are started within 6 months after letters of probate or administration of the estate of the deceased have been granted and proceedings shall not be started in an action under this Act after the expiration of 1 year after the date of death of the deceased.

Footnotes

* Corrigenda issued by the court on September 9, 2005 and September 27, 2005 respectively have been incorporated herein.

2016 FC 1132, 2016 CF 1132
Federal Court

Southwind v. R.

2016 CarswellNat 12282, 2016 CarswellNat 5933, 2016 FC 1132, 2016 CF 1132, 273 A.C.W.S. (3d) 560

ROGER SOUTHWIND FOR HIMSELF, AND ON BEHALF OF THE MEMBERS OF THE LAC SEUL BAND OF INDIANS (Plaintiffs) and HER MAJESTY THE QUEEN IN RIGHT OF CANADA (Defendant) and HER MAJESTY THE QUEEN IN RIGHT OF ONTARIO (Third Party) and HER MAJESTY THE QUEEN IN RIGHT OFMANITOBA (Third Party)

Russel W. Zinn J.

Judgment: October 11, 2016
Docket: T-2579-91

Counsel: William J. Major, Yana R. Sobiski, David G. Leitch, Ben Hiemstra, Kevin Scullion, for Plaintiffs
Michael Roach, Jennifer Francis, Sarah Sherhols, for Defendant, Canada
Leonard Marsello, Donna Salmon, Vanessa Glasser, Nikita Rathwell, for Third Party, Ontario
W. Glen McFetridge, Kirsten Wright, for Third Party, Manitoba

***Russel W. Zinn J.*:**

1 I have before me two objections relating to the proposed evidence of Ms. P.M. (Patt) Larcombe whom the Plaintiff seeks to have qualified as an expert witness.

2 Ontario filed an objection on July 13, 2016, to the proposed expert witness regarding her qualifications to give opinion evidence, pursuant to Rule 52.5 of the *Federal Courts Rules*. Ontario has been joined and supported in its motion by both Canada and Manitoba. Prior to the *voir dire* with respect to the qualifications of Ms. Larcombe, Canada advised that it was objecting to the admissibility of a set of evidence called the Focus Group Transcripts. Canada indicated that if Ms. Larcombe is qualified to testify to some extent as an expert, then her evidence, in so far as it relies upon the Focus Group Transcripts, ought not to be received because the transcripts are not admissible evidence. Canada was supported in its motion by Ontario. Manitoba took no position with respect to this objection.

Ontario's Objection

3 The *voir dire* was held over two days last week during which Ms. Larcombe's qualifications and expertise were explored in some detail by both the Plaintiff and Ontario. Despite the objection of Plaintiff's counsel, the Court permitted Ontario wide latitude in its cross-examination of Ms. Larcombe's report and her expertise. As noted in the Court's ruling at that time, this was permitted in large part because Ms. Larcombe's professed area of expertise, cultural geography, is not an area of expertise previously recognized by this Court or, based on my research, by any other court in this country. Moreover, as the Ontario Court of Appeal stated in *R. v. Abbey*, 2009 ONCA 624 (Ont. C.A.) at paragraph 62: "Before deciding admissibility, a trial judge must determine the nature and scope of the proposed expert evidence."

4 Ms. Larcombe testified that there are two streams of study in geography: physical geography and cultural geography. Physical geography deals with the study of processes and patterns in the natural environment like the atmosphere, hydrosphere, biosphere, and geosphere. Cultural geography was described by Ms. Larcombe as "looking at human community relationships to the landscape; how people relate; how they use the land; other patterns of land use."

5 In opposing Ontario's motion, the Plaintiff submitted that Ontario had failed to comply in a timely manner with Rule 52.5, which provides, that "a party to a proceeding shall, as early as possible in the proceeding, raise any objection to an opposing party's proposed expert witness that could disqualify the witness from testifying." In this case, the objection to Ms. Larcombe as an expert was raised more than two years after her report was presented to the opposing parties.

6 Rule 52.5 says nothing about any consequence of a failure to make a timely objection. It was suggested that the lateness of the objection prejudiced the Plaintiff as it would have to retain other experts and seek an adjournment of the trial if the evidence of Ms. Larcombe was not accepted. It was suggested that the conduct of Ontario in making this late objection was tactical and ought not to be rewarded.

7 Ultimately, the qualification of an expert is a decision for the trial judge, whether or not there has been any objection to that proposed expert. While it would have been preferable if Ontario had raised its concerns with the Plaintiff long ago to avoid any possible disruption of what is scheduled to be a 100-day trial, I cannot let that stand in the way of what I find, in part, to be a valid objection to the expertise of this proposed witness.

8 In calling Ms. Larcombe, counsel stated that the Plaintiff was looking to have her "qualified as an expert to give evaluation on loss of use." It was more specifically stated that the Plaintiff is seeking to have Ms. Larcombe qualified as an expert witness in "cultural geography with specialty in aboriginal traditional livelihood loss of use valuation; evaluating impacts on First Nations' livelihood and living conditions resulting from industrial and hydroelectric development projects; and evaluating mitigation measures aimed at reducing impacts on First Nations' livelihood and living conditions resulting from these projects."

9 In *White Burgess Langille Inman v. Abbott and Haliburton Co.*, 2015 SCC 23 (S.C.C.) at paragraph 22, the Supreme Court of Canada adopted, with minor adjustments, the two-step inquiry for admitting expert opinion evidence as stated by the Ontario Court of Appeal in *R. v. Abbey*, 2009 ONCA 624 (Ont. C.A.).

10 At the first step of the inquiry, the proponent of the evidence must establish the threshold requirements of admissibility. The threshold requirements of admissibility consist of the criteria set out by the Supreme Court of Canada in *R. v. Mohan*, [1994] 2 S.C.R. 9 (S.C.C.). Evidence that does not meet these criteria should be excluded. The criteria are:

(a) Relevance;

(b) Necessity in assisting the trier of fact;

(c) The absence of any exclusionary rule; and

(d) A properly qualified expert.

11 The logical relevance of expert evidence is determined by asking whether it relates to a fact in issue and whether it tends to prove the fact in issue. I agree with the Plaintiff, that the proposed evidence is relevant to the claim as framed by the Plaintiff. Indeed, this was not challenged in the memorandum submitted by Ontario or in its oral submissions.

12 Similarly, there was no suggestion that the proposed opinion evidence ought to be excluded because it offends another rule of evidence.

13 Ontario's challenge was that the proposed witness is not a properly qualified expert and her evidence is not necessary to assist the trier of fact.

14 Let me first address whether the proposed evidence meets the test of necessity in assisting the trier of fact.

15 The Supreme Court of Canada at paragraph 14 of *Mohan* emphasized that the necessity requirement is not met where the proposed evidence is merely "helpful" to the trier of fact. The necessity of the opinion in this case requires that it provides information which is likely to be outside the experience and knowledge of the trial judge.

16 I am satisfied that this condition is also met. The losses to which the expert speaks that resulted from the flooding of Lac Seul and the valuation of those losses are not matters within my knowledge or experience.

17 This brings me to the final question: Is Ms. Larcombe a properly qualified expert?

18 The Supreme Court of Canada at paragraph 17 of *Mohan* observed that an expert witness must possess "special or peculiar knowledge through study or experience in respect of the matters on which he or she undertakes to testify."

19 The Supreme Court of Canada in *R. v. Marquard*, [1993] 4 S.C.R. 223 (S.C.C.), quoted with approval the following passage from Sopinka, Lederman and Bryant, *The Law of Evidence in Canada* (Markham: Butterworths, 1992), at 536-37:

> The admissibility of [expert] evidence does not depend upon the means by which that skill was acquired. As long as the court is satisfied that the witness is sufficiently experienced in the subject-matter at issue, the court will not be concerned with whether his or her skill was derived from specific studies or by practical training, although that may affect the weight to be given to the evidence.

20 Ms. Larcombe has an undergraduate degree, a bachelor of science in geography and a graduate degree, a master of science in geography. It was during her graduate studies that she began to focus on the area of cultural geography. She has had some very limited experience teaching courses which generally can be said to fall within the rubric of cultural geography. She has no publications that have been peer reviewed on the area of cultural geography. She has, however, as part of her work over the past 29 years, prepared a number of reports some of which have been accepted for publication by her clients on their websites. It would appear from her evidence that none of these published documents contain an assessment of economic or financial loss such as that contained in her report in this litigation.

21 Ms. Larcombe has never been qualified by a court as an expert witness. She has limited experience testifying as a witness before one arbitrator and two tribunals. Although she describes herself as having been called as an expert witness for one of the parties, her qualifications were not challenged and there is no evidence that her testimony was accepted by the arbitrator or tribunal, or even found to be of use.

22 During her 29 years as a consultant, Ms. Larcombe has performed a number of studies and authored a number of reports for her clients some of which are described in her curriculum vitae which was entered as Exhibit 7152. She has performed retrospective loss of use evaluation studies. As she explained, these are studies where she has looked backwards to determine the impact a past event had from a contemporary point of view. She described these as typically being situations where First Nation communities have been impacted by hydroelectric projects, loss of reserve lands, and impacts from other industries. She described her work as "after the fact, looking backwards to evaluate and put a monetary value on what the effects were from past experiences." The other aspect of her work was described as predictive impact assessments. This is where she is called upon to provide an assessment of the future impact of an event which is planned or proposed to take place.

23 Specifically, Ms. Larcombe's report in this action provides a loss of use analysis with respect to six items under Tabs A1-A6 of her report: Hay for livestock, food from gardens, trapping income, food from wildlife, food and income from manomin (wild rice), and food from fishing.

24 She described her methodology in estimating the quantity of each of these that was lost from the Lac Seul First Nation economy. She looked for information with respect to these goods prior to the flooding in 1929 and thereafter. Where there was no such information she looked to what she described as "credible literature" which may have been studies done for other First Nations in the same or different decades in history. The difference between the pre-flooding number and the post flooding number, she explains, gives you the loss realized as a result of the flooding. She then attaches a value to each animal or kilogram based on either an imputed or replacement cost and she explained the process she uses in determining that. Lastly when she was looking at the current value she would adjust that value to its 1929 value using cost-of-living information. That, as she described it is the accepted approach in her field of expertise.

25 Based on her years of work in this field, I accept that Ms. Larcombe is an expert in the field of cultural geography and is qualified to provide expert opinion evidence on the specific loss of use by the Lac Seul First Nation as specified in Tabs A1-A6 of her report.

26 The second section of Ms. Larcombe's report, Tabs B1 to 4, describe "avoidable losses" to houses, cabins and campsites, community and agricultural property and access infrastructure, and interment sites. Ms. Larcombe testified that in assessing avoidable costs, she was "looking at what would it have cost in 1929 to avoid the flooding of houses, to avoid the flooding of cabins — or not to avoid it, to address the loss of those by reconstructing new ones in locations that would not be flooded or in the case of, for example fencing, what was the value of those fences that were flooded and in the case of docks what would it cost to construct docks in the year 1929" and evidence regarding interment sites and costs. She testified that in determining avoidable costs she relied on data where it was available that was specific to Lac Seul, but where no such data was available she relied on her "own analysis and interpretation of other data sources that provided an indication of the cost of building or replacing things circa 1929."

27 The Plaintiff submits that Ms. Larcombe is not "being proposed to give appraisal evidence respecting the reasonable cost of housing in 1929 [rather] she is being proposed as an expert qualified to give an opinion on the reasonableness of the mitigation measures, adopted or not by Canada, with respect to the First Nation's housing loss."

28 Her "reasonableness" evaluation is based on her opinion of the cost of replacing houses and other structures. I do not accept that Ms. Larcombe is qualified to provide an opinion as to the value of any of these avoidable losses in 1929 as set out at Tabs B1 to B4. Ms. Larcombe has no expertise in this area whatsoever. Specifically, she has no expertise permitting her to offer an opinion as to the valuation of comparable housing, cabins, other structures, fencing and docks, and interments in 1929. There are experts in this area who can offer evidence of assistance to the Court.

29 Although Ontario was prepared to accept her evidence with respect to interment on the basis that there were no experts on this, the Court is not prepared to accept all of her evidence in this regard. The Court will accept her evidence of *historical facts*, including, for what it may be worth, the views of the Lac Seul First Nations from the transcripts discussed below, in Tab B4 sections 1 to 4 of her report, but not the opinion she expresses in section 5 as in the Court's view this is not retrospective loss of use evaluation. The Court is in as good a position as Ms. Larcombe to make an assessment of the costs of relocating graves set out in section 5 of her report. She has no expertise in this area that assists the Court and her estimate is made on personal, rather than her expert opinion.

30 Finally, with respect to those areas of the proposed evidence that meet the first step of the inquiry enunciated in *Abbey*, I turn to the second step of inquiry. At the second step, the judge performs a "gatekeeping" function by balancing "the potential risks and benefits of admitting the evidence in order to decide whether the potential benefits justify the risks."

31 In *Masterpiece Inc. v. Alavida Lifestyles Inc.*, 2011 SCC 27 (S.C.C.) at para 76, Justice Rothstein stated that "Courts must fulfill their gatekeeper role to ensure that unnecessary, irrelevant and potentially distracting expert and survey evidence is not allowed to extend and complicate court proceedings." The balancing exercise has been described in many ways by the Courts. In *R. c. J. (J.)*, 2000 SCC 51 (S.C.C.) at para 47, Justice Binnie outlined the criteria for reception to be relevance, reliability, and necessity and the counterweights to be consumption of time, prejudice, and confusion.

32 The assessment of reliability within the second step of the inquiry utilizes a flexible approach. In *Abbey* at para 117, the Ontario Court of Appeal stated that the proper question to be answered when addressing the reliability of non-scientific theories is whether an expert's research and experiences has permitted the expert to develop a specialized knowledge that is sufficiently reliable to justify placing the opinion before a judge or jury.

33 Mr. Marsello for Ontario, in his cross-examination of Ms. Larcombe pointed out a number of potential weaknesses or deficiencies or concerns with respect to her evaluation including the reasonableness of the assumptions that she makes in reaching her estimated loss. The Plaintiff submits that these go to the weight to be given to her evidence, not to the reliability of her evidence.

34 If I was able to say with certainty at this stage that her opinion evidence on the value of these losses was of no or very little weight, then it would be appropriate to exclude it as being unreliable and of little or no value to the trial judge. However, although Mr. Marsello has raised significant concerns in that regard, I find that I cannot reach any conclusion in the absence of a full examination of Ms. Larcombe's and other witnesses' testimony. Accordingly, at this point I cannot say that Ms. Larombe's evidence is unnecessary, irrelevant and potentially distracting such that it should not be allowed.

35 For these reasons, I find that Ms. Larcombe is qualified as an expert witness in cultural geography with specialty in:

1. aboriginal traditional livelihood loss of use valuation; and

2. evaluating impacts on First Nations' livelihood and living conditions resulting from industrial and hydro development projects.

36 She is permitted to provide the Court with an expert opinion on loss of use of the Lac Seul First Nation's traditional economy, in relation to losses it experienced on reserve lands and traditional territory as a result of the construction of the Ear Falls Dam and flooding of Lac Seul, specifically with respect to:

a. decreased opportunity and success in Lac Seul First Nation's traditional harvesting practices;

b. lost opportunity to harvest wild rice for human nutritional needs and income;

c. decreased opportunity and success in trapping aquatic furbearer species;

d. lost opportunity to grow vegetable products for human nutritional needs; and

e. lost opportunity to feed cattle that were maintained for human nutritional needs.

37 She is also permitted to provide factual historical evidence relating to interment sites of the Lac Seul First Nation that were lost or damaged.

38 In sum, the Court accepts that Ms. Larcombe is an expert and may offer the opinions she advances in Tabs A1 to A6 inclusive, as well as the facts from historical records set out in Tab B4 sections 1 to 4, and her opinion on interment sites of the Lac Seul First Nation that were lost or damaged based on the historical record.

Canada's Objection

39 Canada is seeking a ruling on the admissibility of the Focus Group Transcripts. It submits that Ms. Larcombe in parts of her report relied "fairly extensively" on them. Canada acknowledges that its expert, Dr. Reimer also relied, in part, on these transcripts.

40 The Focus Group Transcripts are a series of seven transcripts of focus group discussions held between 1994 and 1997.

41 Canada submits that this evidence is compromised as a consequence of the way it was collected. It was collected by the Lac Seul First Nation specifically for statements made by those interviewed about the losses occasioned by the flooding. This is a central issue in the litigation and the statements made by those interviewed appears to have been used by Ms. Larcombe (I cannot speak to Ms. Reimer as I have not yet read her report) as statements of fact as to the losses experienced by members of the Lac Seul First Nation.

42 Canada submits that this evidence is compromised because of the manner in which it was collected — having been collected from members of the Lac Seul First Nation, by the Lac Seul First Nation specifically for the purposes of providing evidence to be used in this action. It is not disputed that the evidence was not given under oath, and that there has been no cross-examination or testing of that evidence. Moreover, where the evidence was provided in the first language of the member, it was translated by a member of the Lac Seul First Nation.

43 It is unknown to the Court whether there are living potential witnesses who can speak to the matters addressed in these transcripts, but that is not relevant in assessing Canada's objection.

44 The Plaintiff submits, and I agree, that Canadian jurisprudence holds that experts are entitled to rely on hearsay or out-of-court evidence or statements when forming their opinions. It is a question of the weight to be accorded to the opinion when it relies on such hearsay evidence.

45 An expert may have formed his or her opinion on the basis of information that is not in evidence before the Court. For example, the expert may have relied on interviews, reports of others, or results from tests administered by others. What is essential is that the trier of fact knows on what basis the expert formed his or her opinion. The evidence used in this way is inadmissible as hearsay in proof of the facts asserted, but is admissible as the basis upon which the opinion was formed.

46 The Plaintiff submits that the transcripts are admissible as the basis on which Ms. Larcombe formed her opinion. It appears to accept that the weight to be given to her opinion evidence may consider the fact that it was based, in whole or part, on evidence collected in the manner objected to by Canada.

47 Where, as here, an expert bases her opinion on hearsay statements made by persons who are members of one of the litigants, Justice Sopinka in *R. v. Lavallee*, [1990] 1 S.C.R. 852 (S.C.C.) at page 898, cautioned that it ought not to be accepted without independent support:

> Where, however, the information upon which an expert forms his or her opinion comes from the mouth of a party to the litigation, or from any other source that is inherently suspect, a court ought to require independent proof of that information. The lack of such proof will, consistent with Abbey, have a direct effect on the weight to be given to the opinion, perhaps to the vanishing point. But it must be recognized that it will only be very rarely that an expert's opinion is entirely based upon such information, with no independent proof of any of it. Where an expert's opinion is based in part upon suspect information and in part upon either admitted facts or facts sought to be proved, the matter is purely one of weight.

48 In the matter before the Court it is unclear whether in all cases where Ms. Larcombe relies on the transcripts there is other independent proof of the "facts" asserted by the First Nation's members. Absent such support, it is likely that the weight given to her opinion will be close to the "vanishing point" noted by Justice Sopinka.

49 Accordingly, while I agree with Canada that the Focus Group Transcripts are not admissible for the truth of their contents, the experts are permitted to provide an opinion based on them, provided that opinion is otherwise within the scope of their expertise. In the case of Ms. Larcombe, that is restricted to the retrospective loss evaluation set out in her opinion at Tabs A1 to A6. The weight accorded that opinion will depend, in part, on the existence of other corroborative evidence.

ORDER

THIS COURT ORDERS that:

1. Ms. Larcombe is qualified as an expert witness in cultural geography with specialty in:

    a. aboriginal traditional livelihood loss of use valuation; and

    b. evaluating impacts on First Nations' livelihood and living conditions resulting from industrial and hydro development projects.

2. Ms. Larcombe is permitted to provide the Court with an expert opinion on loss of use of the Lac Seul First Nation's traditional economy, in relation to losses it experienced on reserve lands and traditional territory as a result of the construction of the Ear Falls Dam and flooding of Lac Seul, specifically with respect to:

    a. decreased opportunity and success in Lac Seul First Nation's traditional harvesting practices;

b. lost opportunity to harvest wild rice for human nutritional needs and income;

c. decreased opportunity and success in trapping aquatic furbearer species;

d. lost opportunity to grow vegetable products for human nutritional needs; and

e. lost opportunity to feed cattle that were maintained for human nutritional needs.

3. Ms. Larcombe is also permitted to provide factual historical evidence and her opinion relating to interment sites of the Lac Seul First Nation that were lost or damaged.

4. In sum, the Court accepts that Ms. Larcombe is an expert and may offer the opinions she advances in Tabs A1 to A6 inclusive, as well as the facts from historical records set out in Tab B4 sections 1 to 4, and her opinion on interment sites of the Lac Seul First Nation that were lost or damaged based on the historical record.

Order accordingly.

2015 SCC 3, 2015 CSC 3
Supreme Court of Canada

Tervita Corp. v. Canada (Commissioner of Competition)

2015 CarswellNat 32, 2015 CarswellNat 33, 2015 SCC 3, 2015 CSC 3, [2015] 1 S.C.R. 161, [2015] S.C.J. No. 3, 248 A.C.W.S. (3d) 811, 380 D.L.R. (4th) 381, 467 N.R. 97, 79 Admin. L.R. (5th) 1, J.E. 2015-140

Tervita Corporation, Complete Environmental Inc. and Babkirk Land Services Inc., Appellants and Commissioner of Competition, Respondent

McLachlin C.J.C., Abella, Rothstein, Cromwell, Moldaver, Karakatsanis, Wagner JJ.

Heard: March 27, 2014
Judgment: January 22, 2015
Docket: 35314

Proceedings: reversing *Commissioner of Competition v. CCS Corp.* (2013), (sub nom. *Tervita Corp. v. Canada (Commissioner of Competition))* [2014] 2 F.C.R. 352, (sub nom. *Tervita Corp. v. Commissioner of Competition)* 446 N.R. 261, 2013 CarswellNat 6936, 2013 CAF 28, 360 D.L.R. (4th) 717, 2013 CarswellNat 1400, 2013 FCA 28, David Stratas J.A., John M. Evans J.A., Robert M. Mainville J.A. (F.C.A.); affirming *Commissioner of Competition v. CCS Corp.* (2012), 2012 CarswellNat 4409, 2012 Comp. Trib. 14, [2012] C.C.T.D. No. 14, Paul Crampton Member, Sandra J. Simpson Chair, Wiktor Askanas Member (Competition Trib.)

Counsel: John B. Laskin, Linda M. Plumpton, Dany H. Assaf, Crawford G. Smith, for Appellants
Christopher Rupar, John Tyhurst, Jonathan Hood, for Respondent

Rothstein J. **(McLachlin C.J.C., Cromwell, Moldaver and Wagner JJ. concurring):**

I. Overview

1 The appellant in this case, Tervita Corp., operates two hazardous waste secure landfills in British Columbia. In February 2010, Tervita Corp. acquired a company which held a permit for another secure landfill site. This transaction attracted the attention of the Commissioner of Competition, who initiated the merger review process under the Competition Act, R.S.C. 1985, c. C-34 (“Act”).

2 The purpose of the Act is in part "to maintain and encourage competition in Canada in order to promote the efficiency and adaptability of the Canadian economy" (s. 1.1). It is within this context that merger reviews are conducted. This appeal provides this Court the opportunity to address two issues in merger review: the "prevention" branch of s. 92 and the s. 96 efficiencies defence.

II. Facts

3 Four permits for the operation of secure landfills for the disposal of hazardous waste generated by oil and gas operations have been issued in Northeastern British Columbia. The appellant Tervita Corp. holds two of the permits and operates two hazardous waste landfills pursuant to them: the Silverberry (capacity for 6,000,000 tonnes of waste) and Northern Rockies (3,344,000 tonnes) landfills. A third permit was issued for the Peejay site, a site developed by an Aboriginal community, but the landfill has not yet been constructed.

4 The fourth permit, Babkirk site, is held by the appellant Babkirk Land Services Inc. ("Babkirk"), a wholly owned subsidiary of the appellant Complete Environmental Inc. ("Complete"). The previous Babkirk owners operated a hazardous waste landfill

on the site from 1998 to 2004. In 2009, they sold Babkirk to Complete, which is owned and controlled by five investors (the "Vendors").

5 The Vendors intended to begin operating the Babkirk site mainly as a bioremediation facility which would treat contaminated soil using micro-organisms, and to complement the bioremediation site with a secure landfill facility to store hazardous waste not amenable to bioremediation. In February 2010, the Vendors received a permit for this secure landfill with a capacity of 750,000 tonnes.

6 Soon afterwards, a company called Integrated Resources Technologies Ltd. ("IRTL") offered to purchase Complete. The Vendors then explored the possibility of selling to other third parties. Secure Energy Services ("SES") showed some interest, but at a lower price. The Vendors decided to accept IRTL's offer, but it was withdrawn in June 2010 due to lack of financing. In one last attempt to sell, the Vendors pursued various discussions with SES and Tervita Corp., then known as CCS Corp. (hereinafter "Tervita Corp."). In July 2010, the Vendors reached an understanding with Tervita Corp. and a letter of intent was signed.

7 The sale of the Vendors' shares in Complete (including Babkirk and the Babkirk site) closed on January 7, 2011. However, prior to closing, the Commissioner of Competition informed the parties that she opposed the transaction on the ground that it was likely to substantially prevent competition in secure landfill services in Northeastern British Columbia. After closing, the Commissioner asked the Competition Tribunal to order, pursuant to s. 92 of the Competition Act, that the transaction be dissolved, or in the alternative, that Tervita Corp. divest itself of Complete or Babkirk.

8 The three appellants in this appeal, Tervita Corp., Complete and Babkirk, are hereinafter referred to collectively as "Tervita".

III. Statutory Provisions

9 The relevant statutory provisions in this case are included in the Appendix. The statutory provisions most directly at issue in this appeal are ss. 92, 93 and 96 of the Act.

IV. Decisions Below

A. Competition Tribunal, [2012] C.C.T.D. No. 14 (Competition Trib.) (QL)

10 Pursuant to s. 92, the Tribunal found that the merger was likely to prevent competition substantially in the relevant market. The Tribunal further found that Tervita had not brought itself within the efficiencies exception contained in s. 96 that would have permitted the merger notwithstanding s. 92. It found that the efficiencies gained by the merger were not greater than the effects of the likely prevention of competition resulting from the merger, and would not offset those effects. It ordered Tervita to divest itself of Babkirk.

(1) Section 92

11 The Tribunal assessed whether "effective competition in the relevant market likely [would] have emerged 'but for' the [m]erger" (para. 129). The parties "essentially agreed" that the commencement of the timeframe for considering the "but for" market condition, i.e. a market condition where the merger did not occur, was the end of July 2010 (para. 131). This was the point in time a letter of intent between Tervita and the Vendors was signed. The Tribunal agreed that this timeframe commenced at the end of July 2010.

12 As of the end of July 2010, the Tribunal saw only two realistic scenarios for the Babkirk site:

1. The Vendors would have sold to a waste company called [SES], which would have operated a Secure Landfill; or

2. The Vendors would have operated a bioremediation facility together with a half cell of Secure Landfill. [para. 132]

13 The Tribunal found that, on a balance of probabilities, SES would not have made an acceptable offer for the Complete site at any time during the summer of 2010. Thus, according to the Tribunal, the Vendors would have moved forward with the second option: operate the Babkirk site as a bioremediation facility.

14 Bioremediation is a "method of treating soil by using micro-organisms to reduce contamination" (para. 42). The Tribunal concluded that the Vendors would have had the bioremediation facility fully operational by October 2011, but that it would have been unprofitable. The Tribunal concluded that it was "unreasonable to suppose that [the Vendors] would have been prepared to operate unprofitably beyond the fall of 2012" (para. 206). Accordingly, the Tribunal found that the Vendors would have either begun operating the Babkirk site as a secure landfill themselves or would have sold the site to a purchaser who would have operated the site as a secure landfill. Either way, the Babkirk site full-service secure landfill would have been a "direct and substantial" competitor with Tervita no later than the spring of 2013 (para. 215).

15 The Tribunal found that a likely effect of the merger would have been to allow Tervita to maintain its ability to exercise materially greater market power than it would in the absence of the merger. It found that in the absence of the merger, disposal fees, called "tipping fees" in the industry, would have been 10 percent lower in the "Contestable Area" (the relevant geographic market) (para. 229(iii)).

16 The Tribunal concluded that the merger was likely to prevent competition substantially.

(2) Section 96

17 The s. 96 efficiencies defence is an exception to the application of s. 92. The defence prohibits the Tribunal from making an order precluding a merger when it finds that the merger is likely to bring about gains in efficiency that would be greater than and would offset the anti-competitive effects of the merger.

18 The Tribunal found that the Commissioner had failed to meet her burden to demonstrate the extent of the quantifiable anti-competitive effects. The Commissioner's expert had only estimated that a price decrease of 10 percent would be precluded by the merger but provided no estimate of the volume having regard to the elasticity of demand. The Tribunal found that this meant that Tervita could not take a position about whether the number it calculated as its total efficiencies was greater than the adverse effects of the merger (para. 246). However, the Tribunal concluded that, "in the unusual circumstances of this case", Tervita was not prejudiced by the Commissioner's failure to quantify the anti-competitive effects of the merger. Tervita was still able to effectively attack the Commissioner's expert's findings and assert the s. 96 defence (para. 246). The Tribunal accepted, on a balance of probabilities, the Commissioner's expert's estimate of a minimum annual deadweight loss (paras. 301-3).

19 The Tribunal also accepted what it found to be qualitative anti-competitive effects — namely environmental effects related to price reduction on-site clean-up and "value propositions", or offers Tervita would have made in a competitive environment to certain customers resulting in lower total cost for overall waste services used by such customers (paras. 306-7).

20 The Tribunal rejected most of Tervita's claimed efficiencies gains because they would likely be achieved even if the divestiture order were made (para. 265). The Tribunal also rejected the claimed "order implementation efficiencies" ("OIEs") — those transportation and market expansion efficiencies resulting from delays associated with the implementation of a divestiture order. The Tribunal held that OIEs are not cognizable under s. 96, because to give merging parties the benefit of these efficiencies would be contrary to the purposes of the Act (para. 270). The Tribunal did accept "overhead" efficiencies claimed by Tervita (para. 275).

21 The Tribunal weighed the proven quantifiable efficiency gains against the quantifiable anti-competitive effects it accepted and found that the combined quantitative and qualitative efficiency gains were not likely to be "greater than" the combined quantitative and qualitative anti-competitive effects (paras. 313-14). The Tribunal further supported this conclusion on the basis that, in the absence of a s. 92 order, the merger would maintain a monopolistic structure in the relevant market, thus precluding "benefits of competition that will arise in ways that will defy prediction" (para. 317).

22 In his concurring reasons, Chief Justice Crampton [1], held that for non-quantified effects, where there is not sufficient evidence to provide even a rough quantification of an effect that is ordinarily quantifiable, the Tribunal is still able to accord this factor some qualitative weight (para. 408).

B. Federal Court of Appeal, 2013 FCA 28, 446 N.R. 261 (F.C.A.)

23 Tervita appealed to the Federal Court of Appeal, challenging the divestiture order made by the Tribunal.

24 The Federal Court of Appeal first determined that the Tribunal's findings on questions of law should be reviewed on a standard of correctness, while its findings on questions of fact or of mixed law and fact should be reviewed on a standard of reasonableness (paras. 52-68).

(1) Section 92

25 The Federal Court of Appeal confirmed the Tribunal's approach that the analysis required under s. 92 of the Act is "necessarily forward-looking" (para. 87) and therefore the Tribunal was correct in "look[ing] into the future to ascertain whether the [Babkirk site entering] the market would have occurred within a reasonable period of time" (para. 88). While recognizing that what constitutes a reasonable period of time will "necessarily vary from case to case and will depend on the business under consideration" (para. 89), the court set out two guidelines for determining what constitutes a "reasonable period of time":

(1) "the time frame must be discernible" (para. 90), and

(2) "the timeframe for market entry should normally fall within the temporal dimension of the barriers to entry into the market at issue" (para. 91).

26 Applying those guidelines, the Federal Court of Appeal held that the Tribunal "discerned a clear time frame under which the Babkirk site would enter the market for secure landfills" (para. 92) and that this discernible timeframe "was also well within the temporal framework of the barriers to market entry" (para. 94).

27 The Federal Court of Appeal upheld the Tribunal's conclusion that the proposed merger would likely substantially prevent competition.

(2) Section 96

28 The Federal Court of Appeal found that the Tribunal had erred in allowing the Commissioner to discharge her burden of proving the quantifiable anti-competitive effects through a reply expert report setting out a "rough estimate" of the deadweight loss arising from the merger (para. 128). Tervita had suffered prejudice because the Tribunal had accepted the methodology of the Commissioner's expert which was "clearly deficient" (para. 124) as the methodology used was not capable of calculating the deadweight loss (paras. 123-25). Although Tervita has the ultimate burden of establishing that the efficiency gains are greater than and offset the anti-competitive effects, this "does not relieve the Commissioner of her burden to prove the anti-competitive effects and to quantify those effects where possible" (para. 127).

29 The Federal Court of Appeal agreed with the Tribunal that to recognize the OIEs would be contrary to the overall scheme of the Act (para. 135). Further, because Tervita had still not started to build or operate at the Babkirk site, those gains had not been and never would be realized (para. 138).

30 Respecting the final balancing under s. 96, the Federal Court of Appeal found that the Tribunal had generally set out the right test (para. 146), except that its methodology was overly subjective. Efficiencies and anti-competitive effects should be quantified wherever reasonably possible, and the weight given to unquantifiable qualitative effects must be reasonable (para. 148). The court held that the Tribunal erred in a number of respects, including considering qualitative environmental effects that were not cognizable under s. 96 (paras. 155-56), double-counting the reduced site clean-up as both a qualitative effect

and as part of the deficient deadweight loss analysis (para. 157) and considering Tervita Corp.'s monopoly as a distinct anti-competitive effect (paras. 159-61).

31 In the Federal Court of Appeal's fresh assessment of the matter, it concluded that the quantitative anti-competitive effects of the merger which were not quantified by the Commissioner should be afforded an "undetermined" weight (paras. 167-68), as opposed to a weight of zero. In this case, the merger only provided marginal gains in efficiency while at the same time strengthening the market monopoly in the area (para. 169). The court held that an anti-competitive merger cannot be approved under s. 96 if only marginal or insignificant gains in efficiency result from it (paras. 170-72). In this case, the conclusion was strengthened because "a pre-existing monopoly, such as is the case here, will usually magnify the anti-competitive effects of a merger" (para. 173).

32 The Federal Court of Appeal dismissed Tervita's appeal.

V. Issues

33 This appeal raises three issues:

1. What is the appropriate standard of review?

2. What is the proper legal test to determine when a merger gives rise to a substantial prevention of competition under s. 92(1) of the Act?

3. What is the proper approach to the efficiencies defence under s. 96 of the Act and, in this respect:

   a. Can order implementation efficiencies be included as efficiency gains in the balancing analysis?

   b. What is the proper approach to the requirement that efficiency gains be greater than and offset the anti-competitive effects?

VI. Analysis

A. Standard of Review

34 The parties agree that the Federal Court of Appeal properly applied a correctness standard of review to the Tribunal's determinations of questions of law. I agree that correctness is the applicable standard in this case.

35 The questions at issue are questions of law arising under the Tribunal's home statute and therefore a standard of reasonableness presumptively applies (*New Brunswick (Board of Management) v. Dunsmuir*, 2008 SCC 9, [2008] 1 S.C.R. 190 (S.C.C.), at para. 54; *Alliance Pipeline Ltd. v. Smith*, 2011 SCC 7, [2011] 1 S.C.R. 160 (S.C.C.), at para. 28, *per* Fish J.; *A.T.A. v. Alberta (Information & Privacy Commissioner)*, 2011 SCC 61, [2011] 3 S.C.R. 654 (S.C.C.), at para. 30). However, the presumption of reasonableness is rebutted in this case.

36 A decision or order of the Tribunal on a question of law is appealable as of right as if "it were a judgment of the Federal Court" with the proviso that leave is required for appeals on questions of fact (Competition Tribunal Act, R.S.C. 1985, c. 19 (2nd Supp.), s. 13(1)). The Federal Court of Appeal has consistently held that questions of law arising from decisions of the Tribunal should be reviewed on a correctness standard (see *Canada (Commissioner of Competition) v. Superior Propane Inc.*, 2001 FCA 104, [2001] 3 F.C. 185 (Fed. C.A.) ("*Superior Propane II*"), at paras. 59-91; see also *Air Canada v. Canada (Commissioner of Competition)*, 2002 FCA 121, [2002] 4 F.C. 598 (Fed. C.A.), at para. 43; *Canada (Commissioner of Competition) v. Canada Pipe Co.*, 2006 FCA 233, [2007] 2 F.C.R. 3 (F.C.A.), at para. 34; *Canada (Commissioner of Competition) v. Labatt Brewing Co.*, 2008 FCA 22, 64 C.P.R. (4th) 181 (F.C.A.), at para. 5).

37 In finding that the presumption of reasonableness is not rebutted, Justice Abella acknowledges that the statutory language in the appeal provisions in *Pezim v. British Columbia (Superintendent of Brokers)*, [1994] 2 S.C.R. 557 (S.C.C.), *British Columbia*

(Securities Commission) v. McLean, 2013 SCC 67, [2013] 3 S.C.R. 895 (S.C.C.), and *Smith* differs from the language at issue here, but is of the opinion that "it is not sufficiently different to undermine the established principle of deference to tribunal expertise in the interpretation of the tribunal's own statute" (para. 179).

38 With respect, the difference in statutory language between the *Competition Tribunal Act* and the legislation relied upon by Justice Abella is significant. The appeal provision at issue in *Pezim* and *McLean* provided that individuals affected by decisions of the B.C. Securities Commission "may appeal to the Court of Appeal with leave of a justice of that court" (Securities Act, S.B.C. 1985, a. 83, s. 149(1), which later became Securities Act, S.B.C. 1996, c. 418, s. 167 (1)). The appeal provision in *Smith* provided that, under the National Energy Board Act, R.S.C. 1985, c. N-7, "[a] decision, order or direction of an Arbitration Committee may, on a question of law or a question of jurisdiction, be appealed to the Federal Court" (s. 101). By contrast, the *Competition Tribunal Act* provides that "an appeal lies to the Federal Court of Appeal from any decision or order ... of the Tribunal *as if it were a judgment of the Federal Court*" (s. 13(1)).

39 The statutes at issue in *Pezim*, *McLean*, and *Smith* did not contain statutory language directing that appeals of tribunal decisions were to be considered as though originating from a court and not an administrative source. The appeal provision in the *Competition Tribunal Act* evidences a clear Parliamentary intention that decisions of the Tribunal be reviewed on a less than deferential standard, supporting the view that questions of law should be reviewed for correctness and questions of fact and mixed law and fact for reasonableness. The presumption that questions of law arising under the home statute should be reviewed for reasonableness is rebutted here.

40 I also agree with the Federal Court of Appeal that the standard of review for mixed questions of fact and law and questions of fact is reasonableness. Reasonableness is normally the "governing standard" for questions of fact or mixed fact and law (*Smith*, at para. 26). In this case, there is nothing to indicate that this presumption should be rebutted.

B. Merger Review Analysis Under Section 92 of Act

41 At the outset, it will be helpful to provide a brief overview of the merger review process under the Act.

(1) Merger Review: An Overview

42 Merger review is conducted under s. 92 of the Act. A merger is "an acquisition of control or a significant interest in all or part of the business of another" (B. A. Facey and D. H. Assaf, *Competition and Antitrust Law: Canada and the United States*. (4th ed. 2014), at p. 205). Section 91 of the Act defines merger as follows:

> **91.** [Definition of "merger"] In sections 92 to 100, "merger" means the acquisition or establishment, direct or indirect, by one or more persons, whether by purchase or lease of shares or assets, by amalgamation or by combination or otherwise, of control over or significant interest in the whole or a part of a business of a competitor, supplier, customer or other person.

43 A merger review is designed to identify those mergers that will have anti-competitive effects (Facey and Assaf, at p. 209). Section 92 identifies these anti-competitive effects as either substantially lessening competition or substantially preventing competition. Section 92(1) provides for remedial orders to be made when a merger is found to either lessen or prevent competition substantially.

44 Generally, a merger will only be found to meet the "lessen or prevent substantially" standard where it is "likely to create, maintain or enhance the ability of the merged entity to exercise market power, unilaterally or in coordination with other firms" (O. Wakil, The 2014 Annotated Competition Act (2013), at p. 246). Market power is the ability to "profitably influence price, quality, variety, service, advertising, innovation or other dimensions of competition" (*Canada (Commissioner of Competition) v. Canadian Waste Services Holdings Inc.* (2001), 11 C.P.R. (4th) 425 (Competition Trib.), at para. 7, aff'd 2003 FCA 131, 24 C.P.R. (4th) 178 (Fed. C.A.) leave to appeal dismissed, [2004] 1 S.C.R. vii (note) (S.C.C.)). Or, in other words, market power is "the ability to maintain prices above the competitive level for a considerable period of time without such action being unprofitable" (*Canada (Director of Investigation & Research) v. Hillsdown Holdings (Canada) Ltd.* (1992), 41 C.P.R. (3d) 289Competition Trib., at p. 314); where "price" is "generally used as shorthand for all aspects of a firm's actions that have

an impact on buyers" (J. B. Musgrove, J. MacNeil and M. Osborne, eds., *Fundamentals of Canadian Competition Law* (2nd ed. 2010), at p. 29). If a merger does not have or likely have market power effects, s. 92 will not generally be engaged (B. A. Facey and C. Brown, *Competition and Antitrust Laws in Canada: Mergers, Joint Ventures and Competitor Collaborations* (2013), at p. 141).

45 The merger's likely effect on market power is what determines whether its effect on competition is likely to be "substantial". Two key components in assessing substantiality under the "lessening" branch are the degree and duration of the exercise of market power (Hillsdownat pp. 328-29). There is no reason why degree and duration should not also be considered under the "prevention" branch.

46 What constitutes "substantial" will vary from case to case. The Tribunal has not found it useful to apply rigid numerical criteria:

> What will constitute a likely "substantial" lessening will depend on the circumstances of each case. ... Various tests have been proposed: a likely 5% price rise sustainable for one year; a 5% price rise sustainable over two years; a small but significant and non-transitory price rise. The Tribunal does not find it useful to apply rigid numerical criteria although these may be useful for enforcement purposes.
>
> (*Hillsdown*, at pp. 328-29)

47 If the Tribunal concludes that the merger substantially lessens or prevents or is likely to substantially lessen or prevent competition, the Tribunal is empowered to make a remedial order pursuant to s. 92(1)(e) and *(f)*. The Tribunal "may prohibit the parties from proceeding with all or part of the merger, or it may order the dissolution of a completed merger or divestiture of assets or shares" (Musgrove, MacNeil and Osborne, at p. 185).

48 The ability to make a remedial order is subject to exceptions (see ss. 94 to 96 of the Act). For the purposes of this appeal, only s. 96, the so-called efficiencies defence, is relevant. After a finding that a merger engages s. 92(1), s. 96 may be invoked by the parties to the merger to preclude a s. 92 remedial order. Section 96 will preclude such an order if it is found that the merger is likely to bring about efficiencies that are greater than and will offset the anti-competitive effects resulting from the merger.

(2) Determining Whether a Substantial Lessening or Prevention Will Likely Occur

(a) "But For" Analysis Should Be Used

49 The Tribunal, relying on *Canada Pipe*, used the "but for" test to assess the merger in this case.

50 *Canada Pipe* was a case involving abuse of dominance under s. 79(1)(c) of the Act. The words of s. 79(1)(c) — "is having or is likely to have the effect of preventing or lessening competition substantially in a market" — are very close to the words of s. 92(1) — "likely to prevent or lessen" — and convey the same ideas. In *Canada Pipe*, the Federal Court of Appeal employed a "but for" test to conduct the inquiry:

> ... the Tribunal must compare the level of competitiveness in the presence of the impugned practice with that which would exist in the absence of the practice, and then determine whether the preventing or lessening of competition, if any, is "substantial"....
>
> The comparative interpretation described above is in my view equivalent to the "but for" test proposed by the appellant. [paras. 37-38]

51 A similar comparative analysis is conducted under s. 92(1). A merger review, by its nature, requires examining a counterfactual scenario: "... whether the merger will give the merged entity the ability to prevent or lessen competition substantially compared to the pre-merger benchmark or 'but for' world" (Facey and Brown, at p. 205). The "but for" test is the appropriate analytical framework under s. 92.

(b) The "But For" Analysis Under Section 92(1) Is Forward-Looking

52 The words of the Act and the nature of the "but for" merger review analysis that must be conducted under s. 92 of the Act require that this analysis be forward-looking.

53 The Tribunal must determine whether "a merger or proposed merger prevents or lessens, *or is likely to prevent or lessen*, competition substantially". While the tense of the words "prevents or lessens" indicates existing circumstances, the ordinary meaning of "is likely to prevent or lessen" points to events in the future. To the same effect, the French text of s. 92(1) states "*qu'un fusionnement réalisé ou proposé empêche ou diminue sensiblement la concurrence, <u>ou aura vraisemblablement cet effet</u>*". Both the English and French text allow for a forward-looking analysis. This proposition is not controversial. Both parties to this appeal agree that a forward-looking analysis is appropriate.

(c) Similarities and Differences Between the "Lessening" and "Prevention" Branches of Section 92

54 In his concurring reasons at the Tribunal, Crampton C.J. found that the assessment of a merger review under either the "prevention" or "lessening" branch is "essentially the same" (para. 367). Both focus on "whether the merged entity is likely to be able to exercise materially greater market power than in the absence of the merger" (*ibid.*). Under both branches, the lessening or prevention in question must be "substantial" (*Canada (Commissioner of Competition) v. Superior Propane Inc.* (2000), 7 C.P.R. (4th) 385 ("*Superior Propane I*"), at paras. 246 and 313). And the analysis under both the "lessening" and "prevention" branches is forward-looking.

55 However, there are some differences between the two branches. In determining whether competition is substantially lessened, the focus is on whether the merged entity would increase its market power. Under the "prevention" branch, the focus is on whether the merged entity would retain its existing market power. As explained by Chief Justice Crampton in his concurring reasons:

> In determining whether competition is likely to be *lessened*, the more particular focus of the assessment is upon whether the merger is likely to facilitate the exercise of new or increased market power by the merged entity, acting alone or interdependently with one or more rivals. In determining whether competition is likely to be *prevented*, that more particular focus is upon whether the merger is likely to preserve the existing market power of one or both of the merging parties, by preventing the erosion of such market power that otherwise likely would have taken place if the merger did not occur. [Emphasis in original.]
>
> (Tribunal decision, at para. 368)

C. The "Prevention" Branch of Section 92(1)

56 While this Court has had occasion to consider the "lessening" branch of s. 92(1) in *Canada (Director of Investigation & Research) v. Southam Inc.*, [1997] 1 S.C.R. 748(S.C.C.), this is the first case, in which we have had the opportunity to focus on the "prevention" branch of s. 92(1).

57 Tervita seeks clarity as to the appropriate legal test under the "prevention" branch. In Tervita's view, the "Tribunal erred in its application of the legal test for a substantial prevention of competition" (A.F., at para. 59). Tervita argues that "the Act requires that the Tribunal focus its analysis on the merger under review" (*ibid.*). Tervita acknowledges that s. 92 does involve a forward-looking approach, but submits that what should be projected into the future is the merging parties as they are, with their assets, plans and businesses at the time of the merger. Tervita argues that the Act does not permit the Tribunal to speculate, as it says it did in this case and that its "fundamental error" is that it focused "not on the merger between Tervita and [the Vendors], but rather on how competition might have developed looking years into the future" (A.F., at para. 71).

58 My understanding of Tervita's argument is that the wording of s. 92 essentially limits the inquiry to whether the Babkirk site was a viable competitive entrant into the secure landfill market at the time it was acquired by Tervita. That is, in order to

establish that the merger is likely to substantially prevent competition, a party to the merger must be a potential competitor based on the assets, plans and businesses of the party at the time of the merger.

59 For the reasons that follow, I am unable to agree with Tervita. Rather, I agree with the Commissioner that the wording of s. 92 generally supports the analysis and conclusions of the Tribunal and the Federal Court of Appeal with respect to s. 92.

(1) The Law

60 The concern under the "prevention" branch of s. 92 is that a firm with market power will use a merger to prevent competition that could otherwise arise in a contestable market. The analysis under this branch requires looking to the "but for" market condition to assess the competitive landscape that would likely exist if there was no merger. It is necessary to identify the potential competitor, assess whether but for the merger that potential competitor is likely to enter the market and determine whether its effect on the market would likely be substantial.

(a) Identify the Potential Competitor

61 The first step is to identify the firm or firms the merger would prevent from independently entering the market, i.e. identifying the potential competitor. In the competition law jurisprudence "entry" is considered "either the establishment of a new firm in the market whether entirely new to the industry or new to the geographic area ..., or local firms which previously did not offer the product in question commencing to do so" (Hillsdown, at p. 325).

62 Typically, the potential competitor will be one of the merged parties: the acquired firm or the acquiring firm. The potential entry of the acquired firm will be the focus of the analysis when, but for the merger, the acquired firm would likely have entered the relevant market. The potential entry of the acquiring firm will be the focus of the analysis when, but for the merger, the acquiring firm would have entered the relevant market independently or through the acquisition and expansion of a smaller firm, a so-called "toehold" entry.

63 I would also not rule out the possibility that, as suggested by Chief Justice Crampton in his concurring reasons, a likely substantial prevention of competition could stem from the merger preventing "another type of future competition" (para. 386). I interpret this to mean that it is possible that a third party entrant, one not involved in the merger, may be prevented from entering the market as a result of the merger.

(b) Examine the "But For" Market Condition

64 The second step in determining whether a merger engages the "prevention" branch is to examine the "but for" market condition to see if, absent the merger, the potential competitor (usually one of the merging parties) would have likely entered the market and if so whether that entry would have decreased the market power of the acquiring firm. If the independent entry has no effect on the market power of the acquiring firm then the merger cannot be said to prevent competition substantially.

65 Tervita argues that the intention of s. 92 is "to establish a merger test that provides certainty to Canadian businesses" (A.F., at para. 66). However, the term "likely" in s. 92 does not require certainty. "Likely" reflects the reality that merger review is an inherently predictive exercise, but it does not give the Tribunal licence to speculate; its findings must be based on evidence.

66 There is only one civil standard of proof: proof on a balance of probabilities (*C. (R.) v. McDougall*, 2008 SCC 53, [2008] 3 S.C.R. 41 (S.C.C.), at paras. 40 and 49). This means that in order for s. 92 of the Act to be engaged, the Tribunal must be of the view that it is more likely than not that the merger will result in a substantial prevention of competition. Mere possibilities are insufficient to meet this standard. And, as will be discussed, as events are projected further into the future, the risk of unreliability increases such that at some point the evidence will only be considered speculative.

(i) Likelihood of Entry by One of the Merging Parties

67 In determining whether one of the merging parties would, in the absence of the merger, be likely to enter the market independently, any factor that in the opinion of the Tribunal could influence entry upon which evidence has been adduced should

be considered. This will include the plans and assets of that merging party, current and expected market conditions, and other factors listed in s. 93 of the Act.

68 Where the evidence does not support the conclusion that one of the merging parties or a third party would enter the market independently, there cannot be a finding of likely prevention of competition by reason of the merger. To the same effect, where the evidence is only that there is a possibility of the merging party entering the market at some time in the future, a finding of likely prevention cannot be made. In this respect, I agree with Justice Mainville that the time frame for entry must be discernible (F.C.A. decision, at para. 90). While timing does not need to be a "precisely calibrated determination" (*ibid.*), there must be evidence of when the merging party is realistically expected to enter the market in absence of the merger. Otherwise the timing of entry is simply speculative and the test of likelihood of prevention of competition is not met. Even where there is evidence of a timeframe for independent entry, the farther into the future predictions are made, the less reliable they will be. The Tribunal must be cautious in declaring a lengthy timeframe to be discernible, especially when entry depends on a number of contingencies.

69 My understanding of Tervita's argument is that it seeks to limit the Tribunal's ability to look into the future to what can be discerned from the merging parties' assets, plans and business at the time of the merger. However, in my view, there is no legal basis to restrict the evidence the Tribunal can look at in this way.

70 Justice Mainville held that how far into the future the Tribunal can look when assessing whether, but for the merger, the merging party would have entered the market should normally be determined by the lead time required to enter a market due to barriers to entry, which he referred to as the "temporal dimension" of the barriers to entry: "... the timeframe for market entry should normally fall within the temporal dimension of the barriers to entry into the market at issue" (F.C.A. decision, at para. 91).

71 Barriers to entry relate to how easily a firm can commence business in the relevant market and establish itself as a viable competitor (*Canada (Director of Investigation & Research) v. Laidlaw Waste Systems Ltd.* (1992), 40 C.P.R. (3d) 289Competition Trib., at p. 330). The lead time required to enter a market due to barriers to entry ("lead time") refers to the inherent time delay that a new entrant, facing certain barriers and acting diligently to overcome them, could be expected to experience when trying to enter the market.

72 In setting lead time as the appropriate length of time to consider, Justice Mainville relied on the American case BOC International Ltd. v. Federal Trade Commission1977557 F.2d 24(2d Cir. 1977), which considered whether a merger violated s. 7 of theClayton Act, 15 U.S.C. § 18, under the "actual potential competition" doctrine, the U.S. equivalent of the "prevention" branch of s. 92 of the Act. *BOC International* turned on whether the evidence was sufficient to meet the requirements under the "actual potential competition" doctrine. The U.S. Federal Trade Commission found that there was a "reasonable probability" that the acquiring firm would have "eventually entered" the U.S. market but for its acquisition of the acquired company (BOC International, at p. 28).

73 The Second Circuit Court of Appeals held that the language "eventual entry" made the overall test based largely on "ephemeral possibilities" (BOC International, at pp. 28-29). An actual potential entrant should be expected to enter in the 'near' future, with "near" being defined in relation to the barriers to entry relevant in that particular industry:

> ... it seems necessary under Section 7 that the finding of probable entry at least contain some reasonable temporal estimate related to the near future, with 'near' defined in terms of the entry barriers and lead time necessary for entry in the particular industry, and that the finding be supported by substantial evidence in the record.
>
> (*BOC International*, at p. 29)

74 Neither Justice Mainville nor *BOC International* expressly explain why the lead time should establish the length of time the Tribunal can look into the future when assessing whether, absent the merger, there would have been likely independent entry of one of the merging parties. Though Justice Mainville notes that lead time should be treated "as a guidepost and not as a fixed temporal rule" (para. 91), it is important to emphasize that lead time should not be used to justify predictions about the distant future. In some contexts, relevant lead time may be short, and thus a determination of whether market entry is likely within that timeframe may be sufficiently definite to meet the "likely" test. However, in other contexts — for example, those where

product development or regulatory approval processes may extend for some years — the lead time may be so lengthy that a determination of the probability of market entry at the far end of that timeframe would be influenced by so many unknown and unknowable contingencies as to render such a prediction largely speculative.

75 The timeframe that can be considered must of course be determined by the evidence in any given case. The evidence must be sufficient to meet the "likely" test on a balance of probabilities, keeping in mind that the further into the future the Tribunal looks the more difficult it will be to meet this test. Lead time is an important consideration, though this factor should not support an effort to look farther into the future than the evidence supports.

76 Business can be unpredictable and business decisions are not always based on objective facts and dispassionate logic; market conditions may change. In assessing whether a merger will likely prevent competition substantially, neither the Tribunal nor courts should claim to make future business decisions for companies. Factual findings about what a company may or may not do must be based on evidence of the decision the company itself would make; not the decision the Tribunal would make in the company's circumstances.

77 If the Tribunal determines that the identified merging party would, absent the merger, be likely to enter within a discernible timeframe, the next question is whether this entry would likely result in a substantial effect on competition in the market.

(ii) Likely to Have a Substantial Effect on the Market

78 It is not enough that a potential competitor must be likely to enter the market; this entry must be likely to have a substantial effect on the market. As discussed above, assessing substantiality requires assessing a variety of dimensions of competition including price and output. It also involves assessing the degree and duration of any effect it would have on the market.

79 Section 93 provides a non-exhaustive list of factors that may be considered when assessing whether a merger substantially lessens or prevents competition or is likely to do so, including whether a party is a failing business, the availability of acceptable substitutes, barriers to entry into the relevant market, the extent to which effective competition remains or would remain after a merger, and whether the merger would result in the removal of a vigorous and effective competitor.

(2) Application to the Present Case

80 The Tribunal's analytical framework and conclusion that the merger will likely substantially prevent competition are, in my view, correct. The Tribunal correctly applied the analytical framework set out above. It used a forward-looking "but for" analysis to determine whether the merger was likely to substantially prevent competition. The Tribunal identified the acquired party, the Vendors, as the focus of the analysis. The Tribunal then assessed whether, but for the merger, the Vendors would have likely entered the relevant product market in a manner sufficient to compete with Tervita.

81 The Tribunal concluded that the merger "is more likely than not to maintain the ability of [Tervita] to exercise materially greater market power than in the absence of the [m]erger, and that the [m]erger is likely to prevent competition substantially" (para. 229(iv)). In coming to this conclusion the Tribunal assessed a number of the s. 93 factors including the following:

- barriers to entry were "at least 30 months" and there was "no evidence of any proposed entry in the Contestable Area" (para. 222; see s. 93(d));

- there is an absence of acceptable substitutes and effective remaining competition (para. 223; see s. 93(c));

- there would be sufficient demand for secure landfill services to make transforming the Babkirk site to a secure landfill profitable as demand has "been projected to increase as new drilling is undertaken in the area north and west of Babkirk" (para. 207; see s. 93(f));

- the permitted capacity of the Babkirk site was sufficient to allow it to "compete effectively" with Tervita (para. 208; see s. 93(f)); and

• "the [m]erger preserves a monopolistic market structure, and thereby prevents the emergence of potentially important competition" (para. 297; see s. 93(e)).

82 I agree with the Commissioner that "the Tribunal did not speculate on what would happen to the Babkirk site .... It made findings of fact based on the abundant evidence before it" (R.F., at para. 61). The reasonableness of the factual findings were reviewed by the Federal Court of Appeal and found to be supported by sufficient evidence. While, as will be discussed, I question the Tribunal's treatment of the asserted 10 percent reduction in prices that would allegedly have been realized in the absence of a merger (para. 229(iii)), it is evident that there was sufficient other evidence upon which the Tribunal could find a substantial prevention of competition as a result of the merger.

83 Accordingly, the Tribunal's conclusion that the merger is likely to substantially prevent competition was correct. As s. 92 is engaged, it is necessary to determine whether the s. 96 defence applies to prevent the making of an order under s. 92.

D. The Efficiencies Defence

84 Tervita raises two issues with respect to the Tribunal's assessment of the s. 96 efficiencies defence. First, should OIEs, or efficiencies that would arise because of the time necessary to implement the Tribunal's divestiture order under s. 92, be taken into account in the balancing test under s. 96? Second, what is the proper approach to the balancing analysis under s. 96? Before addressing the issues raised on appeal, it will be useful to review the history of the statutory efficiencies defence and the adjudicative treatment of the defence prior to this case.

(1) History of the Efficiencies Defence

85 Section 96 was included as part of the new *Competition Act*, proclaimed into force on June 19, 1986. The process of reforming Canada's competition laws began in 1966 when the federal government requested a study from the Economic Council of Canada. The Council's 1969 report "identified economic efficiency as the overriding policy objective" of legislative reform (A. N. Campbell, Mergers Law and Practice: The Regulation *of* Mergers Under the Competition Act (1997), at p. 21). After a number of attempts to amend the legislation and following a lengthy and extensive consultative process, the new *Competition Act* was introduced. This amendment process reflected concerns raised about the number of significant mergers taking place in Canada (Facey and Assaf, at p. 9; see also W. T. Stanbury and G. B. Reschenthaler, "Reforming Canadian Competition Policy: Once More Unto the Breach" (1981), 5 Can. Bus. L.J. 381, at p. 388). In early 1981, the federal Minister of Consumer and Corporate Affairs solicited the views of his provincial counterparts, trade associations, consumer groups and academics with respect to proposals for amending the Combines Investigation Act, R.S.C. 1970, c. C-23 (ibid., p. 381). This process "yielded valuable experience laying the groundwork for what was to become the *Competition Act*" (Facey and Assaf, at p. 10).

86 Bill C-91, *An Act to establish the Competition Tribunal and to amend the Combines Investigation Act and the Bank Act and other Acts in consequence thereof*, was introduced in the House of Commons in 1985 (1st Sess., 33rd Parl., first reading Dec. 17, 1985, assented to June 17, 1986, s.c. 1986, c. 26). This bill included comprehensive amendments to the *Combines Investigation Act*, including the creation of a new expert adjudicative body, the Competition Tribunal, and the inclusion of the efficiencies defence (Facey and Assaf, at pp. 9-10).

87 A stand-alone statutory efficiencies defence was considered "particularly appropriate for Canada because a small domestic market often precludes more than a few firms from operating at efficient levels of production and because Canadian firms need to be able to exploit scale economies to remain competitive internationally" (Campbell, at p. 152; see also *House of Commons Debates*, vol. VIII, 1st Sess., 33rd Parl., April 7, 1986, at p. 11962; and Minister of Consumer and Corporate Affairs, *Competition Law Amendments: A Guide* (1985), at p. 4). In the context of the relatively small Canadian economy, to which international trade is important, the efficiencies defence is Parliamentary recognition that, in some cases, consolidation is more beneficial than competition (ibid., at pp. 15-17).

(2) Jurisprudential History of Section 96

88 The leading case law on the interpretation of the efficiencies defence remains the *Superior Propane* series of cases, which began when the Commissioner applied to the Tribunal seeking an order to prevent a merger between the two largest national distributors of propane (*Superior Propane I*, rev'd on other grounds in *Superior Propane II*, leave to appeal dismissed, [2001] 2 S.C.R. xiii(S.C.C.); redetermination in *Canada (Commissioner of Competition) v. Superior Propane Inc.* (2002), 18 C.P.R. (4th) 417Competition Trib. (“Superior Propane III”), aff'd2003 FCA 53[2003] 3 F.C. 529 ("*Superior Propane IV*"). Although this Court is not bound by these decisions, the *Superior Propane* cases considered a number of factors relevant to the efficiencies defence and its application.

89 The *Superior Propane I* case confirmed that s. 96 is a defence to the application of s. 92 (paras. 398-99). As such, the onus of alleging and proving that efficiency gains from the merger will be greater than and will offset the effects of any prevention or lessening of competition resulting from the merger falls upon the merging parties (*Superior Propane I*, at para. 399; *Superior Propane II*, at para. 154; *Superior Propane IV*, at para. 64).

90 The s. 96 efficiencies defence requires an analysis of whether the efficiency gains of the merger, which result from the integration of resources, outweigh the anti-competitive effects, which result from the decrease in or absence of competition in the relevant geographic and product market. As the Federal Court of Appeal explained in *Superior Propane II*, "This is, in substance, a balancing test that weighs efficiencies on one hand, against anti-competitive effects on the other" (para. 95).

(3) Methodological Approaches to Section 96

91 There are different possible methodologies for the comparative exercise under s. 96 (Facey and Brown, at pp. 256-57). In Canada, two main standards have been the subject of judicial consideration: the "total surplus standard" and the "balancing weights standard". For both standards, two types of economic surplus are relevant: producer surplus and consumer surplus.

92 Producer surplus "measures how much more producers are able to collect in revenue for a product than their cost of producing it" (p. 256). Producer surplus therefore represents the wealth that accrues to producers. Consumer surplus is "a measure of how much more the consumers of a product would have been willing to pay to purchase the product compared to the prevailing market price" (ibid.). Consumer surplus therefore represents the savings that accrue to consumers from what they would have been willing to pay.

93 The term "total surplus" refers to the sum of producer and consumer surplus (see Facey and Brown, at p. 256). If a producer covers its costs, including its cost of capital, by selling a unit of a product at $20 and a consumer is willing to buy the unit for $40, then the total surplus created by the unit is $20. If the eventual sale price is $30, for example, then each of producer and consumer surplus is increased by $10 as a result of the transaction. The total surplus in the economy represents the aggregate of the total surplus created by each unit produced.

94 The total surplus standard involves quantifying the deadweight loss which will result from a merger — "the amount by which total surplus is reduced under certain market conditions that reduce the quantity of a good that is supplied" (Facey and Brown, at pp. 256-57). Deadweight loss "results from the fall in demand for the merged entities' products following a post-merger increase in price, and the inefficient allocation of resources that occurs when, as prices rise, consumers purchase a less suitable substitute" (*Superior Propane IV*, at para. 13). Estimates of the elasticity of demand — or the degree to which demand for a product varies with its price — are necessary to calculate the deadweight loss (Tribunal decision, at para. 244).

95 Under the total surplus standard, equal weight is given from a welfare perspective to changes in producer and consumer surplus (Facey and Brown, at p. 257). The decrease in total surplus resulting from decreased competition is balanced against any offsetting increase in total surplus resulting from more efficient production. The focus of this method is purely on the magnitude of the total surplus: the degree to which total surplus is allocated between producers and consumers is not considered. In other words, the total surplus standard measures only the total benefit flowing to the economy and is not concerned with to whom the benefits flow; the analysis of the relevant effects is limited to the deadweight loss (*Superior Propane IV*, at para. 16). Therefore, the total surplus standard "does not consider the effect of the wealth likely to be transferred from consumers to the shareholders of the merged entity as a result of the anti-competitive merger and the consequent increase of prices. This 'wealth transfer' or

'redistributive effect' is considered to be neutral" (*Superior Propane IV*, at para. 14). As such, under the total surplus standard approach, an anti-competitive merger will proceed when efficiency gains to producer surplus are greater than the decrease in consumer surplus.

96 In the *Superior Propane* cases, the Tribunal and the Federal Court of Appeal recognized another methodology called the "balancing weights" approach. This approach enables Tribunal members to "use their individual judgment and discretion to evaluate whether the gains to shareholders are more or less important to society than the losses of surplus imposed on consumers by the exercise of market power" (*Superior Propane I*, at para. 431).

97 As explained in *Superior Propane IV*, under the balancing weights approach, the Tribunal weighs the effects of the merger on consumers against the effects of the merger on the shareholders of the merged entity. The Tribunal first determines the relative weights to be assigned to producer gains and consumer losses, to equate them, or to make the wealth transfer neutral in effect. Then, the Tribunal engages in a value judgment process to conclude whether the assigned weights are reasonable in light of any disparity between the incomes of the relevant consumers and shareholders of the merged entity (*Superior Propane IV*, at para. 20).

98 The Tribunal may also adopt a modified version of the balancing weights approach (see *Superior Propane IV*, at paras. 21 and 26). Under this modified approach, socially adverse redistribution effects, or the portion of the wealth transfer that is attributable to higher prices paid by low-income households, may be taken into account as an anti-competitive effect, while components of the wealth transfer that are not socially adverse may be treated as neutral (*Superior Propane III*, at para. 333).

99 However, there is no mandated "correct" methodology for the s. 96 analysis (*Superior Propane II*, at paras. 139-42). The statute does not set out which standard should be used. From an economic perspective, there are arguments in favour of the total surplus standard (see M. Trebilcock et al., *The Law and Economics of Canadian Competition Policy* (2002). at pp. 146-51). However, that is not the issue before this Court and, for the purpose of this case, it suffices to say that *Superior Propane II* established that the Tribunal has the flexibility to make the ultimate choice of methodology in view of the particular circumstances of each merger.

100 The Tribunal should consider all available quantitative and qualitative evidence (*Superior Propane I*, at para. 461; *Superior Propane III*, at para. 335). While quantitative aspects of a merger are those which can be measured and reduced to dollar amounts, qualitative elements of a merger, including in some cases such things as better or worse service or lower or higher quality, may not be measurable as they are dependent on individual preferences in the market (see *Superior Propane I*, at paras. 459-60). Effects that can be quantified should be quantified, even as estimates. If effects are realistically measurable, failure to at least estimate the quantification of those effects will not result in the effects being assessed on a qualitative basis (*Superior Propane III*, at para. 233; *Superior Propane IV*, at para. 35).

101 The above principles developed in the *Superior Propane* series of cases provide the foundation for the analysis of the s. 96 efficiencies defence. These principles serve as the backdrop to the legal issues in the present case: consideration of whether specific efficiencies are valid efficiencies for the purposes of the defence and the proper approach to the balancing exercise under s. 96.

(4) Order Implementation Efficiencies Are Not Valid Efficiencies Under Section 96

102 In the context of a merger, efficiencies are pro-competitive benefits. As Brian A. Facey and Cassandra Brown explain, "Economists' conception of efficiency revolves around the benefit, value or satisfaction that accrues to society due to the actions and choices of its members" (p. 253). There are three components: (1) production efficiency, which "is achieved when output is produced using the most cost-effective combination of productive resources available under existing technology"; (2) innovation or dynamic efficiency, which "is achieved through the invention, development and diffusion of new products and production processes"; and (3) allocative efficiency, which "is achieved when the existing stock of goods and productive output is allocated throughout the price system to those buyers who value them most in terms of willingness to pay, such that 'resources available

to society are allocated to their most valuable use'" (Facey and Brown, at pp. 253-55, quoting Competition Bureau, Merger Enforcement Guidelines (2011), at para. 12.4).

103 Tervita argues that the Tribunal erred in rejecting valid efficiencies from its consideration of the efficiency gains, namely those referred to by the Tribunal as OIEs. Tervita submits that all economic efficiencies, however arising, should be considered.

104 Tervita claimed certain transportation and market expansion efficiencies which Tervita could have attained more quickly than a third party purchaser of the Babkirk site (A.F., at para. 100). As the Federal Court of Appeal explained, the *transportation* gains in efficiency are "productive gains in efficiency realized by the customers who are closer to the Babkirk site, allegedly than to Tervita's Silverberry secure landfill. Since Tervita acquired the allegedly to open a full-service secure landfill operation there, customers located closer to that site would achieve transportation cost savings" (para. 131). Tervita asserted before the Tribunal that, had the Commissioner not intervened, it would have already been operating a secure landfill at the Babkirk site by the spring of 2012 (Tribunal decision, at para. 269). However, a third party purchaser would have been unlikely to have a secure landfill in operation before the spring of 2013. Only Tervita therefore could have enabled customers to achieve these additional transportation efficiencies for that one-year period.

105 The *market* gains in efficiency are the result of additional hazardous waste which would be disposed at the Babkirk site secure landfill: "Since there are significant costs and risks associated with transporting such waste over long distances to the Silverberry secure landfill, a site requiring a shorter transportation route (such as the Babkirk site) would attract more hazardous waste than would otherwise have been disposed of at Silverberry ..." (F.C.A. decision, at para. 132). As with the transportation gains in efficiency, Tervita would have been able to achieve the market gains one year earlier than a third party purchaser — from the spring of 2012 to the spring of 2013.

106 The Tribunal held that these one-year transportation and market efficiency gains were a result of the time associated with the implementation of its divestiture order, including the time required to effect the actual sale of the shares or assets of Babkirk (estimated to take at least six months including the due diligence process), to modify or prepare an operations plan for the landfill, for the B.C. Ministry of the Environment ("MOE") to approve the operations plan, and for the purchaser to construct the landfill, which can only be undertaken between June and September (para. 269). As such, the Tribunal held that the OIEs were not cognizable efficiencies under the Act (paras. 269-70).

107 A distinction should be drawn between efficiencies claimed because a merging party would be able to bring those efficiencies into being faster than would be the case but for the merger (what could be called "early-mover" efficiencies), and efficiencies that a merging party could realize sooner than a competitor only because the competitor would be delayed in implementing those efficiencies because of legal proceedings associated with a divestiture order (what the Tribunal identified as OIEs). While, as will be discussed, OIEs are not cognizable efficiencies under s. 96, early-mover efficiencies are real economic efficiencies that are caused by the merger, and not by delays associated with legal proceedings; were it not for the merger, the economy would not gain the benefit of those efficiencies that would have accrued in the time period between the merger and the actions of a future competitor.

108 Though the Tribunal held that the one-year efficiencies claimed by Tervita were OIEs, the Tribunal's reasons also appear to suggest that those efficiencies could have been classified as early-mover efficiencies. The Tribunal noted that Tervita would have been prepared to operate the Babkirk site as a secure landfill by the summer of 2012 (para. 269), and also found that, under its "but for" analysis in which the merger would not have occurred, the site would not have been operated as a secure landfill accepting significant quantities of waste until the spring of 2013 (para. 207). Thus, it would appear that any transportation and market expansion efficiencies arising from the operation of the Babkirk site as a secure landfill from 2012 to 2013 under Tervita's plans could have arisen not due to delays caused by legal proceedings, but by Tervita's ability to bring the site into operation sooner than a potential competitor.

109 The Tribunal's reasons appear inconsistent on whether the facts as found by the Tribunal would properly support the classification of the one-year efficiencies at issue as early-mover efficiencies or as OIEs. However, as will be discussed below, the classification of these efficiencies in this case would not be dispositive because the efficiencies were not ultimately realized

by Tervita. Nevertheless, in light of the importance of the issue of whether OIEs should be cognizable in future cases, I turn now to an examination of that issue.

110 In Tervita's submission, OIEs must be considered because s. 96 affords paramountcy to the statutory objective of economic efficiency such that all efficiencies, however arising, must be considered. I am unable to agree with Tervita on this point.

111 Section 96 does give primacy to economic efficiency. However, s. 96 is not without limitation.

112 For ease of reference, I produce s. 96 here:

> **96. (1)** The Tribunal shall not make an order under section 92 if it finds that the merger or proposed merger in respect of which the application is made has brought about or is likely to bring about gains in efficiency that will be greater than, and will offset, the effects of any prevention or lessening of competition that will result or is likely to result from the merger or proposed merger and that the gains in efficiency would not likely be attained if the order were made.

113 In order for a party to gain the benefit of the s. 96 defence, the Tribunal must be satisfied that the merger or proposed merger has brought about or is likely to bring about gains in efficiency. The Tribunal must also find that the gains in efficiency would not likely be attained if a s. 92 order were made. In addition, and despite the paramountcy given to economic efficiencies in s. 96, s. 96(3) prohibits the Tribunal from considering a "redistribution of income between two or more persons" as an offsetting efficiency gain. The limitation in s. 96(3) demonstrates that Parliament does not intend for all efficiency gains, however arising, to be taken into account under s. 96.

114 The transportation and market efficiencies at issue in this case are efficiency gains resulting from the operation of a secure landfill facility at a location closer to some customers. However, subject to the above discussion as to the proper classification of these efficiencies in this case, the OIEs specifically are efficiency gains resulting not from the merger itself, but from the implementation time associated with a divestiture order (F.C.A. decision, at para. 135). Put simply, if these efficiencies are properly classified as OIEs, they would be achieved by Tervita, and not by a third party, only by virtue of Tervita being in operation one year earlier than a third party purchaser following a divestiture order, and only because of the time that it would take for the Tribunal's order to be implemented.

115 Efficiencies that are the result of the regulatory processes of the Act are not cognizable efficiencies under s. 96. The OIEs result from the operation and application of the legal framework regulating competition law in Canada. The provision states that the *merger* or *proposed merger* must bring about or be likely to bring about gains in efficiency. The OIEs are efficiencies which are not attributable to the merger. They are attributable to the time associated with the implementation of the divestiture order.

116 Finally, regardless of whether the efficiencies are classified as early-mover efficiencies or OIEs, and as the Federal Court of Appeal explained, the efficiencies were nevertheless not realized in this case because Tervita did not actually construct and operate a landfill at the Babkirk site before the merger review, or indeed before the date of the Tribunal's order. Tervita argues that this reasoning does not withstand scrutiny. In this case, Tervita undertook to preserve and maintain all provincial MOE approvals, permits and authorizations for the establishment and operation of a proposed secure landfill at the Babkirk site pending the proceedings before the Tribunal. Tervita argues that, as a result of this "hold separate undertaking", it could not have constructed its planned secure landfill. Again, I cannot agree.

117 "Hold separate" orders are typically issued to prevent the intermingling of assets or businesses that would otherwise occur through the merger (B. A. Facey, G. Hilton-Sullivan and M. Graham, "The Reinvigoration of Canadian Antitrust Law — Canada's New Approach to Merger Review" (2010), 6 *C.L.I.* 28, at p. 33). These orders aim at avoiding the difficulties that would arise in attempting to "unscramble the egg" if an order was issued after a merger proceeded in full. In this case, the hold separate undertaking was not the typical "unscramble the egg" undertaking concerned with the intermingling of assets.

118 The evidence in this case does not support Tervita's claim that the undertaking prevented it from operating the landfill. The undertaking merely required Tervita to preserve and maintain the necessary provincial environmental approvals for establishing and operating the proposed secure landfill at the Babkirk site. The evidence before the Tribunal was that Tervita wanted to

increase the capacity of the secure landfill and doing so would require an amendment to the approval for the site — a process Tervita understood to be contrary to the undertaking. However, nothing prevented Tervita from establishing and operating the landfill at the capacity allowed for under the existing approval.

119 The evidence is that Tervita had not taken the steps to commence operating the landfill. Even assuming no divestiture order were made, Tervita would not have been in a position to begin operating the secure landfill at the conclusion of the proceedings.

120 For these reasons, both the Tribunal and the Federal Court of Appeal were correct that the OIEs are not cognizable efficiencies under s. 96 (see Tribunal decision, at para. 270; F.C.A. decision, at para. 135).

(5) The Balancing Test Under Section 96

121 Tervita argues that the Federal Court of Appeal took an overly subjective approach to the offset analysis under s. 96. This argument is based on the Commissioner's failure to quantify the quantifiable anti-competitive effects — specifically, the failure to quantify the deadweight loss. This raises the specific questions of what content there is to the Commissioner's burden under s. 96 and what consequences flow from a failure to meet the burden. More generally, Tervita's argument requires consideration of the overall balancing approach under s. 96.

(a) The Commissioner's Burden

122 As explained above, the *Superior Propane* series established that the Commissioner has the burden under s. 96 to prove the anti-competitive effects. The merging parties bear the onus of establishing all other elements of the defence, including the extent of the efficiency gains and whether the gains are greater than and offset the anti-competitive effects (see *Superior Propane I*, at paras. 399 and 403; *Superior Propane II*, at para. 154; and *Superior Propane IV*, at para. 64). The parties do not take issue with this allocation of onus.

(i) The Content of the Commissioner's Burden

123 Tervita argues that the Commissioner's onus is to quantify all anti-competitive effects which can be quantified. In this case, the Commissioner did not do so.

124 The Commissioner argues that quantification is not a legal prerequisite to considering anti-competitive effects (R.F., at paras. 84 and 88). On the contrary, the Commissioner's legal burden is to quantify the quantifiable anti-competitive effects upon which reliance is placed. Where effects are measurable, they must be estimated. Effects will only be considered qualitatively if they cannot be quantitatively estimated. A failure to quantify quantifiable effects will not result in such effects being considered qualitatively (*Superior Propane IV*, at para. 35). This approach minimizes the degree of subjective judgment necessary in the analysis and enables the Tribunal to make the most objective assessment possible in the circumstances (*Superior Propane IV*, at para. 38). An approach that would permit the Commissioner to meet her burden without at least establishing estimates of the quantifiable anti-competitive effects fails to provide the merging parties with the information they need to know the case they have to meet.

125 The Commissioner's burden is to quantify by estimation all quantifiable anti-competitive effects. Estimates are acceptable as the analysis is forward-looking and looks to anti-competitive effects that will or are likely to result from the merger. The Tribunal accepts estimates because calculations of anti-competitive effects for the purposes of s. 96 do not have the precision of history. However, to meet her burden, the Commissioner must ground the estimates in evidence that can be challenged and weighed. Qualitative anti-competitive effects, including lessening of service or quality reduction, are only assessed on a subjective basis because this analysis involves a weighing of considerations that cannot be quantified because they have no common unit of measure (that is, they are "incommensurable"). Due to the uncertainty inherent in economic prediction, the analysis must be as analytically rigorous as possible in order to enable the Tribunal to rely on a forward-looking approach to make a finding on a balance of probabilities.

126 In this case, the Commissioner did not quantify quantifiable anti-competitive effects and therefore failed to meet her burden under s. 96.

(ii) What Consequences Flow From a Failure to Meet the Burden?

127 The question concerns the legal implications of a failure by the Commissioner to quantify quantifiable anti-competitive effects. The Federal Court of Appeal recognized that "[a] quantitative effect which has not in fact been quantified should not be considered as a qualitative effect" (para. 158) but went on to hold that the non-quantified deadweight loss should be assigned a weight of "undetermined" (paras. 130 and 167).

128 With respect, I cannot agree. As explained above, the Commissioner's burden is to quantify all quantifiable anti-competitive effects. The failure to do so is a failure to meet this legal burden and, as a result, the quantifiable anti-competitive effects should be fixed at zero. Quite simply, where the burden is not met, there are no proven quantifiable anti-competitive effects.

129 As Tervita submits, this approach is consistent with that in civil proceedings where a party has failed to discharge its burden of proof with respect to loss (see S. M. Waddams, *The Law of Damages* (5th ed. 2012), at paras. 10.10 to 10.30). In addition, setting the effects at zero where the Commissioner has failed to meet her legal burden is consistent with taking an approach to the balancing analysis that is objectively reasonable. In setting the weight at undetermined, the Federal Court of Appeal allowed for subjective judgment to overtake the analysis. Undetermined effects were weighed against the proven overhead gains in efficiency, which were described by the court as "marginal" and "insignificant" (para. 174). Nonetheless, it is not clear how the Federal Court of Appeal — or any court — could weigh undetermined effects.

130 The jurisprudence has consistently recognized the importance of an objective approach to the balancing analysis (see *Superior Propane IV*, at para. 38). As the Federal Court of Appeal recognized in this case:

> Objective determinations are better suited for ensuring predictability in the application of the *Competition Act* and avoiding arbitrary decisions. Predictability is particularly important in merger reviews since most merger transactions are reviewed only by the Commissioner and rarely reach the Tribunal. A methodology which favours objective determinations whenever possible allows the parties to merger transactions and the Commissioner to more readily predict the impacts of a merger, discourages the use of arbitrary judgment in the process, and reduces overall uncertainty in the Canadian business community. [para. 152]

I agree with these reasons for favouring an objective approach. Although the Federal Court of Appeal recognized the importance of an objective analysis, in assigning the quantifiable but non-quantified effects a weight of "undetermined", its analysis did not meet the necessary objective standard.

131 The Federal Court of Appeal's "undetermined" approach also raises concerns of fairness to the merging parties. The court recognized that a "proper interpretation of s. 96 of the Competition Act requires that the [merging parties] must still demonstrate on a balance of probabilities that the gains in efficiency offset the anti-competitive effects" (para. 167). The difficulty with assigning non-quantified quantifiable effects a weight of "undetermined" is that it places the merging parties in the impossible position of having to demonstrate that the efficiency gains exceed and offset an amount that is undetermined. Under this approach, to prove the remaining elements of the defence on a balance of probabilities becomes an unfair exercise as the merging parties do not know the case they have to meet.

132 The Commissioner argues that, although the anti-competitive effects in this case were not quantified, they could be inferred as a result of the Tribunal's finding that competition from the Babkirk site would have led to an average price decrease of at least 10 percent (Tribunal decision, at para. 297; R.F., at paras. 89-91). However, the 10 percent amount is not enough to calculate the deadweight loss as the Commissioner did not establish the price elasticity of demand. The proven facts demonstrated the size of the Contestable Area and the potential tonnes of waste per year. Without a calculation of the actual loss,

all that is known is that there was a certain amount of potential waste subject to the effect of the elasticity. In other words, the 10 percent calculation is not enough to determine the extent of any anti-competitive effect. As the Federal Court of Appeal noted:

> In this case, the Tribunal itself found that estimates of market elasticity [the change over the market as a whole] and the merged entity's own-price elasticity of demand [the degree to which demand is effected by a change in price by the merged entity] are necessary in order to calculate the "deadweight loss". The Tribunal also recognized that a range of plausible elasticities are required in order to understand the sensitivity of the Commissioner's estimates. Without those estimates, the "deadweight loss" could not be properly calculated by the Commissioner, and Tervita could not adequately challenge the calculations. [Emphasis deleted; para. 124.]

133 In his reply expert report, the Commissioner's expert did submit estimates of potential market expansion. However, these estimates were based on Tervita's expert's calculations of Tervita's claimed market expansion efficiencies, which were themselves based on unsupported assumptions. As Tervita's expert testified before the Tribunal, these calculations could not be used to calculate the deadweight loss in the absence of an adequate market demand elasticity study. In response to questioning from the Tribunal, Tervita's expert testified that it is not possible to calculate the deadweight loss without customer-specific elasticity or market elasticity numbers: "You need the shape of the demand curve to figure out dead weight loss" (testimony of Dr. Kahwaty, F.C.A. decision, at para. 125).

134 Without estimates of elasticity, the "deadweight loss" could not be properly calculated by the Commissioner, and Tervita could not adequately challenge the calculations (F.C.A. decision, at para. 124). Indeed, the proven facts serve to demonstrate that the anti-competitive effects might well have been estimated, but were not estimated due to the absence of the critical component of elasticity measure. An inference based on the 10 percent finding and the unknown potential elasticity is not a substitution for quantification.

135 The Commissioner submits in the alternative that the Tribunal did not breach procedural fairness in relying upon the rough estimate of the Commissioner's expert of the deadweight loss flowing from the 10 percent price reduction (R.F., at para. 107). I cannot agree. As the Federal Court of Appeal found, the Commissioner's failure to quantify the quantifiable anti-competitive effects combined with the Tribunal's decision to allow the Commissioner to discharge her burden through a reply expert report setting out the rough estimate resulted in prejudice to Tervita. Tervita was unable to adequately challenge the Commissioner's calculations due to the failure to quantify the anti-competitive effects and as a result of the insufficient time for Tervita to formally respond to the reply expert report (see F.C.A. decision, at paras. 121-30).

136 While the Commissioner has the burden to prove the anti-competitive effects, the merging parties bear the onus of proving the remaining elements of the defence. To allow for these kinds of procedural deficiencies would be to leave the merging parties in an untenable position where they are expected to prove that efficiencies are greater than and offset the anti-competitive effects, despite not knowing what those effects are. I cannot accept the Commissioner's arguments that there was no unfairness in this case because the calculation was "not complex" or because Tervita's expert had the opportunity to respond "briefly in direct examination", in cross-examination and on questioning from the Tribunal (R.F., at para. 108). The reply expert report was only made available to Tervita two weeks before the Tribunal's hearing (Tribunal decision, at para. 235). As the Tribunal noted: "By then, the Tribunal's Scheduling Order did not permit [Tervita] to bring a motion or file a further expert report. In addition ... there was insufficient time before the hearing to permit [Tervita] to move to strike [the Commissioner's expert] report or to seek leave to file a further report in response ..." (ibid.). The Tribunal found that the procedural deficiencies meant that Tervita could not prepare a proper response to the case presented by the Commissioner and that Tervita could not effectively challenge the Commissioner's evidence.

137 In this case, the Commissioner failed to meet her burden to quantify the quantifiable anti-competitive effects. As a result, the Tribunal should have assigned zero weight to the quantifiable anti-competitive effects.

138 Justice Karakatsanis would permit quantitative but unquantified effects to be considered with "undetermined" weight, on the argument that such information is nonetheless probative on the question of efficiency (para. 194). I cannot agree. As discussed above, there are sound reasons to require that the s. 96 analysis be as objective as possible. This argument concerns

evidence for which quantification is entirely possible, but has not been done. To consider such evidence is to conduct an analysis that is less objective than is possible with more complete estimation. The Tribunal should not sacrifice the objectivity of its analysis because a party has failed to conduct a complete quantitative estimate of the magnitude of an effect.

139 In this case, the absence of price elasticity information means that the possible range of deadweight loss resulting from the merger is unknown. All else being equal, high price elasticity would likely result in significant deadweight loss, while low price elasticity could result in minimal deadweight loss. To permit the Tribunal to consider the price decrease evidence without the rest of the information necessary to quantify deadweight loss admits far too much subjectivity into the analysis, with no guarantee that the Tribunal will have enough information to ensure that a subjective assessment would align with what would actually be observed if the effect were properly quantified. Holding parties to account for the quantification of the quantitative effects they wish to adduce by assigning zero weight to undetermined quantitative effects acts to ensure that the Tribunal will be presented with information on all of the parameters necessary to estimate the magnitude of quantitative effects. To do otherwise invites speculation into the analysis.

140 Justice Karakatsanis agrees that "[o]bviously, the Tribunal must apply the test in s. 96 to the evidence before it in a way that is fair to the parties" (para. 196), but she does not explain how the party opposed to such incomplete evidence may fairly determine the quantitative case they must meet, or challenge the methodological details related to the undetermined quantitative effects. These concerns reinforce the appropriateness of assigning "undetermined" quantitative effects a weight of zero in the s. 96 analysis.

(b) The Approach to the Section 96 Balancing

141 The Federal Court of Appeal found that the Tribunal erred in law in its s. 96 analysis by "accepting a defective 'deadweight' loss calculation, by using an overly subjective offset methodology, by treating as qualitative effects certain quantitative effects which the Commissioner had failed to quantify, and by referring to qualitative environmental effects that are not cognizable under the *Competition Act*" (para. 163). Rather than remitting the matter to the Tribunal for a new determination, the court, satisfied that there was a complete record on which to carry out a new determination, engaged in a fresh assessment of the offset analysis. The court found that the efficiencies defence did not apply for two primary reasons. First, "marginal and insignificant gains in efficiency cannot offset known anti-competitive effects even where the weight to be afforded to such effects is undetermined" (para. 174). Second, the present case was one of a pre-existing monopoly, which the Federal Court of Appeal held magnified the anti-competitive effects of the merger (para. 173).

(i) The Requirement That the Efficiency Gains Be "Greater Than" and "Offset" the Anti-competitive Effects

142 The Federal Court of Appeal held that the efficiency gains did not meet the "greater than" and "offset" requirement under s. 96. The gains were "marginal" (paras. 34, 169-71 and 174), "negligible" (para. 169) and "insignificant" (paras. 170 and 174) and therefore were not enough to outweigh the anti-competitive effects. In addition, the Tribunal found that "*even if a zero weighting is given to the quantifiable Effects*, as [Tervita] submitted should be done, [Tervita] has not satisfied the 'offset' element of section 96" (para. 314 (emphasis added; emphasis in original deleted)). Although I have determined that the anti-competitive effects should be assigned zero weight, I nonetheless consider the interpretation of the "greater than and offset" requirement due to the importance of this question in the overall s. 96 assessment.

143 The issue to be determined is whether the statutory standard of "greater than, and will offset" requires that the merging parties demonstrate that the efficiencies not only merely exceed the anti-competitive effects, but in addition offset them. As I understand it, the Commissioner's argument in this regard is that the statutory language mandates a threshold level of "more than marginal" efficiency gains in order for the efficiencies defence to succeed (transcript, at p. 60). With respect, I cannot agree.

144 The statutory requirement that the efficiency gains be "greater than" and "offset" the anti-competitive effects imports a weighing of both quantitative and qualitative aspects. The term "greater than" suggests a numerical comparison of the magnitude of the efficiencies versus the extent of the anti-competitive effects. The use of the term "offset" implies a subjective analysis related to the "balancing of incommensurables (e.g., apples and oranges)" (Tribunal decision, at para. 309) — considerations

that cannot be quantitatively compared because they have no common measure. The statutory use of the language of "offset" suggests that there is a more judgmental component to the analysis (see *Superior Propane II*, at para. 100). As indicated by the use of the term "*neutraliseront*" in the French version of s. 96, this requires a subjective assessment of whether the efficiency gains neutralize or counterbalance the anti-competitive effects.

145 Together, the terms "greater than" and "offset" mandate that the Tribunal determine both quantitative and qualitative aspects of the merger, and then weigh and balance these aspects. This approach is supported by the common understanding of the word "offset". *The Oxford English Dictionary* (2nd ed. 1989) defines the verb "offset" to mean "[t]o set off as an equivalent against something else ...; to balance by something on the other side or of contrary nature" (p. 738). Similarly, the *Merriam-Webster's Collegiate Dictionary* (11th ed. 2003) entry defines it to mean "to serve as a counterbalance for" (p. 862). This understanding supports the interpretation of the "offset" requirement in s. 96 as imposing a consideration of the qualitative aspects of the merger and a balancing of those qualitative aspects against the quantitative effects of the merger.

146 This is a flexible balancing approach, but the Tribunal's conclusions must be objectively reasonable. As the Federal Court of Appeal held, the overall analysis "must be as *objective* as is reasonably possible, and where an objective determination cannot be made, it must be *reasonable*" (para. 147 (emphasis in original)). As such, in most cases the qualitative effects will be of lesser importance. In addition, the statutory requirement that efficiencies be greater than *and* offset the anti-competitive effects would in most cases require a showing that the quantitative efficiencies exceed the quantitative anti-competitive effects as a necessary element of the defence.

147 In light of this recognition, the balancing test under s. 96 may be framed as a two-step inquiry. First, the quantitative efficiencies of the merger at issue should be compared against the quantitative anti-competitive effects (the "greater than" prong of the s. 96 inquiry). Where the quantitative anti-competitive effects outweigh the quantitative efficiencies, this step will in most cases be dispositive, and the defence will not apply. There may be unusual situations in which there are relatively few quantified efficiencies, yet where truly significant qualitative efficiencies would support the application of the defence. However, such cases would likely be rare in view of the emphasis of the analysis on objectivity and the impermissibility of asserting unquantified-but-quantifiable efficiencies as qualitative efficiencies. Qualitative considerations must next be weighed. Under the second step, the qualitative efficiencies should be balanced against the qualitative anti-competitive effects, and a final determination must be made as to whether the total efficiencies offset the total anti-competitive effects of the merger at issue (the "offset" prong of the inquiry). For the Tribunal to give qualitative elements weight in the analysis, they must be supported by the evidence, and the reasoning for the reliance on the qualitative aspects must be clearly articulated.

148 It should be noted that this two-step analysis does not seek to define the methodological details of how quantitative efficiencies and anti-competitive effects are to be identified and compared. Instead, the two-step analysis preserves the ability of the Tribunal to select the quantitative methodology to be employed, provided this quantitative comparison is conducted within step one of the framework described above.

149 Justice Karakatsanis raises concerns that this framework unnaturally separates quantitative and qualitative considerations, and that doing so is "superfluous" in light of the final offset determination which considers both quantitative and qualitative factors (para. 189). Instead, she would instruct the Tribunal to weigh whether the quantitative and qualitative efficiencies, taken as a whole, outweigh the quantitative and qualitative anti-competitive effects, taken as a whole. I would emphasize that the above framework does not require the Tribunal to isolate quantitative and qualitative considerations such that they are never compared. The ultimate offset analysis does allow for consideration of both quantitative and qualitative effects. However, I would think that the Tribunal, even proceeding under Justice Karakatsanis's proposed single-step weighing, would at some point in that consideration ask how the quantitative factors lined up relative to each other, and would also examine how the qualitative factors compared to each other, before attempting to reconcile the whole universe of factors into an ultimate determination. The above framework merely guides the structure of that inquiry to ensure that the Tribunal's reasoning is as explicit and transparent as possible.

150 Respectfully, the assertion in the dissenting reasons that "simply tallying up 'mathematical quantifications', while important, cannot provide a complete answer" (para. 190) misreads these reasons. They do not say that quantitative

considerations are in all cases a sufficient and "complete answer". Rather, they emphasize that the nature of economic efficiencies, the language of s. 96, and the Federal Court of Appeal's apt observation that the s. 96 analysis "must be as *objective* as is reasonably possible" support the notion that quantitative considerations will, in most cases, be of greater importance than qualitative considerations.

151 However, and despite the flexibility the Tribunal has in applying this balancing approach, I cannot accept that more than marginal efficiency gains are required for the defence to apply. Had Parliament intended for there to be a threshold level of efficiencies, qualifying language could have been used to express this intention. The Commissioner's argument essentially asks this Court to read into the statute a threshold significance requirement where the statute does not provide a basis for doing so. In addition, it is not clear to me when efficiency gains become more than marginal. Determining when proven efficiency gains meet a more than marginal threshold would require overly subjective analysis. Although there is some subjectivity in the ultimate weighing of the efficiency gains and anti-competitive effects, in a case such as this where the Commissioner has not established either quantitative or qualitative anti-competitive effects, the weight given to those effects is zero. Proven efficiency gains of any magnitude will therefore outweigh the anti-competitive effects. Moreover, and as discussed above, because of the importance of employing an objective approach, the qualitative effects will assume a lesser role in the analysis in most cases. As such, it is possible that, where proven quantitative efficiency gains exceed the proven quantitative anti-competitive effects to only a small degree, the Tribunal may still find that the s. 96 defence applies.

152 Nor does the statutory context of s. 96(1) indicate that it should be read to include a threshold significance requirement. While s. 96(2) prompts the Tribunal to consider whether the merger will generate "a significant increase in the real value of exports" or "a significant substitution of domestic products for imported products", this significance requirement should not be read back into s. 96(1). Given that the issue of significance was contemplated in s. 96(2), Parliament could just as easily have drafted s. 96(1) to require that efficiencies be "significantly greater than and offset" the anti-competitive effects. Instead, "significance" language appears only in s. 96(2), which is logically subservient to s. 96(1): by its terms, the text of s. 96(2) does not apply the significance threshold to the entire s. 96(1) analysis.

153 With respect, the Federal Court of Appeal's conclusion that marginal efficiency gains cannot meet the requirements for the s. 96 defence to apply does not take into account the fact that the analysis under s. 96 is a balancing exercise. Proven efficiency gains must be assessed relative to any proven anti-competitive effects. Efficiency gains of a smaller scale may not be "marginal" when compared to and weighed against anti-competitive effects of an even smaller degree.

154 Though it is necessary to re-emphasize that there is no requirement that efficiencies cross some formal "significance" threshold, this is not to ignore the truth that economic models are inherently probabilistic and will always carry some associated margin of uncertainty. Where the outcome of quantitative balancing under the first step of the s. 96 analysis shows positive but small net efficiencies relative to the uncertainty of the associated estimates, the Tribunal should be cognizant of this uncertainty in weighing the relevant considerations. This is not to suggest that quantitative efficiencies should be discounted in these situations, but merely to highlight that close cases will require careful consideration of the assumptions underlying the quantitative analysis. In such cases, the Tribunal retains the discretion to reject the efficiencies defence, but must clearly explain the reasons for its decision. The reasons must be seen to be rational even though they reject what the quantitative analysis would otherwise strictly indicate.

155 For these reasons, the Federal Court of Appeal erred in holding that an anti-competitive merger cannot be approved under s. 96 if only marginal or insignificant gains in efficiency result from that merger.

(ii) Pre-existing Monopoly

156 The Federal Court of Appeal held that the Tribunal erred in "taking into account the monopoly position of Tervita resulting from the merger without any evidence from the Commissioner of additional anti-competitive effects resulting from that monopoly" (para. 161), but concluded that a "pre-existing monopoly, such as is the case here, will usually magnify the anti-competitive effects of a merger" (para. 173). The Commissioner submits that the court did not rely on the presence of monopoly

as an effect *per se*, but rather simply concluded that this was a factor likely to *magnify* the merger's anti-competitive effect. There are two problems with this argument.

157 First, to accept that the existence of a monopoly was likely to magnify the anti-competitive effect requires accepting that there are proven anti-competitive effects. In this case, the Commissioner did not establish the impact of Tervita's superior market power and as a result of the Commissioner's failure to quantify the quantifiable anti-competitive effects, zero weight has been assigned to those effects. It is not possible to "magnify" a factor which has zero weight. This equation still results in zero.

158 Second, in my respectful view, the Federal Court of Appeal considered the existence of a monopoly *per se* as opposed to its effects. As the court held in *Superior Propane IV*:

> Monopoly, however it might be defined (e.g. 95 percent market share, 100 percent market share, high barriers to entry), is a description of a market condition, not the effect of that market condition. If monopoly is to be taken into account for purposes of subsection 96(1), it is the effects of the monopoly that must be considered, not the existence of the monopoly *per se*. [para. 49]

Here, where no effects have been proven, it is not possible to say that such effects have been magnified. Inevitably, that approach reverts to relying on the existence of a monopoly *per se*.

(iii) Application to This Case

159 In this case, the Commissioner did not meet her burden to prove the anti-competitive effects. As such, the weight given to the quantifiable effects is zero. The Tribunal did not accept any of Tervita's claimed qualitative efficiencies and Tervita does not challenge this on appeal. Tervita established "overhead" efficiency gains resulting from Babkirk obtaining access to Tervita's administrative and operating functions. These gains meet the "greater than" requirement in this case.

160 Turning to qualitative considerations, the Federal Court of Appeal rejected the qualitative effects accepted by the Tribunal — environmental effects with respect to the price reduction on-site clean-up. This issue is raised by the Commissioner as an alternative to rejecting the efficiencies defence on the basis of quantitative factors. As I have found that the court's rejection of the efficiencies defence was in error, I now turn to whether the evidence of environmental effects was cognizable for the purposes of s. 96.

(c) The Commissioner's Alternative Argument

161 The Commissioner argues that the Federal Court of Appeal erred in rejecting price reduction on potential customers' site clean-up and the resulting environmental benefits which the Tribunal had accepted as qualitative effects of the merger. In rejecting these effects, the court first questioned whether "the environmental effects of a merger, where no economic effect is ascribed to them, can be taken into account in a merger review under the *Competition Act*" (para. 155). The court then went on to hold that, nonetheless, the Tribunal had double-counted this effect as it had already addressed the 10 percent drop in tipping fees which would be brought about by competition and which would result in the disposal of additional tonnes of hazardous waste as part of the "deadweight loss" analysis. The court held that this effect should only have been considered once "as a quantitative anti-competitive effect that had not been appropriately quantified by the Commissioner" (para. 157).

162 The Commissioner's arguments centre on her position that the environmental impacts did have an economic effect. However, while the Federal Court of Appeal questioned whether non-economic environmental effects could be considered under the s. 96 analysis, the effects in this case had an economic aspect. The court ultimately rejected these effects on the basis that the environmental effects had been double-counted by the Tribunal.

163 I agree with the Commissioner that where environmental effects have economic dimensions, these effects may properly be considered under the s. 96 analysis. Indeed, I do not read the Federal Court of Appeal as saying otherwise. The issue raised by the Commissioner is whether the environmental effects put into evidence by the Commissioner did have an economic dimension. I agree that an effect such as a contingent liability on the books of a company which has to remediate a site is an economic

aspect of an environmental effect. However, while there was evidence before the Tribunal with respect to this kind of contingent liability, this evidence cannot be considered in this case.

164 First, there is no evidence as to whether the waste covered by the contingent liability in question fell within the Contestable Area. Second, there is no evidence as to the price elasticity of demand of the customer in question. Finally, and as the Federal Court of Appeal found, if this effect did fall within the Contestable Area, it was quantifiable and therefore should have been quantified by the Commissioner. As explained above, anti-competitive effects which are quantifiable will not be treated qualitatively as a result of a failure to quantify. Therefore, and although the environmental effects in this case had an economic dimension, the Tribunal erred in assessing these effects qualitatively.

(d) Conclusion on the Balancing Under Section 96

165 The Commissioner failed to meet her burden, resulting in the quantifiable anti-competitive effects being assigned a weight of zero. The Federal Court of Appeal properly rejected the environmental effects. There are therefore no proven qualitative anti-competitive effects. Tervita successfully proved quantifiable "overhead" efficiency gains resulting from Babkirk obtaining access to Tervita's administrative and operating functions. In this case, these proven gains met the "greater than and offset" requirement. As there were no quantifiable or qualitative anti-competitive effects proven by the Commissioner, the efficiencies defence applies, and the Federal Court of Appeal was incorrect to conclude otherwise.

166 It may seem paradoxical to hold that the Tribunal was correct in finding a likely substantial prevention of competition, only to then conduct the s. 96 balancing test and find zero anti-competitive effects. However, this result merely appears paradoxical in view of the particular facts of this case. Here, as discussed above, the Tribunal was able to consider evidence as to the effect on the market of the emergence of likely competitors, whether acceptable substitutes existed, and so on. Section 93 expressly permits the consideration of these factors in and of themselves. Ordinarily, the Commissioner would also use the evidence bearing on those factors to quantify the net effect of those factors on the economy in the form of deadweight loss. However, the statutory scheme does not bar a finding of likely substantial prevention where there has been a failure to quantify deadweight loss, and thus the Commissioner's failure to do so in this case was not fatal to the s. 92 determination. By contrast, the balancing test under s. 96 does require that quantifiable anti-competitive effects be quantified in order to be considered. As such, the failure to quantify deadweight loss in this case barred consideration, under s. 96, of the quantifiable effects that supported a finding of likely substantial prevention under s. 92. In circumstances where quantifiable effects were in fact quantified, a finding of likely substantial prevention under s. 92 would be accompanied by the consideration of quantified anti-competitive effects under the s. 96 analysis.

(6) Postscript

167 While the efficiencies defence applies in this case under the terms of s. 96 as written, this case does not appear to me to reflect the policy considerations that Parliament likely had in mind in creating an exception to the general ban on anti-competitive mergers. As discussed above at para. 84 in the historical examination of s. 96, the evidence suggests that the efficiencies defence was created in recognition of the size of Canada's domestic market and with an eye toward supporting operation at efficient levels of production and the realization of economies of scale, particularly with reference to international competition. By contrast, this case deals with competition on a local scale and where the operational efficiencies obtained do not appear to have been central to the acquiring party's ability to realize economies of scale to compete in the relevant market. Although I tend to think that this case may not represent one that Parliament had in mind in creating the efficiencies defence, I nonetheless find that the statute as currently drafted supports a finding that the defence is available in this case.

VII. Conclusion

168 I would allow the appeal. I would set aside the divestiture order of the Tribunal and dismiss the Commissioner's s. 92 application. The appellants are entitled to costs in this Court and in the Federal Court of Appeal.

***Abella J.*:**

169 In *Pezim v. British Columbia (Superintendent of Brokers)*, [1994] 2 S.C.R. 557S.C.C., which predates New Brunswick (Board of Management) v. Dunsmuir[2008] 1 S.C.R. 190(S.C.C.), the Court deferred to the British Columbia Securities Commission's specialized expertise in the interpretation of provisions of the Securities Act, S.B.C. 1985, c. 83, and applied a reasonableness standard despite the presence of a right of appeal and the absence of a privative clause. In other words, the specialized nature of the tribunal was seen to be more determinative of the legislature's true intent to make the tribunal master of its mandate. More recently, notwithstanding the same right of appeal in *British Columbia (Securities Commission) v. McLean*, [2013] 3 S.C.R. 895(S.C.C.), this Court once again applied a reasonableness standard based on the British Columbia Securities Commission's specialized expertise: see Securities Act, R.S.B.C. 1996, c. 418, s. 167.

170 The cornerstone laid in *Pezim* introduced a new edifice for the review of specialized tribunals. Through cases like *McLean*, *Alliance Pipeline Ltd. v. Smith*, [2011] 1 S.C.R. 160 (S.C.C.), and *A.T.A. v. Alberta (Information & Privacy Commissioner)*, [2011] 3 S.C.R. 654 (S.C.C.), judges and lawyers engaging in judicial review proceedings came to believe, rightly and reasonably, that the jurisprudence of this Court had developed into a presumption that regardless of the presence or absence of either a right of appeal or a privative clause — that is notwithstanding legislative wording — when a tribunal is interpreting its home statute, reasonableness applies. I am at a loss to see why we would chip away — again [2] — at this precedential certainty. It seems to me that what we should be doing instead is confirming, not undermining, the reasonableness presumption and our jurisprudence that statutory language alone is not determinative of the applicable standard of review.

171 That is why, with respect, although I otherwise agree with the reasons of the majority, I think the applicable standard is reasonableness, not correctness. I am aware that it is increasingly difficult to discern the demarcations between a reasonableness and correctness analysis, but until those lines are completely erased, I think it is worth protecting the existing principles as much as possible. To apply correctness in this case represents a reversion to the pre-*Pezim* era. Creating yet another exception by relying on the statutory language in this case which sets out a right of appeal, undermines the expertise the statute recognizes. This new exception is also, in my respectful view, an inexplicable variation from our jurisprudence that is certain to engender the very "standard of review" confusion that inspired this Court to try to weave the strands together in the first place.

172 The building blocks in our jurisprudence were carefully constructed. Binnie J. explained in *Khosa v. Canada (Minister of Citizenship & Immigration)*, [2009] 1 S.C.R. 339 (S.C.C.), at para. 25, that

> *Dunsmuir* recognized that *with or without a privative clause*, a measure of deference has come to be accepted as appropriate where a particular decision had been allocated to an administrative decision-maker rather than to the courts. This deference extended not only to facts and policy but to a tribunal's interpretation of its constitutive statute and related enactments because "there might be multiple valid interpretations of a statutory provision or answers to a legal dispute and that courts ought not to interfere where the tribunal's decision is rationally supported" (*Dunsmuir*, at para. 41). A policy of deference "recognizes the reality that, in many instances, those working day to day in the implementation of frequently complex administrative schemes have or will develop a considerable degree of expertise or field sensitivity to the imperatives and nuances of the legislative regime" (*Dunsmuir*, at para. 49, quoting Professor David J. Mullan, "Establishing the Standard of Review: The Struggle for Complexity?" (2004), 17 *C.J.A.L.P.* 59, at p. 93). Moreover, "[d]eference may also be warranted where an administrative tribunal has developed particular expertise in the application of a general common law or civil law rule in relation to a specific statutory context" (*Dunsmuir*, at para. 54).
>
> [Emphasis added.]

173 This was further explained in *Alberta Teachers' Association* in its first paragraph: "Through the creation of administrative tribunals, legislatures confer decision-making authority on certain matters to decision makers who are assumed to have specialized expertise with the assigned subject matter. Courts owe deference to administrative decisions within the area of decision-making authority conferred to such tribunals."

174 In *Smith*, this Court applied a reasonableness standard of review to an arbitration committee's interpretation of its home statute, even though that statute provided that decisions of the arbitration committee on questions of law or jurisdiction *could be*

appealed to the Federal Court (para. 40; see National Energy Board Act, R.S.C. 1985, c. N-7, s. 101). And, as previously noted, in *McLean* the Court held that a reasonableness standard applied to the British Columbia Securities Commission's interpretation of its home statute despite the fact that the statute contained a statutory right of appeal with leave to the British Columbia Court of Appeal: paras. 23-24; Securities Act, s. 167.

175 In *Canada (Attorney General) v. Mowat*, [2011] 3 S.C.R. 471 (S.C.C.), the Court recognized that the fact that little deference had traditionally been extended to human rights tribunals in respect of their decisions on legal questions, was in tension with the deferential approach to judicial review espoused in *Dunsmuir*. The Court ultimately held that because the question of costs was located within the Canadian Human Rights Tribunal's core function and expertise relating to its interpretation and application of its enabling statute, a reasonableness standard of review applied. As LeBel and Cromwell JJ. noted, "[i]n the context of judicial review, deference can shield administrative decision makers from excessive judicial intervention even on certain questions of law as long as these questions are located within the decision makers' core function and expertise": para. 30.

176 The presumption of reasonableness to an administrative decision maker's interpretation of its home statute or closely related legislation, even on questions of law, is therefore well established in this Court's jurisprudence: see also *Canadian National Railway Co. v. Canada (Attorney General)*, [2014] 2 S.C.R. 135, *Agraira v. Canada (Minister of Public Safety and Emergency Preparedness)*, [2013] 2 S.C.R. 559 (S.C.C.); *M.A.H.C.P. v. Nor-Man Regional Health Authority Inc.*, [2011] 3 S.C.R. 616 (S.C.C.); *Celgene Corp. v. Canada (Attorney General)*, [2011] 1 S.C.R. 3 (S.C.C.); *Kerry (Canada) Inc. v. Ontario (Superintendent of Financial Services)*, [2009] 2 S.C.R. 678 (S.C.C.).

177 It is true that this Court has recognized that certain categories of questions warrant a correctness review. Rothstein J. set them out in *Alberta Teachers' Association*, at para. 30:

> There is authority that "[d]eference will usually result where a tribunal is interpreting its own statute or statutes closely connected to its function, with which it will have particular familiarity" (*Dunsmuir*, at para. 54; *Smith v. Alliance Pipeline Ltd.*, 2011 SCC 7, [2011] 1 S.C.R. 160, at para. 28, *per* Fish J.). This principle applies unless the interpretation of the home statute falls into one of the categories of questions to which the correctness standard continues to apply, i.e., "constitutional questions, questions of law that are of central importance to the legal system as a whole and that are outside the adjudicator's expertise, ... '[q]uestions regarding the jurisdictional lines between two or more competing specialized tribunals' [and] true questions of jurisdiction or *vires*" (*Canada (Canadian Human Rights Commission) v. Canada (Attorney General)*, 2011 SCC 53, [2011] 3 S.C.R. 471, at para. 18, *per* LeBel and Cromwell JJ., citing *Dunsmuir*, at paras. 58, 60-61).

178 Notably, a statutory right of appeal is not one of them.

179 While the statutory language granting the right of appeal in this case may be different from the language in *Pezim*, *McLean* and *Smith*, it is not sufficiently different to undermine the established principle of deference to tribunal expertise in the interpretation of the tribunal's own statute. Using such language to trump the deference owed to tribunal expertise, elevates the factor of statutory language to a pre-eminent and determinative status we have long denied it. I see nothing, in other words, that warrants departing from what the legal profession has come to see as our governing template for reviewing the decisions of specialized expert tribunals on a reasonableness standard, most recently on muscular display in Creston Moly Corp. v. Sattva Capital Corp. [2014 CarswellBC 2267S.C.C.] [2014] 2 S.C.R. 633.

180 In this case, applying that template leads to the conclusion that the Competition Tribunal's interpretation of s. 96 of the Competition Act, R.S.C. 1985, c. C-34, was unreasonable. I would allow the appeal.

Karakatsanis J. **(dissenting):**

181 I agree with the reasons of my colleague Justice Rothstein as they concern the proper analytical approach to s. 92(1) of the Competition Act, R.S.C. 1985, c. C-34. I further agree with his conclusion that it was open to the Competition Tribunal to find that the merger in this case was likely to substantially prevent competition contrary to s. 92(1).

182 However, I cannot agree with my colleague's approach to the s. 96 efficiencies defence and his conclusion that Tervita was entitled to the benefit of that defence in this case. I would affirm the decision and the analysis of the Federal Court of Appeal, 2013 FCA 28, 446 N.R. 261 (F.C.A.), in that regard.

183 The efficiencies defence set out in s. 96(1) of the Competition Act requires the Tribunal to balance the efficiencies of the merger against its anti-competitive effects:

> **96.** (1) The Tribunal shall not make an order under section 92 if it finds that the merger or proposed merger in respect of which the application is made has brought about or is likely to bring about gains in efficiency that will be greater than, and will offset, the effects of any prevention or lessening of competition that will result or is likely to result from the merger or proposed merger and that the gains in efficiency would not likely be attained if the order were made.

184 The Federal Court of Appeal and Justice Rothstein concluded, rightly in my view, that the statutory requirement that efficiency gains be "greater than" and "offset" the anti-competitive effects imports a weighing of quantitative and qualitative aspects. The Tribunal has the discretion to decide what methodology to apply on a case-by-case basis, so long as the various objectives of the Act are taken into account. Section 96 provides for flexible trade-off analysis, in order to meet the various objectives of the Act. Efficiencies and effects should be quantified wherever reasonably possible; rough estimates should be provided where precise quantification is not possible; and the assessment of qualitative effects should be objectively reasonable, supported by evidence and clear reasoning. (See Rothstein J.'s reasons, at paras. 144-45 and 148; F.C.A. reasons, at paras. 146 and 148.)

185 However, I do not agree that the need for "reasonable objectivity" justifies Justice Rothstein's hierarchical approach to quantitative and qualitative aspects under the efficiencies defence. Nor do I accept his assessment that "qualitative effects will be of lesser importance" (para. 146; see also paras. 147-48). I see no value in prioritizing quantitative over qualitative efficiencies. Both are relevant to the statutory test, and their significance depends on the circumstances of the case.

186 The statutory language makes no such distinction. Moreover, many of the purposes set out in s. 1.1 of the Act may not be quantifiable. These purposes include not only providing consumers with competitive prices and products, but also promoting adaptability of the Canadian economy, expanding opportunities for Canadian businesses abroad, recognizing the value of foreign competition in Canada, and ensuring that businesses of all sizes are able to participate fully in the Canadian economy.

187 These wide-ranging purposes illustrate that important anti-competitive effects of a merger may be qualitative in nature. In some cases, such qualitative effects may be determinative in the s. 96 analysis. Thus, the flexible analytical approach mandated by this provision reflects the wide range of objectives the Act serves. Where the legislation mandates such a purposive analysis, the relative significance of qualitative and quantitative gains or effects can only be determined in the circumstances of each case. It is neither helpful nor necessary to predetermine their relative role and importance in the s. 96 defence.

188 Justice Rothstein, however, frames the balancing test in s. 96 as a two-step inquiry. First, he says, the quantitative efficiencies of the merger at issue should be compared against the quantitative anti-competitive effects (the "greater than" prong of the s. 96 inquiry). Second, qualitative efficiencies should be balanced against the qualitative anti-competitive effects, and a final determination must be made as to whether the total efficiencies offset the total anti-competitive effects of the merger at issue (the "offset" prong of the inquiry) (paras. 147-48).

189 I do not read s. 96 as mandating a two-step framework that separates quantitative and qualitative efficiencies and anti-competitive effects. Such an approach is unnecessarily artificial and not required by the statutory language or context. Presumably Justice Rothstein's "final determination" assesses whether the (quantitative and qualitative) gains in efficiencies will be *greater than*, and will *offset*, the (quantitative and qualitative) anti-competitive effects of the merger. This is precisely what is required by the language of s. 96. The first two steps are superfluous. In any event, the expert Tribunal is best positioned to identify instances where like factors should be compared, as well as circumstances where this would not be as effective.

190 The Federal Court of Appeal agreed with the Tribunal's articulation of this aspect of the efficiencies defence test. Writing for the court, Mainville J.A. found that "the offset called for under section 96 ... requires the Tribunal to balance both quantitative and non-quantitative (*i.e.* qualitative) gains in efficiency against both the quantitative and non-quantitative (*i.e.* qualitative) effects of any prevention or lessening of competition" flowing from the merger (para. 146). In the court's view, the analysis is at heart about balancing overall efficiency gains against overall anti-competitive effects, and simply tallying up "mathematical quantifications", while important, cannot provide a complete answer (*ibid.*). Of course, quantification is very important in order to ensure, whenever possible, that proper weight is attributed to any given efficiency or anti-competitive effect.

191 The Federal Court of Appeal's approach to the s. 96 analysis provides an appropriate level of flexibility, given that efficiencies and anti-competitive effects will not always be easy to measure. For instance, there may be circumstances where a given quantitative factor is closely linked to a qualitative factor. The s. 96 framework enables the expert Tribunal to holistically assess the entirety of the evidence before it, rather than artificially bifurcating the analysis of qualitative and quantitative effects that may, in some cases, more helpfully be analyzed together. Such a test allows the Tribunal to reach an objective and reasonable determination regarding the s. 96 defence by minimizing subjective considerations, but without limiting itself to solely mathematical considerations. This approach provides more flexibility to achieve the purposes of the Act.

192 Further, I disagree with my colleague that the Tribunal (and in this case the Federal Court of Appeal) is precluded from considering any evidence of a quantifiable anti-competitive effect because the Commissioner of Competition failed to fully quantify it. I agree with the Federal Court of Appeal that while the Commissioner should quantify when possible, the failure to do so does not invalidate the evidence that established there was a known anti-competitive effect of undetermined extent.

193 The Commissioner bears the onus to prove "that a merger or proposed merger prevents or lessens, or is likely to prevent or lessen, competition substantially" under s. 92. She met that onus in this case. Section 96 is a defence. It is the appellants who must demonstrate on a balance of probabilities that the gains in efficiency offset the anti-competitive effects in order for the s. 96 defence to apply. The Commissioner bears the evidentiary burden to lead evidence of the anti-competitive effects of a merger, and bears the risk that the failure to fully quantify such effects where possible may render the evidence insufficient to counter the evidence of efficiency gains.

194 However, where the expert evidence does not fully provide a quantification of the anti-competitive effects, I do not agree with my colleague that the evidence has no probative value whatsoever and must be ignored. Relevant evidence is generally admissible, and the failure to lead the best evidence available goes to weight, not admissibility. Clearly, the evidence will have less probative value without an estimate or quantification. No doubt it would be more difficult for an undetermined anti-competitive effect to outweigh any significant efficiency gains. However, it does not become irrelevant or inadmissible. The statutory language does not require such a result. Nor does the purpose or context of the legislation.

195 Although Justice Rothstein recognizes that this exclusionary rule may lead to a "paradoxical" result in this case, he justifies his restrictive approach on the basis that it promotes objective assessment and discourages subjectivity and speculation (paras. 151 and 166). In my view, such an approach unduly limits the ability of the Tribunal to fulfill its statutory mandate. Section 96 gives the Tribunal the flexibility to meet all the purposes of the Act, including the primary purpose "to maintain and encourage competition in Canada" (s. 1.1). The balancing exercise under s. 96 necessarily requires the Tribunal to use its expert assessment and judgment. It must also provide explicit and transparent reasons for its conclusions.

196 Obviously, the Tribunal must apply the test in s. 96 to the evidence before it in a way that is fair to the parties. Expert decision makers routinely assess evidence that is not the best evidence available, and they are attuned to when the particular circumstances of the case could result in procedural unfairness.

197 Here, the Federal Court of Appeal determined that there was some value to the Tribunal's finding that prices would have been 10 percent lower in the Contestable Area in the absence of a merger. While the evidence did not permit a calculation of the deadweight loss in the absence of estimates of market elasticity and the merged entity's own price elasticity of demand,

in my view the court was entitled to conclude that this amounted to evidence of a known anti-competitive effect, although its extent was undetermined.

198 Since it was open to the Federal Court of Appeal to consider the anti-competitive effects in its analysis, it follows that the court was also in a position to accept that Tervita's pre-existing monopoly was likely to magnify the anti-competitive effects of the merger (F.C.A. reasons, at para. 173). Ultimately, the court was entitled to find that the proven efficiency gains were "marginal to the point of being negligible" and did not likely exceed the known (but undetermined) anti-competitive effects (para. 169).

199 As noted above, the overall analysis under s. 96 must be as objective and reasonable as possible. Effects that can be quantified should be quantified. However, within this framework, negligible gains in efficiency will not necessarily outweigh and offset known anti-competitive effects, even if they are assigned an "undetermined" weight. This approach is in keeping with past jurisprudence of the Tribunal: *Canada (Commissioner of Competition) v. Superior Propane Inc.* (2002), 18 C.P.R. (4th) 417 (Competition Trib.), at paras. 171-72. Such an approach also accurately reflects the primary purpose of the Act, which is "to maintain and encourage competition in Canada" (s. 1.1).

200 The Federal Court of Appeal was accordingly entitled to conclude that the s. 96 efficiencies defence was not available. I would dismiss the appeal, and award costs to the respondent.

Appeal allowed.

Pourvoi accueilli.

Appendix

Competition Act, R.S.C. 1985, c. C-34

1.1 The purpose of this Act is to maintain and encourage competition in Canada in order to promote the efficiency and adaptability of the Canadian economy, in order to expand opportunities for Canadian participation in world markets while at the same time recognizing the role of foreign competition in Canada, in order to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the Canadian economy and in order to provide consumers with competitive prices and product choices.

79. (1) Where, on application by the Commissioner, the Tribunal finds that

(a) one or more persons substantially or completely control, throughout Canada or any area thereof, a class or species of business,

(b) that person or those persons have engaged in or are engaging in a practice of anti-competitive acts, and

(c) the practice has had, is having or is likely to have the effect of preventing or lessening competition substantially in a market,

the Tribunal may make an order prohibiting all or any of those persons from engaging in that practice.

. . . . .

92. (1) Where, on application by the Commissioner, the Tribunal finds that a merger or proposed merger prevents or lessens, or is likely to prevent or lessen, competition substantially

(a) in a trade, industry or profession,

(b) among the sources from which a trade, industry or profession obtains a product,

(c) among the outlets through which a trade, industry or profession disposes of a product, or

(d) otherwise than as described in paragraphs (*a*) to (*c*),

the Tribunal may, subject to sections 94 to 96,

(e) in the case of a completed merger, order any party to the merger or any other person

(i) to dissolve the merger in such manner as the Tribunal directs,

(ii) to dispose of assets or shares designated by the Tribunal in such manner as the Tribunal directs, or

(iii) in addition to or in lieu of the action referred to in subparagraph (i) or (ii), with the consent of the person against whom the order is directed and the Commissioner, to take any other action, or

(f) in the case of a proposed merger, make an order directed against any party to the proposed merger or any other person

(i) ordering the person against whom the order is directed not to proceed with the merger,

(ii) ordering the person against whom the order is directed not to proceed with a part of the merger, or

(iii) in addition to or in lieu of the order referred to in subparagraph (ii), either or both

(A) prohibiting the person against whom the order is directed, should the merger or part thereof be completed, from doing any act or thing the prohibition of which the Tribunal determines to be necessary to ensure that the merger or part thereof does not prevent or lessen competition substantially, or

(B) with the consent of the person against whom the order is directed and the Commissioner, ordering the person to take any other action.

(2) For the purpose of this section, the Tribunal shall not find that a merger or proposed merger prevents or lessens, or is likely to prevent or lessen, competition substantially solely on the basis of evidence of concentration or market share.

93. In determining, for the purpose of section 92, whether or not a merger or proposed merger prevents or lessens, or is likely to prevent or lessen, competition substantially, the Tribunal may have regard to the following factors:

(a) the extent to which foreign products or foreign competitors provide or are likely to provide effective competition to the businesses of the parties to the merger or proposed merger;

(b) whether the business, or a part of the business, of a party to the merger or proposed merger has failed or is likely to fail;

(c) the extent to which acceptable substitutes for products supplied by the parties to the merger or proposed merger are or are likely to be available;

(d) any barriers to entry into a market, including

(i) tariff and non-tariff barriers to international trade,

(ii) interprovincial barriers to trade, and

(iii) regulatory control over entry,

and any effect of the merger or proposed merger on such barriers;

(e) the extent to which effective competition remains or would remain in a market that is or would be affected by the merger or proposed merger;

(f) any likelihood that the merger or proposed merger will or would result in the removal of a vigorous and effective competitor;

(g) the nature and extent of change and innovation in a relevant market; and

(h) any other factor that is relevant to competition in a market that is or would be affected by the merger or proposed merger.

96. (1) The Tribunal shall not make an order under section 92 if it finds that the merger or proposed merger in respect of which the application is made has brought about or is likely to bring about gains in efficiency that will be greater than, and will offset, the effects of any prevention or lessening of competition that will result or is likely to result from the merger or proposed merger and that the gains in efficiency would not likely be attained if the order were made.

(2) In considering whether a merger or proposed merger is likely to bring about gains in efficiency described in subsection (1), the Tribunal shall consider whether such gains will result in

(a) a significant increase in the real value of exports; or

(b) a significant substitution of domestic products for imported products.

(3) For the purposes of this section, the Tribunal shall not find that a merger or proposed merger has brought about or is likely to bring about gains in efficiency by reason only of a redistribution of income between two or more persons.

Footnotes

1 Crampton C.J. is a judicial member of the Competition Tribunal as well as the Chief Justice of the Federal Court.

2 See *Public Performance of Musical Works, Re*, [2012] 2 S.C.R. 283 (S.C.C.).

2012 Trib. conc. 14, 2012 Comp. Trib. 14
Competition Tribunal

Commissioner of Competition v. CCS Corp.

2012 CarswellNat 4409, 2012 CarswellNat 9015, 2012 Trib. conc. 14, 2012 Comp. Trib. 14, [2012] C.C.T.D. No. 14

In the Matter of the Competition Act, R.S.C. 1985, c. C-34, as amended

In the Matter of an Application by the Commissioner of Competition
for an Order pursuant to section 92 of the Competition Act

In the Matter of the acquisition by CCS Corporation of Complete Environmental Inc.

The Commissioner of Competition, (applicant) and CCS Corporation, Complete Environmental Inc., Babkirk Land Services Inc., Karen Louise Baker, Ronald John Baker, Kenneth Scott Watson, Randy John Wolsey, and Thomas Craig Wolsey, (respondents)

Sandra J. Simpson Chair, Paul Crampton Member, Wiktor Askanas Member

Heard: November 16, 2011; November 17, 2011; November 18, 2011; November 22, 2011; November 23, 2011; November 24, 2011; November 25, 2011; November 29, 2011; December 2, 2011; December 13, 2011; December 14, 2011
Judgment: May 29, 2012
Docket: CT-2011-002

Counsel: Nikiforos Iatrou, Jonathan Hood, for Applicant, Commissioner of Competition
Linda Plumpton, Crawford Smith, Dany Assaf, Justin Necpal, for Respondents, CCS Corporation, Complete Environmental Inc. and Babkirk Land Services Inc.
J. Kevin Wright, Morgan Burris, Brent Meckling, for Respondents, Karen Louise Baker, Ronald John Baker, Kenneth Scott Watson, Randy John Wolsey, and Thomas Craig Wolsey

***Paul Crampton Member*:**

A. Executive Summary

1 The Tribunal has decided on a balance of probabilities that the Merger is likely to prevent competition substantially in the market for the supply of secure landfill services for solid hazardous waste from oil and gas producers in a geographic market which, at a minimum, is the area identified by CCS' expert, Dr. Kahwaty, as the "Potentially Contestable Area".

2 The Tribunal has concluded that CCS is a monopolist in the geographic market and that it exercises significant market power which is being maintained as a result of the Merger.

3 Although Dr. Baye, the Commissioner's expert, suggested a wide range of likely price decreases in the absence of the Merger, the Tribunal has found that a decrease in average tipping fees of at least 10% was prevented by the Merger.

4 There is significant time and uncertainty associated with entry. The Tribunal has concluded that effective entry would likely take a minimum of 30 months from site selection to the completed construction and operation of a secure landfill in the relevant market.

5 The Tribunal has also decided that, in the absence of the Merger, the Vendors would likely not have sold the Babkirk Facility in the summer of 2010 but would have operated it themselves and would have constructed a new secure landfill with

a capacity of 125,000 tonnes by October of 2011. This landfill would likely have operated as a complement to the Vendors' bioremediation business until no later than October 2012.

6 The Tribunal has also concluded that the Vendors' bioremediation business would likely have been unprofitable and that by October 2012, the Vendors would likely have changed their business plan to significantly focus on the secure landfill part of their business or would have sold the Babkirk Facility to a secure landfill operator. In either case, no later than the spring of 2013, the Babkirk Facility would have operated in meaningful competition with CCS' Silverberry secure landfill. It is the prevention of this competition by the Merger which constitutes a likely substantial prevention of competition.

7 The efficiencies claimed by CCS do not meet the requirements of section 96 of the Act.

8 Divestiture is an effective remedy and is the least intrusive option.

9 The application has been allowed. The Tribunal has ordered CCS to divest the shares or assets of BLS.

10 In dealing with the facts of this case, the Tribunal's conclusions were all based on an analysis of whether the events at issue were likely to occur.

B. Introduction

11 The Commissioner of Competition (the "Commissioner") has applied for an order under section 92 of the *Competition Act*, R.S.C. 1985, c. C-34, as amended (the "Act"), dissolving a transaction in which CCS Corporation ("CCS") acquired the shares of Complete Environmental Inc. ("Complete") and ownership of its wholly-owned subsidiary Babkirk Land Services Inc. ("BLS") on January 7, 2011 (the "Merger"). In the alternative, the Commissioner requests a divestiture order requiring CCS to dispose of the shares or assets of BLS in a manner to be directed by the Tribunal.

12 In her application (the "Application"), the Commissioner alleges that the Merger is likely to prevent competition substantially in the market for hazardous waste disposal services in North-Eastern British Columbia ("NEBC") because, at the date of the Merger, Complete was a poised entrant by reason of having obtained the regulatory approvals needed to operate a secure landfill for hazardous solid waste on a site at Mile 115, Alaska Highway, Wonowon, B.C. (the "Babkirk Site").

13 Pending the Tribunal's decision on this application, CCS undertook to maintain all approvals, registrations, consents, licenses, permits, certificates and other authorizations necessary for the operation of a hazardous waste disposal facility (the "Babkirk Facility" or "Babkirk") on the Babkirk Site. Complete's other assets and businesses were not subject to this undertaking.

C. The Parties

14 The Commissioner is the public official who is responsible for the enforcement of the Act.

15 CCS is a private energy and environmental waste management company. Its customers are mainly oil and gas producers in Western Canada. CCS owns the only two operating secure landfills in NEBC that are permitted to accept solid hazardous waste. One is the Silverberry secure landfill ("Silverberry"). It opened in 2002. It is located approximately 50 km north-west of Fort St. John. The other is called Northern Rockies secure landfill ("Northern Rockies"). It opened in 2009 and is situated about 340 km northwest of Silverberry, about 260 km from the Babkirk Site and approximately 20 km south of Ft. Nelson. CCS also operates a variety of different types of secure landfills in Alberta and Saskatchewan and owns a separate waste management business called Hazco Waste Management ("Hazco"). Schedule "A" hereto is a map showing the locations of the landfills which are relevant to this Application.

16 BLS was founded in 1996 by Murray and Kathy Babkirk (the "Babkirks"). BLS operated a facility which was not a secure landfill. It had a permit for the treatment and short-term storage of hazardous waste on the 150 acre (approx.) Babkirk Site. It is located approximately 81 km or 1 $^1/_2$ hours by car, northwest of Silverberry. The Babkirks operated their facility for approximately six years under a permit from the British Columbia Ministry of the Environment ("MOE") which was issued

in 1998. However, in 2004, they stopped accepting waste. Two years later, the Babkirks retained SNC Lavalin ("SNCL") to prepare the documents BLS needed to apply for permits for the construction of a secure landfill capable of accepting solid, hazardous waste at the Babkirk Site.

17 The individual Respondents are the former shareholders of Complete who sold their shares to CCS in the Merger. Karen and Ron Baker are married and Ken Watson is their son-in-law. Tom Wolsey is Randy Wolsey's father. The former shareholders will be referred collectively as the "Vendors". All the Vendors, except Tom Wolsey, gave evidence in this proceeding.

18 In November of 2006, Randy Wolsey, acting on his own behalf and on behalf of other individual Respondents, negotiated a "handshake agreement" with the Babkirks to purchase the shares of BLS. The deal was conditional on BLS obtaining approval for the secure landfill from the Environmental Assessment Office ("EAO"). In April 2007, the Vendors incorporated Complete (initially called Newco) to be the company that would eventually purchase the shares of BLS. After an extensive process of consultation and review, the EAO issued a certificate (the "EA Certificate") to BLS on December 3, 2008. Four months later, in April 2009, Complete acquired all the outstanding shares of BLS and it became a wholly-owned subsidiary of Complete. Thereafter, on February 26, 2010, BLS received a permit from the MOE authorizing the construction of a secure landfill, with a maximum storage capacity of 750,000 tonnes, and a storage and treatment facility with a maximum capacity of 90,000 tonnes (the "MOE Permit").

19 At the time of the Merger, Complete had other business interests. It operated municipal solid waste landfills for the Peace River Regional District as well as a solid waste transfer station. In addition, it owned a roll-off container rental business (the "Roll-off Bin Business"). Since the Merger, those businesses have been operated by Hazco.

20 CCS, Complete and BLS will be described collectively as the "Corporate Respondents".

D. The Parties' Positions

The Commissioner

21 The Commissioner alleges that because CCS owns the only two operational secure landfills for solid hazardous waste in NEBC, it has a monopoly and associated market power which allows it to price discriminate between different customers and set the prices for hazardous waste disposal above a competitive level. These prices are known as "Tipping Fees".

22 The Commissioner alleges that Complete was ready to enter the market for secure landfill services in NEBC and that it was likely that competition between Complete and CCS would have caused a decline in average Tipping Fees in NEBC of at least 10%. Alternatively, the Commissioner alleges that the Vendors would have sold Complete to a purchaser which would have operated a secure landfill in competition with CCS. Finally, the Commissioner maintains that any efficiencies associated with the Merger are likely to be *de minimis*.

The Respondents

23 The Vendors submit that their sale of Complete was not a Merger under the Act because there was no business in operation at the Babkirk Site. They also deny (i) that Complete was poised to enter the market for the direct disposal of hazardous waste into a secure landfill and (ii) that, in the absence of the Merger, an alternative buyer would have purchased Complete and operated a secure landfill. The Respondents maintain that if the Vendors had not sold Complete to CCS, they would likely have processed hazardous waste at the Babkirk Facility using a treatment technique called bioremediation. This type of treatment would have been complemented by a half cell (125,000 tonnes) of secure landfill. The secure landfill would only have been used to store the small amount of hazardous waste that could not be successfully treated, and would not have been used to engage in meaningful competition with CCS in respect of the supply of secure landfill services.

24 The Corporate Respondents challenge both the Commissioner's interpretation of CCS' pricing behaviour and her prediction of the anti-competitive effects she has alleged would likely result from the Merger. Among other things, they allege that the Commissioner's approach to market definition is fundamentally flawed and that the area in which there is scope for competition

between the Babkirk and Silverberry facilities is, at best, limited to the very small "Potentially Contestable Area" identified by CCS' expert, Dr. Kahwaty (the "Contestable Area").

25 The Corporate Respondents also submit that the efficiencies resulting from the Merger are likely to be greater than, and will offset, the effects of any prevention of competition brought about by the Merger. They further argue that the Commissioner failed to meet her burden of quantifying the deadweight loss as part of her case in chief. As a result, they say that the Tribunal should conclude that the Merger is not likely to result in any quantifiable effects.

26 Finally, all the Respondents submit that if there is to be remedy, it should be divestiture, rather than dissolution.

E. The Evidence

27 Attached as Schedule "B" is a list of the witnesses who testified for each party and a description of the documentary evidence.

F. Industry Background

28 The management of solid hazardous waste generated by oil and gas operators is regulated in British Columbia by the *Environmental Management Act*, SBC 2003, c 53 (the "EMA") and regulations. If the waste produced meets the definition of "hazardous waste" found in the *Hazardous Waste Regulation*, (B.C. Reg. 63/88) (the "HW Regulation"), oil and gas operators wishing to dispose of hazardous waste must do so within the confines of the legislative framework. The MOE is responsible for administering the EMA and HW Regulation. Hereinafter, hazardous waste as defined in the HW Regulation which is solid will be described as "Hazardous Waste".

29 Under the HW Regulation, a person must receive a permit from the MOE to operate a facility called a secure landfill that can accept Hazardous Waste for disposal. A "secure landfill" is defined in the HW Regulation as a disposal facility where Hazardous Waste is placed in or on land that is designed, constructed and operated to prevent any pollution from being caused by the facility outside of the area of the facility ("Secure Landfill").

Disposal at Secure Landfills

30 Oil and gas drilling operators (also called waste generators) produce two major types of Hazardous Waste that can be disposed of at a Secure Landfill: contaminated soil and drill cuttings. The contaminants are typically hydrocarbons, salts, and metals.

31 Hydrocarbons are categorized as light-end hydrocarbons and heavy-end hydrocarbons. The evidence shows that Hazardous Waste often includes hydrocarbons of both types.

32 Oil and gas generators can contaminate soil with salt when, among other things, they inadvertently spill produced water or brine. Produced water is water that has been trapped in underground formations and is brought to the surface along with the oil or gas. Metals can be found in Hazardous Waste because they occur naturally or because they have been included in additives used in drilling.

33 The HW Regulation states that a Secure Landfill cannot be used to dispose of liquid hazardous waste.

34 Hazardous Waste from "legacy sites" can also be disposed of at Secure Landfills. Dr. Baye defined legacy waste as "accumulated waste from decades of drilling activity that has been left at the drilling site" ("Legacy Waste").

35 Operators pay third-party trucking companies to transport Hazardous Waste to Secure Landfills. Transportation costs are typically a substantial portion of waste generators' overall costs of disposal. Dr. Baye estimated that a generator would pay $4 to $6 per tonne for every hour spent transporting waste from, and returning to a generator's site.

36 At the hearing, Mr. *[CONFIDENTIAL]* and Mr. *[CONFIDENTIAL]*, indicated that no ongoing liability is shown on their books once Hazardous Waste is sent to Secure Landfills, even though generators could be liable if a Secure Landfill operator goes bankrupt or if the landfill fails and Hazardous Waste leaches out of the facility.

37 The MOE has issued five permits for Secure Landfills. Four of them are in NEBC and are currently valid: Silverberry, Northern Rockies, Babkirk and Peejay.

38 Silverberry has a permitted capacity which allows it to accept 6,000,000 tonnes of waste. At 1.52 tonnes per cubic meter, which is the same figure used to calculate tonnes at Silverberry, Northern Rockies' permitted capacity is 3,344,000 tonnes. In 2010, *[CONFIDENTIAL]* tonnes of Hazardous Waste was tipped at Silverberry and, in that year, Northern Rockies accepted *[CONFIDENTIAL]* tonnes.

39 Tipping Fees vary depending on the type of waste. According to the evidence given by Dr. Baye, the average Tipping Fee for all substances at Silverberry was *[CONFIDENTIAL]* per tonne in 2010 and the average Tipping Fee for all waste tipped at Northern Rockies in the same year was *[CONFIDENTIAL]* per tonne.

40 Peejay is located in a relatively inaccessible area near the Alberta border. It was developed by a First Nations community to serve nearby drilling operators such as Canadian Natural Resources Limited ("CNRL"). Construction specifications and an operational plan for Peejay were approved by the MOE on March 11, 2009. However, the Secure Landfill has not yet been constructed and there may be financial difficulties at the project.

41 There are presently no Secure Landfills in operation in NEBC which are owned by oil and gas generators.

Bioremediation - Methodology

42 Bioremediation is a method of treating soil by using micro-organisms to reduce contamination. The microbes can be naturally occurring or they can be deliberately added to facilitate bioremediation. In NEBC, bioremediation usually takes place on an oil and gas producing site where the waste is generated. Bioremediation can also be undertaken offsite but the evidence indicates that there are no offsite bioremediation facilities currently operating in NEBC.

43 A common bioremediation technique is landfarming. In landfarming, contaminated waste is placed on impermeable liners and is periodically aerated by being turned over or tilled. The landfarming technique the Vendors planned to use involves turning soil to create windrows which are *[CONFIDENTIAL]* triangular-shaped piles of soil *[CONFIDENTIAL]*.

44 The preponderance of the evidence showed that, given sufficient time, light-end hydrocarbons can be successfully bioremediated in NEBC despite the cold if the clay soil is broken up. However, the Tribunal has concluded that soil contaminated with heavy-end hydrocarbons is not amenable to cost effective bioremediation because it is difficult, unpredictable, and very time consuming. Further, waste contaminated with metals and salts cannot be effectively bioremediated with technologies currently approved for use in Canada.

45 Once bioremediation is complete, an operator will normally hire a consultant to determine whether the Hazardous Waste can be certified as "delisted" in accordance with a delisting protocol. If so, there is no further liability associated with that particular waste.

46 Mr. Watson testified that his company, Integrated Resource Technologies Ltd. ("IRTL"), had successfully bioremediated hydrocarbon-contaminated soil throughout the winter in NEBC and Northern Alberta. Since about 2002, he has been using a specially designed machine from Finland, the "ALLU AS-38H". This machine *[CONFIDENTIAL]* is capable of breaking up heavy clay so that bacteria can enter the windrow and consume the hydrocarbon contaminants.

G. The Issues

47 The following broad issues are raised in this proceeding:

1. Is CCS' acquisition of Complete a "merger"?

2. What is the product dimension of the relevant market?

3. What is the geographic dimension of the relevant market?

4. Is the Merger Pro-Competitive?

5. What is the analytical framework in a "prevent" case?

6. Is the Merger likely to prevent competition substantially?

7. What is the burden of proof on the Commissioner and on a Respondent when the efficiencies defence is pleaded pursuant to section 96 of the Act?

8. Has CCS successfully established an efficiencies defence?

9. Is the appropriate remedy dissolution or divestiture?

Issue 1 Is CCS' Acquisition of Complete a Merger?

48 As a threshold matter, the Vendors submit that the Application should be dismissed because, at the date of the Merger, Complete was not a "business" within the meaning of section 91 of the Act, given that it was not actively accepting and treating Hazardous Waste, and was not otherwise operational in relation to the supply of Secure Landfill services. Instead, they maintain that Complete was simply an entity which held the assets of BLS, i.e. permits and property. Accordingly, the Vendors' position is that, because CCS acquired assets which had not yet been deployed, it did not acquire a "business", as contemplated by section 91 of the Act. The Vendors also submit that the other businesses owned by Complete and acquired in the Merger are not relevant for the purposes of this Application because the Commissioner does not allege that they caused or contributed to a substantial prevention of competition.

49 A merger is defined in section 91 as the acquisition of a "business". The section reads as follows:

> In sections 92 to 100, "merger" means the acquisition or establishment, direct or indirect, by one or more persons, whether by purchase or lease of shares or assets, by amalgamation or by combination or otherwise, of control over or significant interest in the whole or a part of a business of a competitor, supplier, customer or other person.
>
> Pour l'application des articles 92 à 100, « fusionnement » désigne l'acquisition ou l'établissement, par une ou plusieurs personnes, directement ou indirectement, soit par achat ou location d'actions ou d'éléments d'actif, soit par fusion, association d'intérêts ou autrement, du contrôle sur la totalité ou quelque partie d'une entreprise d'un concurrent, d'un fournisseur, d'un client, ou d'une autre personne, ou encore d'un intérêt relativement important dans la totalité ou quelque partie d'une telle entreprise.

50 Business is defined as follows in subsection 2(1) of the Act (the "Definition"):

> "business" includes the business of
>
> (a) manufacturing, producing, transporting, acquiring, supplying, storing and otherwise dealing in articles, and
>
> (b) acquiring, supplying and otherwise dealing in services.
>
> It also includes the raising of funds for charitable or other non-profit purposes.
>
> « entreprise » Sont comprises parmi les entreprises les entreprises:

a) de fabrication, de production, de transport, d'acquisition, de fourniture, d'emmagasinage et de tout autre commerce portant sur des articles;

b) d'acquisition, de prestation de services et de tout autre commerce portant sur des services.

Est également comprise parmi les entreprises la collecte de fonds à des fins de charité ou à d'autres fins non lucratives.

51 The Tribunal notes two features of the Definition. First, it uses the word "includes", which means that it is not exhaustive. Second, unlike the definitions of the term "business" found in statutes such as the *Investment Canada Act*, R.S.C. 1985, c. 28 (1 st Supp.), the Definition makes no reference to generating profits or revenues.

52 Turning to the facts, it is the Tribunal's view that, for the reasons described below, Complete was actively engaged in the development of the Babkirk Site as a hazardous waste treatment facility.

53 Before the Merger, Complete had taken the following steps:

• It had purchased the shares of BLS, thereby acquiring the EA Certificate and the Babkirk Site;

• It had continued the application process and had secured the MOE Permit;

• It had held numerous shareholders' meetings to plan how the Babkirk Site would be developed as a bioremediation facility and how that facility would operate in conjunction with other businesses owned by the Vendors;

• Its shareholders had discussed bioremediation with Petro-Canada and had solicited its interest in becoming a customer for both bioremediation and Secure Landfill services;

• It had hired IRTL and had paid it *[CONFIDENTIAL]* to bioremediate the soil in cell #1 at the Babkirk Facility. This work was undertaken because it was a condition precedent to the construction of the half cell of Secure Landfill;

• It was developing an operations plan for the Babkirk Facility.

54 In the Tribunal's view, these activities demonstrate that Complete was engaged in the business of developing the Babkirk Site as a Hazardous Waste treatment service that included a Secure Landfill. Since the Definition is not exhaustive, the Tribunal has concluded that it encompasses the activities in which Complete and its shareholders had been engaged at the time of its purchase by CCS. Further, the absence of a requirement for revenue in the Definition suggests to the Tribunal that it covers a business in its developmental stage.

55 For all these reasons, the Tribunal has concluded that Complete was a business under section 91 of the Act at the date of the Merger.

56 In view of this conclusion, it is not necessary to decide whether Complete's Roll-off Bin Business or its management of municipal dumps could be businesses for the purposes of section 91 of the Act.

57 However, in the Chairperson's view, a business being acquired in a merger must have some relevance to a Commissioner's application. In other words, it must have the potential to impact competition in the markets at issue. This observation means that, in this case, Complete's Roll-off Bin Business and its management of municipal dumps would not have been caught by the definition in section 91 because they are not involved in any way in the disposal or treatment of Hazardous Waste. In his separate reasons, Crampton C.J. has taken a different position on this point.

Issue 2 What is the Product Dimension of the Relevant Market?

The Analysis

58 In defining relevant markets, the Tribunal generally follows the hypothetical monopolist approach. As noted in *Canada (Commissioner of Competition) v. Superior Propane Inc.*, 2000 Comp. Trib. 15, 7 C.P.R. (4th) 385 (Comp. Trib.) ("*Propane 1*"), at para. 57, the Tribunal embraces the description of that approach set forth at paragraph 4.3 in the Commissioner's Merger Enforcement Guidelines ("MEGs"), which state:

> Conceptually, a relevant market is defined as the smallest group of products, including at least one product of the merging parties, and the smallest geographic area, in which a sole profit-maximizing seller (a "hypothetical monopolist") would impose and sustain a small but significant and non-transitory increase in price ("SSNIP") above levels that would likely exist in the absence of the merger.

59 The price that would likely have existed in the absence of or "but for" the merger in a "prevent case" is the Base Price. The burden is on the Commissioner to demonstrate the "Base Price". In this case, Dr. Baye has predicted a decrease in Tipping Fees in the absence of the Merger of at least 10% and in some of his economic modelling the price decrease is as large as 21%. In *Canada (Commissioner of Competition) v. Canadian Waste Services Holdings Inc.*, 2001 Comp. Trib. 3, 11 C.P.R. (4th) 425 (Competition Trib.); aff'd 2003 FCA 131 (Fed. C.A.), at para. 92, the Tribunal observed that, when a price change can be predicted with confidence, it is appropriate to delineate markets based on the likely future price even if the future level of that price cannot be predicted precisely. In such cases, it may be sufficient for the Commissioner to demonstrate a range in which the likely future price would have fallen.

60 However, if a reasonable approximation of the likely future price cannot be demonstrated, it may be difficult for the Tribunal to clearly define the boundaries of the relevant market. In such cases, it will nevertheless be helpful for the Tribunal to be provided with sufficient evidence to demonstrate why substitutes that appear to be acceptable at the prevailing price level would or would not remain acceptable at price levels that would likely exist "but for" the merger or anti-competitive practice in question. In any event, evidence about various practical indicia is typically required to apply the hypothetical monopolist approach. The Tribunal recognizes that, like other approaches to market definition, the hypothetical monopolist approach is susceptible to being somewhat subjective in its practical application, in the absence of some indication of what constitutes a "small but significant and non-transitory increase in price" (SSNIP). For this reason, objective benchmarks such as a five percent price increase lasting one year, can be helpful in circumscribing and focusing the inquiry.

61 In the Application at paragraph 11, the Commissioner alleged that "[t]he anti-competitive effects of the Merger "primarily" affect oil and gas companies disposing of Hazardous Waste produced at oil and gas fields within NEBC." [our emphasis]. However, in his initial report Dr. Baye did not limit the product market to Hazardous Waste produced at oil and gas fields. Nevertheless, during the hearing, Dr. Baye and Dr. Kahwaty essentially agreed that the amount of solid hazardous waste generated by non-oil and gas sources and tipped at Secure Landfills in British Columbia is so small that it does not warrant consideration in these proceedings. Accordingly, in the Tribunal's view, the Commissioner's product market definition is "solid hazardous waste generated by oil and gas producers and tipped into secure landfills in NEBC".

62 However, the Respondents deny that the product market is as narrow as the Commissioner suggests. They say that it also includes bioremediation and the storage or risk management of waste on the sites where the waste was generated. They assert that these options constrain any market power that CCS may have. We will deal with these positions in turn.

Evidence about the Use of Bioremediation

63 Bioremediation has been described above and the evidence is clear that it is not an acceptable substitute for generators of Hazardous Waste if soil is contaminated with salts or metals. The Tribunal also accepts that, if heavy-end hydrocarbons are present, bioremediation is not cost effective or successful in a reasonable timeframe.

64 Mr. Andrews gave evidence about the use of bioremediation. He joined the MOE in January 2011. At that time, he was asked to review the E-Licensing Database, which keeps track of the progress made by operators who are bioremediating Hazardous Waste. He found that approximately 50% of the operators who had entries in the Database had reported no annual

activity. He said that this indicated that many operators "had stopped actively treating H[azardous] W[aste] at these sites, or at least had stopped reporting any activities to the MOE."

65 He therefore contacted Conoco Philips Canada, Suncor Energy Inc. ("Suncor"), Progress, Devon Canada Corporation ("Devon") and Apache Canada Ltd. ("Apache"). They accounted for 80% of the registered sites with no reported activity. Among other things, he asked these operators to update their operations plans and submit annual reports.

66 According to Mr. Andrews' witness statement, three of the operators reported that they had dealt with the Hazardous Waste they were bioremediating by sending it to a Secure Landfill and he anticipated that the remaining operators would do the same because bioremediation had failed. Mr. Andrews also said that Suncor filed an operations plan for its registered bioremediation sites which stated that, in the future, it would be sending all its Hazardous Waste to a Secure Landfill.

67 Mr. Andrews also described his experience with onsite treatment before he joined the MOE. He stated the following in his witness statement [paragraphs 23-26]:

> I managed the HW at seven sites that CNRL had registered. These sites were allocated north of Fort St John and on existing oil and gas lease sites or on abandoned sites. There were approximately 50,000 tonnes of HW at these sites.
>
> Initially, we tried treating the HW onsite. At each of these sites we put the HW into windrows and used a turner to turn the HW three times per year at each site. Hazco Environmental Services was the contractor that provided the windrow turner. We also added fertilizers and nutrients in the soil to assist in the bioremediation process. The fertilizer is meant to add additional nutrients to aid the bacteria to process the hydrocarbons.
>
> CNRL pursued this treatment process for two years. While CNRL was able to reduce the contaminants in the HW at these sites, it failed to reduce the contaminants enough to "delist" the HW. Delisting HW means reducing the presence of contaminants low enough so that the soil is no longer considered to be HW. CNRL spent significant amounts of money on treatment because the sites required constant monitoring. The sites would get wet and require dewatering out to prevent berm overflow and enable equipment access.
>
> Ultimately, after two years of treatment, it was clear that bioremediation would not work to address the contamination issues. CNRL decided to send the remaining HW to a Secure Landfill, specifically Silverberry, which was the landfill closest to the sites. I was also responsible for this process. It took CNRL approximately 2-3 years and several million dollars to send all the waste to Silverberry.

68 *[CONFIDENTIAL]*, who works as a Contracting and Procurement Analysist for *[CONFIDENTIAL]*, testified that its current operations in NEBC are in two fields called *[CONFIDENTIAL]*. He indicated that *[CONFIDENTIAL]* uses Secure Landfills to dispose of its Hazardous Waste and that it does not bioremediate because of the associated costs, the time necessary to bioremediate, and the manpower required to undertake bioremediation. He stated that liability has the potential to remain if the Hazardous Waste is not effectively bioremediated and that additional costs might be incurred if the Hazardous Waste, which is not effectively treated, must be tipped into a Secure Landfill. He added that there is ongoing uncertainty about whether bioremediation is effective or not.

69 *[CONFIDENTIAL]*, the Vice-President of Operations at *[CONFIDENTIAL]*, testified that *[CONFIDENTIAL]* uses an oil-based mud system to reduce friction on horizontal wells and that the oil-based mud cuttings are typically tipped into Secure Landfills. He also stated that *[CONFIDENTIAL]* sees disposal at a Secure Landfill as the most economic alternative for dealing with the Hazardous Waste from drilling, as disposal eliminates the increased environmental risk and cost of long term storage and/or site remediation. He explained that "[c]ontainment, transport and disposal of hazardous waste generated from drilling operations is currently the only option used by *[CONFIDENTIAL]* for managing hazardous waste generated from drilling." Accordingly, it is clear that, at its current drilling sites, only Secure Landfills are used for disposal.

70 However, with respect to the Legacy Waste in NEBC on drilling sites which *[CONFIDENTIAL]*, Mr. *[CONFIDENTIAL]* testified that *[CONFIDENTIAL]* will bioremediate some of the waste on these sites. He explained that bioremediation of the

Legacy Waste had already been started by *[CONFIDENTIAL]*. He stated that the decision to dispose of Hazardous Waste instead of treating it is taken on a case-by-case basis, and depends on the type and amount of Hazardous Waste present on the legacy site, the likelihood of successful remediation, and the cost of excavation, transport and disposal.

71 During a review of the HW Regulation undertaken by the MOE, the MOE retained Conestoga-Rovers & Associates to conduct a report on Secure Landfill disposal. The report is entitled "Secure Landfill Disposal Policy Review" and dated March 2011. It states:

> Based on equal weighting of cost, cost variability, timeline, and treatment certainty landfilling [Secure Landfill] is the preferred option under all scenarios. Landfarming [bioremediation] can be an appropriate method for treating hydrocarbon contaminated soils given appropriate concentrations and a multi-year timeline.

72 Devin Scheck, the Director of Waste Management and Reclamation at the British Columbia Oil and Gas Commission, testified that many operators still choose to dispose of their contaminated soils in Secure Landfills, even in situations where bioremediation is feasible, because of the associated costs and timeframe. He said the following in his witness statement [paragraphs 25-27]:

> In my experience, a significant number of the sites that Operators seek to remediate are remediated by the Operator disposing of the contaminated soils at a landfill. With sites that are only contaminated with light end hydrocarbons, Operators may seek to bioremediate the soil on site, but heavy end hydrocarbons tend to have a poor response to bioremediation. As well, tight clay (which is prevalent in North Eastern B.C. where the oil and gas activity is most prevalent) makes bioremediation difficult, as does the relatively cold weather in the region. The presence of other contaminants, such as salts or metals that exceed CSR standards, prevent bioremediation from being an appropriate option, as salts and metals cannot be bioremediated.
>
> Accordingly, when dealing with anything other than light end hydrocarbons, my experience is that Operators will usually dig up the soil, and dispose of it at a Secure Landfill like Silverberry in B.C. or a closer landfill across the Alberta border, such as the CCS Class II Alberta Landfill at LaGlace.
>
> In my experience, even where bioremediation may be feasible, many Operators will still choose to landfill their contaminated soils. With bioremediation there is much uncertainty about costs, and the timeframe required for treatment is also uncertain. Weather conditions, site access issues, amount/type of treatment, future equipment and labour costs, as well as the costs of ongoing access for treatment and sampling to determine if the soils are remediated contribute to this uncertainty.

73 Mark Polet, an expert environmental biologist with specialized knowledge in environmental assessment, remediation and reclamation, as well as waste facility management development, stated as follows in paragraph 17 of his expert report:

> Once an Operator in NEBC decides to clean up its waste, the two most practical options available are: 1) the disposal of the waste at an appropriate landfill; or 2) the treatment of the waste onsite through a process known as bioremediation. Operators do not have a uniform preference for either option but, in my experience, will choose an option based on cost, risk, efficacy and other reasons such as environmental stewardship.

74 At the hearing, Mr. Polet testified that the costs of bioremediation and secure landfilling can be comparable. He stated:

> Once you define the types [of contaminants], you can decide on the most prudent response. And so, for instance, if I found on a site just the light end hydrocarbons with no other types of contamination mixed with it, I would look at bioremediation as an alternative. If it had salts and metals associated with the contamination, as well, then I would lean very strongly to landfill. If it had heavier end hydrocarbons, I would lean strongly to landfill, as well.

> In terms of cost, there — can be quite comparable in price, but of course bioremediation is very limited in what it can be applied to. And the one thing that we've noticed in working in the field is that when bioremediation is not managed properly, then much material actually lands back up in the landfill, anyway. So it has to be well managed to work properly.

75 There is also evidence about bioremediation in the Statement of Agreed Facts (the "Agreed Facts"). However, at the hearing it became clear that, contrary to the way in which they are presented, some of the facts were not actually agreed. The problematic evidence concerns bioremediation and was gathered in two ways. The evidence in paragraphs 63-67 of the Agreed Facts was given directly to the Commissioner's staff. This evidence will be called "Evidence A".

76 Evidence A has two significant characteristics. The sources are not named and the Agreed Facts state in paragraph 63 that "...the Bureau has not confirmed the truth of the facts communicated to it by the operators..." Evidence A is in the Agreed Facts because CCS insisted that it be included and CCS asks the Tribunal to give it weight and assume it is true.

77 Evidence A reflects that operator "F" bioremediates at least 70% of its waste in BC because it considers bioremediation to be better for the environment. Operators "H" and "J" bioremediate about 50% their waste. These operators appear to be bioremediating on their drilling sites to avoid the transportation charges and Tipping Fees associated with Secure Landfills.

78 Although the Commissioner cannot confirm its truth, the Tribunal is nevertheless prepared to give Evidence A some weight because it can see no reason why industry participants would lie to the Commissioner about their use of onsite bioremediation. However, without knowing the volume of waste produced by "F", "H" and "J", it is impossible to determine whether bioremediation is being undertaken on a significant scale. In any event, it is clear that, even for these waste generators, there is a substantial portion of Hazardous Waste in respect of which bioremediation is not used.

79 The second category of evidence is found in paragraphs 69-74 of the Agreed Facts. It was gathered in July 2011 by representatives of National Economic Research Associates ("NERA"). Dr. Baye works at NERA and it appears that NERA was retained by the Commissioner to interview industry participants. The Commissioner's staff attended these interviews and the six sources are named (*[CONFIDENTIAL]*). No concern is expressed about the reliability of this evidence. This evidence will be called "Evidence B".

80 The Commissioner only called witnesses from *[CONFIDENTIAL]* and *[CONFIDENTIAL]* who, as discussed above, indicated that they do not bioremediate as a matter of policy *[CONFIDENTIAL]*.

81 CCS states the evidence of the other four operators, described in Evidence B, shows that they are active bioremediators and CCS asks the Tribunal to draw an adverse inference from the fact that they were not called by the Commissioner. However, in the Tribunal's view, no such inference should be drawn because the Commissioner had no obligation to adduce the evidence and it was open to CCS to do so.

82 Evidence B shows that *[CONFIDENTIAL]* bioremediates 10-15% of its waste. *[CONFIDENTIAL]* engages in some bioremediation at about 70% of its sites and *[CONFIDENTIAL]* bioremediates about 75% of its treatable material onsite. (It also appears to treat the balance of treatable material offsite but this is not explained. Since there are no offsite bioremediation facilities in NEBC, the Tribunal has concluded that this statement must refer to offsite treatment elsewhere.) *[CONFIDENTIAL]* bioremediates onsite and sometimes moves waste between its sites for bioremediation. In the last 3-4 years, it has bioremediated 60-70% of its abandoned well waste.

83 It is noteworthy that this evidence gives no volumes for treatable and Legacy Hazardous Waste. In these circumstances, and given that the Respondent did not call witnesses from these four operators or other operators, the Tribunal is not persuaded that bioremediation is being undertaken on a significant scale in NEBC.

Evidence about Storage and Risk Management

84 Storage means that Hazardous Waste is left untreated on a drilling site which is still under lease. As long as the MOE does not order a cleanup, this option is available even though drilling has finished, as long as the operator continues to make

the lease/tenure payments for the site. Since such payments are low compared to the cost of cleaning up the site, doing nothing may be an attractive option in some cases and the evidence from Trevor Mackay's examination for discovery is that "many" operators have waste stored on their sites. However, Mr. *[CONFIDENTIAL]* testified that *[CONFIDENTIAL]* does not store the Hazardous Waste generated from drilling operations for long periods of time, due to the cost and potential liability issues. He explained that the typical well site storage costs during drilling operations are *[CONFIDENTIAL]* per well.

85 Risk Management is a process undertaken when drilling is finished and an operator wishes to terminate a lease. The operator must restore the site's surface as nearly as possible to the condition it was in before drilling. Once this has been accomplished, a Certificate of Restoration (also referred to as a Certificate of Compliance) is issued and the operator's lease is terminated. However, the operator remains liable for any issues arising from the Hazardous Waste that is left behind and is obliged to comply with conditions such as monitoring even after the certificate is issued.

86 On this topic, Mark Polet said the following in his reply report:

> Based on my experience, Operators use risk management as a last resort if treatment or disposal are not practical. I rarely recommend it because even if approval is obtained, which in my experience is very difficult, the Operator retains liability and there is a recognition that the site may need to be revisited if issues arise.

87 Pete Marshal, an expert in Hazardous Waste management, testified that, although disposal in a Secure Landfill, bioremediation and risk management are each potentially available methods for dealing with Hazardous Waste, he did not know how many operators choose risk management.

88 This evidence leads the Tribunal to conclude that risk management is seldom used and is not considered to be an acceptable substitute for disposing of Hazardous Waste in a Secure Landfill.

Conclusions about the Product Market

89 Although some operators with Hazardous Waste which is contaminated with light-end hydrocarbons consider bioremediation to be an acceptable substitute for disposal in a Secure Landfill, there is no evidence about the volumes of waste which are successfully bioremediated. More importantly, there is no evidence that the availability of bioremediation has any constraining impact on Tipping Fees in NEBC. In addition, the Tribunal finds that bioremediation is not considered by at least some waste generators to be an acceptable substitute for disposal in a Secure Landfill, particularly in respect of soil that is contaminated with heavy-end hydro-carbons, salts or metals.

90 With regard to storage and risk management, there was no evidence about the volumes stored in NEBC and no evidence to suggest that the tenure payments or the cost to obtain a certificate of restoration have any impact on Tipping Fees at Silverberry.

91 Because bioremediation is not cost effective and is slow for a substantial volume of contaminated soil in NEBC and because it does not work at all on salts and metals, the Tribunal is satisfied that a substantial number of generators do not consider bioremediation to be a good substitute for the disposal of such Hazardous Waste in a Secure Landfill and would not likely switch to bioremediation in response to a SSNIP. Accordingly, the Tribunal is satisfied that the relevant product is "solid hazardous waste generated by oil and gas producers and tipped into secure landfills in NEBC".

Issue 3 What is the Geographic Dimension of the Relevant Market?

92 The Tribunal and the courts have traditionally considered it necessary to define a relevant market before proceeding to assess the competitive effects of mergers under the Act. (See, for example, *Canada (Director of Investigation & Research) v. Hillsdown Holdings (Canada) Ltd.* (1992), 41 C.P.R. (3d) 289 (Competition Trib.), at 297 ; *Canada (Director of Investigation & Research) v. Southam Inc.*, [1997] 1 S.C.R. 748 (S.C.C.), at para. 79). However, they have cautioned against losing sight of the ultimate inquiry, which is whether the merger being assessed prevents or lessens, or is likely to prevent or lessen, competition substantially. (*Southam*, above; "*Propane*", above, at para. 48). With this admonition in mind, it is the Tribunal's view that, in this case, the Tribunal may evaluate the competitive effects of the Merger without precisely defining the relevant geographic market.

93 This conclusion is important because, as will be discussed below, the evidence that has been adduced does not permit the Tribunal to delineate the exact boundaries of the geographic market.

94 The Tribunal agrees with the approach taken in the MEGs. The process begins with a small area around one of the merging parties' locations (in this case, a Secure Landfill site) and then asks whether all rivals operating at locations in that area, if acting as a hypothetical monopolist, would have the ability and incentive to impose a small but significant price increase (typically 5%) and sustain that increase for a non-transitory period of time (typically one year). If the postulated price increase would likely cause purchasers of the relevant product in that area to switch sufficient quantities of their purchases to suppliers located outside that area to render the price increase unprofitable, then the geographic dimension of the relevant market would be progressively expanded until the point at which a seller of the relevant product, if acting as a hypothetical monopolist, would have the ability and incentive to impose a SSNIP.

95 In the case at bar, the evidence dealt with three geographic regions:

I. *The Contestable Area* - this was identified by Dr. Kahwaty on behalf of CCS.

II. *All of NEBC* - the Commissioner, supported by her expert Dr. Baye, submitted this definition of the geographic market.

III. *The Babkirk Polygon* - this area was identified in internal CCS documents dealing with the potential impact of the Babkirk Facility on CCS.

I. The Contestable Area

96 In broad terms, the Contestable Area identified by Dr. Kahwaty encompasses an hourglass shaped area of 11,000 square kilometres which lies between the Babkirk Site and Silverberry. In his analysis, the road network in this area is such that there are some areas in which both Silverberry and a potential landfill at the Babkirk Site may be viable disposal options for customers with well sites in those areas. Dr. Kahwaty acknowledges that the transportation costs required to reach Silverberry or the Babkirk Site are such that both may be economic alternatives for these customers. In Dr. Kahwaty's view, the geographic scope of the relevant market should be limited to this area.

97 Dr. Kahwaty used Dr. Baye's 10% predicted decline in Tipping Fees as his benchmark for defining the geographic scope of the relevant market. In short, he assessed every well site and calculated whether, if given a 10% reduction off the Tipping Fees paid at Silverberry, the customer would be indifferent as between tipping at Babkirk and Silverberry, having regard for the fact that their total disposal cost (transportation plus Tipping Fee) would be the same for each Secure Landfill. Twelve such customers were identified, accounting for approximately 41,900 tonnes in the Contestable Area. Dr. Kahwaty acknowledged that a larger critical price discount would produce a larger contestable area.

98 The Tribunal is satisfied that a hypothetical monopolist supplying Secure Landfill services to these twelve customers in respect of the Hazardous Waste generated in the Contestable Area would have the ability and incentive to impose and sustain a SSNIP above levels that would likely exist in the absence of the Merger.

99 Indeed, the Tribunal considers that the Contestable Area is likely understated and, in fact, smaller than the minimum area in which a hypothetical monopolist would have the ability and incentive to impose and sustain a SSNIP. The Tribunal has reached this view for several reasons. First, the Tribunal accepts Dr. Baye's position that "Babkirk need not have a location advantage for a customer — and the customer need not switch from Silverberry to Babkirk — for that customer to significantly benefit from the lower Tipping Fees stemming from competition". Second, the evidence suggests that new wells are likely to be drilled in the area between Babkirk and Northern Rockies, and that there is Legacy Waste sitting on abandoned well-sites in that region. Meaningful price and non-price competition between Babkirk and Northern Rockies for at least some of that waste likely would have developed in the absence of the Merger. Third, the geographic extent of the Contestable Area is necessarily limited by Dr. Kahwaty's assumption of a base price that is only 10% below prevailing levels. If that figure is too low Dr. Kahwaty admitted that the geographic market would be larger than the Contestable Area.

100 In addition, the Tribunal notes that the volume of Hazardous Waste generated in the Contestable Area likely is greater than reported by Dr. Kahwaty because he only used data for 2010. Moreover, Dr. Kahwaty excluded CCS' national customers from his analysis and this may also have resulted in an understated geographic market.

101 With respect to the possibility that Secure Landfills in Alberta might be economically accessible for generators of waste in the Contested Area, Dr. Kahwaty stated that "transportation costs are too great for [customers located to the south and east of Silverberry, who currently tip their waste in Alberta] to opt to dispose at a potential landfill at the Babkirk site (even with a significant discount) as compared to disposing at Silverberry at current prices." The Tribunal extrapolates from this and concludes that customers generating Hazardous Waste in the Contestable Area are unlikely to transport their waste to secure landfill sites in Alberta due to the significant transportation costs and potential liability that would be associated with hauling waste over such a long distance.

102 For all these reasons, the Tribunal concludes that the geographic market is at least as large as the Contestable Area. We now turn to whether it could be as large as all of NEBC.

II. All of NEBC

103 NEBC covers approximately 118,800 square kilometres and is vast in comparison to Dr. Kahwaty's Contestable Area. NEBC and the much smaller Contestable Area are compared on the map attached hereto as Schedule "C", which is taken from Tab 29 of Dr. Kahwaty's report of October 21, 2011.

104 Dr. Baye concludes that the relevant geographic market is NEBC on the basis that this is the region where targeted customers are located, including current customers at both Silverberry and Northern Rockies Secure Landfills.

105 In reaching this conclusion, Dr. Baye relies on an economic theory of market equilibrium which predicts that CCS would have an incentive to compete with an independently operated Babkirk Facility for customers located outside of Dr. Kahwaty's Contested Area. This theory is based on his understanding that CCS' average 2010 Tipping Fees at Silverberry were approximately *[CONFIDENTIAL]* per tonne and its average landfill costs were approximately *[CONFIDENTIAL]* per tonne, yielding a margin in excess of 60%. Using these figures, Dr. Baye assumes that CCS would be prepared to reduce its Tipping Fees by 25% or greater in some areas to retain business in the face of competition from an independent Babkirk Facility.

106 However, among other problems, Dr. Baye's theory fails to take into account the opportunity cost to CCS that would be associated with substantially reducing its Tipping Fees to sell landfill capacity today, which could be sold in the future at higher Tipping Fees to customers located closer to Silverberry. In the absence of any analysis of how this opportunity cost would factor into CCS' current decision-making process, the Tribunal finds that the economic theory relied on by Dr. Baye is not particularly helpful in defining the geographic scope of the relevant market.

107 In his initial report, Dr. Baye also provides estimates based on econometric regression models which he asserts are consistent with this theory and his definition of the geographic market as extending throughout all of NEBC. The first set of models, found at Exhibits 19 and 20 of Dr. Baye's initial report, test his hypothesis that the distance between a Secure Landfill and its closest competitor is a significant predictor of the average Tipping Fees at that landfill.

108 Exhibit 20 predicts that the opening of an independent landfill at the Babkirk Site will result in a large decline in average Tipping Fees at Northern Rockies, because it would reduce the distance to Northern Rockies' nearest competitor to three hours and 49 minutes. However, this ignores (i) the substantial transportation costs that the vast majority of customers who tip at Northern Rockies would have to incur to transport their waste to Babkirk, (ii) the very small number of well-sites located between those two facilities, and (iii) the apparent absence of any incentive for CCS to alter its Tipping Fees at Northern Rockies in response to entry at Babkirk.

109 The second set of regression models are estimates offered by Dr. Baye which relate to a "natural experiment" involving SES' entry at Willesden Green, Alberta, in December 2008. That facility became the closest competitor to CCS' Rocky Mountain

House landfill ("Rocky"), located approximately one hour away. In his analysis of CCS' 2010 transactions data, Dr. Baye discovered that CCS substantially reduced the Tipping Fees it charged to several customers subsequent to the opening of SES' facility at Willesden Green.

110 To address the possibility that these substantial price reductions were purely coincidental, Dr. Baye developed "difference in difference" ("DiD") regression models, reported at Exhibit 26 of his initial report. The DiD approach controls for unobserved events, other than SES' entry at Willesden Green, which might have led to the observed decline in Tipping Fees at Rocky. In short, the DiD models include a "treatment" setting in which the event (in this case, entry) occurred and a "control" setting in which the event did not occur. Dr. Baye took the change in Tipping Fees that occurred in the treatment setting and subtracted any change that occurred in the control setting. He interpreted the difference in the change (or the "difference in difference") as the effect of entry at Willesden Green on Tipping Fees at Rocky.

111 It is significant that, in selecting a control landfill, Dr. Baye considered it important to pick a site that "is unlikely to be affected by the treatment event — in this case entry at Willesden Green." One of the principal criteria that he employed in making that selection was that the control landfill had to be "at least 300 km away" from Willesden Green. The same logic would imply that entry at Babkirk would not likely affect Tipping Fees at Northern Rockies, which is situated 260 km away from the Babkirk Site. A key assumption underlying Dr. Baye's DiD models is therefore inconsistent with his definition of the geographic market as all of NEBC. This, together with the fact that Northern Rockies is almost four times further away from Babkirk than SES' Willesden Green facility is away from CCS' Rocky facility, lead the Tribunal to conclude that Dr. Baye's DiD analysis is not particularly helpful in defining the geographic scope of the relevant market. That said, as discussed in detail below, the transactions data which reveals substantial price reductions by CCS to seven of its customers following SES' entry at Willesden Green is relevant to the Tribunal's assessment of the likely competitive effects of the Merger.

112 Finally, the Tribunal notes that Dr. Baye also points to internal documents of CCS which he says are consistent with his definition of the relevant geographic market. However, those documents simply: (i) make projections of the overall annual operating margin (*[CONFIDENTIAL]*) that CCS stood to lose at Silverberry and Northern Rockies were an independent landfill to open at the Babkirk Site; (ii) predict a pricing war if the Babkirk Facility was operated independently or acquired by a third party; (iii) discuss the likelihood of having to compete through "value propositions"; and (iv) reflect that CCS likely takes into account its customers' transportation costs to the next closest competing landfill in setting its Tipping Fees. While these types of statements assist in assessing whether the Merger is likely to prevent competition substantially, they are not particularly helpful to the Tribunal in defining the geographic scope of the relevant market.

III. The Babkirk Polygon

113 The Babkirk Polygon is the third area that was discussed at the hearing. That area was identified by a member of CCS' business development team who was asked to project Babkirk's market capture area. The Tribunal has added a rough depiction of that area on Schedule "C" hereto.

114 The Babkirk Polygon was apparently intended to identify the locations of existing Silverberry customers who would be likely to tip at Babkirk rather than at Silverberry, if Babkirk was operated as a Secure Landfill. In other words, the Babkirk Polygon was CCS' representation of the geographic locations of business it risked losing if Babkirk opened as a Secure Landfill. It includes territory north and west of Babkirk and is a larger area than Dr. Kahwaty's Contestable Area.

115 The Tribunal is satisfied that the locational advantage that the Babkirk Facility would enjoy for customers with drilling operations situated to its north and west is such that those customers would not likely tip at Silverberry in the absence of a very substantial reduction in its Tipping Fees. Given the opportunity cost that CCS would incur by offering such a substantial reduction in its Tipping Fees, and given the absence of any analysis by the Commissioner or Dr. Baye of the impact of that opportunity cost on CCS's decision-making, the Tribunal is not persuaded that CCS would have an incentive to compete for those customers in the absence of the Merger.

116 Likewise, the Tribunal has not been persuaded on a balance of probabilities that such customers who operate to the north and west of the Babkirk Facility would tip at Silverberry, in response to a SSNIP above the maximum average tipping fee level that it believes is likely to exist in the absence of the Merger. For the reasons discussed below, the Tribunal has concluded that such price level will be at least 10% below existing levels. However, transportation costs and the liability associated with transporting Hazardous Waste over the long distance to Silverberry are such that it would require more than a SSNIP to induce waste generators located in those regions to tip their Hazardous Waste at Silverberry.

117 The Tribunal has concluded that the geographic scope of the relevant market is at least as large as the Contestable Area identified by Dr. Kahwaty, and likely falls between the limits of that area and the bounds of the Babkirk Polygon, which includes some of the Contestable Area, but adds significant territory north and west of Babkirk.

118 The Tribunal is satisfied that it would not matter if the geographic scope of the relevant market actually includes additional customer locations in the Babkirk Polygon, beyond the Contestable Area, because CCS would remain the sole supplier of Secure Landfill services to any reasonably defined broader group of customers.

Issue 4 Is the Merger Pro-Competitive?

119 CCS has suggested that the Merger is pro-competitive because it brings to the market a new Secure Landfill at the Babkirk Site. CCS further asserts that the Merger will most quickly transform the Babkirk Site into a Secure Landfill to complement CCS' existing business and serve the growing oil and gas industry in NEBC. CCS says that these facts explain its customers' failure to complain about the Merger.

120 The Tribunal disagrees. In its view, a merger which prevents all actual or likely rivalry in a relevant market cannot be "pro-competitive," even if it expands market demand more quickly than might otherwise be the case. Such a merger might be efficiency-enhancing, as contemplated by the efficiency defence in section 96 of the Act. However, it has adverse consequences for the dynamic process of competition and the benefits that such process typically yields. In the absence of actual rivalry, or a very real and credible threat of future rivalry, meaningful competition does not exist.

Issue 5 What is the Analytical Framework in a "Prevent Case?

121 The "prevention" branch of section 92 was raised in three previous Tribunal cases: *Canada (Director of Investigation & Research) v. Southam Inc.* (1992), 43 C.P.R. (3d) 161 (Competition Trib.), rev'd on other grounds (1995), 63 C.P.R. (3d) 1 (Fed. C.A.), rev'd, [1997] 1 S.C.R. 748 (S.C.C.), *Propane* and *Canadian Waste Services*. However, since those cases were primarily concerned with allegations involving a substantial lessening of competition, the Tribunal did not address in any detail the analytical framework applicable to the assessment of an alleged substantial prevention of competition.

122 In determining whether competition is likely to be prevented, the Tribunal will assess whether a merger is more likely than not to maintain the ability of the merged entity to exercise greater market power than in the absence of the merger, acting alone or interdependently with one or more rivals. For the purposes of this case, this requires comparing a world in which CCS owns the relevant Secure Landfills in NEBC (i.e. Northern Rockies, Silverberry and Babkirk) with a world in which Babkirk is independently operated as a Secure Landfill.

123 In assessing cases under the "prevent" branch of section 92, the Tribunal focuses on the new entry, or the increased competition from within the relevant market, that the Commissioner alleges was, or would be, prevented by the merger in question. In the case of a proposed merger, the Tribunal assesses whether it is likely that new entry or expansion would be sufficiently timely, and occur on a sufficient scale, to result in: (i) a material reduction of prices, or in a material increase in non-price competition, relative to prevailing price and non-price levels of competition, (ii) in a significant (i.e., non-trivial) part of the relevant market, and (iii) for a period of approximately two years. If so and if the entry or expansion likely would occur within a reasonable period of time, the Tribunal will conclude that the prevention of competition is likely to be substantial.

124 The Tribunal also considers whether other firms would be likely to enter or expand on a scale similar to that which was prevented or forestalled by the merger, and in a similar timeframe. Where the Tribunal finds that such entry or expansion would probably occur, it is unlikely to conclude that the merger is likely to prevent competition substantially.

125 As noted earlier and as recognized by all parties, the price against which the prevailing prices will be compared will be the price that would likely have existed in the absence of the merger. The burden will be on the Commissioner to demonstrate that price level, or the range of prices, that likely would have existed "but for" the merger.

126 In final argument, the Commissioner and CCS suggested that helpful guidance on the approach that should be taken to prevention of competition cases can be provided by the U.S. jurisprudence pertaining to mergers that have been alleged to reduce potential competition. In the Tribunal's view, that jurisprudence is not particularly helpful to merger assessment under the Act, because it was developed in respect of a different statutory test and, for the most part, many years ago. (It appears that the US Supreme Court and the federal appellate courts have not had an opportunity to revisit that jurisprudence since the 1980s. See M. Sean Royall and Adam J. Di Vincenzo, "Evaluating Mergers between Potential Competitors under the New Horizontal Merger Guidelines", *Antitrust* (Fall 2010) 33, at 35.)

Issue 6 is there a Substantial Prevention of Competition?

A. The "But For" analysis

Introduction

127 In *Canada (Commissioner of Competition) v. Canada Pipe Co.*, 2006 FCA 233 (F.C.A.), the Federal Court of Appeal decided that a "but for" analysis was the appropriate approach to take when considering whether, under paragraph 79(1)(c) of the Act, "...the practice has had, is having or is likely to have the effect of preventing or lessening competition substantially." The specific question to be asked is stated, as follows, at paragraph 38 of the decision "...would the relevant markets — in the past, present or future — be substantially more competitive but for the impugned practice of anti-competitive acts?"

128 Language similar to that found in section 79 appears in section 92 of the Act. Section 92 says that an order may be made where "...the Tribunal finds that a merger or proposed merger prevents or lessens, or is likely to prevent or lessen competition substantially." For this reason, the parties and the Tribunal have determined that the "but for" approach is also appropriate for use in cases under section 92 of the Act. The parties recognize that the findings will be forward looking in nature and CCS has cautioned the Tribunal against unfounded speculation. With this background, we turn to the "but for" analysis.

129 The discussion below will address the threshold issue of whether effective competition in the supply of Secure Landfill services in the Contestable Area identified by Dr. Kahwaty likely would have materialized in the absence of the Merger. Stated alternatively, would effective competition in the relevant market likely have emerged "but for" the Merger? After addressing this issue, the Tribunal will turn to the section 93 factors that are relevant in this case, as well as the issue of countervailing power.

130 In undertaking the "but for" analysis, the Tribunal will consider the following questions:

(i) If the Merger had not occurred, what new competition, if any, would likely have emerged in the Contestable Area?

(ii) If the Merger had not occurred, what would have been the likely scale of that new competition?

(iii) If the Merger had not occurred, when would the new competition likely have entered the market?

131 The Commissioner suggested that either June or July, 2010 be used as the timeframe for considering the "but for" world. CCS, on the other hand, was more precise and suggested that the relevant time for this purpose should be the end of July 2010, when CCS and Complete signed the letter of intent which led to the Merger. Since the parties have essentially agreed, the Tribunal will focus on the end of July.

132 The Tribunal's view is that, as of the end of July 2010, there were only two realistic scenarios for the Babkirk Site absent the Merger. They were:

1. The Vendors would have sold to a waste company called Secure Energy Services Inc. ("SES"), which would have operated a Secure Landfill; or

2. The Vendors would have operated a bioremediation facility together with a half cell of Secure Landfill.

133 Extensive evidence was adduced on these topics. The discussion below summarizes the most important aspects of that evidence.

Scenario #1 — A sale of Complete to SES

134 In February of 2007 when the Vendors first met to organize Complete, they decided that their exit strategy would be to sell the company to Newalta Corporation or to CCS. Newalta is a waste company which operates Secure Landfills in Alberta. However, it was always the Vendors' intention to sell only when they could achieve an acceptable return on their investment.

135 In November 2007, Canaccord Capital sent a four-person investment team to Fort St. John to investigate the purchase of a number of the Vendors' companies, including Complete. At that time, the Vendors' intentions about a sale of Complete were recorded in the company's minutes, which, among other things, stated:

> ...consensus at Complete's meeting was to carry on the way we are going unless we are presented with a very attractive proposal from outside. We don't want to do all the work for the benefit of others — better to take a longer time, but to have higher rewards for ourselves...

136 Subsequently, a Vision Statement, dated June 22, 2008, was prepared by Karen Baker. That document stated that they wanted to make a "good return on sale of company". The Statement also observed:

> The VISION of Complete Environmental Inc. is to become a diversified, highly efficient, environmental corporation in NEBC generating a high profit margin thus, presenting itself as an attractive acquisition to multiple potential purchasers.

137 After Complete received its MOE Permit on February 26, 2010, Ken Watson's company, IRTL, offered to purchase Complete for *[CONFIDENTIAL]*. Before that offer was made, the Vendors had not been actively considering a sale. However, IRTL's offer spurred them to seriously consider the matter and, before they responded to IRTL's, they authorized Randy Wolsey to contact CCS and SES for expressions of interest.

138 On March 23, 2010, Randy Wolsey spoke to SES but was told that it had no interest in making an offer because it was busy with its initial public share offering. However, SES did indicate a possible future interest and stated that it valued BLS at approximately *[CONFIDENTIAL]* in either mixed cash and shares or *[CONFIDENTIAL]* plus a share offering. In contrast, CCS expressed immediate interest and Dan Wallace of CCS verbally offered *[CONFIDENTIAL]* for BLS.

139 The Vendors eventually decided to sell Complete to IRTL. However, IRTL's offer was withdrawn in early June 2010 after Ken Watson learned that, contrary to his expectations, Canaccord Capital would not finance IRTL's acquisition of Complete. After Cannacord declined, he did not have time to arrange alternative financing.

140 According to Karen Baker, after IRTL's offer was withdrawn, the Vendors decided to try to sell Complete one last time. They concluded that, if they did not receive an interesting offer, they would operate the Babkirk Facility themselves. This would involve moving forward with an operating plan and constructing a half cell of Secure Landfill. To ascertain if a sale was possible, Randy Wolsey was again asked to contact CCS and SES. In addition, he was asked to contact Newalta. He did so, but Newalta did not respond to his email.

141 At about that time, Dan Wallace of CCS apparently heard that IRTL's offer had fallen through and sent Randy Wolsey an email asking if CCS could renew its earlier offer. Mr. Wolsey responded by offering to sell BLS for *[CONFIDENTIAL]*. On June 22, 2010, CCS agreed to purchase the shares of BLS for that amount.

142 Inexplicably, Randy Wolsey did not tell the other Vendors about his deal with CCS. Instead, he arranged a meeting with SES (the "Meeting"). It was held on June 29, 2010 and was attended by Rene Amirault, President and CEO of SES, Dan Steinke, SES' Vice-President of Business Development, and Corey Higham, SES' Business Development Representative (the "SES Group").

143 According to the Vendors, the SES Group spent much of the Meeting giving a presentation to show that SES was an attractive investment. An SES brochure prepared for potential investors was used for this purpose. However, the Vendors were not interested in acquiring shares of SES and they testified that no price for BLS or Complete was ever suggested and no offer was discussed.

144 According to Mr. Amirault, he indicated during the Meeting that an all cash offer could be made. The Vendors denied this. Since this evidence is significant and was not included in Mr. Amirault's witness statement, the Tribunal has concluded an all cash offer was not mentioned and that the Vendors understood that SES would only purchase Complete if it could use its shares to finance part of the purchase price.

145 During the Meeting, the SES Group had questions about how to secure the necessary regulatory approvals to allow SES to expand the permitted capacity of the Babkirk Facility and to upgrade the design of the Secure Landfill cells (the "Questions"). The Vendors could not answer the Questions and Mr. Amirault testified that he asked for and was refused permission to speak to Del Reinheimer about the Questions. However, some Vendors could not remember anyone from the SES Group asking for permission to speak to Del Reinheimer about the Questions and other Vendors denied that anyone asked for such permission at that time. Mr. Reinheimer was the Section Head, Environmental Management in the Environmental Protection Division of the MOE.

146 Mr. Amirault stated that following the Meeting, SES was actively interested in purchasing Complete and gave the following reasons to explain its failure to make an offer or submit a letter of intent in July 2010:

- The Questions had to be answered before a price could be established.

- There was no particular urgency about making an offer because there were no other buyers. Mr. Amirault testified that the Vendors had indicated at the Meeting that Complete had promised a First Nation that it would not sell to CCS and the SES Group knew that Newalta was not interested.

147 Mr. Amirault acknowledged that the Questions were about process i.e. "how to" go about getting approvals for increased permitted capacity and enhanced cell design. He also stated that he had no doubt that the approvals would be forthcoming. In these circumstances and because, as described below, SES was actively engaged in the development of another Secure Landfill, it is the Tribunal's view that SES would have known what it needed to spend to increase the permitted capacity and upgrade the landfill cells at the Babkirk Site. Accordingly, the Tribunal does not accept Mr. Amirault's evidence that SES could not establish a purchase price without the answers to the Questions.

148 There is a dispute about whether, on July 6, 2010, Corey Higham sent Ron Baker an email setting out the Questions which had been discussed at the Meeting. Mr. Amirault stated in hearsay evidence in his witness statement that Corey Higham had told him that the email had been sent. A photocopy of that alleged email was appended to Mr. Amirault's witness statement. However, after Ron Baker made a witness statement stating that he did not recall having received the email, no reply evidence was filed by Corey Higham to say that it had, in fact, been sent. The email is an important document to the extent that it evidences an ongoing interest by SES in receiving answers to the Questions. However, given that it was not properly adduced, the Tribunal gives it no weight.

149 As mentioned above, Mr. Amirault testified that Ron Baker told the SES Group during the Meeting that he had promised a First Nation that the Vendors would not sell the Babkirk Facility to CCS. This meant that SES understood that the Vendors were not likely to receive a competing offer. However, this apparently significant detail did not appear in Mr. Amirault's witness statement and was not referred to in his examination-in-chief. It was mentioned for the first time in answer to a question posed by the Tribunal. For this reason, this evidence is not accepted as an explanation for SES' failure to show a more active interest in purchasing Complete.

150 Mr. Amirault acknowledged that the window for undertaking construction in 2010 "...was closing, closing fast" and that SES wanted to begin construction at Babkirk at the end of August or by mid-September at the latest. This meant that, if SES had been actively interested in acquiring Complete, it would have moved quickly to present the Vendors with a letter of intent. Mr. Amirault also testified that, apart from updating its earlier market study of the Babkirk Facility, no further due diligence was required. In addition, he testified that he did not need the approval of his Board of Directors to deliver a letter of intent. In these circumstances, the Tribunal has concluded that SES' failure to follow up more quickly on its meeting with the Vendors and its failure to demonstrate any interest in making an offer at that time are attributable to a lack of active interest in acquiring BLS in July 2010.

151 Ron Baker recalls that he was called by Corey Higham on July 28, 2010. However, Mr. Baker does not remember what Mr. Higham said during that telephone call. Since Corey Higham did not give evidence, the Tribunal considers it fair to assume that he did not make an offer to purchase Complete or propose a letter of intent. Although Mr. Baker does not recall much of his own side of the conversation, he does remember telling Mr. Higham that Complete had just signed a letter of intent with CCS.

152 The Tribunal considers it noteworthy that, since 2007, SES had been developing a new Secure Landfill called Heritage. It was located approximately 153 km south of the Babkirk Site. However, it was not favourably received during public consultations because it was to be located near a populated area and on a site where a landslide had occurred. Corey Higham of SES was told on July 26, 2010 that the EA's review of the Heritage Project had been "suspended" pending further evidence from SES about the suitability of the site. SES eventually abandoned the project in December of 2010.

153 Based on this evidence, the Tribunal has concluded that SES had an ongoing general interest in the Babkirk Facility. It had spoken to Murray Babkirk when he owned BLS and it had indicated possible future interest when Randy Wolsey contacted it in March of 2010. SES also sent its most senior executive to the Meeting in June 2010. However, the Tribunal has also concluded that SES was not actively interested in a purchase in July 2010. It never discussed a potential price, and, although it asked the Questions, the answers were not crucial to setting the price and SES already knew that it would be granted the additional approvals it sought. Finally, although Mr. Amirault testified that there was no due diligence of any consequence to be undertaken, SES did not send a letter of intent and there are no internal SES documents showing that it was preparing to make an offer. The Tribunal has concluded that SES' failure to take a more active interest in purchasing Babkirk is explained by the fact that it was still giving priority to its project at the Heritage site. This is understandable, since it had already invested three years and approximately $1.3 million in developing the project.

154 In all these circumstances, the Tribunal has concluded, on a balance of probabilities, that SES likely would not have made an acceptable offer for Complete by the end of July 2010 or at any time in the summer of 2010 and that the Vendors would have moved forward with their own plans to develop the Babkirk Facility.

Scenario #2 — The Vendors Operate Babkirk

155 The Vendors' position is that Complete was created to purchase BLS and to operate a bioremediation facility on the Babkirk Site. They assert that their plan was to accept only Hazardous Waste contaminated with light-end hydrocarbons which could be treated using bioremediation.

156 However, the Vendors recognized that bioremediation might sometimes fail and that they might be left with clumps of contaminated soil ("Hot Spots") after the surrounding waste had been successfully treated. The Vendors understood that the

contaminated soil would have to be placed in a Secure Landfill before the remaining soil could be tested and de-listed as non-hazardous waste.

157 To enable BLS to permanently dispose of the contaminated soil from the Hot Spots and to attract customers to the Babkirk Facility, the Vendors proposed to construct a Secure Landfill on the Babkirk Site, which they described as "incidental" to their treatment operation. This meant that only soil that was not successfully treated using bioremediation would be moved into the Secure Landfill. The Tribunal will give this meaning to the term "Incidental" in the context of the Vendors' Secure Landfill in the balance of this decision.

158 The Commissioner denies that the Vendors' Secure Landfill was only to be used on an Incidental basis. She maintains that the Vendors always intended to accept and directly and permanently dispose of all types of Hazardous Waste in their Secure Landfill. We will refer to this business model as a "Full Service" Secure Landfill. To support her position, the Commissioner relies, in part, on the documents used to obtain the EA Certificate and the MOE Permit. These documents will be described collectively as the Regulatory Approval Documents ("RADs"). As discussed below, the RADs clearly indicate that a Secure Landfill was to be opened on the Babkirk Site. The Commissioner also relies on the Draft Operations Plans (the "Operations Plan") for the Babkirk Site, which show that a Full Service Secure Landfill was planned.

159 Finally, the Commissioner relies on statements in a variety of documents which she asserts reflect that the Vendors intended to compete with CCS. She submits that references in those documents to competing with CCS meant operating the Babkirk Facility as a Full Service Secure Landfill.

The Vendors' Documents

160 The Vendors explained that they needed an EA Certificate and an MOE Permit for a Secure Landfill in order to accept Hazardous Waste of any kind for any type of treatment at the Babkirk Facility. However, they also stated that neither document required them to operate on a Full Service basis. In other words, although they were entitled to do so, they were not required to accept all types of Hazardous Waste for direct disposal. Instead, they were free to operate an "Incidental" Secure Landfill.

161 The Vendors ask the Tribunal to focus on the documents which were prepared when Complete was being incorporated and when the MOE Permit was finally granted, as the best evidence of their intention, which they say was to use the Secure Landfill on the Babkirk Site only as Incidental to their bioremediation. The five documents in this category will be described as the "Vendors' Documents". We will deal with them in turn below.

162 *Minutes of a meeting that Randy Wolsey and Ken Watson attended with Del Reinheimer and other MOE and EAO officials on January 24, 2007.* The minutes state:

> <u>Ken [Watson] discussed the remediation side of the facility's operations, which will continue even after (if) the landfill is constructed.</u> He stated that he has had interest expressed from companies who wish to pursue remediation as well as landfilling. Ken outlined some of the practices and equipment currently used in other operations with which he is involved, and showed some pictures and videos of the equipment (e.g. ALLU AS 38 composting machine) in action.
>
> Ken and Randy stated that their intention would be to have an ALLU AS 38 kept at the facility full-time. They cited that it would be capable of processing up to about 25,000m per day of Peace River region clay.
>
> [our emphasis]

163 In his testimony, Mr. Reinheimer agreed that his understanding was that the Vendors were going to operate a bioremediation facility and that it was an open question whether or not the Secure Landfill, for which application had been made, would ever be built. In the Tribunal's view, this evidence supports the Incidental nature of the Secure Landfill.

164 *Minutes of a Newco meeting dated in February 2007*. These minutes record the Vendors' vision for their new business, which was to become Complete. The minutes make no mention of a Secure Landfill at the Babkirk Site. They speak only of processing waste. The document also describes CNRL and Petro-Canada as customers for treatment and indicates that Petro-

Canada has been interested for years. In context, it is clear that Petro-Canada's interest was in bioremediation. The fact that a Secure Landfill is not mentioned even though the application for its approval was already underway, strongly suggests that it was to play an Incidental role in Complete's business at the Babkirk Site.

165 The minutes read as follows:

> **Newco name** should be "**Environmental Services Co**." not "Waste Management (Facility) Co." **Services** to be offered by Newco were suggested to include drilling for sites in the 115 area, remediation on clients' sites, excavation at client sites, and processing at 115 landfill. We could also coordinate the trucking to haul clients' contaminated dirt that we would excavate at client sites to Mile 115 for processing, although we would not own such trucks.
>
> The **Target Market** would be environmental engineering companies and end-user oil and gas companies such as PetroCanada and CNRL. It would be good if we could get a letter from PetroCan/Matrix regarding the potential amount of work. Our services are needed — PetroCan has been interested for years now. This should be a "Market Pull" rather than "Product Push" situation.
>
> There would considerable **landfill preparation** at Mile 115 [the Babkirk Site]. Randy suggested Tom would probably like to be involved here with heavy equipment operation. We expect to have the permit by Nov 1/07. It would probably take 1 year for money to come in from sales for the landfill itself since we have to build the cells.
>
> [the emphasis is in the original]

166 The Tribunal has studied the final passage quoted above and has concluded that, although the term "landfill" is used, the topic under discussion was actually bioremediation and the Vendors' plan to sell the successfully treated soil.

167 *A diagram outlining Newco's operation*. This document shows how Complete's treatment facility on the Babkirk Site would complement other businesses operated by the Vendors. The diagram does not refer to the existence of a Secure Landfill. This omission also suggests that a Secure Landfill was not a significant part of Complete's business or of the Vendors' plan to integrate a number of their businesses.

168 *Minutes of January 20, 2010*. This document describes a meeting that Ken Watson and Ron Baker attended with Del Reinheimer and other officials from the MOE to discuss the Vendors' plans for the Babkirk Site. By this time, Complete owned Babkirk and had received the EA Certificate. The issuance of the MOE Permit for the Secure Landfill was the next step. The relevant portions of the minutes read as follows:

> Ken [Watson] and Ron [Baker] both stressed that although they would rather not use Babkirk as a Landfill but as a treatment facility, industry demands that Babkirk is Permitted as a Secure Landfill prior to transporting materials to or using Babkirk in any way. The term "Secure" appears to be of utmost importance to all major oil and gas companies.
>
> • Although Del [Reinheimer of the MOE] didn't understand why industry perceives as such, he realized the concern.
>
> • He stated that even though the Permit may be approved, operation of a Secure Landfill may not begin until the Operating Plan is also approved and the landfill has been constructed.
>
> • <u>Ken and Ron agreed it is rather the perception of the word "Secure" that is required at this time to entice clients, than the use of an actual operating landfill.</u>
>
> • <u>Ken suggested that prior to approved Secure Landfill operations, unacceptable material could be sent to CCS (small amount around contamination source) and the remainder could be accepted at Babkirk.</u>
>
> All agreed construction of the landfill is to commence within 2 years of Permit issuance; and that the Landfill Operating Plan must be completed prior to construction but the issuance of the Permit itself is not affected by the existence or not of the Operating Plan.

> Ron [Baker] suggested that the Permit read that the construction phase of the landfill be completed in small segments of a $^1/_2$ cell over a period of time rather than the construction of a full $^1/_2$ cell at one time (as suggested by Reg).
>
> [our emphasis]

169 In the Tribunal's view, there are several reasons why this document indicates that the Secure Landfill at the Babkirk Site was to be Incidental. First, Ron Baker was suggesting that even a half cell was not needed and proposed that smaller segments be constructed. This approach makes sense only if the Secure Landfill was to be Incidental. No one intending to compete with CCS' Full Service Secure Landfill at Silverberry would contemplate the construction of a small segment of a half cell.

170 Second, the Incidental nature of the Secure Landfill is disclosed when Ken Watson suggested that, before the Secure Landfill was operational at Babkirk, unacceptable material could be moved to CCS. The interesting point is that the unacceptable material is not material delivered by waste generators for direct disposal into the Secure Landfill at the Babkirk Site. Rather, it is only the "small amount around [the] contamination source" or, in other words, the material around Hot Spots. Once again, this confirms that the Vendors' intention was that their Secure Landfill would only be used on an Incidental basis.

171 *Minutes dated March 20, 2010*. These minutes reflect the Vendors' thinking in response to the offer to purchase that they received from IRTL. The minutes indicate that, at that time, they believed they had the following three options:

> 1. Operate start first secure cell and bioremediate [inc salt];
>
> 2. Bioremediate without cell;
>
> 3. Sell???

The Minutes also stated:

> Need 12 month season to see how well bioremediation works.

172 The Vendors ask the Tribunal to note that this evidence all predates CCS' purchase of Complete and the Commissioner's interest in the Merger. The Vendors also submit that their evidence at the hearing was consistent with their intention to operate only an Incidental Secure Landfill. Both the proposed manager of the Babkirk Facility (Randy Wolsey) and the man who would be in charge of daily operations (Ken Watson) testified that the only waste they intended to accept at Babkirk was waste which could be bioremediated.

The RADs

173 There are numerous RADs, however, those which are particularly relevant are: the "Terms of Reference" dated August 29, 2007; the "Application for an Environmental Assessment Certificate" dated February 11, 2008; the "Babkirk Secure Landfill Project Assessment Report" dated November 12, 2008; and a "BC Information Bulletin" dated December 9, 2008.

174 The first significant RAD is the Terms of Reference for the Babkirk Secure Landfill Project. It was approved by the EAO on August 29, 2007.

175 Section 3.1 reads as follows:

> The Proponent [Murray Babkirk] has experienced a considerable decline in the amount of waste brought to the existing facility for storage and treatment since the approval of the Silverberry Secure Landfill Facility application (north of Fort St. John, B.C.) as understandably, direct disposal forms a more cost effective option for clients than treatment and disposal. The conversion of the existing facility from a purely Short-term Storage and Treatment Facility to a Secure Landfill and Short-term Storage and Treatment Facility will allow fair competition between the Proponent and Silverberry facilities in providing responsible waste management solutions for local industry.

[...]

This section will provide:

[...]

• a list of the materials to be accepted at the Project for disposal;

• a general description of the criteria that will be used to determine whether contaminated soil will be disposed of directly into the secure landfill or treated by bioremediation;

[...]

[our emphasis]

176 This document suggests that the proposed facility on the Babkirk Site would accept Hazardous Waste for direct disposal into the Secure Landfill and that the Secure Landfill was being developed so that the Babkirk Site could compete with CCS at Silverberry. This document was first drafted by SNCL on the instructions of Murray Babkirk, who was effectively the proponent, since, with his wife, he owned BLS. However, as discussed below, some of the Vendors later reviewed it and they did not suggest changes to reflect their intention to operate only an Incidental Secure Landfill. Since the further RADs contain similar language, it is not necessary to describe them in detail. The Tribunal is satisfied that they all indicate that there would be a Full Service Secure Landfill on the Babkirk Site.

177 It is clear that some of the Vendors were, in Karen Baker's words, "integrally involved" during the regulatory process leading to the EA Certificate. Some attended and assisted with information sessions, consultation meetings, and presentations to First Nations; some were included in correspondence regarding the EA Certificate; some participated directly in drafting or reviewing some of the RADs; and some assisted the Babkirks with technical matters. The Vendors also advanced funds which the Babkirks were able to use to finance the environmental assessment process and pay the fees charged by SNCL. This financial support totalled approximately $300,000 and was deducted from the purchase price that Complete eventually paid the Babkirks for the BLS shares. In all these circumstances, the Commissioner submits that the RADs reflect the Vendors' true intentions.

178 However, the Vendors state that while the RADs authorized the construction of a Full Service Secure Landfill, they say nothing about the Vendors' intentions. Mr. Baker explained that, as far as the Vendors were concerned, as long as they had an approval for a Secure Landfill, no one would complain if they chose to operate it on an Incidental basis. He also stated that, if they had asked to amend the Terms of Reference, which is clearly the document on which the later RADs were based, it would have slowed down the approval process for changes that, in the Vendors' opinion, were unnecessary.

179 The Tribunal has concluded that this explanation is reasonable and that it underpins Mr. Baker's response when he was asked why the Vendors didn't correct the Terms of Reference to reflect their intention to operate an Incidental Secure Landfill. He testified:

[...] There was nothing in it that was that onerous to us or important to us to warrant changing.

180 In view of this explanation and in view of the Vendors' Documents which, starting in January 2007, consistently show that their plan was to operate an Incidental Secure Landfill, the Tribunal concludes that, although the RADs accurately described what could be offered at the Babkirk Facility, they did not accurately reflect the Vendors' intentions.

The Operations Plan

181 The Vendors never completed an Operations Plan for the Secure Landfill on the Babkirk Site.

182 The first Operations Plan was prepared by SNCL. An early and incomplete draft of that document is dated January 9, 2008. The evidence showed that a revision was prepared in December 2008. The Tribunal is satisfied that both versions provided in several places that the Secure Landfill could be operated on a Full Service basis. For example:

> [...] <u>The addition of secure landfill capabilities to this facility would allow for direct disposal</u> in addition to treatment and remediation of contaminated soil. This addition would allow the Babkirk facility to compete with the nearby Silverberry Secure Landfill facilities. The proposed facilities would be contained entirely within the footprint of the former facilities.
>
> [our emphasis]

183 Mr. Baker's evidence was that the Vendors worked directly with SNCL on the Operations Plan and that they had worked "quite a little bit" on revisions to the first draft. However, he testified that when the Vendors reviewed the revised version they were not satisfied and decided to prepare their own plan. He added that writing a new plan would have taken "months" of work.

184 However, other evidence makes it clear that the Vendors did not pursue the idea of rewriting the Operations Plan. Minutes of Complete's meeting, which Ron Baker attended in March 2010, show that the Vendors then thought that it was "mostly in order" and that only a couple of weeks were needed to put it in final form for the MOE. Minutes of a later meeting in May 2010 suggest that the Operations Plan needed "4-5 days work".

185 Mr. Baker acknowledged that he understood the Operations Plan to be saying that waste generators could directly and finally dispose of untreatable Hazardous Waste into the Secure Landfill at the Babkirk Site. In this regard, the transcript of his cross-examination at p. 1212 reads:

> Mr. Iatrou: So you would accept waste. Some of it might be highly contaminated, not really treatable. That would stay in [the secure landfill], but the stuff that could be treated would come out of that cell as capacity and the bioremediation cell was freed up?
>
> Mr. Baker: That's correct.

186 However, a review of Mr. Baker's entire cross-examination on the Operations Plan reveals, in the Tribunal's view, that when he gave that answer, he was not saying that the Vendors intended to operate a Full Service Secure Landfill. Rather, he was describing what was possible under the plan. This difference becomes clear in the following exchange:

> Mr. Iatrou: You would accept the same sort of material that you could take to Silverberry?
>
> Mr. Baker: Yes, correct. We <u>could</u> accept it. <u>Our plan was not to accept the type of soil that can only go to Silverberry,</u> if you get my drift here. I suppose I have to explain that slightly.
>
> [our emphasis]

187 Towards the end of his cross-examination, Mr. Baker began to answer questions from the Vendors' perspective. For example, when asked about the section of the Operations Plan that spoke about closing secure cells once they were filled, he stated "This was the concept, that *if we ever got around to using the Secure Landfill section of our facility*..." [our emphasis].

188 And at the end of his examination, when asked whether or not all three secure cells had to be built at once, Mr. Baker said "No, no, no. This whole idea of graded construction was that we — our intention half of one cell and never have to do anything further. That was our intention. *We would store so little of this landfillable material in that portion of a cell that it would last us the lifetime of our interest in this operation*." [our emphasis].

189 In the Tribunal's view, it is clear that the Vendors' approach to the Operations Plan was the same as it had been to the RADs. A plan that permitted the direct disposal of Hazardous Waste did not oblige the Vendors to accept it. It is obvious to the Tribunal that, from the early days of Newco in 2007, the Vendors wanted to make the Babkirk Facility as attractive as

possible for sale and this meant that it had to be capable of being operated as a Full Service Secure Landfill. However, this does not mean that the Vendors intended to operate the Babkirk Facility in that manner given their long expressed preference for a bioremediation facility with an Incidental Secure Landfill.

Was Babkirk Going to Compete with CCS?

190 The Commissioner also relies on what she describes as the Vendors' expressed intention to compete with CCS to support her allegation that Complete was poised to operate a Full Service Secure Landfill at the Babkirk Site. The statements on which she relies are found in the RADs, the Operations Plan and in Complete's minutes.

191 There is no doubt that, in 2006 when the Babkirks approached SNCL to work on documents for the EA Certificate, they intended to operate a Full Service Secure Landfill on the Babkirk Site once the approvals were in place. As noted earlier, the original project description prepared by SNCL makes this clear when it says:

> The Proponent [BLS owned by the Babkirks] has reportedly experienced a considerable decline in his soil storage and treatment business since the approval of the Silverberry Secure Landfill Facility application (north of Fort St. John, BC) as understandably, direct disposal forms a more cost effective option for clients than treatment and disposal. <u>The conversion of the existing facility from a purely Short-term Storage and Treatment Facility to a Secure Landfill and Short-term Storage and Treatment Facility will allow fair competition between the Proponent and Silverberry facilities in providing responsible waste management solutions for local industry.</u>
>
> [our emphasis]

192 This language is repeated in the Terms of Reference and the point is made even more clearly in the application for the EA Certificate. It states that the proposed facility would allow the proponent to provide "market competition for direct disposal of waste soil" and speaks of the Babkirk Facility being in "direct competition" with CCS at Silverberry.

193 The Vendors' Operations Plan also mentions that the Secure Landfill has been added to the Babkirk Site to allow it to compete with Silverberry and, in the Vision Statement she wrote for Newco, which is attached to minutes dated June 22, 2008, Karen Baker stated that the Vendors wanted Complete "...to become the Number One Competitor to the industry leader [CCS/Newalta]".

194 In his cross-examination at the hearing, Randy Wolsey acknowledged an intention to compete with CCS. However, he testified that while landfilling and competing with Silverberry was "going to happen", it would be on a "very different scale" because the Vendors were going to supply a "brand new service".

195 Mr. Baker also acknowledged in his testimony that the Vendors did intend to compete with CCS and others, but not on price. He stated that they were going to compete by offering a service that was different from anything offered by CCS or Newalta.

196 The Tribunal has concluded that Complete intended to "compete" with Silverberry by offering a new bioremediation service, and that its statements about competition were not intended to mean that the Vendors planned to operate a Full Service Secure Landfill on the Babkirk Site.

Conclusions

197 If the Merger had not occurred, it is the Tribunal's view that, at the end of July 2010, in the absence of a letter of intent from SES, the Vendors would have proceeded to develop the Babkirk Facility. This would have involved:

- Completing the Operations Plan;
- Securing the MOE's approval for the Operations Plan;

• Constructing a half cell of Secure Landfill capacity i.e. 125,000 tonnes; and

• Accepting Hazardous Waste for bioremediation and moving waste that could not be successfully bioremediated into the Incidental Secure Landfill.

198 Although there was evidence to suggest that the Vendors might have decided to start accepting waste for bioremediation without any Secure Landfill capacity, the Tribunal has concluded that the Vendors would likely have built their half cell of Secure Landfill as soon as possible for two reasons. First, the Vendors told Del Reinheimer of the MOE on January 20, 2010 about the importance customers placed on having Secure Landfill capacity available. Indeed, Petro-Canada had refused to deliver waste for bioremediation until the Vendors opened a Secure Landfill. Second, Ken Watson testified that the plan was to store in the Secure Landfill all waste that was awaiting treatment. Presumably, this storage capacity would have been needed as soon as the business started in earnest.

199 The Tribunal has also concluded that it is more likely than not that the Vendors would have had an approved operations plan by the end of October 2010 and that the three months of preparatory work, which Ken Watson testified was needed before the Babkirk Facility could accept waste, would have been substantially completed by the end of October 2010.

200 This means that in the spring of 2011, the Vendors would have been able to accept waste for bioremediation. However, since generators had advised that they would not tip until a Secure Landfill was available, it is unlikely that any meaningful quantity of waste would have been delivered. Construction of the half cell of Incidental Secure Landfill would have begun as soon as the construction season opened in June 2011. Accordingly, given that the evidence showed that the construction would take three or four months, the Tribunal has concluded that the Babkirk Facility would have been fully operational by October 2011.

201 The evidence establishes that the Vendors felt that a twelve month period was needed to see how well bioremediation would work. The Tribunal therefore considers it reasonable to project that the Vendors would have carried on with bioremediation as their principal focus through the fall of 2012. However, the Tribunal has also concluded that, notwithstanding Ken Watson's contacts and his experience with bioremediation, the Vendors' bioremediation business would have been unprofitable for the reasons discussed below.

202 There would have been few if any customers for two reasons. First, while the evidence showed that there is a significant amount of treatable soil on drilling sites in the area around the Babkirk Facility, the bioremediation that presently occurs is done by generators on their own sites. There was no evidence that any companies are paying to transport waste to offsite bioremediation facilities in NEBC. Although Ken Watson testified that he expected that CNRL, Encana, and Bonavista would be interested in disposing of their waste in this fashion and, although Petro-Canada had been interested, the Vendors did not call evidence from any prospective customers to say that they would be prepared to truck their waste to the Babkirk Facility for bioremediation. Further, the Vendors provided the Commissioner with a list of potential customers and *[CONFIDENTIAL]* was first on that list. However, Mr. *[CONFIDENTIAL]*, Vice-President, Operations at *[CONFIDENTIAL]*, testified for the Commissioner that *[CONFIDENTIAL]* philosophy is "going to landfill". In other words, his company was not a significant potential customer for the Vendors' bioremediation facility.

203 Second, the Vendors testified that the Tipping Fees they would charge for bioremediation would be significantly higher than Silverberry's Tipping Fees for Secure Landfill services. It is difficult to imagine that generators with waste that could be bioremediated on their own sites would pay large sums to transport their Hazardous Waste to Babkirk and tip there at rates higher than those at Silverberry, given that they could continue to bioremediate on their own sites or tip for less at Silverberry.

204 Further, there was no evidence from any potential purchasers who might have bought treated waste from Complete for use as cover for municipal dumps or as backfill for excavations. It does not appear that any such sales would have been available to generate revenue for Complete.

205 It is not clear how long the Vendors would have been prepared to operate on an unprofitable basis, without beginning to accept more waste at the Secure Landfill part of the Babkirk Facility. In their final written submissions, the Vendors ask the Tribunal to assume that they would have incurred losses for two years before they decided that their venture had failed.

206 However, the Tribunal has concluded that, because there was no evidence that the Vendors have deep pockets or significant borrowing power, it is unreasonable to suppose that they would have been prepared to operate unprofitably beyond the fall of 2012, when they could have generated additional revenues by accepting more waste into the Secure Landfill part of their facility.

207 Accordingly, it is the Tribunal's view that the Vendors would have started to operate a Full Service Secure Landfill at least by the spring of 2013. In other words, they would have begun to accept significant quantities of Hazardous Waste for direct disposal into Babkirk's Secure Landfill, in competition with CCS. In the alternative, they would have sold Complete or BLS to a purchaser which would have operated a Full Service Secure Landfill. Given that the Vendors had a valuable and scarce asset and given the evidence that demand for Secure Landfill services has, for some time, been projected to increase as new drilling is undertaken in the area north and west of Babkirk, the Tribunal is satisfied that such a sale would have been readily available to the Vendors. Finally, whether Babkirk was operated by the Vendors or a new owner, Babkirk and Silverberry would have become direct and serious competitors by no later than the spring of 2013.

208 We have reached this conclusion notwithstanding CCS' submission that the Vendors' lack of experience and the smaller capacity of the Babkirk Facility would have constrained it from functioning as a serious competitor. In our view, as they had done in the past when they retained IRTL, the Vendors would have hired experts, if needed, to redress their lack of expertise. Moreover, 750,000 tonnes of permitted capacity was sufficient to allow the Vendors or a purchaser to compete effectively with CCS at Silverberry.

209 To summarize, the Tribunal has decided that it is likely that the Vendors would have operated a bioremediation treatment facility with an Incidental Secure Landfill for approximately one year from October 2011 to October 2012 (the "Initial Operating Period"). Thereafter, in the spring of 2013, the Babkirk Facility would have become a Full Service Secure Landfill.

210 Turning to the impact of these developments, it is the Tribunal's view that, as soon as the half cell of the Secure Landfill capacity at the Babkirk Facility was operational in October of 2011, waste generators who tipped at Silverberry would have seen that there was a potential alternative to Silverberry at the Babkirk Facility. The Tribunal cannot predict what would actually have happened. However, we can reasonably expect that, during the Initial Operating Period, some generators of Hazardous Waste would have asked the Vendors to take their waste for direct disposal, if only to use the possibility of disposing at Babkirk as a basis for negotiating lower Tipping Fees at Silverberry. This would have been possible because many oil and gas producers have one year non-exclusive contracts with CCS.

211 As well, given that the Vendors would have needed revenue and given that it might have been convenient for some of their customers, it is reasonable to assume that the Vendors would have accepted at least some Hazardous Waste for direct disposal during the Initial Operating Period, in spite of their evidence that this was not their intention. This possibility was foreseen by Ron Baker when, in his cross-examination, he was asked about the decision matrix in the Operations Plan which reflected that soil which arrived and could not be bioremediated would be landfilled with other soil that could not be bioremediated. He said that, "if we had room", "chances are" such soil would be put in the Secure Landfill.

212 The question is whether this competition afforded by Babkirk in the Initial Operating Period can be considered substantial. In *Canada (Director of Investigation & Research) v. Tele-Direct (Publications) Inc.* (1997), 73 C.P.R. (3d) 1 (Competition Trib.), the Tribunal addressed the question of the potential importance of a small amount of competition, in the course of examining the impact on Yellow Pages consultants of Tele-Direct's discriminatory anti-competitive practices. In that case, the Tribunal was considering whether there had been a substantial lessening of competition.

213 The Tribunal heard evidence that consultants, who charged fees to place Yellow Pages advertisements, had lost time and money and that their ability to attract new customers had been damaged by Tele-Direct's conduct. The Tribunal also found that, although the consultants only occupied a small segment of the market and had a limited and fragile ability to compete with

Tele-Direct, they had had a significant positive influence on the level of service Tele-Direct provided to customers who were purchasing yellow pages advertisements. In this context the Tribunal stated at paragraph 758:

> Where a firm with a high degree of market power [Tele-Direct] is found to have engaged in anti-competitive conduct, smaller impacts on competition resulting from that conduct will meet the test of being "substantial" than where the market situation was less uncompetitive to begin with. In these circumstances, particularly Tele-Direct's overwhelming market power, even a small impact on the volume of consultants' business, of which there is some evidence, by the anti-competitive acts must be considered substantial.

214 In contrast, in this case, the Tribunal has concluded that the competition offered by the Babkirk Facility in the Initial Operating Period would likely have had no material, let alone significant, impact on pricing at Silverberry, because any competition would have been offered on an extremely small scale. In our view, during the Initial Operating Period, Silverberry could have ignored any requests by customers for lower prices because the Babkirk Facility would not have been a viable alternative for the volumes of Hazardous Waste oil and gas producers tipped at Silverberry. This means that the prevention of any competition that would have developed in the Initial Operating Period would not have been "substantial".

215 Turning to the spring of 2013, the competition that would have been offered by Babkirk as a Full Service Secure Landfill would have been direct and substantial and, as discussed below, it is this competition that was substantially prevented by the Merger.

B. What are the Relevant Assessment Factors?

Conditions of Entry

216 The conditions of entry into a relevant market can be a decisive factor in the Tribunal's assessment of whether a merger is likely to prevent or lessen competition substantially. This is because, "[i]n the absence of significant entry barriers it is unlikely that a merged firm, regardless of market share or concentration, could maintain supra-competitive pricing for any length of time" (*Hillsdown*, above, at 324; see also *Propane*, above, at para. 127).

217 To be effective, entry must be timely, likely and sufficient to ensure that any prevention of future competition will not be substantial.

218 CCS maintains that the evidence in this case is that the Secure Landfill business is not characterized by significant entry barriers and that the conditions for entry are conducive for potential competitors. In this regard, CCS asserts that (i) the regulatory regime is permissive, as evidenced by the fact that a number of permits to operate a Secure Landfill have been granted in NEBC in recent years, (ii) there is a growing market in the NEBC region for oil and gas drilling and related services, coupled with a growing demand and pressure for socially responsible waste management alternatives, and (iii) the industry practice of engaging in short-term contracts is conducive to entry. CCS further asserts that the Commissioner's reliance on the fact that BLS took nearly four years to obtain its Secure Landfill permit is misplaced, most importantly because BLS did not pursue concurrent permitting. Concurrent permitting allows an applicant to pursue applications for EA Certificates and an MOE Permits (together the "Authorizations") in tandem. CCS also asserts that entry is much less time consuming if a remote area near Babkirk is selected. Thus, attempts to develop secure landfills in populated areas around Dawson Creek should not be accepted as precedents for the timing that entry might involve near Babkirk.

219 Among other things, prior to seeking the Authorizations, a new entrant must spend several months selecting a site from among various potential sites. This involves drilling test holes to determine whether the site's subsurface characteristics are appropriate for Secure Landfilling. If so, a further assessment is undertaken which involves drilling multiple test holes and installing monitoring equipment. There is no evidence about the time needed to complete only a site selection. However, *[CONFIDENTIAL]* spent 15 to 18 months on site selection and the preparation of an application for a potential landfill.

220 Once a potential entrant has completed the site selection described above, it must then obtain the required Authorizations. The evidence is that this process would likely take at least 18-24 months and that a further 3 to 4 months are needed for construction.

221 Notwithstanding the time and money ($1.3 million) it spent during the development process, as described earlier, SES abandoned its plans to open the Heritage landfill and, after spending $885,000.00, CCS abandoned its proposed Sunrise Landfill in NEBC, due to opposition from local residents. These two incidents of site abandonment by knowledgeable industry participants underscore the risk and uncertainty associated with new entry, as well as the "sunk" nature of the entry costs in the event that an entry initiative is unsuccessful.

222 Based on this evidence, the Tribunal has concluded that, even in a remote location and even with concurrent permitting, it would take a new entrant at least 30 months to complete the process of selecting a new site, obtaining the required Authorizations and constructing a new Secure Landfill. That said, the Tribunal notes that there is no evidence of any proposed entry in the Contestable Area.

Absence of Acceptable Substitutes/Effective Remaining Competition

223 For the reasons given earlier, the Tribunal is satisfied that, for some product and for some generators, bioremediation does not compete in the same market as the supply of Secure Landfill services and does not exercise any constraining influence on price or non-price competition within the latter market.

224 This conclusion is supported by the fact that CCS' Tipping Fees are significantly higher in areas where it does not face competition from other Secure Landfill operators, than they are in areas where CCS does face such competition. In addition, the "natural experiment" that occurred when SES opened its facility in Willesden Green Alberta, and CCS substantially reduced its Tipping Fees to seven of its significant customers, strongly suggests that CCS' pricing behaviour is primarily determined by reference to the location of competing suppliers of Secure Landfill services, rather than by competition with suppliers of bioremediation services.

225 Dr. Baye provided extensive evidence with respect to CCS' alleged ability to price discriminate in order to show that it had market power. However, given the foregoing and because CCS is a monopolist in the relevant market and is not constrained by any actual or potential competition from within or outside the market, it is clear that CCS has significant market power. This conclusion is further supported by the discussion of countervailing market power immediately below. For this reason, it is not necessary to consider the allegation of price discrimination.

Countervailing Power

226 CCS correctly notes that none of its customers have complained about the Merger. CCS encourages the Tribunal to infer from this that the Merger is not likely to prevent competition substantially. However, the Tribunal is not persuaded that this is a reasonable inference.

227 The Tribunal recognizes that CCS' largest customers pay lower Tipping Fees than its smaller customers. However, the Tribunal notes that Dr. Baye's report indicates that even CCS' largest customers are forced to pay higher Tipping Fees in areas where CCS faces no competition than in areas where such competition exists and this evidence was not contested. In 2010, the average Tipping Fees at Silverberry and Northern Rockies were *[CONFIDENTIAL]* and *[CONFIDENTIAL]* respectively. However, Tipping Fees at CCS' South Grande Prairie *[CONFIDENTIAL]* and Rocky *[CONFIDENTIAL]* in Alberta were significantly lower because they both face competition from SES. This no doubt explains why Mr. *[CONFIDENTIAL]*, who testified for the Commissioner, made it clear in his testimony that he would welcome competition for CCS in NEBC.

228 The attenuated or limited nature of any countervailing power that may be in the hands of CCS' largest customers is also reflected in the evidence that written requests by them for price relief were rejected by CCS during the industry downturn in late 2008 and early 2009.

C. Conclusions

229

> (i) Based on all of the foregoing, the Tribunal has concluded that the Merger is likely to prevent competition substantially. The Merger prevented likely future competition between the Vendors and CCS in the supply of Secure Landfilling services in, at the very least, the Contestable Area. Although the competition that was prevented in 2012 is not likely to be substantial, the Tribunal is satisfied that by no later than the spring of 2013, either the Vendors or a party that purchased the Babkirk Facility would have operated in direct and serious competition with CCS in the supply of Secure Landfill services in the Contestable Area.
>
> (ii) In estimating the magnitude of the likely adverse price effects of the Merger, the Commissioner relied on expert evidence adduced by Dr. Baye. That evidence included economic theory and regression models. However, for reasons discussed below the Tribunal has not given significant weight to that economic theory or to those regression models in assessing the magnitude of the likely adverse price effects of the Merger. In reaching this decision, the Tribunal took into account the fact that the models do not control for costs, and the fact that, although Dr. Baye acknowledged that his theory of spatial competition should only be used if other data were unavailable, he used his theory even though he had actual CCS data.
>
> (iii) Nevertheless, as discussed below in connection with the "effects" element of section 96, the Tribunal is satisfied that prices likely would have been at least 10% lower in the Contestable Area in the absence of the Merger.
>
> (iv) The Tribunal therefore finds that the Merger is more likely than not to maintain the ability of CCS to exercise materially greater market power than in the absence of the Merger, and that the Merger is likely to prevent competition substantially.

Issue 7 When the Efficiencies Defence Is PLEADED, What is the Burden of Proof on the Commissioner and on the Respondent?

230 CCS has alleged that the Commissioner failed to properly discharge her burden to prove the extent of the quantifiable effects of the Merger. CCS alleges that the Commissioner's failure to prove those effects in her case in chief has precluded CCS from being able to meet its overall burden to prove the elements of the efficiencies defence on a balance of probabilities. CCS asserts that the Commissioner's failure means that the effects should be zero and that the Application should therefore be dismissed.

231 In paragraph 48 of its response to the Commissioner's Application, CCS pleaded the efficiencies defence in the following terms:

> The Acquisition has brought about or is likely to bring about gains in efficiency that will be greater than, and will offset, the effects of any prevention of competition that will result from the Acquisition, and the gains in efficiency will not likely be attained if the requested order or orders are made by the Tribunal.

232 The burdens of proof under section 96 were established and applied over the course of the four decisions in *Propane* (*Propane*, at para. 48, rev'd on other grounds 2001 FCA 104, [2001] 3 F.C. 185 (Fed. C.A.) ("*Propane 2*"), leave to appeal to SCC refused [2001 CarswellNat 1905 (S.C.C.)], 28593 (September 13, 2001), redetermination, *Canada (Commissioner of Competition) v. Superior Propane Inc.*, 2002 Comp. Trib. 16, 18 C.P.R. (4th) 417 (Competition Trib.) ("*Propane 3*"), aff'd 2003 FCA 53, [2003] 3 F.C. 529 (Fed. C.A.) ("*Propane 4*")). "The effects of any prevention or lessening of competition" must be demonstrated by the Commissioner on balance of probabilities (*Propane*, above, at para. 402; *Propane*, above, at para. 177, *Propane*, at para. 17). Her burden is to prove (i) the extent of the *anti-competitive* effects in question where they are quantifiable, even if only roughly so (*Propane*, at paras. 35-38), and (ii) any non-quantifiable or qualitative *anti-competitive* effects of the merger. It also includes the burden to demonstrate the extent of any *socially adverse* effects that are likely to result from the merger, i.e., the proportion of the otherwise neutral wealth transfer that should be included in the trade-off assessment contemplated by section 96, as well as the weighting that should be given to those effects (*Propane*, above, at paras. 35-38,

and 61-64). In this case, there being no socially adverse effects, the term "Effects" will be used to described quantifiable and non-quantifiable anti-competitive effects.

233 That said, the respondents bear the burden on the ultimate issue, namely, that the efficiency gains are likely to be greater than, and to offset, the effects of any prevention or lessening of competition likely to result from the merger (*Propane*, above, at para. 154).

234 There is no dispute about the fact that, in his expert report in chief, Dr. Baye only calculated that an average price decrease of at least 10% would be prevented by the Merger. This meant that CCS did not have a figure for the Effects and was obliged to serve its expert report on efficiencies with no ability to take a position about whether the number it calculated for its total efficiencies was greater than the Effects. As a result, CCS maintains that, as a matter of substantive and procedural fairness, it was effectively denied a right of response and the ability to properly meet its own burden under section 96. It therefore asserts that the Tribunal should conclude that there are no quantified Effects as a result of the Merger.

235 Dr. Baye did eventually quantify the Effects but not until he wrote his reply report, which was only made available to CCS two weeks before the hearing. By then, the Tribunal's Scheduling Order did not permit CCS to bring a motion or file a further expert report. In addition, the Tribunal accepts that, in practical terms, there was insufficient time before the hearing to permit CCS to move to strike Dr. Baye's report or to seek leave to file a further report in response to the Commissioner's quantification of the Effects.

236 The Commissioner maintains that her substantive burden to quantify the Effects only arises once a respondent advances its affirmative defence by proving efficiencies. She submits that any other result would require her to respond to every bald assertion of efficiencies, regardless of whether a respondent actually relies on efficiencies at the hearing. She asserts in her final written argument that this "would be an incredible waste of resources, and one that is antithetical to the notion of responding to an affirmative defence".

237 In the Tribunal's view, the Commissioner's argument about resources does not justify her failure to meet her burden to prove the Effects as part of her case in chief. Once CCS pleaded section 96, the efficiencies defence became part of the fabric of the case and, if it had not been pursued by CCS, the Commissioner would have been entitled to costs fully compensating her for work done by her experts to calculate the Effects.

238 The Commissioner also defended her approach by stating that, until CCS served Dr. Kahwaty's report on efficiencies ("Efficiencies Report"), it was an open question whether it was going to pursue the efficiencies defence at all. In this regard, she noted that prior to serving that report, CCS advanced no facts or proof of efficiencies, and provided no guidance on the types of efficiencies that Dr. Kahwaty planned to identify and quantify. She also observed that the Tribunal's Revised Scheduling Order, dated August 19, 2011, indicated that CCS might not pursue the efficiencies defence.

239 The revised scheduling order required the "Corporate Respondents to serve expert reports*, if any*, on efficiencies and provide them to the Tribunal" on or before October 7, 2011 (our emphasis). However, since the phrase "if any" was proposed by the Commissioner and not by CCS, the Tribunal does not accept that it suggests that CCS had resiled from its pleading.

240 In addition, the Tribunal can find no basis in the record for concluding that CCS did not intend to mount the efficiencies defence. The Tribunal notes that the Commissioner asked questions about efficiencies during examination for discovery and asked, during a case management teleconference on August 15, 2011, that CCS be ordered to produce documents relevant to the issue. During that teleconference, the Presiding Judicial Member stated that efficiencies were at issue and that, if relevant documents existed, their production was required.

241 Given the pleading of section 96 and these developments, the Tribunal concludes that there was no reason to doubt that CCS would pursue an efficiencies defence.

242 The Commissioner further asserts that the legislation and the case law do not dictate how she must meet her burden to prove the extent of the Effects. She submits that she is not obliged in every case to lead evidence about demand elasticities

and provide detailed calculations about the range of likely Effects. This is particularly so in a case such as this in which she asserts that the efficiencies are "plainly so minimal that it was an open question whether [the efficiencies defence would even be pursued]".

243 The Tribunal acknowledges that the legislation and the jurisprudence do not dictate how the Commissioner must meet her burden. However, as noted above, where it is possible to quantify the Effects of a merger, even if only in "rough" terms, the Commissioner has the onus to provide an estimate of such Effects (*Propane*, above, at paras. 35 — 38).

244 Indeed, where the necessary data can be obtained, the Commissioner will be expected in future cases to provide estimates of market elasticity and the merged entity's own-price elasticity of demand in her case in chief. These estimates facilitate the calculation of the magnitude of the output reduction and price effects likely to result from the merger. They are also necessary in order to calculate the deadweight loss ("DWL") that will likely result from the output reduction and related price effects. DWL is the loss to the economy as a whole that results from the inefficient allocation of resources which occurs when (i) customers reduce their purchases of a product as its price rises, and shift their purchases to other products that they value less, and (ii) suppliers produce less of the product.

245 Given that there will often be shortcomings in the data used to estimate market elasticities and the merged entity's own-price elasticity of demand, prudence dictates that a range of plausible elasticities should be calculated, to assist the Tribunal to understand the sensitivity of the Commissioner's estimates to changes in those elasticities. The Tribunal will be open to making its assessment of the quantitative extent of the Effects on the basis of persuasively supported "rough estimates" of those Effects, but only if the data required to reliably estimate elasticities cannot reasonably be obtained. Such rough estimates may be derived from evidence with respect to the magnitude of the likely price effects of the merger, including statements or projections made in the internal documents of the respondent or its advisors (including its investment bankers); persuasive estimates by customers, other lay witnesses, or expert witnesses; and persuasive evidence from "natural experiments."

246 Although the Commissioner failed to meet her burden, in the unusual circumstances of this case, CCS was not prejudiced by that failure because, instead of doing the required independent analysis of elasticities, Dr. Baye relied on his assumed price decrease of at least 10% and on certain assumptions used by Dr. Kahwaty in calculating CCS' claimed market expansion efficiencies. In making that calculation, Dr. Kahwaty assumed that the opening of a Secure Landfill at Babkirk would lead waste generators to dispose of approximately *[CONFIDENTIAL]* additional tonnes of Hazardous Waste, as forecast in CCS' internal documents. Further, during the hearing. Dr. Kahwaty was able to effectively attack Dr. Baye's DWL calculations on various grounds, including his failure to base them on conventional calculations of elasticities when he could have obtained the data necessary to perform those calculations. In short, CCS was able to effectively assert the defence and argue that the efficiencies its expert presented were greater than the Effects (i.e. the DLW) calculated by Dr. Baye. For these reasons, the Tribunal declines to dismiss the Application.

247 There is a second reason why CCS' request is being denied. CCS was also required to show that the cognizable efficiencies would be likely to *offset* the Effects. This means that even if the Tribunal had accepted CCS' submission that a zero weighting should be given to the quantifiable Effects, it would not necessarily follow that the Tribunal would find that the *offset* element of section 96 has been established on a balance of probabilities.

248 This is so for two reasons. First, as noted in *Propane*, above, at para. 172, "it cannot be concluded that the Tribunal would find that efficiency gains (whether large or small) that marginally exceeded the effects (whether large or small) would necessarily offset those effects." This is because the loss of dynamic competition will always merit some non-trivial qualitative weighting in the trade-off assessment. Indeed, dynamic efficiencies and dynamic Effects can have a major impact on the trade-off assessment. Second, in this case, the Commissioner adduced evidence of *qualitative* Effects in Dr. Baye's expert report in chief. As well, CCS adduced evidence of qualitative efficiencies, such as improved service, reduced risk for customers and the environment, which put in play the issue of whether a substantial prevention of competition likely would adversely impact upon these matters.

249 Accordingly, the Commissioner's failure to meet her burden to quantify the Effects, even in rough terms, at the appropriate time is not a sufficient reason to conclude that CCS is relieved of its obligation to meet its burden to meet the "offset" element in section 96.

Issue 8 Has CCS Successfully Established an Efficiencies Defence?

What are the Claimed Efficiencies?

250 We now turn to summarizing the efficiencies claimed by CCS. In that regard, Dr. Kahwaty testified on behalf of CCS that the Merger would likely result in efficiencies that he grouped into the following five categories.

251 *Transportation efficiencies*: These were described as being productive efficiencies realized by those customers presently serviced at Silverberry, who have an aggregate of *[CONFIDENTIAL]* locations that are situated closer to the Babkirk Facility than to Silverberry. Once CCS opens the Babkirk as a Secure Landfill, those customers will realize significant transportation cost savings, thereby freeing up resources for other uses. Based on what he described as the "going rate" of approximately *[CONFIDENTIAL]* for trucking services, the number of loads shipped from each of the above-mentioned *[CONFIDENTIAL]* locations in 2010, and the time saved by tipping at Babkirk instead of Silverberry, Dr. Kahwaty estimated the annual aggregate transportation cost savings for the aforementioned customers to be *[CONFIDENTIAL]*. Using a lower trucking rate of *[CONFIDENTIAL]* per hour per load (or $5 per tonne per hour of transport), Dr. Kahwaty provided a second estimate of those annual transportation cost savings, which totaled *[CONFIDENTIAL]*. Dr. Kahwaty also calculated that his two estimates represented approximately *[CONFIDENTIAL]* and *[CONFIDENTIAL]* respectively of CCS' 2010 revenue derived from the *[CONFIDENTIAL]* customer locations in question.

252 *Market expansion efficiencies*: Dr. Kahwaty stated that, absent the opening of a Secure Landfill at Babkirk, a significant volume of existing Legacy Waste and newly generated Hazardous Waste, within the drawing area of the Babkirk Facility, would not have been transported to Silverberry due to the significant risk, and related financial liability, that would be associated with transporting such waste over the long distance to Silverberry. However, with the opening of a Secure Landfill at the Babkirk Site, CCS estimated that approximately *[CONFIDENTIAL]* tonnes per year of such waste ("Market Expansion Waste") likely would be transported for disposal at Babkirk. Dr. Kahwaty acknowledged that this estimate is "necessarily imprecise," and suggested that the incremental volume of Market Expansion Waste could substantially exceed CCS' estimate of *[CONFIDENTIAL]* tonnes per year. Based on the reported margin for Silverberry in 2009 of *[CONFIDENTIAL]* and a price of *[CONFIDENTIAL]* per tonne, Dr. Kahwaty estimated an increase in producer surplus from this incremental volume of *[CONFIDENTIAL]*. In addition, based on an estimated reduction in disposal costs of *[CONFIDENTIAL]* per tonne, Dr. Kahwaty estimated that customers would gain approximately *[CONFIDENTIAL]* per year in consumer surplus. This is only 50% of the product of multiplying *[CONFIDENTIAL]* by *[CONFIDENTIAL]*, because Dr. Kahwaty felt that customers do not gain the full reduction in the costs of disposal when they are induced to dispose of their waste by virtue of a lower overall cost of disposition. The sum of the estimated *[CONFIDENTIAL]* in producer surplus gains and the estimated *[CONFIDENTIAL]* in consumer gains, was a total of *[CONFIDENTIAL]* of annual market expansion efficiencies.

253 *Overhead Efficiencies*: Dr. Kahwaty estimated that the Merger would result in annual overhead savings of approximately *[CONFIDENTIAL]*. He stated that these savings likely would be achieved by virtue of the fact that CCS could draw upon its existing administrative staff (e.g., those persons who deal with legal, regulatory, marketing, engineering, financial and health & safety matters) in operating the Babkirk Facility. In the absence of the Merger, he stated that the Vendors likely would have had to incur expenses associated with these functions. In reaching his estimate of *[CONFIDENTIAL]*, Dr. Kahwaty used the cost reductions that CCS has achieved in operating Complete's Roll-off Bin Business as a proxy. In addition, he submitted that some "qualitative" credit should be given to this category of efficiencies, because Complete would otherwise need to expend resources developing administrative systems and to deal with some of the matters identified above.

254 *Roll-off Bin Business Efficiencies*: Dr. Kahwaty estimated that CCS's Merger of the Roll-off Bin Business has resulted in annual cost savings of approximately *[CONFIDENTIAL]*. These savings were described as having been achieved as a result

of (i) the upgrading of its trucks to meet higher safety standards, (ii) investments in business development efforts, and (iii) the absorption of administrative functions, such as billing, into CCS' pre-existing corporate systems.

255 *Qualitative efficiencies*: Dr. Kahwaty listed the following qualitative efficiencies as being likely to result from the Merger:

a. the landfill services to be offered by CCS at the Babkirk Site will be of higher (and known) quality and involve less risk for customers due to CCS's knowledge and experience in the operation and management of hazardous waste landfills;

b. customers will benefit from being able to purchase bundled packages of services that may include, for example, loading, trucking and tipping services;

c. the landfill services to be offered by CCS at the Babkirk Site will reduce risks for customers due to CCS's substantial financial resources, which provide assurance to customers regarding the long-term management of the Babkirk Facility and the potential continuing liability for wastes disposed in that landfill;

d. CCS will have the capability and resources necessary to expand the Babkirk Facility as necessary and to meet special customer needs (e.g., rapid responses to increased disposal needs);

e. since landfilling is CCS' business and since the Vendors were not planning to operate a Secure Landfill, CCS will promote landfilling services to a greater extent than the Vendors would have done, once the Babkirk Site is operational, making trucking cost efficiencies available to more customers;

f. the provision of Secure Landfill services by CCS at the Babkirk Site will reduce risks for generators, trucking firms, and other road users related to the transportation of Hazardous Waste on roads over long distances;

g. increased competition in the Roll-off Bin Business will benefit roll-off customers and may reduce the extent of any DWL in the roll-off industry, which will increase the total surplus generated in the roll-off marketplace; and

h. increased site remediation from reduced trucking costs will benefit area residents, wildlife, and the overall environment, and will also further the government's policy of expanding contaminated site remediations.

256 Dr. Kahwaty also stated that some or all of the efficiencies identified above would likely be achieved sooner by CCS than by Complete or by any third-party who might acquire the Babkirk Facility pursuant to an order of the Tribunal.

257 In addition, Dr. Kahwaty stated that CCS should be given credit for some of the efficiencies that it has already achieved in respect of the Roll-off Bin Business.

258 Finally, Dr. Kahwaty provided reasoned estimates about the extent to which the above-mentioned trucking and market expansion efficiencies would increase under market growth scenarios of 1%, 2% and 4% compounded annually over the next 10 years. Based on this work, he suggested that these increased efficiencies ought to be considered by the Tribunal.

259 After providing his annual estimates of the quantifiable efficiencies, Dr. Kahwaty calculated the net present value of those efficiencies as of January 1, 2012 using three different discount rates: (i) a risk-free interest rate of 1%, which he described as being the annual yield on one to three year government of Canada marketable bonds over the 10 week period preceding the date of his report (October 7, 2011); (ii) an interest rate of 10%, which he described as being "roughly equivalent to rates prevailing in the oil and gas industry"; and (iii) an intermediate rate of 5.5%.

260 The Tribunal accepts the evidence of Mr. Harrington, the Commissioner's expert, that, in broad terms, the discount rate used in calculating the net present value of efficiencies typically does not matter, so long as the same discount rate is used to calculate the net present value of the Effects. That said, the Tribunal also accepts Mr. Harrington's evidence that, (i) as a general principle, the appropriate discount rate to use in discounting a set of future cash flows is a function of the risk of those cash flows being wrong, (ii) there is some uncertainty associated with the efficiencies identified and estimated by Dr. Kahwaty and

CCS, and therefore (iii) the midpoint (5.5%) of the three discount rates identified by Dr. Kahwaty is the most defensible of the three rates to use in calculating efficiencies and Effects in this case.

The assessment of the claimed efficiencies

261 In the initial stage of assessing efficiencies claimed under section 96 of the Act, the Tribunal applies five screens to eliminate efficiencies that are not cognizable under that section.

262 The first screen eliminates claims that do not involve a type of productive or dynamic efficiency, or that are not otherwise likely to result in any increase in allocative efficiency. The second screen narrows the claimed efficiencies to those that the Tribunal is satisfied are *likely* to be brought about by the Merger. Efficiencies that cannot be demonstrated to be more likely than not to be attained in the Merger are filtered out at this stage. The third screen filters out claimed efficiency gains that would be brought about by reason only of a redistribution of income between two or more persons, as contemplated by subsection 96(3). These types of gains include savings that result solely from a reduction in output, service, quality or product choice, as well as from increases in bargaining leverage and reductions in taxes. The fourth screen filters out claimed efficiency gains that would be achieved outside Canada and would not flow back to shareholders in Canada as well as any savings from operations in Canada that would flow through to foreign shareholders.

263 In the case at bar, the application of the first four screens does not result in the elimination of any of the claimed efficiencies.

264 The fifth screen filters out claimed efficiencies that either (a) would likely be attained through alternative means if the Tribunal were to make the order that it determines would be necessary to ensure that the merger in question does not prevent or lessen competition substantially, or (b) would likely be attained through the Merger even if that order were made. This screen has a critical role to play in the case at bar.

265 In this case, the fifth screen eliminates most of the efficiencies claimed by CCS. With three exceptions, being the one year of transportation efficiencies and the one year of market expansion efficiencies discussed at paragraph 269 below, as well as the overhead efficiencies discussed above, virtually all of the efficiencies claimed by CCS would likely be achieved even if the order referred to in the preceding paragraph is made. That order is an order for the divestiture of the shares or assets of BLS (the "Order").

266 Although there is currently some uncertainty regarding the identity of a prospective purchaser, the Tribunal is satisfied that a divestiture will ultimately be made to a purchaser who will operate the Babkirk Facility and attract essentially the same volumes of Hazardous Waste as were assumed by Dr. Kahwaty in arriving at his estimates of transportation and market expansion efficiencies.

267 The Tribunal has decided that, absent exceptional circumstances, it will not be prepared to conclude that the claimed efficiencies that would be realized by any acceptable alternative purchaser should be included in the trade-off assessment, on the basis that it is not possible to identify any particular *likely* purchaser of the shares or assets contemplated by the divestiture order.

Transportation and Market Expansion Efficiencies

268 Based on the reasonable assumption that a purchaser under the Order will emerge and attract, in its first year of operation, the volume of Hazardous Waste that formed the basis for Dr. Kahwaty's estimates of CCS' claimed transportation and market expansion efficiencies, those efficiencies cannot be considered in the section 96 assessment because they are likely to be achieved even if the Order is made.

269 A noteworthy exception to this conclusion concerns the transportation and market expansion efficiencies that CCS claims would be achieved more quickly by CCS than by a purchaser. In this regard, CCS asserted that it would already have been operating at Babkirk but for the Commissioner's intervention and that, in any event, it is likely to be in a position to operate a Secure Landfill at the Babkirk Site by the summer of 2012. In contrast, CCS stated that a purchaser following a divestiture

is unlikely to be in a position to operate a Secure Landfill facility at the Babkirk Site before mid-2013, having regard to the time required (i) for the Tribunal to render a decision in this proceeding, (ii) to effect the actual sale of the shares or assets of BLS (which it estimates to will require "at least six months, or more," inclusive of due diligence), (iii) to modify or prepare an operations plan for the landfill, (iv) for the MOE to approve the operations plan, and (v) for the purchaser to construct the landfill, bearing in mind that construction can only be undertaken between June and September.

270 In the Tribunal's view, claimed efficiencies that would not likely be achieved by a purchaser under the Order, but that would likely be achieved by CCS solely because of the types of delays identified immediately above and associated with the implementation of the Order, are not cognizable efficiencies under section 96. These will be described as "Order Implementation Efficiencies". In the case at bar, CCS and the Vendors completed the Merger after being advised that the Commissioner intended to apply to the Tribunal. To give the Respondents the benefit of Order Implementation Efficiencies in such circumstances, and thereby potentially preclude the Tribunal from issuing the Order in respect of their anticompetitive Merger, would be contrary to the purposes of the Act.

271 In any event, even if CCS were given full credit for the Order Implementation Efficiencies, those efficiencies are only likely to be between *[CONFIDENTIAL]* and *[CONFIDENTIAL]* (which represents one year of transportation cost savings) plus *[CONFIDENTIAL]* (which represents one year of annual market expansion efficiencies). As discussed below in connection with the Tribunal's treatment of the "offset" element of section 96, these efficiencies are not sufficient to change the Tribunal's overall determination with respect to section 96.

The Roll-off Bin Business Efficiencies

272 The divestiture of the shares or assets of BLS will not have any impact on the Roll-off Bin Business efficiencies claimed by CCS. Stated alternatively, those efficiencies will likely be attained even if the Order is made. Accordingly, those efficiencies cannot be considered in the trade off assessment contemplated by section 96.

273 CCS has also submitted that certain productive efficiencies have already been achieved as a result of (i) its upgrading and sale of trucks to meet higher safety standards and to operate more efficiently, and (ii) CCS having absorbed certain administrative functions into its pre-existing corporate functions. However, as Mr. Harrington testified on behalf of the Commissioner, these efficiencies would only be lost if CCS were required to divest the Roll-off Bin Business. Given that the Order does not include the Roll-off Bin Business, those efficiencies will not be affected by the Order as contemplated by subsection 96(1) of the Act. Accordingly, they are not cognizable. In any event, given the value of these efficiencies, which Dr. Kahwaty estimated to be approximately *[CONFIDENTIAL]*, the Tribunal's overall conclusion with respect to section 96, set forth below, would not change even if these efficiencies were given full value in the trade-off assessment.

274 More generally, if certain efficiencies have already been achieved, they cannot be considered to be a potential "cost" of making the order contemplated by section 96. Therefore, they cannot be considered in the assessment under section 96. In other words, it cannot be said that those efficiencies "would not likely be attained if the order were made," as required by subsection 96(1).

The Overhead Efficiencies

275 As has been noted, Dr. Kahwaty estimated that these efficiencies would likely total approximately *[CONFIDENTIAL]* per year. He arrived at this assessment by, among other things, using as a proxy the cost reductions that CCS has achieved in operating the Roll-off Bin Business. Those cost reductions amounted to approximately 21% of the overhead expenses that previously were incurred by Complete in operating the Roll-off Bin Business. Dr. Kahwaty applied this 21% to the overhead expenses incurred at Silverberry, to reach his estimate of approximately *[CONFIDENTIAL]* in annual overhead savings. Mr. Harrington took issue with this methodology, in part because the Roll-off Bin Business is different from the landfill business. In addition, he opined that if there is a divestiture, some of these savings, which he described as being equivalent to one-half of the annual cost of a full time back-office employee, would likely be achieved by the purchaser. The Tribunal is persuaded

by this reasoning and therefore accepts Mr. Harrington's conclusion that the annual overhead efficiencies which are cognizable under section 96 are reasonable but are probably somewhat less than the *[CONFIDENTIAL]* that CCS has claimed.

276 As a practical matter, given the conclusion that the Tribunal has reached with respect to the "offset" element of section 96, discussed below, the fact that a more precise estimate of the cognizable overhead efficiencies is not available does not affect the Tribunal's overall determination with respect to the efficiencies defence in section 96.

The Qualitative Efficiencies

277 As discussed above, Dr. Kahwaty identified eight types of qualitative efficiencies that he claimed would likely result from the Merger. The Tribunal is not persuaded that any of these efficiencies "would not likely be attained if the Order were made," as provided in subsection 96(1). Ultimately, the answer to that question is dependent upon the expertise, financial resources, and reputation of the purchaser under the Order. Given that the purchaser may well have the same expertise, financial resources and reputation as CCS, the Tribunal cannot give significant weight to these claimed efficiencies. Indeed, given that the purchaser will have to be approved by the Commissioner, the Tribunal is of the view that all, or virtually all, of these claimed efficiencies are likely to be achieved by that purchaser.

278 Regardless of the identity of the purchaser, some of the types of qualitative efficiencies identified by Dr. Kahwaty will be achieved, including those related to the Roll-off Bin Business, the reduction of risks related to the transportation of Hazardous Waste over long distances and the increased site remediation that will benefit residents, wildlife, and the overall environment. In fact, to the extent that the Merger is likely to substantially prevent competition, as the Tribunal has found, we conclude that it is entirely appropriate to take into account, in the trade-off assessment, the likelihood that there will be less site clean-up and tipping of Hazardous Waste in Secure Landfills than otherwise would have occurred if an Order were made. This will be described below when non-quantifiable effects are considered.

279 The Tribunal concludes that the only efficiencies claimed by CCS that are cognizable under section 96 are a maximum of *[CONFIDENTIAL]* in annual overhead efficiencies, having a net present value of approximately *[CONFIDENTIAL]*, using a discount rate of 5.5%.

280 If, contrary to the Tribunal's conclusion, the Order Implementation Efficiencies are also cognizable under section 96, then it would be appropriate to include in the trade-off assessment further amounts of approximately *[CONFIDENTIAL]* to *[CONFIDENTIAL]* (i.e., one year of transportation cost savings) plus *[CONFIDENTIAL]* (i.e., one year of annual market expansion efficiencies).

What are the Effects for the Purposes of Section 96 of the Act?

281 As CCS noted in its Final Argument, the total surplus approach remains the starting point in assessing the effects contemplated by section 96. Under that approach, the cognizable quantifiable efficiencies will be balanced against the DWL that is likely to result from a merger. In addition, the Tribunal considers any cognizable dynamic or other non-quantifiable efficiencies and *anti-competitive* Effects. Where there is evidence of important dynamic or other non-quantifiable efficiencies and anti-competitive effects, such evidence may be given substantial weight in the Tribunal's trade-off assessment.

282 After the Tribunal has assessed the evidence with respect to the quantifiable (i.e., DWL) and non-quantifiable *anti-competitive* Effects of the merger, it will assess any evidence that has been tendered with respect to the other effects contemplated by section 96 and the purpose clause in section 1.1 of the Act. It is at this point that the Tribunal's assessment will proceed beyond the total surplus approach. In brief, at this stage of the Tribunal's assessment, it will determine whether there are likely to be any *socially adverse* effects associated with the merger. If so, it will be necessary to determine how to treat the wealth transfer that will be associated with any adverse price effects that are likely to result from the merger. In a merger among sellers of products, that wealth transfer will be from the merging parties' customers to the merged entity. Of course, to the extent that the merging parties' rivals may be likely to follow such price effects, the wealth transfer would need to be calculated across the sales or purchases of such rivals as well.

283 The Tribunal expects that in most cases, it will be readily apparent that the wealth transfer should be treated as neutral in its analysis, because the socio-economic profiles of consumers and the merged entity's shareholders will not be sufficiently different to warrant a conclusion that the wealth transfer is likely to lead to *socially adverse* Effects. For greater certainty, the cognizable social Effects under section 96 do not include broader social effects, such as those related to plant-closings and layoffs (*Superior Propane Inc.*, at para. 444).

284 In these proceedings, the Commissioner adduced no evidence with respect to *socially adverse* effects. Indeed, in her Final Argument (at para. 208) she conceded that the Merger is not likely to result in any such effects, and that the wealth transfer should be treated as being neutral in this case. Accordingly, the discussion below will be confined to *anti-competitive* effects. In other words, in making its determination under section 96 in the case at bar, the Tribunal will adopt the total surplus approach.

Quantifiable Effects

285 Quantifiable *anti-competitive* Effects are generally limited to the DWL that is likely to result from a merger.

286 In this case, the DWL is the future loss to the economy as a whole that will likely result from the fact that purchasers of Secure Landfill services in the Contestable Area will purchase less of those services than they would have purchased had the Tipping Fees for such services declined due to the competition that would likely have materialized between CCS and Babkirk operated as a Full Service Secure Landfill.

287 The DWL that is likely to result from a merger is likely to be significantly greater when there is significant pre-existing market power than when the pre-merger situation is highly competitive (*Propane*, above, at para. 165). In the case at bar, as in *Propane*, the Commissioner did not adduce specific evidence of pre-existing market power, for example, with respect to the extent to which prevailing Tipping Fees exceed competitive levels. Therefore, the Tribunal is not in a position to quantify the impact that any such pre-existing market power likely would have on the extent of the DWL. Where, as in this case, the pre-existing market situation is characterized by a monopoly and the Tribunal is not provided with sufficient persuasive evidence to enable it to quantify the Effects associated with such market power, it will be open to the Tribunal to give qualitative weight to those Effects. Given the very limited nature of the cognizable efficiencies in this case, it has not been necessary for the Tribunal to attribute such a qualitative weighing to those Effects in making its determination under section 96.

288 As discussed above, CCS submitted that the Tribunal should conclude that there are no quantifiable Effects as a result of the Merger, because the Commissioner did not lead any evidence with respect to such Effects until she served Dr. Baye's reply report, on November 4, 2011. The Tribunal has rejected that position because CCS was not ultimately prejudiced in this regard. The Tribunal will therefore proceed to address the evidence adduced in Dr. Baye's reply report. As will be noted below, the Tribunal is satisfied that CCS would not have met its burden under section 96, even if the quantifiable Effects had been deemed to be zero.

289 At the outset of his reply report, Dr. Baye summarized a number of the conclusions set forth in his initial report, dated September 30, 2011. These included the following:

a. the Merger likely prevents the prices for the disposal of Hazardous Waste generated in NEBC from falling significantly for many customers;

b. the effects of the Merger are unlikely to be uniform across all customers in the relevant market; and

c. the average reduction in the Tipping Fees throughout NEBC is likely to be at least 10%, but the effects are likely to be significantly higher for customers generating Hazardous Waste in the vicinity near Babkirk and Silverberry and lower for customers located near the southern and northern boundaries of NEBC.

290 The Tribunal is satisfied, on a balance of probabilities, that with the exception of the geographic extent of the Effects, the foregoing conclusions are supported by the weight of the evidence that it has found to be credible and persuasive. As to the geographic region over which the aforementioned Effects are likely to result from the Merger, the Tribunal finds that, at a

minimum, such Effects are likely to extend throughout the Contestable Area identified by Dr. Kahwaty. Given the conclusions that the Tribunal has reached regarding the minimal nature of the efficiencies claimed by CCS, it is unnecessary to define the scope of the anti-competitive Effects with greater precision.

291 As Dr. Baye explicitly noted, his conclusions were based on a range of different sources of information and economic analyses, rather than on any specific source of information or economic methodology. Those sources included CCS' internal documents and a "natural experiment." The Tribunal has not placed weight on the economic models that are set forth in Dr. Baye's reports, for example, the tipping fee and DiD regressions presented at exhibits 20 and 26 of his initial Report, which are also briefly discussed in his reply report. In the Tribunal's view, some of the assumptions underlying those models are questionable. The same is true of some of the outcomes of those models, such as the prediction of greater adverse price effects for customers located closer to Northern Rockies than to Babkirk. In the Tribunal's view, those predictions of Dr. Baye's models are counterintuitive and are not supported by the weight of the other evidence adduced in these proceedings.

292 More generally, as noted above, Dr. Baye's models do not account for the opportunity cost that CCS would incur if it were to lower Tipping Fees to the 20 - 25% range necessary to attract business from customers located farthest away from Silverberry and Babkirk, respectively, as discussed at paragraphs six and seven of his reply report. The Tribunal is not persuaded that it would be in CCS' interest to reduce prices to that extent in the near future, and to thereby deplete its finite Secure Landfill capacity at Silverberry, assuming that CCS would likely be able to attract business at higher Tipping Fees further in the future to fill that capacity.

293 Notwithstanding the fact that the Tribunal has found the models at exhibits 20 and 26 to be unreliable, we are satisfied, on a balance of probabilities, that competition from an independently owned and operated Full Service Secure Landfill at the Babkirk Site likely would result in CCS reducing its prices by an average of at least 10% for customers in the geographic market described above. This conclusion is based on evidence from CCS' own internal documents, evidence given by *[CONFIDENTIAL]* of *[CONFIDENTIAL]* and the transactions data pertaining to the "natural experiment" at Willesden Green modelled in Dr. Baye's DiD analysis.

294 The internal CCS documents referenced above include:

a. a slide presentation, dated August 26, 2010, which is attached at Exhibit K to Mr. D. Wallace's witness statement, *[CONFIDENTIAL]*

b. an e-mail, dated July 15, 2010, sent by Trevor Barclay to Ryan Hotston and Lance Kile, *[CONFIDENTIAL]*

c. a document, entitled *[CONFIDENTIAL]*, containing several slides dated "3/9/2009/ *[CONFIDENTIAL]*

d. a financial analysis prepared by Dan Wallace, attached to an e-mail dated March 31, 2010, and at Exhibit C to his witness statement, *[CONFIDENTIAL]*

e. a document dated March 31, 2010, entitled *[CONFIDENTIAL]*, attached at Exhibit D to Dan Wallace's witness statement, *[CONFIDENTIAL]*

f. a document, entitled *[CONFIDENTIAL]*, dated September 15, 2009 and included at Tab 32 of the Parties' Admissions Brief, *[CONFIDENTIAL]*.

295 Turning to evidence from customers, there was, as mentioned earlier, an unusual paucity of such evidence in this case. However, Mr. *[CONFIDENTIAL]*, Vice President, Operations, at *[CONFIDENTIAL]* testified that "competition, in our mind, provides a more competitive playing field in terms of your pricing setup" and that "in Northeast B.C. we currently don't have that same level of competition in this facet of our business."

296 Lastly, the transactions data from the "natural experiment" at Willesden Green, which is found in Dr. Baye's initial report, demonstrates that CCS reduced its prices significantly to seven customers after SES' entry at South Grande Prairie.

297 For all these reasons, we have concluded that, in the absence of the Merger, competition in the provision of Secure Landfill services at Silverberry and the Babkirk Site likely would have resulted in prices being, on average, at least 10% lower in the geographic market described above. This is a sufficient basis for concluding that the Merger likely will prevent competition substantially, particularly given that the Merger preserves a monopolistic market structure, and thereby prevents the emergence of potentially important competition.

298 In his reply report, Dr. Baye opined that even if competition is only likely to be substantially prevented in the Contestable Area identified by Dr. Kahwaty, the welfare loss is likely to be significant. Specifically, Dr. Baye estimated that loss to be approximately *[CONFIDENTIAL]* annually. That estimate was based on an assumed price decrease of 10%, from *[CONFIDENTIAL]* to *[CONFIDENTIAL]* per tonne, and certain assumptions and estimates used by Dr. Kahwaty in calculating the market expansion efficiencies, discussed above. In making that calculation, Dr. Kahwaty assumed that the opening of a Secure Landfill facility at Babkirk would likely lead customers to dispose of approximately *[CONFIDENTIAL]* additional tonnes of Hazardous Waste, as forecast in CCS' internal documents. As discussed earlier in these reasons, that forecast increase in demand concerned Legacy Waste and future waste that would not otherwise be transported to Silverberry, due to (i) the level of the current disposal cost (Tipping Fees plus transportation cost) and (ii) the risk that would be associated with transporting Hazardous Waste to Silverberry. Dr. Kahwaty estimated that the total disposal costs of customers located in the Contestable Area that he identified likely would decline by approximately *[CONFIDENTIAL]* per tonne, due to the closer proximity of the Babkirk Facility, relative to Silverberry.

299 Based on the foregoing numbers used by Dr. Kahwaty to estimate the market expansion efficiencies, and the linear demand that was assumed by Dr. Kahwaty, Dr. Baye estimated that a 10% price reduction (from *[CONFIDENTIAL]* to *[CONFIDENTIAL]*) for customers in the Contestable Area would increase the volume of waste disposed of by those customers from *[CONFIDENTIAL]* tonnes to *[CONFIDENTIAL]* tonnes, annually. He further estimated CCS' unit costs to be approximately *[CONFIDENTIAL]*, based on the average 2010 price at Silverberry of *[CONFIDENTIAL]* across all substances, and the *[CONFIDENTIAL]* landfill margin reported for Silverberry in 2009, which was used by Dr. Kahwaty in estimating the market expansion efficiencies.

300 Given the foregoing estimates, Dr. Baye calculated the area under the demand curve for the Contestable Area to be (i) a rectangle that is approximately *[CONFIDENTIAL]* tonnes multiplied by *[CONFIDENTIAL]*, for a total of *[CONFIDENTIAL]*, plus (ii) a right triangle that is *[CONFIDENTIAL]* high and *[CONFIDENTIAL]* wide, for an area of *[CONFIDENTIAL]*. Summing (i) plus (ii) yielded a figure of *[CONFIDENTIAL]*. From this latter amount, Dr. Baye deducted CCS' unit cost of *[CONFIDENTIAL]* multiplied by *[CONFIDENTIAL]*, to arrive at an estimated welfare loss of *[CONFIDENTIAL]*.

301 The Tribunal is persuaded that, on a balance of probabilities, the approach adopted by Dr. Baye, and the numbers he used in reaching his estimate of the likely DWL, are reasonable for the purposes of the Tribunal's assessment of Effects under section 96 of the Act. In the Tribunal's view, the manner in which Dr. Baye proceeded in this regard is sound, and the inputs that he used are reliable and conservative. The fact that Dr. Baye relied on certain assumptions made by Dr. Kahwaty is not particularly important for the purposes of the Tribunal's assessment under section 96. What is important is that there is reliable evidence before the Tribunal that permitted the DWL to be estimated.

302 The Tribunal acknowledges Dr. Kahwaty's testimony that, to calculate the DWL, it is necessary to know the shape of the demand curve, and that, when prices are likely to differ across customers, it is necessary to have customer-specific elasticity data. However, the Tribunal is persuaded that, in the absence of such information, a reliable "rough" estimate of the likely DWL can be obtained based on information such as that which was used by Dr. Baye in reaching his estimated annual welfare loss of approximately *[CONFIDENTIAL]*.

303 Accordingly, the Tribunal accepts Dr. Baye's estimate of *[CONFIDENTIAL]*, as being the minimum annual DWL.

304 Dr. Baye then speculated that, (i) if the average price decrease in that area was 21 percent, the annual DWL would be approximately *[CONFIDENTIAL]*, (ii) if prices across all Hazardous Waste tipped at Silverberry in 2010 decreased by 10%, the

DWL would be approximately *[CONFIDENTIAL]*, and (iii) if prices across all such waste decreased by 21%, the DWL would be approximately *[CONFIDENTIAL]*. However, the Tribunal is not persuaded that these speculations about prices are reasonable.

Non-quantifiable Effects

305 The Tribunal is satisfied that the Merger likely would result in certain important qualitative or other non-quantifiable Effects.

306 In his initial report, Dr. Baye identified at least two important qualitative anti-competitive Effects of the Merger. First, at paragraph 157, he stated that lower Tipping Fees would induce waste generators to more actively clean up legacy sites in NEBC. At paragraph 91 of his report, he described this in terms of lower Tipping Fees inducing waste generators to substitute away from "delay," or bioremediation, towards disposal at a Secure Landfill. As Dr. Kahwaty noted at paragraph 96 of his Efficiencies Report, increased site remediation from lower disposal costs benefits "area residents, wildlife, and the overall environment."

307 Second, at paragraph 137(c) of his initial report, Dr. Baye stated that, to retain its waste volumes in the face of competition from an independently owned and operated Babkirk Facility, CCS "would have had an incentive to compete through 'value propositions' that, among other things, link prices on various services to provide customers with a lower total cost for waste services." Although the services in question were not further discussed by Dr. Baye, they were addressed in "read-in" evidence adduced by the Commissioner and cited by Dr. Baye (at footnote 93 of his initial report). The Tribunal is satisfied, on a balance of probabilities, that competition between CCS and an independently owned and operated Babkirk Facility would have led to important non-price benefits to waste generators in the form of various "value propositions" that include either existing services being provided at lower prices, or new or enhanced services being provided that likely would not otherwise be provided if the Order is not made.

Are the Cognizable Efficiencies Greater than and do they Offset the Effects?

308 Section 96 requires the Tribunal to determine whether the cognizable efficiencies "will be greater than, and will offset" the cognizable effects of any prevention or lessening of competition that will result or is likely to result from a merger.

309 The Tribunal considers that the terms "greater than" and "offset" each contemplate both quantifiable and non-quantifiable (i.e., qualitative) efficiencies. In the Tribunal's view, "greater than" connotes that the efficiencies must be of larger magnitude, or more extensive than, the effects referred to in section 96. This contemplates a balancing of commensurables, even if some of the efficiencies being balanced are not capable of accurate or rough quantification. By contrast, the term "offset" is broad enough to connote a balancing of incommensurables (e.g., apples and oranges) that requires the exercise of subjective judgment to determine whether the efficiencies compensate for the likely effects referred to in section 96.

310 In the case at bar, the Tribunal has found that the cognizable, quantifiable, efficiencies likely to result from the Merger will be a maximum of *[CONFIDENTIAL]* annually. Those are the overhead efficiencies estimated by Dr. Kahwaty. In addition, the Tribunal has found that CCS has not demonstrated, on a balance of probabilities, that the qualitative efficiencies it has claimed are cognizable. In other words, it has not demonstrated that those efficiencies would not likely be attained if the Order were made.

311 On the other hand, the Tribunal has found that the quantifiable Effects are likely to be at least *[CONFIDENTIAL]* annually. That is the value of the minimum DWL associated with the Contestable Area.

312 Based on these findings, it is readily apparent that CCS has not demonstrated that the cognizable, *quantifiable*, efficiencies likely to be brought about by the Merger will likely be "greater than" the *quantifiable* Effects that are likely to result from the Merger. Using a 5.5% discount rate, CCS estimated that the present value of these (overhead) efficiencies to be approximately *[CONFIDENTIAL]*, in comparison with a present value of *[CONFIDENTIAL]* for the aforementioned Effects.

313 Given the Tribunal's conclusion that the Merger would result in a number of important qualitative or other non-quantifiable effects, and that it would not likely bring about significant qualitative, cognizable, efficiencies, it is also readily apparent that the

combined quantitative and qualitative efficiencies are not likely to be "greater than" the combined quantitative and qualitative Effects.

314 In addition, the Tribunal is persuaded, on a balance of probabilities, that even if a zero weighting is given to the *quantifiable* Effects, as CCS submitted should be done, CCS has not satisfied the "offset" element of section 96. In short, the Tribunal is satisfied that the very minor *quantitative* efficiencies, (*[CONFIDENTIAL]* annually) that are cognizable, together with any qualitative or other non-quantifiable efficiencies that may be cognizable, would not "offset" the significant qualitative Effects that it has found are likely to result from the Merger.

315 This conclusion would remain the same even if the Tribunal were to accept and give full weight to the Order Implementation Efficiencies, which only amount to a maximum of *[CONFIDENTIAL]* (which represents one year of transportation cost savings) plus *[CONFIDENTIAL]* (which represents one year of annual market expansion efficiencies).

316 This is because, in the Tribunal's view, the qualitative Effects, when taken together merit substantial weight. That weight is greater than the weight attributable to the aggregate of the cognizable quantitative and qualitative efficiencies under any reasonable approach. In brief, those qualitative Effects are (i) reduced site clean-up and the benefits that such remediation would confer upon "area residents, wildlife, and the overall environment"; and, more importantly, (ii) reduced "value propositions" than would likely otherwise emerge in the relevant market, linking prices to various new or enhanced services.

317 Most importantly, in the absence of the Order, the Merger will maintain a monopolistic structure in the relevant market. In other words, the Merger will not only give rise to the qualitative effects summarized immediately above, but it will also preclude benefits of competition that will arise in ways that will defy prediction.

318 In summary, the Tribunal is satisfied that CCS has not met its burden to establish, on a balance of probabilities, the "greater than" or "offset" elements set forth in section 96.

Issue 9 What is the Appropriate Remedy — Dissolution or Divestiture?

319 An important question under this heading is whether SES is currently a willing purchaser for the Babkirk Site. Surprisingly, when Mr. Amirault of SES testified for the Commissioner, neither her counsel during questioning in chief nor counsel for the Vendors during cross-examination asked Mr. Amirault if SES is still interested in acquiring BLS.

320 The Commissioner's position is that, once she showed that dissolution was an effective and available remedy, the burden of proof shifted to the Vendors to demonstrate that divestiture was an available, effective and less intrusive remedy. The Commissioner maintains that the Vendors were obliged to ask Mr. Amirault if SES is still interested and, because they failed to ask that question and because they failed to lead any evidence about other prospective purchasers, they have no basis to argue that divestiture will be an effective remedy.

321 The Tribunal does not accept the Commissioner's characterization of the onus. In the Tribunal's view, if the Commissioner proposes alternative remedies, as she did in this case, she bears the onus of showing that, although one may be preferable, each is available and effective. Accordingly, the Commissioner's counsel should have asked Mr. Amirault about SES' interest in purchasing the shares of BLS.

322 The Tribunal notes that, in her written final argument, the Commissioner asks the Tribunal not to infer that SES is an interested purchaser. However, in contrast, in final oral argument, counsel for the Commissioner suggested that SES is an interested buyer.

323 The Tribunal accepts the latter submission and has determined, for the following reasons, that SES is likely to make an offer to purchase the Babkirk Facility at some point during the divestiture process under the Order:

- SES has already decided to operate a Secure Landfill in NEBC. It tried unsuccessfully and at considerate expense to secure the Authorizations at its Heritage Site;

• Babkirk already has the necessary Authorizations and SES is confident that its plans to expand the permitted capacity at Babkirk and upgrade the cell design will be approved;

• SES has demonstrated an active and continuing interest in the Babkirk Facility since the Merger. Among other things, this is demonstrated by SES' lawyers' written submissions to the Commissioner and by the participation of its CEO, Mr. Amirault, as a witness in these proceedings.

324 We now turn to the proposed remedies.

325 The Commissioner wants the Babkirk Site operated as a competitive Full Service Secure Landfill and she believes that dissolution will produce this result more quickly than divestiture.

326 Her submission is that, once the Vendors again hold the shares of Complete and have repaid CCS the purchase price, they will be highly motivated to resell Complete or the shares of BLS because this will enable them to recover their funds as soon as possible. However, this submission assumes that the Vendors will immediately be offered a price they are prepared to accept. In the Tribunal's view, there is no basis for this assumption. The evidence is clear that the Vendors have never been willing to be pushed into a quick sale.

327 The Commissioner's submission also assumes that the Vendors will have an incentive to sell quickly because they will be short of funds as a result of having to repay CCS as soon as the shares of Complete are returned to them. This assumption is also questionable, in part because it appears that CCS has indemnified the Vendors against all claims arising from any investigation or actions by the Bureau with respect to the Merger. Given this background, it is possible that CCS may not insist on immediate payment.

328 Even if the Commissioner is correct and the Vendors are cash-strapped and anxious to resell BLS or Complete, the Tribunal still anticipates that they will want an attractive price. It is also important to remember that all five individual Vendors must agree to accept an offer and they will not necessarily be like-minded, in part because some are near retirement and others are in mid-career.

329 The Tribunal notes that two years will have passed since the Babkirk Facility was last for sale. This means that purchasers, other than SES, may show interest, especially given the increasing rate of gas production in the area northwest of Babkirk. Dr. Baye testified that he thought SES, Newalta and Clean Harbours were potential purchasers. As well, it is not unreasonable to think that an oil and gas producer may decide to own and operate a Secure Landfill. The Tribunal heard evidence that *[CONFIDENTIAL]* is considering becoming a part-owner of the Secure Landfill at Peejay. If the Vendors receive multiple offers, protracted negotiations may follow.

330 Finally, if they do not receive an offer they consider attractive, the Vendors are free to change their minds and resurrect their plan to operate a bioremediation facility with an Incidental Secure Landfill. This would not result in the competition the Commissioner seeks because it will only be realized if the Babkirk Facility operates as a Full Service Secure Landfill.

331 There is also the question of whether a purchaser after dissolution will be an effective competitor. In the proposed order for dissolution found at the conclusion of the Commissioner's final argument, she does not seek the right to approve a purchaser and she only asks for notice of a future merger if it is "among the Respondents". In our view, this makes dissolution a less effective remedy.

332 Given all these observations, the Tribunal is concerned that dissolution may not be effective in that it may not lead to a prompt sale and a timely opening of the Babkirk Facility as a Secure Landfill.

333 It is also the case that dissolution is the more intrusive remedy.

334 Three of the Vendors testified about the financial hardship they would face if dissolution were ordered by the Tribunal. Ken Watson's share of the proceeds of the transaction was *[CONFIDENTIAL]*. He testified that if ordered to return the proceeds to CCS, *[CONFIDENTIAL]*, he expects to face significant financial hardship.

335 Randy Wolsey's share of the proceeds was approximately *[CONFIDENTIAL]*. He testified that almost half of the proceeds have been used to develop a property on which he is constructing a new family home. The balance has been invested in the purchase of various investment products. According to Mr. Wolsey, he expects to lose approximately *[CONFIDENTIAL]* if he is forced to make a quick sale on the residential property before the house under construction has been completed.

336 Karen Baker testified that if required to return her share of the proceeds, approximately *[CONFIDENTIAL]*, then her ability to continue to provide financial support to certain small business will be compromised. She also indicated that if the transactions were to be dissolved, she expects that the "work required to reverse the sale and calculate the adjustments required to account for changes in Complete's assets, working capital and lost opportunity costs, as well as the opportunity costs in time away from the other businesses in which [she is] involved, and cost to some of those businesses for replacement personnel to do the work that [she] should be doing, would cause [her] significant stress and emotional hardship."

337 The Commissioner asserts that, in the particular circumstances of this case, hardship is irrelevant, because she warned the Vendors that she would seek dissolution before they sold Complete to CCS. However, in the Tribunal's view it is the right of private parties to disagree with the Commissioner and make their case before the Tribunal. Accordingly, they are not estopped from raising issues of hardship.

338 The Tribunal is also of the view that dissolution is overbroad, since it involves Complete's other businesses and not just BLS.

339 In the spring of 2007, Complete acquired the assets of a municipal waste management business based in Dawson Creek, British Columbia. As noted earlier, those assets included contracts for the management of the Fort St. John and Bessborough municipal landfills and the Dawson Creek Transfer Station, the supply and hauling of roll-off bins, and the provision of rural refuse collections and transfer services. At the time of the Merger, those contracts and related equipment were transferred to CCS. Hazco has been responsible for this business since then.

340 Mr. Garry Smith, the president of Hazco, testified that Hazco has upgraded Complete's trucks and has sold some older equipment which it considered surplus. The two municipal landfill contracts have been extended and are now held directly by Hazco. Complete's employees are now employed by Hazco and there have been personnel changes. At the hearing, Mrs. Baker testified about the impact of the sale of some of the assets. She stated:

> Now, that equipment was older equipment. It wouldn't have brought big money, but the point is it was sufficient for us to do the work that we wanted it to do. Well, now the oil and gas industry is hot, hot up there. Trying to get equipment back, we certainly wouldn't get that equipment back. Any decent used equipment, I have no idea. The prices would be through the roof. Would we buy new equipment? I don't know. So right now, we don't even have the equipment to go back to work

341 To conclude, the Tribunal has decided that dissolution is intrusive, overbroad and will not necessarily lead to a timely opening of the Babkirk Facility as a Full Service Secure Landfill.

342 Turning to divestiture, the Tribunal finds that it is an available and effective remedy. If reasonable but tight timelines are imposed, it will not matter if, as the Commissioner alleges, SES and CCS are reluctant to negotiate because of their outstanding litigation. In the end, if they cannot agree, a trustee will sell the shares or assets of BLS, either to SES or another purchaser approved by the Commissioner. In other words, divestiture will be effective.

343 A divestiture with tight timelines has other advantages. The Commissioner will have the right to pre-approve the purchaser, the person responsible for effecting the divestiture will ultimately be CCS or a professional trustee, rather than five

individuals, the timing will be certain, a sale will ultimately occur and the approved purchaser will compete with Silverberry on a Full Service basis.

344 For all these reasons, the Tribunal will order CCS to divest the shares or assets of BLS.

H. Costs

345 The Commissioner chose dissolution as her preferred remedy when she commenced the Application. She made this choice because she believed that at the time of the Merger, the Vendors were about to construct and operate a Full Service Secure Landfill. For this reason she concluded that the most timely way to introduce competition was to return Babkirk to the Vendors.

346 However, for the reasons given above, the Tribunal has concluded that the Vendors did not intend to operate a Full Service Secure Landfill. This means that the Commissioner has failed to prove the premise which caused her to name the individual Vendors as parties to the Application. In essence she failed to prove her case against them and for this reasons she is liable for their costs.

347 However, during the Vendors' motion for summary disposition which was heard two weeks before the hearing, they indicated that, if the motion was successful and they were removed as parties, four of them would nevertheless attend the hearing to give evidence. The Tribunal assumes that, had done so, they would have been represented by one counsel. Accordingly, the Commissioner is to pay their costs less the legal fees which would have been incurred had they appeared as witnesses.

I. For These Reasons the Tribunal Orders That:

348 CCS is to divest the shares or assets of BLS on or before December 28, 2012 failing which a trustee is to effect a sale on or before March 31, 2013. If possible, the terms for this process are to be agreed between the Commissioner and CCS and are to be submitted to the Tribunal on or before June 22, 2012. If the agreed terms are accepted by the Tribunal, they will be incorporated in a further order to be called the Divestiture Procedure Order. If the Commissioner and CCS cannot agree to terms, each party is to submit a proposed Divestiture Procedure Order on or before June 29, 2012. If necessary, the Tribunal will hear submissions about each party's proposal in early July and then make the Divestiture Procedure Order.

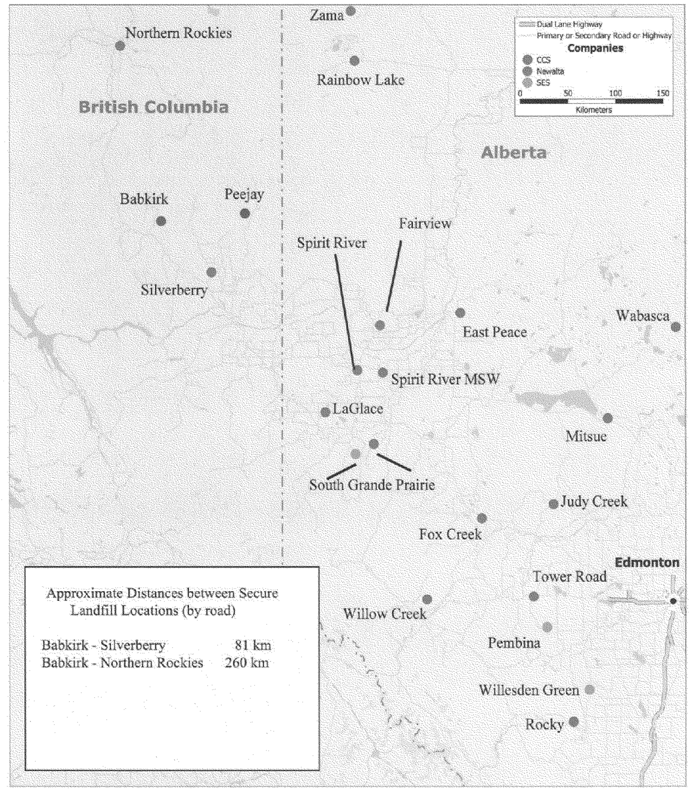
349 CCS is to pay the Commissioner's costs and, because dissolution was not ordered, the Commissioner is to pay the Vendors' costs less the fees they would have paid for legal representation if they had attended as non-parties to give their evidence. The Commissioner is to prepare a bill of costs to be submitted to CCS and the Vendors are to submit a bill of costs to the Commissioner both on or before August 31, 2012. Both are to be prepared in accordance with Federal Court Tariff B at the mid-point of column 3. If by September 14, 2011 no agreement is reached about lump sums to be paid, the Tribunal will hear submissions and fix the awards of costs.

***Paul Crampton Member*:**

J. The Schedules

350 The schedules appear on the following pages:

Schedule A: Map Showing Secure Landfills (based on Exhibit 4-A to Dr. Baye's Expert Report)



Graphic 1

Source: CCS, SES, and Newalta company websites.

This map may be printed in colour.

SCHEDULE "B"

THE EVIDENCE

Witnesses who gave oral testimony (in alphabetical order)

<u>For the Commissioner of Competition</u>

- **Rene Amirault**

  President & CEO of Secure Energy Services Inc.

- **Robert Andrews**

  Section Head- Environmental Management, Government Unit in the British Columbia Ministry of the Environment.

- **Michael Baye**

  Expert Economist - Special Consultant at National Economic Research Associates, Inc. and the Bert Elwert Professor of Business Economics and Public Policy at the Indiana University Kelley School of Business.

- **Chris Hamilton**

  Project Assessment Director at the British Columbia Environmental Assessment Office.

- **Andrew Harrington**

Expert on Efficiencies - Managing director of the Toronto office of Duff & Phelps.

• **[CONFIDENTIAL]**

Contracting and Procurement Analyst for the **[CONFIDENTIAL]**.

• **[CONFIDENTIAL]**

Vice-President, Operations at **[CONFIDENTIAL]**.

• **Mark Polet**

Associate at Klohn Crippen Berger Ltd. ("KCB"). KCB is a private, specialized engineering and environmental consulting firm with its head office in Vancouver.

• **Del Reinheimer**

Environmental Management Officer in the Environmental Protection Division at the British Columbia Ministry of the Environment.

• **Devin Scheck**

Director, Waste Management & Reclamation at the British Columbia Oil and Gas Commission.

For the Vendors

• **Karen Baker**

One of the founding shareholders of Complete Environmental Inc.

• **Ronald Baker**

One of the founding shareholders of Complete Environmental Inc.

• **Kenneth Watson**

One of the founding shareholders of Complete Environmental Inc.

• **Randy Wolsey**

One of the founding shareholders of Complete Environmental Inc.

For the Corporate Respondents

• **Trevor Barclay**

Landfill Manager of the Northern Rockies Secure Landfill.

• **James Coughlan**

Director of Sales and Marketing of CCS Corporation

• **Henry Kahwaty**

Expert economist - Director with Berkeley Research Group, LLC.

• **Richard Lane**

Vice-President of CCS Midstream Services, a division of CCS Corporation.

• **Pete Marshall**

Principal of Adelantar Consulting, an environmental consultancy based in Edmonton, Alberta.

• **Daniel Wallace**

Manager, Business Development of CCS Corporation's Midstream Services division

__Other Evidence__

• The witness statements from those who testified.

• Read-ins from Examinations for Discovery of Karen Baker and Kenneth Watson for the Vendors, Daniel Wallace for the Corporate Respondents and Trevor MacKay for the Commissioner of Competition

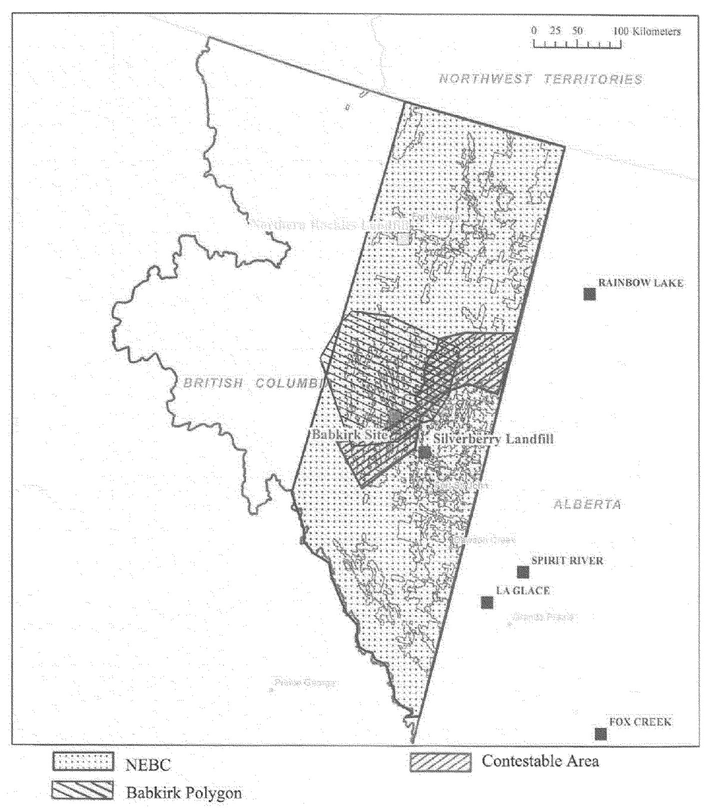
• The statement of agreed facts.

• The witness statements of **Robert Coutts**, President of SkyBase Geomatic Solutions Inc. and **Garry Smith**, President of Hazco Waste Management (owned by CCS). On consent these witnesses were not called to give oral testimony.

• A Joint list of agreed documents.

• The exhibits marked during the hearing.

Schedule C: Map of NEBC, the Contestable Area and the Babkirk Polygon



Graphic 2

K. Concurring Reasons by P. Crampton C.J.

351 Although I participated in the writing of, and signed, the Panel's decision in this case, I would like to comment on certain additional matters.

A. Is CCS's Acquisition of Complete a Merger?

352 At paragraph 56 of the Panel's reasons, it is noted that it was not necessary to decide whether Complete's Roll-off Bin Business or its management of municipal dumps could be a business for the purposes of section 91 of the Act. That said, the conclusion reached by the Chairperson on this point was articulated at paragraph 57. That conclusion was stated as follows:

> [A] business being acquired in a merger must have some relevance to a Commissioner's application. In other words, it must have the potential to impact competition in the markets at issue. This observation means that, in this case, Complete's Roll-off Bin Business and its management of municipal dumps would not have been caught by the definition in section 91 because they are not involved in any way in the disposal or treatment of Hazardous Waste.

353 I respectfully disagree. In my view, the term "business", as contemplated by section 91 of the Act, is not, as the Vendors maintained, confined to a business that competes with a business of an acquiring party. There is no such limitation in section 91 or in the definition of the term "business" that is set forth in subsection 2(1) of the Act.

354 The Vendors attempted to support their position by noting that section 92 of the Act requires that a "merger" prevent or lessen, or be likely to prevent or lessen, competition substantially. However, it is not necessary for a merger to involve two or more competing businesses to have the potential to prevent or lessen competition substantially. For example, the inclusion of the terms "supplier" and "customer" in section 91 reflects Parliament's implicit recognition that a vertical merger may have such an effect. The words "or other person" in section 91 reflect that Parliament also did not wish to exclude the possibility that other types of non-horizontal mergers may also have such an effect.

355 Considering the foregoing, I am not persuaded that the Vendors' position is assisted by reading the words of section 91 "in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament" (E. A. Driedger, *Construction of Statutes* (2nd ed. 1983), at p. 87, quoted in *Rizzo & Rizzo Shoes Ltd., Re*, [1998] 1 S.C.R. 27 (S.C.C.), at 41; and *Canada (Attorney General) v. Mowat*, 2011 SCC 53 (S.C.C.), at para. 33 (".*Mowat*")). In the absence of any apparent ambiguity, one must adopt an interpretation of section 91 "which respects the words chosen by Parliament" (*Mowat*, above). The principle that the Act be given "such fair, large and liberal construction and interpretation as best ensures the attainment of its objects" also supports the view that section 91 ought not be read in the limited manner suggested by the Vendors (*Interpretation Act*, R.S.C. 1985, c. I-21, s. 12).

356 Indeed, if anything, a reading of section 91 in a manner that is harmonious with the scheme and object of the Act and the intention of Parliament arguably further supports interpreting section 91 in a way that does not require the type of assessment of competitive effects that is contemplated by the interpretation advanced by the Vendors. That is to say, when viewed in the context of the scheme and object of the Act as a whole, it is arguable that section 91 was intended by Parliament to be a gating provision, in respect of which an assessment ordinarily is to be made relatively early on in the evaluation contemplated by sections 92 and 93.

357 For example, all but one of the assessment factors in the non-exhaustive list that is set forth in section 93 refer to the "merger or proposed merger" in respect of which an application under section 92 has been made. In my view, this suggests that the merger or proposed merger in question should be identified before the assessment contemplated by sections 92 and 93 is conducted.

358 If an agreement, arrangement or practice cannot properly be characterized as a merger, it will fall to be investigated under another provision of the Act, such as section 45, section 79, or section 90.1, each of which has a substantive framework which

differs in important respects from the framework set forth in section 92. Indeed, in the case of agreements or arrangements that may be investigated under section 45, which is a criminal provision, there are important procedural implications associated with the decision to pursue a matter under that section, versus under section 90.1, 79 or 92. I recognize that there may be cases in which it may be appropriate to assess a matter under section 92 as well as under one or more of the other provisions mentioned immediately above, for a period of time before an election is made under section 98, 45.1, 79(7) or 90.1(10). However, the scheme of the Act and the interests of administrative efficiency arguably support the view that a determination as to whether a matter ought to be investigated as a merger, rather than a type of conduct addressed elsewhere in the Act, ordinarily should be made before the central substantive determinations under the applicable section of the Act are made. Among other things, such substantive determinations often take several months, and sometimes take much longer, to make.

359 In summary, for all of the foregoing reasons, I have concluded that the term "business" in section 91 is sufficiently broad to include any business in respect of which there is an acquisition or establishment of control or a significant interest, as contemplated therein. In the case at bar, this would include Complete's Roll-off Bin Business, which was fully operational at the time of Complete's acquisition by CCS. It would also include Complete's management of municipal dumps.

B. Market Definition

360 Market definition has traditionally been a central part of merger analysis in Canada and abroad for several reasons. These include (i) helping to focus the assessment on products and locations that are close substitutes for the products and locations of the merging parties, (ii) helping to focus the assessment on the central issue of market power, (iii) helping to identify the merging parties' competitors, (iv) helping to understand the basis for existing levels of price and non-price competition, and (v) facilitating the calculation of market shares and concentration levels. In turn, changes in market shares and concentration levels can be very helpful, albeit not determinative, in understanding the likely competitive effects of mergers and in assisting enforcement agencies to triage cases and to provide guidance to the public.

361 In recent years, developments in antitrust economics have reached the point that the United States Department of Justice and Federal Trade Commission have begun to embrace approaches that "need not rely on market definition" (*Horizontal Merger Guidelines* (August 19, 2010), at § 6.1). Likewise, the MEGs, at paragraph 3.1, have been amended to stipulate that market definition is not necessarily a required step in the Commissioner's assessment of a merger.

362 These developments can be accommodated within the existing framework of the Act and the Tribunal's jurisprudence.

363 In discussing market definition, the Panel noted, at paragraph 92 of its reasons, that the Tribunal has in the past cautioned against losing sight of the ultimate inquiry, which is whether the merger being assessed prevents or lessens, or is likely to prevent or lessen, competition substantially. The Tribunal has also previously noted that the Act does not require that a relevant market be defined in assessing whether competition is likely to be prevented or lessened substantially (*Superior Propane Inc.*, above, at para. 56). The logical implication is that defining a relevant market is not a necessary step in assessing whether a merger prevents or lessens, or is likely to prevent or lessen, competition substantially. Accordingly, it will be open to the Tribunal, in an appropriate case, to make this assessment without defining a relevant market.

364 That said, at this point in time, it is anticipated that such cases will be exceptional. Indeed, failing to define a relevant market may make it very difficult to calculate, or even to reasonably estimate, the actual or likely DWL associated with a merger, for the purposes of the efficiencies defence in section 96 of the Act.

C. The Analytical Framework in a "Prevent" Case

365 At the outset of the Commissioner's final oral argument, her counsel urged the Tribunal to clarify the analytical approach applicable to three areas, namely, (i) the assessment of whether a merger prevents, or is likely to prevent, competition substantially, (ii) the efficiencies defence, and (iii) the circumstances in which the Tribunal will entertain the remedy of dissolution, and what factors will be taken into account in determining the appropriate remedy in any particular case.

366 These topics are all addressed to some extent in the Panel's decision. I would simply like to add some additional comments, particularly with respect to the analytical framework applicable to the Tribunal's assessment of whether a merger prevents, or is likely to prevent, competition substantially.

367 The Tribunal's general focus in assessing cases brought under the "substantial prevention of competition" and "substantial lessening of competition" branches of section 92 is essentially the same. In brief, that focus is upon whether the merged entity is likely to be able to exercise materially greater market power than in the absence of the merger. The same is true with respect to other sections of the Act that contain these words.

368 In determining whether competition is likely to be *lessened*, the more particular focus of the assessment is upon whether the merger is likely to facilitate the exercise of new or increased market power by the merged entity, acting alone or interdependently with one or more rivals. In determining whether competition is likely to be *prevented*, that more particular focus is upon whether the merger is likely to preserve the existing market power of one or both of the merging parties, by preventing the erosion of such market power that otherwise likely would have taken place if the merger did not occur.

369 In making its assessment in the latter context, and with respect to a proposed merger, the Tribunal compares (i) the state of competition that would likely exist if the merger were to proceed, with (ii) the state of competition that would likely exist if the merger did not proceed. Scenario (ii) typically is referred to as the "but for", or "counterfactual", scenario. In the case of a completed merger, that "but for" scenario is the market situation that would have been most likely to emerge had the merger not occurred.

370 When the Tribunal determines that a merger is not likely to enable the merged entity to exercise greater market power than in the absence of the merger, the Tribunal generally will conclude that the merger is not likely to prevent or lessen competition at all, let alone substantially. With respect to allegations that competition is likely to be *lessened*, this conclusion generally will flow from a finding that the merger is not likely to enable the merged entity to *enhance existing, or to create new*, market power. With respect to allegations that competition is likely to be *prevented*, this conclusion generally will flow from a finding that the merger in question is not likely to enable the merged entity to *maintain* greater existing market power than in the absence of the merger. Once again, the foregoing also applies with respect to other sections of the Act that contain the "prevent or lessen competition substantially" test.

371 With respect to sellers, market power is the ability to profitably maintain prices above the competitive level, or to reduce levels of non-price competition (such as service, quality or innovation), for an economically meaningful period of time. With respect to purchasers, market power is the ability to profitably depress prices below the competitive level, or to reduce levels of non-price competition, for such a period of time.

372 In assessing whether market power is likely to be created, enhanced or maintained by a merger or a reviewable trade practice, the Tribunal assesses the intensity of competition, as reflected in its price and non-price dimensions. Competition is a dynamic, *rivalrous process* through which the exercise of market power is prevented or constrained as firms strive, among other things, to develop, produce, distribute, market and ultimately sell their products in rivalry with other firms. That rivalrous process generates the principal source of pressure on firms to innovate new or better products or business methods, and to deliver those products at competitive prices. In turn, those innovations and competitive prices serve to increase aggregate economic welfare in the economy, the economy's international competitiveness and the average standard of living of people in the economy.

373 In assessing the intensity of price competition, the Tribunal focuses upon whether prices are likely to be higher than in the absence of the merger. In assessing the intensity of non-price competition, the Tribunal focuses upon whether levels of service, quality, innovation, or other important non-price dimensions of competition are likely to be lower than in the absence of the merger. This focus ensures that the assessment of the intensity of price and non-price dimensions of competition is *relative*, rather than *absolute*, in nature (*Canada Pipe Co.*, above, at paras. 36 — 38). In short, the assessment of levels of price and non-price competition is made relative to the levels of price and non-price competition that likely would exist "but for" the merger.

The same approach is taken with respect to non-merger matters that require an assessment of whether competition is likely to be prevented or lessened substantially.

374 Competition may be said to be *prevented* when future competition is hindered or impeded from developing. Common examples of such prevention of competition in the merger context include (i) the acquisition of a potential or recent entrant that was likely to expand or to become a meaningful competitor in the relevant market, (ii) an acquisition of an incumbent firm by a potential entrant that otherwise likely would have entered the relevant market *de novo*, and (iii) an acquisition that prevents what otherwise would have been the likely emergence of an important source of competition from an existing or future rival.

375 In determining whether a prevention or lessening of competition is likely to be *substantial*, the Tribunal typically will assess the likely magnitude, scope and duration of any adverse effects on prices or on non-price levels of competition that it may find are likely to result from the creation, enhancement or maintenance of the merged entity's market power. That is to say, the Tribunal assesses the likely degree of such price and non-price effects, the extent of sales within the relevant market in respect of which such effects are likely to be manifested, and the period of time over which such effects are likely to be sustained.

376 With respect to magnitude or degree, the Tribunal has previously defined substantiality in terms of whether customers are "likely to be faced with *significantly* higher prices or *significantly* less choice over a *significant* period of time than they would be likely to experience in the absence of the acquisitions" (*Southam Inc.*, above, at 285, emphasis added). However, given that the Tribunal has now embraced the hypothetical monopolist framework and the SSNIP test for market definition, it is necessary to revisit this definition of substantiality. This is because if the degree of market power used to define relevant markets is the same as the degree of market power used to assess competitive effects, a merger would not be found to be likely to prevent or lessen competition substantially unless the degree of new, enhanced or maintained market power of the merged entity is the same degree of market power held by as the hypothetical monopolist that was conceptualized for the purposes of market definition.

377 Accordingly, the degree of market power used in assessing whether competition is likely to be prevented or lessened substantially must be recalibrated downwards. That recalibrated degree of market power is a level of market power required to maintain prices *materially* higher, or to depress one or more forms of non-price competition to a level that is *materially* lower, than they likely would be in the absence of the merger. As a practical matter, in the case at bar, this distinction between "material" and "significant" is of little significance, because the Panel has found that prices are likely to be significantly (i.e., at least 10%) higher than they would likely have been in the absence of the Merger.

378 Turning to the scope dimension of "substantiality", the Tribunal will assess whether the merged entity, acting alone or interdependently with other firms, likely would have the ability to impose the above-mentioned effects in a material part of the relevant market, or in a respect of a material volume of sales.

379 With respect to the duration dimension of "substantiality", the Tribunal typically will assess whether the merged entity, acting alone or interdependently with other firms, likely would have the ability to sustain the above-mentioned effects for approximately two years or more, relative to the "but for" scenario. This explains why the Tribunal typically assesses future entry and the expansion of potential rivals to the merged entity by reference to a benchmark of approximately two years.

380 When, as in this case, the merger has already occurred and the Commissioner alleges that the merger is likely to prevent competition substantially, the Tribunal's assessment of the duration dimension of "substantiality" will focus on two things. First, the Tribunal will assess whether the entry or expansion that was prevented or forestalled by the merger likely would have been sufficiently timely, and on a sufficient scale, to have resulted in a material reduction of prices, or a material increase in one or more non-price dimensions of competition, had the merger not occurred. If so, the Tribunal will assess whether the entry or expansion of third parties likely will achieve this result, notwithstanding the fact that the merger has occurred.

381 Before assessing whether a likely prevention of future competition would be "substantial," the Tribunal also will assess whether that future competition likely would have materialized "but for" the merger in question. In this regard, the Tribunal will assess whether such competition likely would have developed within a reasonable period of time.

382 What constitutes a reasonable period of time will vary from case to case and will depend on the business under consideration. In situations where steps towards entry or expansion were being taken by the firm whose entry or expansion was prevented or forestalled by the merger, a reasonable period of time would be somewhere in the range of time that typically is required to complete the remaining steps to enter or expand on the scale described above. Similarly, in situations where the entry or expansion was simply in the planning stage, a reasonable period of time would be somewhere in the range of time that typically is required to complete the plans in question and then to complete the steps required to enter or expand on the scale described above. In situations where entry on such a scale cannot occur for several years because, for example, a new blockbuster drug is still in clinical trials, a reasonable period of time would be approximately the period of time that it typically would take for such trials to be completed, relevant regulatory approvals obtained, and commercial quantities of the drug produced and sold. In situations where entry on the scale described above cannot occur for several years because of long term contracts between customers and suppliers, a reasonable period of time would be approximately one year after a volume of business that is sufficient to permit entry or expansion on that scale becomes available.

383 In all cases, the Tribunal must be satisfied that the future competition that is alleged to be prevented by the merger likely would have materialized within a reasonable period of time. If so, the Tribunal will assess whether the prevention of that competition likely would enable the merged entity to exercise materially greater market power than in the absence of the merger, for a period of approximately two years or more, subsequent to that time.

384 Notwithstanding the foregoing, it is important to underscore that the magnitude, scope and duration dimensions of "substantiality" are interrelated. This means that where the merged entity is likely to have the ability to prevent a particularly large price decrease that likely would occur "but for" the merger, the volume of sales in respect of which the price decrease would have had to be experienced before it will be found to be "material" may be less than would otherwise be the case. The same is true with respect to the period of time in respect of which the likely adverse price effects must be experienced — it may be less than the two year period that typically is used. Likewise, where the volume of sales in respect of which a price decrease is likely to occur is particularly large, (i) the degree of price decrease required to meet the "materiality" threshold may be less than would otherwise be the case, and (ii) the period of time required for a prevention of competition to be considered to be "substantial" may be less than two years.

385 In conducting its assessment of whether a merger is likely to prevent competition substantially, the Tribunal also assesses whether other firms likely would enter or expand on a scale similar to that which was prevented or forestalled by the merger, and in a similar timeframe. Where the Tribunal finds that such entry or expansion likely would occur even if the merger proceeds, it is unlikely to conclude that the merger is likely to prevent competition substantially.

386 In summary, to demonstrate that a merger is likely to prevent competition substantially, the Commissioner must establish, on a balance of probabilities, that "but for" the merger, one of the merging parties likely would have entered or expanded within the relevant market within a reasonable period of time, and on a sufficient scale, to effect either a material reduction of prices or a material increase in one or more levels of non-price competition, in a material part of the market, for approximately two years. Alternatively, the Commissioner must establish a similar likely effect on prices or on levels of non-price dimensions of competition as a result of the development of another type of future competition that likely would have occurred "but for" the merger.

D. When Efficiencies Can be Considered

387 The Tribunal's decision in *Propane*, above, has been interpreted as suggesting that cost reductions and other efficiencies can never be considered prior to the triggering of the defence set forth in section 96. This appears to be a misreading of *Propane*. The source of this misunderstanding appears to be found in paragraph 137 of that decision. The focus of the discussion in that paragraph was on the differences between the Canadian and American approaches to efficiencies, and, specifically, whether section 96 requires the efficiencies likely to result from a merger to be so great as to ensure that there are no adverse price effects of the merger.

388 There may well be situations in which any cost reductions or other efficiencies likely to be attained through a merger will increase rivalry, and thereby increase competition, in certain ways. These include: (i) by enabling the merged entity to better compete with its rivals, for example, by assisting two smaller rivals to achieve economies of scale or scope enjoyed by one or more larger rivals, (ii) by increasing the merged entity's incentive to expand production and to reduce prices, thereby reducing its incentive to coordinate with other firms in the market post-merger, and (iii) by leading to the introduction of new or better products or processes.

389 There is no "double counting" of such efficiencies when it is determined that the merger in question is likely to prevent or lessen competition substantially and a trade-off assessment is then conducted under section 96. This is because, in that assessment, such efficiencies would only be considered on the "efficiencies" side of the balancing process contemplated by section 96. They would not directly or indirectly be considered on the "effects" side of the balancing process, because they would not be part of any cognizable (i) quantitative effects (e.g., the DWL or any portion of the wealth transfer that may be established to represent socially adverse effects), or (ii) qualitative effects (e.g., a reduction in dynamic competition, service or quality). Moreover, at the section 92 stage of the analysis, they typically would not be found to be a source of any new, increased or maintained market power that must be identified in order to conclude that the merger is likely to prevent or lessen competition substantially.

E. The Efficiencies Defence

390 The analytical framework applicable to the assessment of the efficiencies defence has been set forth in significant detail in the Panel's decision. I simply wish to make a few additional observations.

(i) Conceptual framework

391 In broad terms, section 96 contemplates a balancing of (i) the "cost" to the economy that would be associated with making the order that the Tribunal has determined should otherwise be made under section 92 (the "Section 92 Order"), and (ii) the "cost" to the economy of not making the Section 92 Order. The former cost is the aggregate of the lost efficiencies that otherwise would likely be attained as a result of the merger. The latter cost is the aggregate of the effects of any prevention or lessening of competition likely to result from the merger, if the Section 92 Order is not made.

392 Section 96 achieves this balancing of "costs" by (i) confining efficiencies that are cognizable in the trade-off assessment to those that "would not likely be attained if the [Section 92 Order] were made", as contemplated by subsection 96(1), and (ii) confining the effects that may be considered in the trade-off assessment to "the effects of any prevention or lessening of competition that will result or is likely to result from the merger or proposed merger".

393 In short, the efficiencies that are eliminated by this language in subsection 96(1), which is referred to at paragraph 264 of the Panel's decision as the fifth "screen" established by section 96, are not considered in the trade-off assessment because they would not represent a "cost" to society associated with making the Section 92 Order. That is to say, the efficiencies excluded by this screen either would likely be achieved through alternative means in any event, or they would be unaffected by the Section 92 Order. This could occur, for example, because they would be attained in one or more markets or parts of the merged entity's operations that would be unaffected by the Section 92 Order. It is in this sense that the assessment contemplated by section 96 is heavily dependent on the nature of the Section 92 Order.

394 That said, to the extent that there are efficiencies in other markets that are so inextricably linked to the cognizable efficiencies in the relevant market(s) that they would not likely be attained if the Section 92 Order were made, they are cognizable under section 96 and will be included in the trade-off assessment.

395 In assessing whether efficiencies are likely to be achieved through alternative means, the Tribunal will assess the realities of the market(s) concerned, and will not exclude efficiencies from its analysis on the basis of speculation that the efficiencies could *possibly* be achieved through such alternative means.

396 It bears emphasizing that, under section 96, the relevant counterfactual is the scenario in which the Section 92 Order is made. This is not necessarily the scenario in which the merger does not occur.

(ii) Socially adverse effects

397 At paragraph 284 of the Panel's decision, it was observed that the Commissioner adduced no evidence with respect to what the Tribunal in the past has characterized as being *socially adverse* effects. The Panel also observed that the Commissioner conceded that the merger is not likely to result in any such effects. Accordingly, the Panel confined its assessment to the *anti-competitive* effects claimed by the Commissioner.

398 However, given that the Commissioner requested, in her final oral submissions, that the Panel clarify the analytical approach applicable to the efficiencies defence, the following observations will be provided with respect to the potential role of socially adverse effects in the trade-off analysis contemplated by section 96, in future cases.

399 At paragraph 205 of its final argument, CCS characterized the approach established by the Federal Court of Appeal in *Propane*, above, as being the "balancing weights approach." This is the same terminology that was used by Dr. Baye at footnote 14 of his reply report, where he referred to the approach established in *Propane*, above, and *Propane*, above. However, as the Tribunal noted in *Propane*, at para. 336, balancing weights "is incomplete [as an approach] and useful only as a tool to assist in its broader inquiry" under section 96. With this in mind, the Tribunal characterized that broader inquiry mandated by *Propane* in terms of the "socially adverse effects" approach. However, on reflection, the term "weighted surplus" approach would seem to be preferable.

400 As noted at paragraphs 281 — 283 of the Panel's decision, the total surplus approach remains the starting point for assessing the effects contemplated by the efficiencies defence set forth in section 96 of the Act. After the Tribunal has assessed the evidence with respect to the quantifiable (i.e., the DWL) and non-quantifiable anti-competitive effects of the merger in question, it will assess any evidence that has been tendered with respect to socially adverse effects. In other words, if the Commissioner alleges that the merger is likely to give rise to socially adverse effects, the Tribunal will determine how to treat the wealth transfer that is likely to be associated with any adverse price effects of the merger. The wealth transfer is briefly discussed at paragraph 282 of the Panel's decision.

401 As the Tribunal observed in *Propane*, above, at para. 372, "demonstrating significant adverse redistributional effects in merger review will, in most instances, not be an easy task." Among other things, determining how to treat the wealth transfer will require "a value judgment and will depend on the characteristics of [the affected] consumers and shareholders" (*Propane*, above, at para. 329). It will "rarely [be] so clear where or how the redistributive effects are experienced" (*Propane*, above, at para. 329). In general, the exercise "will involve multiple social decisions" and "[f]airness and equity [will] require complete data on socio-economic profiles on [*sic*] consumers and shareholders of producers to know whether the redistributive effects are socially neutral, positive or adverse" (*Propane*, above, at paras. 329 and 333).

402 Where it is determined that the merger likely will result in a socially adverse transfer of wealth from one or more identified lower income group(s) to higher income shareholders of the merged entity, a subjective decision must be made as to how to weigh the relevant part(s) of the wealth transfer. (If the entire wealth transfer will involve a socially adverse transfer, then it would be necessary to decide how to weigh the full transfer.) If the income effect on some purchaser groups would be more severe than on others, different weightings among the groups may be required.

403 It is at this point in the assessment that the balancing weights tool can be of some assistance. As proposed by Professor Peter Townley, one of the Commissioner's experts in *Propane*, above, this tool simply involves determining the weight that would have to be given to the aggregate reduction in consumer surplus (*i.e.*, the sum of the deadweight loss, including any deadweight loss attributable to pre-existing market power, plus the wealth transfer) in order for it to equal the increased producer surplus that would likely result from the merger (*i.e.*, the sum of the efficiency gains and the wealth transfer). (See the Affidavit of Peter G.C. Townley, submitted in *Propane*, above, (available at http://www.ct-tc.gc.ca/CMFiles/CT-1998-002_0115_38LES-1112005-8602.pdf).)

404 For example, in *Propane*, the aggregate reduction in consumer surplus was estimated to be $43.5 million, *i.e.*, the estimated $40.5 million wealth transfer plus the estimated $3 million DWL. By comparison, the aggregate increase in producer surplus was estimated to be $69.7 million, *i.e.*, the sum of the efficiency gains accepted by the Tribunal, namely $29.2 million, plus the wealth transfer of $40.5 million. The balancing weight was therefore represented by *w* in the following formula: 1(69.7) — *w* ($43.5) = 0. Solving for *w* yielded a value of 1.6, which was the weight at which the consumer losses and the producer gains just balanced. (See *Propane*, above, at paras. 102-104.) Accordingly, for consumer losses to outweigh producer gains, they would have had to be given a weight of greater than 1.6, assuming that producer gains were given a weight of 1.

405 Professor Townley's helpful insight was that members of the Tribunal often would be in a position to subjectively determine, even in the absence of substantial information, whether there was any reasonable basis for believing that a weighting greater than the balancing weight ought to be applied to the socially adverse portion(s) of the wealth transfer. If not, then notwithstanding an insufficiency of the information required to accurately calculate a full set of distributional weights, it could be concluded that the efficiencies likely to result from the merger would outweigh the adverse effects on consumer surplus. Unfortunately, there was not sufficient information adduced in *Propane* to permit the Tribunal to assess whether the estimated balancing weight of 1.6 was reasonable, given the socio-economic differences between and among consumers and shareholders (*Propane*, above, at para. 338).

406 Where the balancing weights tool does not facilitate a determination of the weights to be assigned to any identified socially adverse effects, other evidence may be relied upon to assist in this regard. For example, in *Propane*, the Tribunal relied upon Statistics Canada's report entitled *Family Expenditure in Canada, 1996*, which suggested that only 4.7% of purchasers of bottled propane were from the lowest-income quintile, while 29.1% were from the highest-income quintile. The Tribunal ultimately determined that the redistributive effects of the merger on customers in the lowest-income quintile would be socially adverse, and included in its trade-off analysis an estimate of $2.6 million to reflect those adverse effects. Although it found that it had no basis upon which to determine whether the DWL should be weighted equally with adverse redistribution effects, the Tribunal ultimately concluded that, even if the $2.6 million in adverse distribution effects were weighted twice as heavily as the $3 million reduction in DWL and a further $3 million to represent the adverse qualitative effects of the merger, the combined adverse impact on consumer surplus would not exceed $11.2 million (*Propane*, above, at para. 371). Since that estimate was still far below the recognized efficiency gains of $29.2 million, it concluded that the defence in section 96 had been met. This conclusion was upheld on appeal.

(iii) Non-quantifiable/qualitative effects

407 The Panel's assessment of the non-quantifiable effects that were considered in the section 96 trade-off assessment in this case is set forth at paragraphs 305-307 of its reasons.

408 I simply wish to add that where there is not sufficient evidence to quantify, even roughly, effects that ordinarily would be quantifiable, it will remain open to the Tribunal to accord *qualitative* weight to such effects. For example, in the case at bar, it would have been open to accord qualitative weight to the anti-competitive effects of the Merger expected to occur outside the Contestable Area, given that the evidence established that such effects were likely, but could not be calculated due to shortcomings in the evidence. As it turned out, it was unnecessary for the Panel to give those effects any weighting whatsoever.

409 Similarly, had the Panel not accepted the Commissioner's evidence with respect to the quantitative magnitude of the DWL, such that there was then no evidence on this specific matter, it would have been open to the Panel to accord qualitative weight to the fact that there would have been *some* significant DWL associated with the adverse price effects which it determined were likely to result from the Merger. The same will be true in other cases in which either it is not possible to reliably quantify the likely DWL, even in rough terms, or the Commissioner fails to adduce reliable evidence regarding the extent of the likely DWL, at the appropriate time.

2021 SCC 47, 2021 CSC 47
Supreme Court of Canada

Trial Lawyers Association of British Columbia v. Royal & Sun Alliance Insurance Company of Canada

2021 CarswellOnt 16666, 2021 CarswellOnt 16667, 2021 SCC 47, 2021 CSC 47, [2022] I.L.R. I-6321, 16 C.C.L.I. (6th) 175, 22 B.L.R. (6th) 1, 338 A.C.W.S. (3d) 184, 463 D.L.R. (4th) 477, 81 M.V.R. (7th) 1, EYB 2021-419166

Trial Lawyers Association of British Columbia (Appellant) and Royal & Sun Alliance Insurance Company of Canada (Respondent) and Ontario Trial Lawyers Association (Intervener)

Wagner C.J.C., Moldaver, Karakatsanis, Côté, Brown, Rowe, Kasirer JJ.

Heard: May 17, 2021
Judgment: November 18, 2021
Docket: 38949

Proceedings: affirming *Bradfield v. Royal Sun Alliance Insurance Company of Canada* (2019), [2019] O.J. No. 5047, 96 C.C.L.I. (5th) 68439 D.L.R. (4th) 11553 M.V.R. (7th) 25[2020] I.L.R. I-6194148 O.R. (3d) 1612019 CarswellOnt 159362019 ONCA 800, Doherty J.A., Harvison Young J.A., J.A. Thorburn J.A. (Ont. C.A.); reversing *Bradfield v. Royal and Sun Alliance Insurance Company of Canada* (2018), [2019] I.L.R. I-6085, 2018 ONSC 44772018 CarswellOnt 12536, Alexander Sosna J. (Ont. S.C.J.)

Counsel: Ryan D.W. Dalziel, Q.C., Esher V. Madhur, for Appellant
David A. Tompkins, Mark A. Borgo, for Respondent
Gavin MacKenzie, for Intervener

***Moldaver, Brown JJ.* (Wagner C.J. and Côté, Rowe and Kasirer JJ. concurring):**

I. Overview

1 Steven Devecseri died in a motorcycle accident. His insurer, Royal & Sun Alliance Insurance Company of Canada ("RSA"), proceeded to defend his estate in two lawsuits started by others injured in the accident, including Jeffrey Bradfield. Three years after the accident, and over a year into litigation, RSA learned Mr. Devecseri had consumed alcohol immediately prior to the accident, putting him in breach of his insurance policy. RSA promptly ceased defending Mr. Devecseri's estate and denied coverage. This reduced the value to Mr. Bradfield (and another third-party claimant) of Mr. Devecseri's policy from the policy limits of $1,000,000 to the statutory minimum coverage of $200,000. Nearly three years later, one of the actions proceeded to trial, resulting in a judgment against Mr. Devecseri's estate and Mr. Bradfield, and a judgment for Mr. Bradfield on a cross-claim against the estate.

2 In enforcing his judgment against Mr. Devecseri's estate, Mr. Bradfield rejected RSA's position that its exposure on behalf of the estate was confined to the statutory minimum of $200,000. He advanced two grounds: first, waiver by conduct, and secondly, promissory estoppel. The trial judge agreed that RSA had waived its right to deny full coverage. The Court of Appeal rejected both grounds. Of particular significance, it found that RSA's conduct could not amount to a "promise or assurance which was intended to affect [the parties'] legal relationship and to be acted on" because RSA lacked knowledge of Mr. Devecseri's policy breach when it provided him with a defence (see *Maracle v. Travellers Indemnity Co. of Canada*, [1991] 2 S.C.R. 50, at p. 57). In so concluding, it saw no basis to fix RSA with imputed knowledge of the policy breach, even though the parties agreed that a coroner's report, available shortly after the accident — and approximately three years before RSA took an off-coverage position — would have provided RSA with evidence of the breach. Mr. Bradfield appealed to this Court, advancing both waiver by conduct and promissory estoppel arguments.

3 We would dismiss the appeal. The appellant now concedes, correctly in our view, that waiver by conduct was precluded by statute at the relevant time. With respect to promissory estoppel, we agree with the Court of Appeal that RSA could not have intended to alter its legal relationship with Mr. Bradfield because it lacked knowledge of the facts which demonstrated (or otherwise put RSA on notice) of Mr. Devecseri's policy breach. Nonetheless, even if this obstacle could be overcome, we would still harbour serious reservations about the availability of any estoppel argument on the facts of this case. A third-party claimant like Mr. Bradfield faces additional hurdles in establishing a successful estoppel argument against an insurer, given the nature of their statutory relationship. Whether and to what extent Ontario's Insurance Act, R.S.O. 1990, c. I.8, permits third parties like Mr. Bradfield to assert estoppel arguments, including on behalf of a first-party insured, raises a number of issues that were not fully or satisfactorily argued but which warrant comment.

4 A preliminary issue also arises. Mr. Bradfield discontinued his appeal after this Court granted leave to appeal because he and RSA reached a settlement agreement. This Court then granted the request of the Trial Lawyers Association of British Columbia to be substituted as the appellant. Although the appeal is moot, Trial Lawyers argues that we ought to exercise our discretion to hear it on the merits in accordance with *Borowski v. Canada (Attorney General)*, [1989] 1 S.C.R. 342. We agree.

II. Background

5 On May 29, 2006, Mr. Bradfield, Mr. Devecseri and several others were riding motorcycles when Mr. Devecseri rode into oncoming traffic, colliding with a car being driven by Jeremy Caton. The collision killed Mr. Devecseri and injured both Mr. Caton and Mr. Bradfield. At the time, Mr. Devecseri had alcohol in his system, in contravention of his motorcycle license and thereby in breach of his standard motor vehicle insurance policy.

6 RSA appointed an adjuster to investigate the accident. He interviewed Mr. Bradfield, who — despite having accompanied Mr. Devecseri prior to the accident — did not mention that Mr. Devecseri had been drinking alcohol. Nor was this fact revealed by the police report which had been provided in a redacted form to the adjuster. The adjuster's report to RSA concluded that, while speed was a factor in the collision, further investigation would be required to know whether drugs or alcohol played any role. The adjuster also expressed confusion about who would normally be responsible for obtaining a coroner's report, although RSA's initial instructions to the adjuster listed a coroner's report as a potential avenue of investigation. Neither he nor anyone else at RSA took steps to obtain a coroner's report.

7 On October 7, 2007, Mr. Bradfield sued Mr. Devecseri's estate. On May 27, 2008, Mr. Caton sued the estate, as well as Mr. Bradfield and another motorcyclist in the group. Pursuant to its insurance policy with Mr. Devecseri, RSA responded to these claims on behalf of the estate. RSA retained counsel and filed a statement of defence in each action on March 5, 2009.

8 On June 25, 2009, examinations for discovery of Mr. Bradfield and the other motorcyclist occurred. The other motorcyclist testified that he had seen Mr. Devecseri and Mr. Bradfield consuming alcohol at a restaurant shortly before the accident. Mr. Bradfield testified that he was at a restaurant with Mr. Devecseri, but said he could not recall if Mr. Devecseri was drinking alcohol. A coroner's report, dated August 29, 2006, was then obtained, confirming that Mr. Devecseri had a modest quantity of alcohol in his system when he died.

9 On July 8, 2009, RSA advised all parties that it was taking an off-coverage position. This change in position meant that if their claims were to succeed, Mr. Bradfield and Mr. Caton would be collectively entitled to no more than the statutory minimum coverage of $200,000 (Insurance Act, s. 251(1)), rather than the $1 million that would have been available under Mr. Devecseri's full policy.

10 Almost three years later, in May 2012, Mr. Bradfield settled his action against Mr. Devecseri's estate. As part of the settlement, RSA paid him $100,000 plus costs, representing half its statutory minimum coverage, while paying the other half to Mr. Caton. The settlement also included a payment to Mr. Bradfield by his own insurer of $750,000 in underinsured coverage.

11 In June 2012, Mr. Caton obtained a judgment for $1.8 million against Mr. Devecseri's estate and Mr. Bradfield. While each was jointly liable to Mr. Caton, several liability was apportioned 90 percent against Mr. Devecseri and 10 percent against

Mr. Bradfield. In the same proceeding, Mr. Bradfield also obtained judgment on a cross-claim for contribution and indemnity against Mr. Devecseri's estate.

12 Following the trial, Mr. Bradfield sought a declaration of entitlement to recover judgment against RSA on the basis that RSA waived Mr. Devecseri's breach or was estopped from denying coverage to Mr. Devecseri's estate. The trial judge granted the declaration, finding that RSA waived its right to deny coverage by failing to take an off-coverage position and by providing a defence to Mr. Devecseri's estate as the litigation progressed (2018 ONSC 4477). Having found waiver by conduct, the trial judge did not consider the estoppel argument.

13 The Court of Appeal allowed RSA's appeal (2019 ONCA 800, 148 O.R. (3d) 161). It rejected Mr. Bradfield's waiver argument, in part because, at that time, s. 131(1) of the Insurance Act precluded recognition of waiver by conduct. Likewise, Mr. Bradfield's promissory estoppel argument failed because RSA lacked knowledge of the policy breach, such knowledge could not be imputed to RSA, and Mr. Bradfield was unable to establish detrimental reliance.

III. Issues

14 Commencing with waiver, the parties before this Court agree that s. 131(1) of the Insurance Act, as it read at the relevant time, required that waiver be given in writing and that RSA did not waive any rights in writing. [1] Accordingly, promissory estoppel is the sole issue before us: was RSA estopped from denying coverage because it responded to the claims against Mr. Devecseri's estate long after it could have discovered evidence of Mr. Devecseri's policy breach?

IV. Analysis

15 Promissory estoppel is an equitable defence whose elements were stated by Sopinka J. for this Court in *Maracle*, at p. 57:

> The principles of promissory estoppel are well settled. The party relying on the doctrine must establish that the other party has, by words or conduct, made a promise or assurance which was <u>intended</u> to affect their <u>legal relationship</u> and <u>to be acted on</u>. Furthermore, the [promisee] must establish that, in reliance on the [promise], he acted on it or in some way changed his position. [Emphasis added.]

The equitable defence therefore requires that (1) the parties be *in a legal relationship* at the time of the promise or assurance; (2) the promise or assurance be *intended* to affect that relationship and to be acted on; and (3) the other party in fact *relied* on the promise or assurance. It is, as we will explain, implicit that such reliance be to the promisee's detriment.

16 Promissory estoppel seeks to protect against the "inequity of allowing the other party to resile from his statement where it has been relied upon to the detriment of the person to whom it was directed" (*Fort Frances v. Boise Cascade Canada Ltd.*, [1983] 1 S.C.R. 171, at p. 202). In the insurance context, estoppel arises most commonly where an insurer, having initially taken steps consistent with coverage, then denies coverage because of the insured's breach of a policy term or its ineligibility for insurance in the first place. To prevent the insurer from denying coverage, the insured will attempt to show that the insurer is estopped from changing its coverage position based on its prior words or conduct.

17 Although the nuances of the relationship between promissory estoppel and other forms of estoppel were not argued before us in this appeal, we observe that Trial Lawyers' arguments may be better framed as supporting estoppel by representation rather than promissory estoppel (see Ryan v. Moore, 2005 SCC 38, [2005] 2 S.C.R. 53, at para. 5; *Page v. Austin*, (1884), 10 S.C.R. 132, at p. 164). While the latter doctrine prevents the promisor from reneging on an assurance to alter the parties' legal relationship, the former doctrine prevents a promisor from denying the truth of a prior representation (see, generally, B. MacDougall, *Estoppel* (2nd ed. 2019), at §§ 5.33 to 5.45). Given the similarities between the doctrines, however, we resolve this appeal applying only the principles of promissory estoppel upon which Trial Lawyers relies, while noting that similar reasoning would apply if the claim were grounded in estoppel by representation.

18 As we will explain, Trial Lawyers' estoppel argument must fail, primarily because RSA gave no promise or assurance intended to affect its legal relationship with Mr. Bradfield. RSA lacked knowledge, at the time it provided a defence to Mr.

Devecseri's estate, of Mr. Devecseri having breached the policy by consuming alcohol. This is fatal to Trial Lawyers' position. Further, and *even if* constructive knowledge of the facts demonstrating a breach were sufficient for purposes of estoppel (which, as we will explain, it is not), RSA cannot be fixed with constructive knowledge of such facts in the circumstances of this case. RSA was under a duty to Mr. Devecseri to investigate the claim against him "fairly", in a "balanced and reasonable manner" (Fidler v. Sun Life Assurance Co. of Canada, 2006 SCC 30, [2006] 2 S.C.R. 3, at para. 63, citing with approval *702535 Ontario Inc. v. Lloyd's London, Non-Marine Underwriters*, (2000), 184 D.L.R. (4th) 687 (Ont. C.A.), at para. 29). It did so. RSA was under no additional duty to Mr. Bradfield or other third-party claimants to investigate policy breaches at all, much less on a different and more rigorous standard than that which it owed to its insured.

19 These points are sufficient to dispose of this appeal. As indicated, however, we propose to canvass some additional difficulties that a third-party claimant like Mr. Bradfield must contend with in raising a successful estoppel argument against an insurer.

A. Intention

20 The parties agree that, for three years — from the date of the accident in May 2006 to discoveries in June 2009 — RSA was ignorant of Mr. Devecseri's alcohol consumption. The issue is whether, *that ignorance notwithstanding*, RSA can be held to an assurance, by words or conduct, that it would not deny coverage on the basis of this policy breach. In our view, RSA's lack of knowledge is fatal to Trial Lawyers' estoppel argument.

21 To ground promissory estoppel, the requirement stated in *Maracle* that a promise or assurance must be *intended* to affect the parties' legal relationship signifies that the promisor must *know* of the facts that are said to give rise to that legal relationship, and of the alteration thereto — in this case, that Mr. Devecseri would be covered to the full policy limits *despite his having breached the policy*. We acknowledge that the jurisprudence from this Court speaks of *intention*, not knowledge (*Maracle*, at pp. 57-59; *John Burrows Ltd. v. Subsurface Surveys Ltd.*, [1968] S.C.R. 607, at p. 615). But the significance of *intention* depends entirely on what the promisor *knows*. A promisor, such as RSA, cannot *intend* to alter a relationship by promising to refrain from acting on information that it does not have. If RSA is to be taken, by having furnished a defence, as having intended to affect a relationship with Mr. Bradfield by extending coverage *notwithstanding* Mr. Devecseri's breach, it must be shown to have known *of the facts* which demonstrate that breach.

22 As we explain below, the requirement that RSA be shown to have known *of the facts* demonstrating a breach leaves a narrow role for *imputed* knowledge in this context. Trial Lawyers seeks to broaden this role, arguing that *constructive* knowledge arising from a breach of a duty to investigate is enough. We disagree. As we explain below, to hold otherwise would be to unwisely and unnecessarily undermine the existing duty on insurers owed to insureds — and not to third-party claimants like Mr. Bradfield — to investigate liability claims fairly, in a balanced and reasonable manner.

23 It is this simple: RSA lacked knowledge of the facts demonstrating Mr. Devecseri's breach. This alone is dispositive of Trial Lawyers' appeal.

(1) Imputed Knowledge

24 As we have explained, promissory estoppel requires that an insurer know the facts demonstrating a breach in order to be bound to any promise to cover, notwithstanding that breach. To be clear, that is all that is required: knowledge of *the facts*. Had, therefore, RSA known of *the fact* that demonstrated Mr. Devecseri's breach (specifically, that he had consumed alcohol prior to the accident) but had failed to appreciate *its legal significance* (specifically, that this *was a breach*), knowledge of that legal significance could have been imputed to RSA. The leading authority from this Court and the jurisprudence developed in lower courts support this view. But, as will be seen, this jurisprudence does not assist Trial Lawyers here.

25 In *Western Canada Accident and Guarantee Insurance Co. v. Parrott*, (1921), 61 S.C.R. 595, an employee was injured while working at her employer's unguarded laundry machine. The employer, whose insurance policy required that all the machines be equipped with a safety guard, sent the insurer a report of the accident that implied that the machine in question was not guarded. Further, two of the insurer's agents either saw or were told that the machine was unguarded. Justice Idington held that, upon

reading the employer's report alone, it would be "inconceivable" that the insurer did not turn its mind to the breach (p. 598). It followed that the insurer was in possession of the relevant fact that demonstrated the breach. While the contention that the insurer did not understand the legal significance of this fact was rejected by Idington J. as *unbelievable* (at p. 600), it was also *irrelevant*: because the insurer knew of the relevant fact, the knowledge of its legal significance could be imputed to the insurer. In separate reasons, other members of this Court agreed that the insurer was taken, by its knowledge of *the fact* of the unguarded machine, to have full knowledge of its rights to deny coverage (at p. 601, per Duff J.; at pp. 602-3, per Anglin J.; at pp. 606-7, per Mignault J.), and the insurer was therefore estopped from denying coverage after having defended the action.

26 *Parrott* demonstrates the narrow operation of imputed knowledge in this context. Where the insurer is shown to have known of the fact demonstrating a breach but has failed to appreciate its legal significance (that is, failed to discern that it indeed demonstrated *a breach*), a trier of fact may infer the insurer knew of its right to withhold coverage while intending to assure the insured that it would not act thereon (see *Maracle*, at p. 59; *John Burrows*, at p. 616). The employer's reliance on the insurer's conduct — in providing a defence and taking the matter to trial — as an assurance of coverage was reasonable in view of the insurer having actual knowledge of the fact of the unguarded machine.

27 This view finds support in the lower courts. In Rosenblood Estate v. Law Society of Upper Canada198937 C.C.L.I. 142 (Ont. H.C.), aff'd 199216 C.C.L.I. (2d) 226 (Ont. C.A.), the very nature of the claim — that a solicitor was aware that a property he was dealing with was over-mortgaged — fell outside the scope of the insurance policy. Again, however, while the insurer knew of the solicitor's awareness, it failed to appreciate its significance as demonstrative of a policy breach. And as in *Parrott*, that did not matter: it was taken, by virtue of its knowledge of *the fact*, as appreciating its significance (p. 156). Whether the insurer actually did appreciate the significance of the fact was irrelevant. In this sense, estoppel differs from waiver, which requires knowledge of the legal significance of the facts (*Saskatchewan River Bungalows Ltd. v. Maritime Life Assurance Co.*, [1994] 2 S.C.R. 490, at p. 500). In *Rosenblood Estate* , the reliance of the solicitor's estate on the insurer providing a defence as an assurance of coverage was reasonable in light of the insurer having actual knowledge of the mere fact that brought the claim outside the scope of the policy.

28 This was echoed recently at the Court of Appeal for Ontario in *The Commonwell Mutual Assurance Group v. Campbell*, 2019 ONCA 668, 95 C.C.L.I. (5th) 344, aff'g 2018 ONSC 5899, 95 C.C.L.I. (5th) 328, at paras. 38 and 40, where, again, the nature of the claim itself fell outside the scope of coverage. The insurer thus had knowledge of facts supporting a denial of coverage from the moment it received a statement of claim. It was irrelevant that the insurer did not turn its mind to the applicable exclusion, and it was estopped from relying on that exclusion later to deny coverage.

29 This point — that the provision of a defence by an insurer, despite its knowledge of a fact demonstrating a breach, supports an inference that the insurer intended to alter its legal relationship with the insured — is widely accepted in our law (see, e.g., Parlee v. Pembridge Insurance Co., 2005 NBCA 49, 283 N.B.R. (2d) 75, at para. 12; Fellowes, McNeil v. Kansa General International Insurance Co.. 200022 C.C.L.I. (3d) 1 (Ont. C.A.), at para. 69; Gilewich v. 3812511 Manitoba Ltd., 2011 MBQB 169, 267 Man. R. (2d) 40, at para. 42; Gillies v. Couty1994100 B.C.L.R. (2d) 115 (B.C. S.C. [In Chambers]) (S.C.), at paras. 5 and 8; *Federal Insurance Co. v. Matthews*, (1956), 3 D.L.R. (2d) 322 (B.C.S.C.), at p. 345; see also *Owen Sound Public Library Board v. Mial Developments Ltd*, (1979), 26 O.R. (2d) 459 (Ont. C.A.), at p. 467). Also widely accepted is the proposition that, where an insurer knows of the facts demonstrating a breach, a failure to appreciate their legal significance *as such* — that is, as demonstrative of a breach — is irrelevant, so that such an appreciation may be imputed to the insurer, and the insurer estopped from denying coverage (see, for instance, Personal Insurance Co. v. Alexander Estate, 2012 NWTSC 19, 30 M.V.R. (6th) 282, at paras. 33-35 and 41-42; *Snair v. Halifax Insurance Nationale-Nederlanden North America Corp*, (1995), 145 N.S.R. (2d) 132 (S.C.), at para. 62; *Rowe v. Mills*, (1986), 72 N.B.R. (2d) 344 (Q.B.), at para. 12; *Hassan v. Toronto General Insurance Co*, (1960), 22 D.L.R. (2d) 360 (Ont. H.C.J.), at pp. 368-69).

30 In sum, where an insurer is shown to be in possession of the facts demonstrating a breach, an inference may be drawn that the insurer, by its conduct, *intended* to alter its legal relationship with the insured — notwithstanding the fact that the insurer did not realize the legal significance of the facts or otherwise failed to appreciate the terms of its policy with the insured.

31 Here, it is undisputed that, when RSA defended Mr. Devecseri's estate, it did not know of the fact of his consumption of alcohol prior to the accident, which fact, if known, would have demonstrated his policy breach. This is not a case where RSA knew of Mr. Devecseri's consumption of alcohol but failed to appreciate it as putting him in breach. On that basis, *Parrott* , *Rosenblood Estate* and *Campbell* are readily distinguishable. Knowledge of the facts demonstrating Mr. Devecseri's breach cannot be imputed to RSA, and RSA therefore cannot be taken to have intended to assure his estate, or Mr. Bradfield, or anyone else, that it would not be relying upon that breach to deny coverage.

(2) Constructive Knowledge

32 Trial Lawyers urges us to find that RSA *constructively* knew of Mr. Devecseri's breach, and is thus taken to know what it ought to or should have known. This submission is premised on what Trial Lawyers says is RSA's breach of a duty to diligently investigate the claim against its insured. We would reject Trial Lawyers' argument, and with it the possibility of recognizing constructive knowledge arising from a breach of a duty to investigate as grounding promissory estoppel, for two reasons.

33 First, this argument entails a significant — and, in our view, unwise and unnecessary — modification of the obligation an insurer owes to the insured in the context of a liability claim. This duty exists because insurers have strong economic incentives to deny coverage, which this Court has sought to moderate in the public interest. As claims arise under a policy of liability insurance, insurers are bound by a duty to the insured to investigate each claim "*fairly*", in a "*balanced and reasonable manner*", and not engage in a relentless search for a policy breach (*Fidler* , at para. 63, citing *702535 Ontario Inc.*, at para. 29). The point bears reiteration: this Court has sought to *temper* the incentives of insurers in order to protect the interests of insureds, who are vulnerable when insurers act with "wilful tunnel vision" to look for policy breaches where there is "nothing to go on" (Whiten v. Pilot Insurance Co., 2002 SCC 18, [2002] 1 S.C.R. 595, at paras. 102-3).

34 The duty owed to the insured to investigate fairly, in a balanced and reasonable manner, as recognized by this Court is at odds with the duty to investigate "thoroughly" and "diligently" urged upon us by Trial Lawyers (A.F., at paras. 121 and 123). Apparently relying on *Coronation Insurance Co. v. Taku Air Transport Ltd.*, [1991] 3 S.C.R. 622, Trial Lawyers submits that the insurer is bound by a duty to "know the things that were within [its] grasp" (transcript, p. 24; see also A.F., at para. 124; *Coronation Insurance*, at p. 640). But *Coronation Insurance* is of minimal assistance here. First, the standard set in that case and in *Canadian Indemnity Co. v. Canadian Johns-Manville Co.*, [1990] 2 S.C.R. 549, related to insurers' presumed knowledge of their own files and of issues of public notoriety. The coroner's report at issue in this case was neither in the possession of the insurer nor notorious. More fundamentally, those cases concerned an insurer's assessment of the risks associated with a prospective insured *before even entering into an insurance contract*. At that pre-contract stage, this Court's concern was to temper the insurer's incentives to enter into a contract while turning a blind eye to the risks posed by the insured, only to then use the non-disclosure of those risks as a basis for denying coverage as claims arose. The incentives operate differently where, as here, we are concerned with claims under an existing contract. At that stage, the insurer has every incentive to search for breaches in relation to a given claim. We fear that, far from tempering these incentives, Trial Lawyers' submission would *augment* them, pushing insurers to go the extra mile to find policy breaches. For this reason, the submission must be rejected.

35 Secondly, there is no basis in law for a third-party claimant such as Mr. Bradfield to be able to ground an estoppel argument in any alleged breaches of an insurer's duty to its insured. In other words, the duty to investigate fairly, in a balanced and reasonable manner, is owed only to the insured, not third parties. Were such a duty owed to third parties, it would sit uneasily, and indeed would undermine, the duties of utmost good faith and fair dealing that govern the relationship between the parties to an insurance contract — in this case, between RSA and Mr. Devecseri. This is because the obligations between the insurer and the insured are reciprocal; while the insurer has the aforementioned duty to investigate fairly, in a balanced and reasonable manner, *the insured* is *also* under a reciprocal duty to disclose facts material to the claim (*Whiten* , at para. 83, citing *Andrusiw v. Aetna Life Insurance Co. of Canada*, (2001), 289 A.R. 1 (Q.B.), at paras. 84-85; Bhasin v. Hrynew, 2014 SCC 71, [2014] 3 S.C.R. 494, at para. 55).

36 This reciprocity of obligation is worth stressing. This Court has taken care to strike a careful balance in stating and developing the duty of utmost good faith and fair dealing between insurer and insured with a view to facilitating the honest,

fair, and expeditious resolution of insurance claims. Here, RSA owed Mr. Devecseri a duty to investigate the claims against his estate fairly, in a balanced and reasonable manner, and without being zealous or relentless in its search for policy breaches. Had he survived, Mr. Devecseri would have owed a reciprocal duty to disclose any information in his possession which might have voided his coverage — in particular, that he had consumed alcohol. If, after having received this disclosure, RSA had continued to provide a defence, Mr. Devecseri could have relied on that continued defence as an assurance of coverage that could prevent RSA from later changing positions. Had, however, Mr. Devecseri failed to disclose to RSA the fact of his having consumed alcohol, the breach of his duty to disclose would foreclose any later assertion by him and against RSA of estoppel.

37 Trial Lawyers asks that we allow third-party claimants to piggy-back onto the relationship between insurer and insured, characterized as it is by mutual duties of utmost good faith and fair dealing, but in a way that strips the new relationship between an insurer and third-party claimants of all such mutuality. So, while Mr. Bradfield claims he does not recall whether Mr. Devecseri consumed alcohol, it is worth bearing in mind that, *had he known*, he would be under no obligation to RSA to disclose that fact. And yet, Trial Lawyers would have this Court burden RSA with a duty *to Mr. Bradfield* to discover that selfsame fact. We see no justice in impressing RSA with such a duty while Mr. Bradfield owes no corresponding obligation. Further, and in any event, we note that promissory estoppel requires that the party seeking the aid of equity come with clean hands, which may also entail an obligation to disclose material facts, particularly in contexts such as insurance where parties are bound by reciprocal duties of utmost good faith (see, e.g., MacDougall, at §§ 5.289 to 5.292).

38 Viewed in light of the reciprocity of obligations between the actual contracting parties — the insurer and the insured — there is a certain absurdity to Trial Lawyers' position. It would effectively mean that a contract of liability insurance provides greater protection to, and imposes fewer (indeed, no) obligations upon, third parties like Mr. Bradfield than it provides to and imposes upon the first-party insured. This result effectively runs contrary to the clear expression of legislative intent in s. 258(11) of the Insurance Act, which provides that an insurer is entitled to assert any defences against the claimant as it could raise against the insured.

39 For these reasons, we must reject Trial Lawyers' argument that RSA can be fixed with constructive knowledge of Mr. Devecseri's policy breach.

B. Further Issues

40 Trial Lawyers says it can assert estoppel on behalf of both Mr. Devecseri's estate and Mr. Bradfield, based on assurances to each, and based on detriment suffered by each. This submission is extraordinary. While these issues were not satisfactorily argued by the parties and we therefore leave their resolution to another day, we highlight below some of the difficulties that Trial Lawyers would face in asserting estoppel in the manner it proposes, given the third-party nature of its claim and the relevant statutory context.

(1) Limits of the Statutory Relationship

41 Promissory estoppel generally requires that the promisor and promisee already have a legal relationship (*Maracle*, at p. 57; *Canadian Superior Oil Ltd. v. Paddon-Hughes Development Co.*, [1970] S.C.R. 932, at p. 938; *Atlantic Steel Buildings Ltd. v. Cayman Group Ltd*, (1982), 50 N.S.R. (2d) 609 (S.C. (App. Div.)); see also MacDougall, at § 5.92). Trial Lawyers says that Mr. Bradfield, as a third-party claimant relative to Mr. Devecseri's insurance policy, was in a legal relationship with RSA by virtue of s. 258 of the Insurance Act. The relevant provisions of s. 258 of the Insurance Act read as follows:

> **Application of insurance money, 3rd party claims, etc.**
>
> **258** (1) Any person who has a claim against an insured for which indemnity is provided by a contract evidenced by a motor vehicle liability policy, even if such person is not a party to the contract, may, upon recovering a judgment therefor in any province or territory of Canada against the insured, have the insurance money payable under the contract applied in or towards satisfaction of the person's judgment and of any other judgments or claims against the insured <u>covered by the contract</u> and may, <u>on the person's own behalf and on behalf of all persons having such judgments or claims</u>, maintain an action against the insurer to have the insurance money so applied.

Defence where excess limits

(11) Where one or more contracts provide for coverage in excess of the limits mentioned in section 251 [i.e. the $200,000 mandatory insurance minimum], ... the insurer may,

(a) with respect to the coverage in excess of those limits; and

(b) as against a claimant,

avail itself of any defence that it is entitled to set up against the insured ....

42 Trial Lawyers submits that this statutory language creates the requisite legal relationship allowing Mr. Bradfield to assert a right of coverage as against RSA, both on his own behalf and by "stand[ing] in the shoes" of Mr. Devecseri's estate (A.F., at para. 102). We agree that s. 258 creates a legal relationship between Mr. Bradfield and RSA. It grants third-party claimants under an insurance policy a cause of action directly against an insurer, thereby bypassing the insured. In this way, and to that extent, it ousts the common law rule of contractual privity which would otherwise bar a third-party claimant from suing an insurer on an insurance contract to which the claimant is not a party. Absent s. 258, the third-party claimant's ability to recover funds from an insurer would be "entirely dependent upon the extent to which the insured [here, Mr. Devecseri's estate] chooses to or is able to enforce its contractual rights against the insurer [here, RSA]" (B. Billingsley, *General Principles of Canadian Insurance Law* (3rd ed. 2020), at p. 295). All other provinces and territories have enacted provisions similar in effect to s. 258.

43 We are, however, far from persuaded that Trial Lawyers accounts correctly for the nature of this relationship or of the rights and responsibilities flowing therefrom, and their implications for the estoppel analysis. This is because the precise nature of this legal relationship, as determined by the statutory text, permits a claimant to sue the insurer only "upon recovering a judgment" against the insured. On the facts of this case, this restriction is significant because RSA abandoned its defence of Mr. Devecseri in 2009, three years before Mr. Bradfield obtained his cross-claim judgment against RSA. This is the first obvious difficulty with Trial Lawyers' position: it relies on conduct by RSA that predates the existence of the relevant legal relationship.

44 The difficulties do not end there. It is unclear to us, based on the text of the statute, whether Mr. Bradfield can assert an estoppel argument on behalf of Mr. Devecseri's estate, as Trial Lawyers proposes. Section 258(1) permits Mr. Bradfield to bring his claim only on his "own behalf and on behalf of all persons having such judgments or claims ... against the insured", which would appear to foreclose claims in which Mr. Bradfield "steps into the shoes" of Mr. Devecseri's estate and asserts an estoppel on that basis. We note, on the other hand, that s. 258(1) states that it applies to judgments against the insured that are "covered by the contract", which language contemplates a judicial determination of whether the first-party insured is, indeed, "covered", in the sense that the insured could estop the insurer from denying coverage.

45 Accordingly, without fuller submissions than we received, we would refrain from definitively concluding whether s. 258(1) allows the type of claim that Mr. Bradfield advanced. But we nevertheless emphasize that these questions require clear answers before a claim like Mr. Bradfield's could succeed.

(2) Assurance Regarding Coverage

46 Even accepting for the purposes of argument that s. 258 operates as Trial Lawyers suggests — by permitting Mr. Bradfield to assert estoppel based on RSA's conduct predating the cross-claim judgment, whether on his own behalf or on behalf of Mr. Devecseri — there are further difficulties to resolve. We are of the view that Trial Lawyers has not identified any conduct by RSA that could amount to a "clear and unequivocal" or "unambiguous" assurance that it would refrain from denying coverage based on a later-revealed policy breach (*Engineered Homes Ltd. v. Mason*, [1983] 1 S.C.R. 641, at pp. 646-47, citing *Halsbury's Laws of England* (4th ed.), vol. 16, at para. 1514).

47 Trial Lawyers relies exclusively on RSA's fulfilment of its various statutory obligations and its duty to defend as such an assurance. At the initial stages of the litigation, Ontario's insurance legislation required RSA to advise plaintiffs of the existence of a policy covering Mr. Devecseri, the liability limits under that policy, and "whether the insurer will respond under the policy

to the claim" (Insurance Act, s. 258.4). In answering the latter question, RSA had to determine whether its duty to defend Mr. Devecseri required it to respond under the policy. Importantly, RSA's duty to defend Mr. Devecseri was triggered *not* by RSA being satisfied that Mr. Devecseri was not in breach, but simply by the receipt of a claim against the insured alleging facts which, "if proven to be true, would require the insurer to indemnify the insured for the claim" (Progressive Homes Ltd. v. Lombard General Insurance Co. of Canada, 2010 SCC 33, [2010] 2 S.C.R. 245, at para. 19; see also Monenco Ltd. v. Commonwealth Insurance Co., 2001 SCC 49, [2001] 2 S.C.R. 699, at para. 29; Non-Marine Underwriters, Lloyd's of London v. Scalera, 2000 SCC 24, [2000] 1 S.C.R. 551, at paras. 74-78; *Nichols v. American Home Assurance Co.*, [1990] 1 S.C.R. 801, at pp. 810-11). Put simply, and absent a known policy breach, at the initial stages of a liability dispute the insurer may decline to defend the insured only where it is clear that the true nature of the facts as pleaded fall outside the scope of the policy (*Scalera* , at paras. 50-55), or the claim is expressly excluded.

48 Where, therefore, an insurer responds to a claim against its insured by defending, it is communicating — to the insured *and* to the third-party claimant — only that the claims against its insured are of a type that fall within the terms of coverage. In no sense can such a limited communication, without more, be taken as a promise *to indemnify* the claimant if the insured is found at fault, irrespective of any later-revealed or later-occurring policy breaches. Trial Lawyers, in short, seeks to imbue RSA's provision of a defence to Mr. Devecseri's estate with greater significance than RSA's conduct in fact signified.

49 Lastly, even were it possible to construe the insurer's assumption of a defence on behalf of its insured as a promise not to deny coverage, the third-party context of this case raises yet more problems for Trial Lawyers. In cases of questionable coverage, insurers often rely on reservation-of-rights letters or non-waiver agreements to preserve their right to deny coverage upon investigating the claim (see, generally, N. P. Kent, "Preventive Paperwork: Non-Waiver Agreements, Reservation-of-Rights Letters and the Defence of Claims in Questionable Coverage Situations" (1995), 17 *Advocates' Q*. 399). It is unclear to us how and whether a third party would ever obtain knowledge of a rights-reserving instrument of this kind, and in the absence of such knowledge, the third party could conceivably argue an estoppel unavailable to the insured. In this way, Trial Lawyers' submission once more appears to give more to the third party than to the first-party insured.

(3) Detrimental Reliance

50 The final hurdle for Trial Lawyers would lie in establishing detrimental reliance. While we need not decide whether detrimental reliance is made out on the facts of this case, we note that the parties advanced arguments on the extent to which detrimental reliance can be presumed in cases where litigation has progressed to an advanced stage (see *Rosenblood Estate*, at pp. 156-57). This Court has never opined on such a presumption of prejudice and we decline to do so here, but we nevertheless highlight that the cases upon which Trial Lawyers relies involved claims by the first-party insured, not third-party claimants. This distinction requires careful consideration in a future case.

51 We also affirm that detrimental reliance by the promisee must be shown to assert promissory estoppel. The Court in *Maracle* did not refer to the requirement of detrimental reliance because the detriment in that case was self-evident: the promisor allegedly stated it would not act on an expired limitation period and the promisee then allowed the limitation period to expire before bringing an action. Detrimental reliance has, however, always been a requirement for asserting promissory estoppel, or for that matter any form of estoppel. This is because, being an equitable doctrine, its goal is to address unconscionable, unjust, or unfair conduct (*Ryan* , at paras. 68 and 74; Cowper-Smith v. Morgan, 2017 SCC 61, [2017] 2 S.C.R. 754, at paras. 20 and 28). And what makes it unconscionable, unjust, or unfair to resile from a promise or assurance is that the promisor has, by intention and effect, induced the promisee to change its position in reliance thereon, *to its detriment*. For that reason, asserting promissory estoppel requires evidence of prejudice, inequity, unfairness or injustice before courts will give hold a promisor to its promise or assurance (see *Hughes v. Metropolitan Railway Co*, (1877), 2 App. Cas. 439 (H.L.), at p. 448, aff'd in *Conwest Exploration Co. v. Letain*, [1964] S.C.R. 20, at pp. 27-28, per Judson J.; *Fort Frances*, at p. 202, and *Ryan* , at para. 51, citing *Amalgamated Investment & Property Co. (In Liquidation) v. Texas Commerce International Bank Ltd.*, [1982] 1 Q.B. 84 (C.A.), at p. 122).

V. Disposition and Costs

52 We would dismiss the appeal.

53 Trial Lawyers says costs should not be awarded against it because it is a public interest litigant and because RSA was not obliged to participate in this appeal. The latter suggestion we find highly unrealistic, given the obligation Trial Lawyers sought to have imposed on insurers in this case. Nevertheless, and while this is a close call, we are of the view that the parties should bear their own costs on the appeal and the motion to substitute Trial Lawyers as a party. Our order in this regard should not be taken as a suggestion to other similarly situated groups that they may in future take up and prosecute appeals arising out of settled litigation without the risk of exposure to a costs order.

***Karakatsanis J.*:**

54 I have read the reasons of Moldaver and Brown JJ. and I agree that the appeal must be dismissed. I also agree with much of their legal analysis. However, in my view, they have added an unnecessary gloss to an element of promissory estoppel, inconsistent with the jurisprudence and inconsistent with the underlying principles of equity. By doing so, they have undermined the protection that this equitable doctrine provides.

55 As my colleagues note, the elements of promissory estoppel were stated by this Court in *Maracle v. Travellers Indemnity Co. of Canada*, [1991] 2 S.C.R. 50, and are well established in the jurisprudence. A basic requirement is that the promisor "has, by words or conduct, made a promise or assurance which was intended to affect their legal relationship and to be acted on" (*Maracle* , at para. 57). Justices Moldaver and Brown interpret this requirement — an intention to vary legal rights — as requiring the promisor's actual knowledge of the facts underlying the legal right. They reason that the promisor cannot intend to affect the legal relationship unless they have actual knowledge of the facts underlying that relationship (para. 21). Nevertheless, because they accept that the jurisprudence does not require actual knowledge of the legal significance of the facts, they conclude that knowledge of the legal significance may be imputed.

56 I cannot agree that actual knowledge is required precisely because the promisor's intent must be analyzed objectively. Subjective intent is unknowable to anyone other than the promisor and is not the appropriate lens for this equitable doctrine. The jurisprudence has long established that the intent of the promisor must be interpreted objectively. A promise is intended to vary legal relations when it would be reasonable for the promisee to interpret it as such. The objective approach is grounded in our jurisprudence — going back to the origins of the doctrine — and aligns with the fundamental purpose of promissory estoppel: preventing inequity.

57 As I shall explain, under an objective approach, knowledge is relevant because it informs the interpretation of the promisor's conduct in the full factual context. The objective approach considers whether, viewed objectively in light of the full context and including all the facts that the promisor knew or reasonably can be taken to have known, the promisor intended to alter legal rights.

58 Because knowledge of the underlying facts is an important part of the context in which an objective assessment is made, my colleagues' additional requirement of actual knowledge may have little practical effect on the result in many cases. As my colleagues observe, even if constructive knowledge were sufficient for the purposes of promissory estoppel, it would not be available on the facts of this case and the appeal could be dismissed on that basis. However, my colleagues' addition of an absolute requirement of actual knowledge of the facts distracts from the true inquiry and unduly constrains the flexibility inherent in equity.

I. Analysis

59 Confusion over the role of the promisor's knowledge in this appeal stems from a failure to properly apply an objective analysis of the promisor's intent. There is no dispute in our jurisprudence that promissory estoppel requires a promise or assurance that was intended by the promisor to alter legal relations and that the promise or assurance must be clear and unequivocal. Importantly, the jurisprudence indicates that the promisor's conduct is analyzed *objectively*. The promisor's intent is discerned from their words or conduct and their knowledge is relevant to the extent that it illuminates how the words or conduct can be reasonably interpreted.

60 Whether the promisor intended the promise to be binding is often the contentious question in promissory estoppel cases (A. Robertson, "Knowledge and Unconscionability in a Unified Estoppel" (1998), 24 Monash U.L. Rev. 115, at pp. 127-28). This requirement of intention did not appear in *Hughes v. Metropolitan Railway Co*, (1877), 2 App. Cas. 439 (H.L.), the case often credited as the source of the modern doctrine. It was Lord Denning's summary of the principle in *Central London Property Trust Ltd. v. High Trees House Ltd.*, [1947] K.B. 130, that added the requirement that the promise be "intended to be binding, intended to be acted upon and in fact acted upon" (p. 134).

61 The interpretive issue is how this intent should be judged: objectively or subjectively (i.e. according to the subjective perspective of the promisor).

62 This issue was addressed by the Court of Appeal for Ontario in *Owen Sound Public Library Board v. Mial Developments Ltd*, (1979), 26 O.R. (2d) 459. The Court of Appeal concluded that "a promise, whether express or inferred from a course of conduct, is intended to be legally binding if it reasonably leads the promisee to believe that a legal stipulation, such as strict time of performance, will not be insisted upon" (p. 465). The Court of Appeal held that intent does not require a direct statement to that effect and determined that "[k]nowledge by the promisor that the *promisee is likely to regard the promise as affecting their legal relations* constitutes an appropriate basis from which the inference of the existence of a sufficient intent can be drawn" (p. 467 (emphasis added)). As Professor McCamus explains, "the court [in *Owen Sound*,] clearly indicated that the fact the contractor may not have intended to signal a willingness to ignore the time limit was irrelevant" (*The Law of Contracts* (3rd ed. 2020), at p. 313).

63 One of the earliest endorsements of this objective analysis was that of Parke B. in *Freeman v. Cooke*, (1848), 2 Ex. 654, 154 E.R. 652, who wrote:

> [I]f whatever a man's real intention may be, he so conducts himself that a reasonable man would take the representation to be true, and believe that it was meant that he should act upon it, and did act upon it as true, the party making the representation would be equally precluded from contesting its truth .... [p. 656]
>
> (See also *Birmingham and District Land Co. v. London and North Western Railway Co*. (1888), 40 Ch. D. 268(C.A.), at p. 287, per Bowen L.J.; *Charles Rickards Ld. v. Oppenheim*, [1950] 1 K.B. 616(C.A.), at p. 623, per Denning L.J.)

64 In addition to the jurisprudence, an objective interpretation of the promisor's words or conduct is strongly supported by commentators. In his treatise, Professor McCamus writes: "The test for whether the undertaking was given is ... objective" (p. 313). Professor MacDougall similarly concludes, "a promise or assurance, whether express or inferred from a course of conduct, is intended to be legally binding if it reasonably leads the promisee to believe that a right or other legal stipulation ... will not be insisted upon" (*Estoppel* (2nd ed. 2019), at § 5.195). Professor Manwaring has observed that, "[s]ubjective intention is unknowable and intention can only be inferred from words and actions or, in other words, the objective manifestations of intent" and that the "case law clearly supports the view that the intentions of the promisor are to be discovered through an objective analysis" ("Promissory Estoppel in the Supreme Court of Canada" (1987), 10 Dal. L.J. 43, at p. 64).

65 There are important doctrinal reasons to focus on the reasonable interpretation of the promisor's conduct, and not on their subjective intent or actual knowledge. Promissory estoppel responds to unconscionability (or inequity or unfairness) and reliance, which are closely linked concepts (see Cowper-Smith v. Morgan, 2017 SCC 61, [2017] 2 S.C.R. 754, at paras. 15-16). As Moldaver and Brown JJ. acknowledge in this appeal, "[p]romissory estoppel seeks to protect against the 'inequity of allowing the other party to resile from his statement where it has been relied upon to the detriment of the person to whom it was directed'" (para. 16, quoting *Fort Frances v. Boise Cascade Canada Ltd.*, [1983] 1 S.C.R. 171, at p. 202). However, inequity is found where the promisor acted in a manner that the promisee reasonably interpreted as a promise and the promisee changed their position as a result. As expressed by Mason C.J. and Wilson J. in Walton Stores (Interstate) Ltd. v. Maher1988164 C.L.R. 387(Australia H.C.) , "equity will come to the relief of a plaintiff who has acted to his detriment on the basis of a basic assumption in relation to which the other party to the transaction has 'played such a part in the adoption of the assumption that

it would be unfair or unjust if he were left free to ignore it'" (p. 404, quoting Grundt v. Great Boulder Property Gold Mines Ltd.. 193759 C.L.R. 641(Australia H.C.) , at p. 675, per Dixon J.).

66 In my view, the role of knowledge in promissory estoppel flows from the nature of this objective analysis, which focuses on whether it was reasonable in the circumstances to interpret the promisor's words or conduct as an intent to change legal relations. Subjective intent — which is unknowable to the promisee — is not the appropriate focus for promissory estoppel. For the same reason, promissory estoppel does not require *actual* knowledge in every case.

67 Proprietary estoppel — unlike promissory estoppel — initially did require the defendant's actual knowledge (of both the existence of the right and the claimant's mistaken belief as to their legal right). The House of Lords in *Thorner v. Major*, [2009] UKHL 18, [2009] 1 W.L.R. 776(Eng. H.L.) , followed by this Court in *Cowper-Smith*, removed the explicit knowledge requirement and endorsed an objective interpretation. Lord Scott of Foscote described the objective analysis as follows:

> If it is reasonable for a representee to whom representations have been made to take the representations at their face value and rely on them, it would not in general be open to the representor to say that he or she had not intended the representee to rely on them .... It could not be thought reasonable for a representee to rely on a representation that, objectively viewed, was not intended by the representor to be relied on. [para. 17]

68 Because equity is concerned with addressing unfairness, the application of the doctrine must be fair to *both* parties and must consider the context from both perspectives. Equity is not just concerned with the subjective intention or the actual knowledge of the promisor. The person who relies on the promisor's words or conduct should be able to rely on the entire context, including what the promisor could reasonably be assumed to know. And the impact of any words or conduct must also be assessed from the perspective of what the promisor could reasonably assume the promisee knew. Therefore, in order to determine whether, viewed objectively, the words or conduct convey an intention to vary legal rights, the fact-finder must look at the entire context, including what the promisor knew or can be taken to have known.

69 As an illustrative example, if it were industry practice to immediately obtain a police report after a motor vehicle accident, and this practice was generally known or the insurer knew that the person relying on the promise had knowledge of this practice, then it would be reasonable to interpret the insured's conduct in light of an assumption that they were aware of the contents of the police report. The fact that an insurer, through mistake or negligence, actually failed to obtain the report would not be decisive to an objective interpretation of their conduct unless the insured knew that the insurer had not obtained the report.

70 For this reason, the objective lens does not mean that there is no role for the knowledge of the promisor (and promisee). *Western Canada Accident and Guarantee Insurance Co. v. Parrott*, (1921), 61 S.C.R. 595, illustrates the role that knowledge plays in the promissory estoppel analysis. The insurance company's conduct could be reasonably interpreted as a promise intended to alter legal relations precisely because it was clear in the context that they knew they had the option to void the policy but chose not to. As Duff J. wrote, the insurance company's conduct in the circumstances provided "ample evidence to support the inference, and that I think is the right inference, that the company agreed to assume responsibility under the policy" (p. 601). Actual knowledge of the facts supported the inference that the promisor intended to change legal relations; but it does not follow that actual knowledge is therefore a requirement of promissory estoppel. *Parrott* did not, therefore, create a unique promissory estoppel test for the insurance context that *requires* knowledge.

71 Importantly, knowledge plays this role *not* because there is a bright-line rule that the promisor must have knowledge of the underlying facts in every case. Knowledge is simply part of the context that informs the reasonable interpretation of the promisor's conduct. There is only one test for promissory estoppel in Canadian law, and the jurisprudence confirms that it is based on an objective interpretation of the promisor's conduct.

72 My colleagues accept that imputed knowledge can be sufficient for promissory estoppel so long as the promisor is aware of the underlying facts; it does not matter if the promisor lacks knowledge about the legal significance of those facts. In other words, a court can "impute" knowledge of legal significance of the facts to the promisor. However, my colleagues reject the idea that "constructive knowledge" arising from a breach of a duty to investigate is sufficient. I find this distinction unhelpful.

Again, promissory estoppel does not depend on a rigid categorization of different types of knowledge, but on the objective assessment of how the promisor's conduct can be interpreted.

73 It is well established that a promisor cannot resist promissory estoppel by claiming that they only had knowledge of the facts but not their legal rights (see *Peyman v. Lanjani*, [1985] 1 Ch. 457 (C.A.), at p. 495, per May L.J.; Parlee v. Pembridge Insurance Co., 2005 NBCA 49, 283 N.B.R. (2d) 75, at para. 12; The Commonwell Mutual Assurance Group v. Campbell, 2018 ONSC 5899, 95 C.C.L.I. (5th) 328, at paras. 38 and 40, aff'd 2019 ONCA 668, 95 C.C.L.I. (5th) 344). This is significant because the knowledge that is relevant *to an intention to change legal relations* is knowledge of legal rights. In other words, if the promisor does not realize the legal significance of the underlying facts, they cannot intend to change legal relations at all. As Professor Manwaring writes: "If the promisor can easily discover what her legal rights are, it would be inequitable to allow her to act without making a reasonable effort to do so" (p. 63). Equity's goal of preventing inequitable conduct is engaged where the promisor could easily have discovered their legal rights, chose not to, and then, through words or conduct, reasonably led the promisee to believe that the promisor would not enforce the legal rights.

74 The jurisprudence "imputes" knowledge of legal rights precisely because it would be inequitable for the promisor to resile where their conduct can reasonably be interpreted as an intention to change legal relations. The same objective analysis applies where the promisor can be *taken to have knowledge of the facts*. What matters is whether the context supports the inference of intent.

75 The objective approach also maintains the proper distinction between waiver — a common law doctrine — and promissory estoppel. Waiver, which requires "full knowledge of rights" and "an unequivocal and conscious intention to abandon them", imposes this strict test because there is no consideration for the promise (*Saskatchewan River Bungalows Ltd. v. Maritime Life Assurance Co.*, [1994] 2 S.C.R. 490, at p. 500). Further, unlike promissory estoppel, waiver does *not* require detrimental reliance. Waiver requires a *conscious intention*; full knowledge is necessary. By contrast, promissory estoppel — which is rooted in equity — does not impose a strict knowledge requirement, but requires detrimental reliance. Equity relieves against the harsh consequences of the application of common law rules.

76 Therefore, whether the promisor has made a promise or assurance with the intent to change legal relations is a factual determination that must be made in light of the full context. A promise or assurance is intended to be legally binding where it would be reasonable for the promisee to rely on it.

77 I agree with my colleagues that in this case, Royal & Sun Alliance Insurance Company of Canada's (RSA) conduct cannot be interpreted as an unequivocal assurance that RSA would continue to provide coverage even if the policy was void. A coroner's report that *none* of the parties had accessed is not relevant to the objective interpretation of RSA's conduct. RSA's continued coverage did not signify any intent to change legal relations: the motor vehicle accident report included no reference to alcohol; none of the motorcyclists told the police about alcohol consumption; Mr. Bradfield never told RSA's investigators or his own insurer about alcohol consumption; and the Durham Regional Police Collision Investigation Unit report did not mention alcohol.

78 I would also reject the idea that RSA is estopped simply because three years passed before it took an off-coverage position. The length of time is not determinative here. Ultimately, there is nothing unique in RSA's conduct to suggest that RSA promised that it would not void coverage if it failed to discover breaches after a specific period of time.

79 Therefore, Mr. Bradfield cannot succeed in establishing promissory estoppel because RSA did not make a promise or assurance that can be reasonably interpreted as intending to alter legal relations. This is sufficient to dispose of this appeal.

II. Conclusion

80 In my view, the promisor's intent in promissory estoppel must be interpreted objectively based upon their words or conduct: a promise is intended to be binding when it would be reasonable for the promisee to interpret it as such. Given that the analysis does not focus on the subjective intent of the promisor, there is no absolute requirement that the promisor have knowledge of their legal rights or the underlying facts giving rise to those rights in every case. Instead, knowledge is relevant because it is part

of the context informing the objective interpretation of the promisor's words or conduct. Because the intention of the words or conduct must be assessed objectively, both what the promisor knew and what they reasonably ought to have known are relevant.

81 I would dismiss the appeal.

Appeal dismissed.

Pourvoi rejeté.

Footnotes

1 Although s. 131(1) has since been amended to allow for recognition of waiver by conduct, the parties agree that the prior legislation applies to deciding this appeal.

833 F.Supp.2d 36
United States District Court, District of Columbia.

UNITED STATES of America, Plaintiff,
v.
H & R BLOCK, INC., et al., Defendants.

Civil Action No. 11–00948 (BAH)
|
Nov. 10, 2011.

Synopsis
Background: United States, through Antitrust Division of Department of Justice, sought to enjoin proposed merger between two companies that offered tax software products on grounds that it violated antitrust laws and would lead to anticompetitive duopoly.

Holdings: The District Court, Beryl A. Howell, J., held that:

relevant product market was that for digital do-it-yourself tax preparation products and did not include other methods in broader industry;

DDIY and assisted products were not sufficiently close substitutes to constrain any anticompetitive digital do-it-yourself tax preparation pricing after proposed merger;

manual tax preparation (or "pen and paper" method) also was not in relevant product market;

court would rely on Internal Revenue Service (IRS) switching data relied on by DOJ expert, rather than simulated diversion data derived from consumer surveys and relied on by defendant's expert;

DOJ made out prima facie case that proposed merger was reasonably likely to cause anticompetitive effects within relevant product market; and

because defendants failed to rebut resulting presumption that merger would substantially lessen competition, proposed acquisition would be enjoined.

Ordered accordingly.

Attorneys and Law Firms

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MEMORANDUM OPINION [1]

BERYL A. HOWELL, District Judge.

Last year, approximately 140 million Americans filed tax returns with the Internal Revenue Service ("IRS"). Paying taxes is a fundamental civic duty in our democracy. Taxes pay for the government to carry out its constitutionally mandated functions and enable the government to give force to the laws and policies adopted by the people of the United States through their elected representatives. Despite the necessity of taxes to fund our government and to sustain services that many citizens depend upon, the task of preparing a tax return brings joy to the hearts of few. Many find it to be a complex and tedious exercise. Fortunately, various businesses offer different products and services designed to assist taxpayers with preparing their returns. These tax preparation businesses principally include accountants, retail tax stores, and digital tax software providers—all of which provide important services to the American taxpayer. In this case, the United States, through the Antitrust Division of the Department of Justice, seeks to enjoin a proposed merger between two companies that offer tax software products—H & R Block and TaxACT—on the grounds that the merger violates the antitrust laws and will lead to an anticompetitive duopoly in which the only substantial providers of digital tax software in the marketplace would be H & R Block and Intuit, the maker of the popular "TurboTax" software program. After carefully considering all of the evidence, including documents and factual and expert testimony, the applicable law, and the arguments before the Court, the Court will enjoin the proposed merger for the reasons explained in detail below.

* * *

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***43 I. BACKGROUND**

A. Overview

The United States, through the Antitrust Division of the Department of Justice (the "DOJ," the "government," or the "plaintiff"), filed this action on May 23, 2011. The DOJ seeks to enjoin Defendant H & R Block, Inc. from acquiring Defendant 2SS Holdings, Inc. ("TaxACT"), which sells digital do-it-yourself tax preparation products marketed under the brand name TaxACT. Compl. ¶ 10. H & R Block ("HRB") is a Missouri corporation headquartered in Kansas City, Missouri. *Id.* ¶ 9. 2SS Holdings, or TaxACT, is a Delaware corporation headquartered in Cedar Rapids, Iowa. *Id.* ¶ 10. Defendant TA IX, L.P. ("TA"), a Delaware limited partnership headquartered in Boston, Massachusetts, owns a two-thirds interest in TaxACT. *Id.* ¶ 11.

As noted above, approximately 140 million Americans filed tax returns with the IRS in 2010. *Id.* ¶ 1. Broadly speaking, there are three methods for preparing a tax return. The "pen and paper" or "manual" method includes preparation by hand and with free, electronically fillable forms available on the IRS website. A second method, known as "assisted" preparation, involves hiring a tax professional—typically either a certified public accountant ("CPA") or a specialist at a retail tax store. HRB operates the largest retail tax store chain in the United States. Cobb, TT, 9/19/11 a.m., at 37. The companies Jackson–Hewitt and Liberty Tax Service also operate well-known retail tax stores. Finally, many taxpayers now prepare their returns using digital do-it-yourself tax preparation products ("DDIY"), such as the popular software product "TurboTax." DDIY preparation is becoming increasingly popular and an estimated 35 to 40 million taxpayers used DDIY in 2010. GX 19 at 3; *see also* GX 27.[2]

***44** The three most popular DDIY providers are HRB, TaxACT, and Intuit, the maker of TurboTax. According to IRS data, these three firms accounted for approximately 90 percent of the DDIY-prepared federal returns filed in tax season 2010.[3] GX 27. The next largest firm is TaxHawk, also known as FreeTaxUSA, with 3.2 percent market share, followed by TaxSlayer, with 2.7 percent. *Id.* The remainder of the market is divided among numerous smaller firms. *Id.* Intuit accounted for 62.2 percent of DDIY returns, HRB for 15.6 percent, and TaxACT for 12.8 percent. *Id.* DDIY products are offered to consumers through three channels: (1) online through an internet browser; (2) personal computer software downloaded from a website; and (3) personal computer software installed from a disk, which is either sent directly to the consumer or purchased by the consumer from a third-party retailer. GX 629 at 11. In industry parlance, DDIY products provided through an internet browser are called "online" products, while software applications downloaded onto the user's computer via the web or installed from a disk are referred to as "software" products. *See id.*

The proposed acquisition challenged in this case would combine HRB and TaxACT, the second and third most popular providers of DDIY products, respectively. According to the government, this combination would result in an effective duopoly between HRB and Intuit in the DDIY market, in which the next nearest competitor will have an approximately 3 percent market share, and most other competitors will have less than a 1 percent share. GX 27. The government also alleges that unilateral anticompetitive effects would result from the elimination of head-to-head competition between the merging parties. Compl. ¶ 45.

Thus, the DOJ alleges that because the proposed acquisition would reduce competition in the DDIY industry by eliminating head-to-head competition between the merging parties and by making anticompetitive coordination between the two major remaining market participants substantially more likely, the proposed acquisition violates Section 7 of the Clayton Act, 15 U.S.C. § 18. *Id.* ¶¶ 40–49. Accordingly, the government seeks a permanent injunction blocking HRB from acquiring TaxACT. *Id.* ¶¶ 53–55.

On July 6, 2011, the Court entered a scheduling order in this case that provided for an expedited schedule of fact and expert discovery and briefing on the government's anticipated motion to enjoin the transaction. Joint Scheduling and Case Mgmt. Order, ECF No. 30. On August 1, 2011, the DOJ filed a motion for preliminary injunction against the merger, which was fully briefed by August 18, 2011. The parties subsequently agreed to forego the preliminary injunction phase and proceed directly to a trial on the merits of this action. TT, 9/6/11 a.m., at 8–9.

On September 2, 2011, the Court held a pre-trial conference. On September 6, the Court began a nine-day bench trial that was held on September 6, 7, 8, 9, 12, 13, 15, 19, and 20. Eight fact witnesses and ***45** three expert witnesses testified at the hearing. The parties presented testimony from additional witnesses by affidavit and deposition. Each side submitted over 800 exhibits, totaling many thousands of pages. Following the conclusion of the evidentiary phase of the trial, the Court gave the parties approximately two weeks to submit post-trial memoranda and proposed findings of fact, which were filed on September 28, 2011. ECF Nos. 98–99. The Court then heard closing arguments on October 3, 2011.

The government's motion to enjoin HRB's acquisition of TaxACT is presently before the Court. For the reasons explained in this opinion, the Court grants the government's motion.

Before proceeding to a discussion of the relevant legal standards governing this case, the Court will provide additional background regarding the parties, their proposed transaction, and the tax preparation industry in general.

B. The Merging Parties

HRB is a Missouri corporation with its principal place of business in Kansas City, Missouri. Compl. ¶ 9; Defs.' Answer, ECF No. 31, ¶ 9. HRB provides both assisted tax preparation services and DDIY products through separate business units. Bennett, TT, 9/6/11 a.m., at 106. HRB offers its DDIY products for consumers under the brand name “H & R Block At Home” (formerly known as “TaxCut”). GX 629 at 9.

In 2011, HRB's DDIY products generated {significant} revenue. GX 296–2. For the same period, HRB sold approximately 6.69 million DDIY units to consumers. GX 296–2. Separately, in 2011, HRB's assisted tax preparation business generated approximately $2.7 billion in revenue (based on 14,756,000 U.S. tax returns at an average fee of $182.96, as reported in HRB's 2011 Annual Report). GX 532 (Cobb Dep.) at 32; GX 565 at 19.

2SS Holdings, Inc. (“2SS”) is a Delaware corporation with its principal place of business in Cedar Rapids, Iowa. Compl. ¶ 10; Defs.' Answer ¶ 10. 2SS owns 2nd Story Software, Inc., which offers DDIY products under the brand name “TaxACT.” GX 629 at 8–9.

In the fiscal year ending April 30, 2011, TaxACT products generated approximately {half as much revenue as H & R Block}. GX 151 at 6. In the same year, consumers used TaxACT to electronically file approximately 5 million federal tax returns. GX 151 at 3–4.

TA IX, L.P. (“TA”) is a private equity firm organized under the laws of Delaware with its headquarters in Boston, Massachusetts. Compl. ¶ 11; Defs.' Answer ¶ 11. In December of 2004, TA purchased a majority interest in 2SS for $85 million, and as a result TA has majority control of 2SS Holdings and 2nd Story Software. GX 55 (Greif Dep.) at 72–73; GX 28–3.

C. The History Of TaxACT And The Proposed Transaction

TaxACT was founded in 1998 by Lance Dunn and three others, with Mr. Dunn serving as president. Dunn, TT, 9/7/11 p.m., at 49–52. Before founding TaxACT, Mr. Dunn and the other co-founders of the company had worked at Parsons Technology, a software company that had created a DDIY tax preparation product called “Personal Tax Edge.” *Id.* at 49–52. In 1994, Intuit acquired Parsons Technology and continued to operate Personal Tax Edge as a separate product for approximately two years before merging it into its TurboTax product line. *Id.* at 51. Mr. Dunn testified that the business objective of founding TaxACT was “to make money selling value tax software which ... was a category that ***46** did not exist at that time” because Intuit's acquisition of Parsons Technology had eliminated Personal Tax Edge, which had previously occupied a value tax software niche. *Id.* at 52. Thus, TaxACT “recreated” the category or “niche that the Personal Tax Edge product line filled when it existed.” *Id.*

Over the years, TaxACT has emphasized high-quality free product offerings as part of its business strategy. *Id.* at 53. TaxACT initially offered a DDIY tax preparation product that made it free to prepare and print a federal tax return, but TaxACT charged a fee for electronic filing (“e-filing”) or preparation of a state tax return. *Id.* at 54. Thus, from the beginning, TaxACT's business strategy relied on promoting “free” or “freemium” products, in which a basic part of the service is offered for free and add-ons and extra features are sold for a price.[4] As Mr. Dunn put it, “Free is an integral part of the value model. And the beauty of it is it has universal appeal. Everybody likes something for free.” *Id.*

Currently, TaxACT's free product offering allows customers to prepare, print, and e-file a federal tax return completely for free. *Id.* at 54; GX 28–10 at 5–7. TaxACT's “Deluxe” edition, which costs $9.95, contains additional features, such as the ability to import data from a return filed the prior year through TaxACT. GX 55–26; Dunn, TT, 9/7/11 p.m., at 91–92; GX 28–10 at 5–7; GX 28 (Dunn. Dep.) at 219. Customers who use TaxACT to prepare a state tax return in addition to a federal return pay either $14.95 for the state return in combination with the free federal product or $17.95 for the state return in combination with the “Deluxe” federal product. GX 55–26; Dunn, TT, 9/8/11 a.m., at 49. TaxACT's prices have generally remained unchanged for the past decade. Dunn, TT, 9/7/11 p.m., at 91.

The parties first began discussing the potential acquisition of TaxACT by HRB in July 2009. Bowen, TT, 9/15/11 p.m., at 14. During the fall of 2009, teams from HRB and TaxACT met to discuss the possibilities for the potential acquisition and HRB performed due diligence on TaxACT. *See* DX 244 at 8–9; Bowen, TT, 9/15/11 p.m., at 19–23, 26; DX 9527 at 35.

Negotiations between the parties stalled in December 2009 and the proposed deal collapsed. Bowen, TT, 9/15/11 p.m., at 33. The CEOs of the two companies continued to discuss a potential acquisition through the spring of 2010, however. *Id.* at 34. Serious merger talks resumed in July 2010. *Id.* at 38–39; DX1005.

In October 2010, the HRB Board of Directors approved a plan for HRB to acquire TaxACT. DX 600 at 12–13; Bowen, TT, 9/15/11 p.m., at 59–60. On October 13, 2010, HRB entered into a merger agreement with 2SS and TA. GX 120 at 1. Under this agreement, HRB would acquire control of 2SS for $287.5 million. GX 120 at 6; GX 119 at 1. HRB's stated post-merger plan is to maintain both the HRB and TaxACT brands—with the HRB-brand focusing on higher priced-products and the TaxACT brand focusing on the lower-priced products. *See* Bennett, TT, 9/6/11 a.m., at 101–102; DX 1005 at 1. HRB plans {redacted} ultimately to rely on TaxACT's current technological platform and intends to give Mr. Dunn responsibility for running the combined firm's ***47** entire DDIY business operation from Cedar Rapids, Iowa. Dunn, TT, 9/8/11 p.m. (sealed), at 14–16; *see also* Bennett, TT, 9/6/11 a.m., at 110.

D. Free Products And The Free File Alliance

The evolution of TaxACT's free product offerings and the other free offerings in the DDIY market is important for understanding the claims in this case. The players in the DDIY market offer various "free" tax preparation products, but the features and functionality offered in these free products vary significantly, as do the ways in which these free products are ultimately combined with paid products to earn revenue. While the availability of some types of free product offers has long been a feature of the DDIY market, a spike in free offerings occurred during the last decade in parallel with the growth of e-filing.

As a matter of public policy, the IRS actively promotes e-filing because it has an interest in efficient and accessible tax return preparation and filing. The Internal Revenue Service Restructuring and Reform Act of 1998 set a goal of having eighty percent of individual taxpayers e-filing their returns by 2007. IRS Stip., ECF No. 80, ¶ 2. The IRS is close to achieving that goal and the IRS Oversight Board has recommended that the 80 percent benchmark be achieved by 2012. *Id.* According to stipulated facts attested to by IRS employees, in 2001, the IRS adopted an initiative "to decrease the tax preparation and filing burden of wage earners by providing greater access to free online tax preparation and filing options for a significant number of taxpayers." *Id.* ¶ 4. The IRS also determined that it could save a substantial amount of public money by encouraging filers to switch to e-filing, since e-filed returns are cheaper for the IRS to process. *Id.* ¶ 5.

The IRS determined that the most effective and efficient way to accomplish its goal of promoting access to free online tax preparation and filing options was to partner with a consortium of companies in the electronic tax preparation and filing industry. *Id.* ¶ 6; GX 297–D7 at E–2. In 2002, this consortium of companies formed Free File Alliance, LLC ("FFA") in order to partner with the IRS on this initiative to promote free filing. IRS Stip. ¶ 6; GX 297–D7 at E–2. HRB, TaxACT, and Intuit are all members of the FFA, as are approximately fifteen smaller companies. *See* IRS Stip. ¶ 8; DX 328. On October 30, 2002, the IRS and the FFA entered into a "Free On–Line Electronic Tax Filing Agreement" to provide free online tax return preparation and filing to individual taxpayers. IRS Stip. ¶ 9. Pursuant to this agreement, members of the FFA would offer free, online tax preparation and filing services to taxpayers, and the IRS would provide taxpayers with links to those free services through a web page, hosted at irs.gov and accessible through another government website. *Id.* ¶ 12. HRB, TaxACT, and Intuit were among the original members to make free offers through the FFA. *Id.* ¶ 8.

"In 2003, the first year in which free services were available to taxpayers through the FFA, none of the FFA members offered free services to all taxpayers." *Id.* ¶ 14. Rather, each "member set eligibility criteria. Most members, including H & R Block, TaxACT, and Intuit, used adjusted gross income ('AGI') as a way to define which taxpayers were eligible" for their offers of free federal tax return preparation services. *Id.* "For example, H & R Block offered free services to taxpayers with an AGI of $28,000 or less." *Id.* Some members that offered free federal return ***48** preparation services based on AGI also offered free services to taxpayers who met other conditions, such as eligibility to file a Form 1040EZ. *Id.* "Several members did not define eligibility based on AGI. Of the eleven FFA members that offered free services based on AGI, only TaxACT's AGI-based offering was available to individuals with AGI over $33,000." *Id.* Specifically, TaxACT made its free federal services available exclusively to taxpayers who had AGI over $100,000 or were eligible to file a Form 1040EZ. *Id.*

In 2004, the second year in which free services for federal returns were available to taxpayers through the FFA, TaxACT introduced a new offer through the FFA that offered free preparation and e-filing of federal returns for all taxpayers regardless of AGI or other limitations ("free for all"). *See id.* ¶ 15; Dunn, TT, 9/7/11 p.m., at 65, 78. After TaxACT introduced a free-for-all offer through the FFA, other companies followed by introducing federal free-for-all offers of their own. Dunn, TT, 9/7/11 p.m., at 78 ("After we offered free for everyone in 2003, in 2004, a lot of companies offered free for everyone on the FFA.").

According to Mr. Dunn's testimony, after TaxACT made its FFA offer of a free federal product for all taxpayers, without any AGI or other limitations, other companies made efforts to restrict the wide availability of free offers on the FFA. *Id.* at 79. Specifically, according to Mr. Dunn, Intuit proposed that companies in the FFA collude by agreeing to restrict free offers. *Id.* Mr. Dunn and TaxACT opposed Intuit's proposal and believed that it was "probably not legal for that group to restrain trade." *Id.*

Subsequently, HRB, Intuit and others successfully lobbied the IRS to implement restrictions on the number of taxpayers that could be covered by a free offer through the FFA website. GX 28 (Dunn Dep.) at 114–15; GX 28–4; GX 35 at HRB–DOJ–00912870; GX 569 (DuMars Dep.) at 108, 112–113; Ernst, TT, 9/7/11 a.m., 26–27; GX 41 at 4; GX 25 (TaxHawk Decl.) ¶ 16. HRB desired these restrictions because, among other things, it was concerned about how free-for-all offers would affect the pricing structure for the industry and believed that such offers might undermine the company's ability to generate money through the paid side of its DDIY business. Ernst, TT, 9/7/11 a.m., at 26–27; GX 531 (Ciaramitaro Dep.) at 60–62; *see also* GX 41 at 4; GX 25 (TaxHawk Decl.) ¶ 16.

The IRS amended the FFA rules in October 2005 to prevent FFA members from making free-for-all offers. Dunn, TT, 9/7/11 p.m., at 78–79; Ernst, TT, 9/7/11 a.m., at 29; GX 42; GX 25 (TaxHawk Decl.) ¶ 16; GX 29 (Intuit Decl.) ¶ 9. Therefore, TaxACT could no longer make its free-for-all offer through the FFA.

In tax year 2005, in response to restrictions that the IRS imposed on the scope of offers that could be made through the FFA, TaxACT became the first DDIY company to offer all tax payers a free DDIY product for preparation of federal returns directly on its website. Dunn, TT, 9/7/11 p.m., at 79–80; GX 28 (Dunn Dep.) at 122–23. Today, free offers in various forms are an entrenched part of the DDIY market. Dunn, TT, 9/8/11 a.m., 85; Defs.' Opening Stmt., TT, 9/6/11 a.m., at 86–87.

II. STANDARD OF REVIEW

"Section 7 of the Clayton Act, 15 U.S.C. § 18, prohibits a corporation from acquiring 'the whole or any part of the assets of another [corporation] engaged also in commerce or in any activity affecting commerce, where in any line of commerce or in any activity affecting commerce in any section of the country, the ***49** effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.' " *United States v. Sungard Data Sys., Inc.,* 172 F.Supp.2d 172, 180 (D.D.C.2001) (quoting 15 U.S.C. § 18). "The United States is authorized by Section 15 of the Clayton Act to seek an injunction to block a pending acquisition." *Id.* (citing 15 U.S.C. § 25). "The United States has the ultimate burden of proving a Section 7 violation by a preponderance of the evidence." *Id.*

"To establish a Section 7 violation, plaintiff must show that a pending acquisition is reasonably likely to cause anticompetitive effects." *Id.* (citing *United States v. Penn–Olin Chem. Co.,* 378 U.S. 158, 171, 84 S.Ct. 1710, 12 L.Ed.2d 775 (1964)); *see also United States v. Oracle Corp.,* 331 F.Supp.2d 1098, 1109 (N.D.Cal.2004). "Congress used the words 'may be substantially to lessen competition' (emphasis supplied), to indicate that its concern was with probabilities, not certainties." *FTC v. H.J. Heinz Co.,* 246 F.3d 708, 713 (D.C.Cir.2001) (quoting *Brown Shoe Co. v. United States,* 370 U.S. 294, 323, 82 S.Ct. 1502, 8 L.Ed.2d 510 (1962)). "Section 7 does not require proof that a merger or other acquisition has caused higher prices in the affected market. All that is necessary is that the merger create an appreciable danger of such consequences in the future." *Hosp. Corp. of Am. v. FTC,* 807 F.2d 1381, 1389 (7th Cir.1986).

"As this Circuit explained in *Heinz,* 246 F.3d at 715, the decision in *United States v. Baker Hughes Inc.,* 908 F.2d 981 (D.C.Cir.1990), sets forth the analytical approach for establishing a Section 7 violation."[5] *Sungard,* 172 F.Supp.2d at 180.[6] "The basic outline of a section 7 horizontal acquisition case is familiar. By showing that a transaction will lead to undue concentration in the market for a particular product in a particular geographic area, the government establishes a presumption that the transaction will substantially lessen competition." *Baker Hughes,* 908 F.2d at 982. To establish this presumption, the government must "show that the merger would produce 'a firm controlling an undue percentage share of the relevant market, and [would] result [ ] in a significant increase in the concentration of firms in that market.' " *Heinz,* 246 F.3d at 715 (quoting *United States v. Philadelphia Nat'l Bank,* 374 U.S. 321, 363, 83 S.Ct. 1715, 10 L.Ed.2d 915 (1963)) (alterations in original). Once the government has established this presumption, the burden shifts to the defendants to rebut the presumption by "show[ing] that the market-share statistics give an inaccurate account of the merger's probable effects on ***50** competition in the relevant market." *Heinz,* 246 F.3d at 715 (internal quotation omitted). " 'If the defendant successfully rebuts the presumption [of illegality], the burden of producing additional evidence of anticompetitive effect shifts to the government, and merges with the ultimate burden of persuasion, which remains with the government at all times.' " *Id.* (quoting *Baker Hughes,* 908 F.2d at 983). Ultimately, "[t]he Supreme Court has adopted a totality-of-the-circumstances approach to the statute, weighing a variety of factors to determine the effects of particular transactions on competition." *Baker Hughes,* 908 F.2d at 984.

III. DISCUSSION

A. The Relevant Product Market

"Merger analysis begins with defining the relevant product market." *FTC v. Swedish Match,* 131 F.Supp.2d 151, 156 (D.D.C.2000) (citing *Brown Shoe,* 370 U.S. 294, 324, 82 S.Ct. 1502 (1962)). "Defining the relevant market is critical in an antitrust case because the legality of the proposed merger [ ] in question almost always depends upon the market power of the parties involved." *Id.* (quoting *FTC v. Cardinal Health, Inc.,* 12 F.Supp.2d 34, 45 (D.D.C.1998)). Indeed, the relevant market definition is often "the key to the ultimate resolution of this type of case because of the relative implications of market power."[7] *Id.*

The government argues that the relevant market in this case consists of all DDIY products, but does not include assisted tax preparation or pen-and-paper. Under this view of the market, the acquisition in this case would result in a DDIY market that is dominated by two large players—H & R Block and Intuit—that together control approximately 90 percent of the market share, with the remaining 10 percent of the market divided amongst a plethora of smaller companies. In contrast, the defendants argue for a broader market that includes all tax preparation methods ("all methods"), comprised of DDIY, assisted, and pen-and-paper. Under this view of the market, the market concentration effects of this acquisition would be much smaller and would not lead to a situation in which two firms control 90 percent of the market. This broader view of the market rests primarily on the premise that providers of all methods of tax preparation compete with each other for the patronage of the same pool of customers—U.S. taxpayers. After carefully considering the evidence and arguments presented by all parties, the Court has concluded that the relevant market in this case is, as the DOJ contends, the market for digital do-it-yourself tax preparation products.

A "relevant product market" is a term of art in antitrust analysis. The Supreme Court has set forth the general rule for defining a relevant product market: "The outer boundaries of a product market are determined by the reasonable interchangeability of use [by consumers] ***51** or the cross-elasticity of demand between the product itself and substitutes for it." *Brown Shoe,* 370 U.S. at 325, 82 S.Ct. 1502; *see also United States v. E.I. du Pont de Nemours & Co.,* 351 U.S. 377, 395, 76 S.Ct. 994, 100 L.Ed. 1264 (1956). In other words, courts look at "whether two products can be used for the same purpose, and, if so, whether and to what extent purchasers are willing to substitute one for the other." *FTC v. Staples, Inc.,* 970 F.Supp. 1066, 1074 (D.D.C.1997) (citation omitted); *see also Bon–Ton Stores, Inc. v. May Dep't Stores Co.,* 881 F.Supp. 860, 868 (W.D.N.Y.1994) (citing *Hayden Pub. Co. v. Cox Broad. Corp.,* 730 F.2d 64, 71 (2d Cir.1984)).

A broad, overall market may contain smaller markets which themselves "constitute product markets for antitrust purposes."[8] *Brown Shoe,* 370 U.S. at 325, 82 S.Ct. 1502. "[T]he mere fact that a firm may be termed a competitor in the overall marketplace does not necessarily require that it be included in the relevant product market for antitrust purposes." *Staples,* 970 F.Supp. at 1075. Traditionally, courts have held that the boundaries of a relevant product market within a broader market "may be determined by examining such practical indicia as industry or public recognition of the [relevant market] as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors." *FTC v. Whole Foods Market, Inc.* 548 F.3d 1028, 1037–38 (D.C.Cir.2008) (Brown, J.) (quoting *Brown Shoe,* 370 U.S. at 325, 82 S.Ct. 1502).[9] *See also FTC v. CCC Holdings, Inc.,* 605 F.Supp.2d 26, 38 (D.D.C.2009). These "practical indicia" of market boundaries may be viewed as evidentiary proxies for proof of substitutability and cross-elasticities of supply and demand.

Rothery Storage & Van Co. v. Atlas Van Lines, Inc., 792 F.2d 210, 218 (D.C.Cir.1986).

An analytical method often used by courts to define a relevant market is to ask hypothetically whether it would be profitable to have a monopoly over a given set of substitutable products. If so, those products may constitute a relevant market. *See* 5C Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law (hereinafter, "Areeda & Hovenkamp"), ¶ 530a, at 226 (3d ed. 2007) ("[A] market can be seen as the array of producers of substitute products that could control price if united in a hypothetical cartel or as a hypothetical monopoly."). This approach—sometimes ***52** called the "hypothetical monopolist test"—is endorsed by the Horizontal Merger Guidelines issued by the DOJ and Federal Trade Commission. *See Fed. Trade Comm'n & U.S. Dep't of Justice Horizontal Merger Guidelines* (2010) (hereinafter, "Merger Guidelines"), § 4.1.1.[10] In the merger context, this inquiry boils down to whether "a hypothetical profit-maximizing firm, not subject to price regulation, that was the only present and future seller of those products ... likely would impose at least a small but significant and non-transitory increase in price ("SSNIP") on at least one product in the market, including at least one product sold by one of the merging firms." *Id.* The "small but significant and non-transitory increase in price," or SSNIP, is typically assumed to be five percent or more. *Id.* § 4.1.2.

Thus, the question here is whether it would be hypothetically useful to have a monopoly over all DDIY tax preparation products because the monopolist could then profitably raise prices for those products by five percent or more; or whether, to the contrary, there would be no reason to monopolize all DDIY tax preparation products because substitution and price competition with other methods of tax preparation would restrain any potential DDIY monopolist from profitably raising prices. In other words, would enough DDIY users switch to the assisted or pen-and-paper methods of tax preparation in response to a five-to-ten percent increase in DDIY prices to make such a price increase unprofitable?

In evaluating the relevant product market here, the Court considers business documents from the defendants and others, the testimony of the fact witnesses, and the analyses of the parties' expert economists. This evidence demonstrates that DDIY is the relevant product market in this case.

1. The Defendants' Documents Show That DDIY Is The Relevant Product Market.

When determining the relevant product market, courts often pay close attention to the defendants' ordinary course of business documents. *See, e.g., Staples,* 970 F.Supp. at 1076; *CCC Holdings,* 605 F.Supp.2d at 41–42. The government argues that the defendants' ordinary course of business documents in this case "conclusively demonstrate that competition with other [DDIY] firms drive Defendants' pricing decisions, quality improvements, and corporate strategy" for their own DDIY products—thus supporting the government's view of the relevant market. Pl.'s Post–Trial Mem. at 7. The defendants contend that the government has relied on "select, 'out-of-context' snippets from documents," and that the documents as a whole support the defendants' view that the relevant product market is all methods of tax preparation. Defs.' Post–Trial Mem. at 1. The Court finds that the documentary evidence in this case supports the conclusion that DDIY is the relevant product market.

Internal TaxACT documents establish that TaxACT has viewed DDIY offerings by HRB and TurboTax as its primary competitors, that it has tracked their marketing, product offerings, and pricing, and that it has determined its own pricing and business strategy in relation to those companies' DDIY products. *See* GX 295–16 ("Competitive Analysis" comparing the three companies); GX 102 (email explaining TaxACT is a "direct competitor" with HRB and Intuit's products); GX 55 (Greif Dep.) at 137–38 (describing TaxACT's ***53** compilation of a routine, end-of-season competitive analysis that "typically" covers Intuit, HRB, and TaxACT). Confidential memoranda prepared by TaxACT's investment bankers for potential private equity buyers of TaxACT identify HRB and TurboTax as TaxACT's primary competitors in a DDIY market. *See* GX 7 (Greene Holcomb & Fisher "Confidential Memorandum") at 14 ("The Company's major competitors for both desktop and Internet-based income tax software and e-filing services include Intuit (the makers of TurboTax software) and H & R Block (the makers of TaxCut software)."); GX 134 (Deutsche Bank "Confidential Information Memorandum") at 17 ("The Company's two main competitors, Intuit and H & R Block ..."); *see also* Dunn, TT, 9/7/11 p.m., at 97–104. These documents also recognize that TaxACT's strategy for competing with Intuit and HRB is to offer a lower price for what it deems a superior product. GX 7 at 14 ("Relative to its two major competitors, 2nd Story has positioned its product offerings as being of equal or higher quality, and completely fulfilling the needs of a vast portion of the potential market. It also pursues a pricing strategy that positions its products and services meaningfully below either Intuit or H & R Block, in some instances free.").

While, as defendants point out, parts of these TaxACT documents also discuss the broader tax preparation industry, these documents make clear that TaxACT's own view—and that conveyed by its investment bankers to potential buyers—is that the company primarily competes in a DDIY market against Intuit and HRB and that it develops its pricing and business strategy with that market and those competitors in mind. These documents are strong evidence that DDIY is the relevant product market. *See Whole Foods,* 548 F.3d at 1045 (Tatel, J.) ("[E]vidence of industry or public recognition of the submarket as a separate economic unit matters because we assume that economic actors usually have accurate perceptions of economic realities.") (internal quotation omitted).

Internal HRB documents also evidence HRB's perception of a discrete DDIY market or market segment. HRB and its outside consultants have tracked its digital competitors' activities, prices, and product offerings. *See* GX 28–19 ("2009 Competitive Price Comparison"); GX 118 (independent analyst's report analyzing digital competitors as one of three separate categories of competitors); GX 61–8 at 1 (slide on competition in "digital market" identifying TurboTax and TaxACT as competitors); GX 199 (HRB "digital strategy update" Powerpoint tracking features and prices for TurboTax and TaxACT); GX 188 (HRB spreadsheet comparing HRB, TurboTax, and TaxACT prices for various product offerings). Documents from HRB's DDIY business have also referred to HRB, TaxACT, and TurboTax as the "Big Three" competitors in the DDIY market. GX 61–3 ("OCS Offsite Competitive Intelligence Review of TS07") at 5; GX 61–4 at 1 (email referencing request for data from consultant regarding "big 3 digital tax prep companies"); *see also* GX 70 (email from head of HRB's digital business stating its "only real direct competitors are turbotax in san diego and taxact in cedar rapids" [sic]); Ernst, TT, 9/7/11 a.m., at 13–14. Finally, the documents show that, in connection with a proposed acquisition of TaxACT, HRB identified the proposed transaction as a way to grow its digital "market share" and has measured TaxACT's market share in a DDIY market. GX 130 at 96–99; GX 21–37 (projections from 2009 for different potential scenarios for acquisition of TaxACT, including their effect on DDIY market share); *see also* Newkirk, TT, 9/7/11 a.m., at 95–96 (explaining GX 21–37). All of these documents ***54** also provide evidence that DDIY is a relevant product market.

The defendants acknowledge that "the merging parties certainly have documents that discuss each other and digital competitors generally, and even reference a digital market and the 'Big Three,' " but contend this evidence is insufficient to prove a market. Defs.' Post–Trial Mem. at 9. Rather, the defendants argue that the documents show that the relevant market is all methods of tax preparation, especially in light of documented competition between DDIY providers and assisted providers for the same overall pool of U.S. taxpayers who are potential customers. *See id.* 9–10; *see, e.g.,* DX 78 at 4 (Intuit document explaining 2011 strategic goal of acquiring tax store customers); GX 650 at 41 (Intuit document noting goal of acquiring tax store customers and specifically mentioning HRB). As discussed below, the Court disagrees and finds that the relevant product market is DDIY products.

2. The Relevant Product Market Does Not Include Assisted Tax Preparation Or Manual Preparation.

It is beyond debate—and conceded by the plaintiff—that all methods of tax preparation are, to some degree, in competition. Pl.'s Post–Trial Mem. at 8. All tax preparation methods provide taxpayers with a means to perform the task of completing a tax return, but each method is starkly different. Thus, while providers of all tax preparation methods may compete at some level, this "does not necessarily require that [they] be included in the relevant product market for antitrust purposes." *Staples,* 970 F.Supp. at 1075. DDIY tax preparation products differ from manual tax preparation and assisted tax preparation products in a number of meaningful ways. As compared to manual and assisted methods, DDIY products involve different technology, price, convenience level, time investment, mental effort and type of interaction by the consumer. Taken together, these different attributes make the consumer experience of using DDIY products quite distinct from other methods of tax preparation. *See Whole Foods,* 548 F.3d at 1037–38 (Brown, J.) (noting that a "product's peculiar characteristics and uses" and "distinct prices" may distinguish a relevant market) (citing *Brown Shoe,* 370 U.S. at 325, 82 S.Ct. 1502); *see also, e.g.,* GX 130 at 140 (HRB internal analysis discussing convenience and price as factors differentiating DDIY and assisted methods for consumers). The question for this court is whether DDIY and other methods of tax preparation are "reasonably interchangeable" so that it would not be profitable to have a monopoly over only DDIY products.

a. Assisted Tax Preparation Is Not In The Relevant Product Market.

Apart from the analysis of their economic expert, the defendants' main argument for inclusion of assisted tax preparation in the relevant market is that DDIY and assisted companies compete for customers.[11] As evidence for this point, the defendants emphasize that Intuit's marketing efforts have targeted HRB's assisted customers. *See* DX 78 at 3 (Intuit document noting strategic goal to "Beat Tax Store[s]"). While the evidence does show that companies in the DDIY and assisted markets all generally compete with each ***55** other for the same overall pool of potential customers—U.S. taxpayers—that fact does not necessarily mean that DDIY and assisted must be viewed as part of the same relevant product market. DDIY provides customers with tax preparation services through an entirely different method, technology, and user experience than assisted preparation. As Judge Tatel explained in *Whole Foods:*

> [W]hen the automobile was first invented, competing auto manufacturers obviously took customers primarily from companies selling horses and buggies, not from other auto manufacturers, but that hardly shows that cars and horse-drawn carriages should be treated as the same product market. That Whole Foods and Wild Oats have attracted many customers away from conventional grocery stores by offering extensive selections of natural and organic products thus tells us nothing about whether Whole Foods and Wild Oats should be treated as operating in the same market as conventional grocery stores. Indeed, courts have often found that sufficiently innovative retailers can constitute a distinct product market even when they take customers from existing retailers.

Whole Foods, 548 F.3d at 1048; *see also Staples,* 970 F.Supp. at 1074–80 (finding a distinct market of office supply superstores despite competition from mail-order catalogues and stores carrying a broader range of merchandise).

The key question for the Court is whether DDIY and assisted products are sufficiently close substitutes to constrain any anticompetitive DDIY pricing after the proposed merger. Evidence of the absence of close price competition between DDIY and assisted products makes clear that the answer to that question is no—and that DDIY is the relevant product market here. *See Swedish Match,* 131 F.Supp.2d at 165 ("Distinct pricing is also a consideration" in determining the relevant product market) (citing *Brown Shoe,* 370 U.S. at 325, 82 S.Ct. 1502). Significantly, despite some DDIY efforts to capture tax store customers, none of the major DDIY competitors sets their prices based on consideration of assisted prices. *See, e.g.,* Ernst, TT, 9/7/11 a.m., at 35 (HRB set its digital and assisted prices separately); {redacted} (Dep.) at 183:18–25 (explaining that {redacted} does not consider assisted pricing in setting prices because its prices are already "substantially less than both tax stores and most professionals"). Indeed, there are quite significant price disparities between the average prices of DDIY and assisted products. The average price of TurboTax, the most popular DDIY brand is approximately $55. GX 293 (Intuit Dep.) at 21. The average price of HRB's DDIY products is approximately $25. GX 296–7 at 6. Overall, the DDIY industry average price is $44.13. GX 121 at 57. In contrast, the typical price of an assisted tax return is significantly higher, in the range of $150–200.[12] A 10 percent or even 20 percent price increase in the average price of DDIY would only move the average price up to $48.54 or $52.96, respectively—still substantially below the average price of assisted tax products. The overall lack of evidence of price competition between DDIY and assisted products supports the conclusion that DDIY is a separate relevant product market for evaluating this transaction, despite the fact that DDIY ***56** and assisted firms target their marketing efforts at the same pool of customers.

The defendants point to some evidence that HRB sets prices for certain assisted products to compete with DDIY. For example, defendants note that in 2009, HRB "reduced prices on its assisted tax preparation services to $39 for federal 1040EZ preparation and $29 for state tax preparation to compete with and {redacted}" to DDIY. DFF ¶ 77a. These are limited product offerings for which prices appear well below even the 25th percentile price for HRB's assisted products. *See* GX 128 (HRB "TS10 Market Dynamics" presentation) at 38 (noting, for Tax Season 2010, that the 25th percentile for prices at HRB stores was {higher than DDIY}). Relatedly, the defendants' claim that prices for assisted and DDIY products "significantly overlap" is not strongly supported and relies on a comparison of the most limited, low-end assisted products with DDIY products generally. *See* DFF ¶ 78b (citing tax year 2009 data that show that 14 percent of customers using name-brand tax stores paid $50 or less and another 20 percent paid between $51–100); *id.* ¶ 78c-d (quoting prices for Jackson Hewitt's preparation of form 1040EZ, a simplified tax form, at Wal–Mart and for HRB's Second Look service, which actually only double-checks an already completed tax return for errors). In sum, while defendants' have identified isolated instances in which assisted product offerings are priced lower than the average prices for typical assisted products, they do not and cannot demonstrate that this is generally the case.

Testimony from HRB executives further supports treating DDIY as a relevant product market in evaluating this transaction. HRB's DDIY and assisted businesses are run as separate business units. Bennett, TT, 9/6/11 a.m., at 106. Alan Bennett, who was the CEO of HRB in 2010 when the parties reached the proposed merger agreement, testified that "net-net," he did not believe that HRB's DDIY business had impacted its assisted business in terms of taking away customers.[13] *Id.* at 108; *see also* GX 1151 at 4 (HRB internal analysis stating "Online is not growing materially at the expense of assisted."). Mark Ernst, HRB's CEO from 2001 to 2007, also explained that, in his opinion based on research he reviewed while at HRB, the primary reason consumers switched between assisted and DDIY was because of "life events" that led to changes in tax status. Ernst, TT, 9/7/11 a.m., at 34–35.

Finally, defendants argue that their broad relevant market is appropriate because there is "industry movement toward 'hybrid' products that combine some elements of both digital and assisted tax preparation." Defs.' Post–Trial Mem. at 11. Based on the evidence presented at the hearing, however, it would be premature for the Court to identify any trend toward hybrid products. In fact, neither Intuit nor TaxACT presently offers a hybrid product and the defendants openly concede that HRB's current hybrid product has had "somewhat limited success," which defendants attribute to "technical issues" and a "lack of consistent marketing." *Id.* at 11 n. 16. {redacted} {T}he Court finds it unlikely that there will be a sufficiently large scale shift into these products in the immediate future to compel the conclusion that DDIY and assisted ***57** products make up the same relevant product market.

b. Manual Tax Preparation Is Not In The Relevant Product Market.

The defendants also argue that manual tax preparation, or pen-and-paper, should be included in the relevant product market. At the outset, the Court notes that pen-and-paper is not a "product" at all; it is the task of filling out a tax return by oneself without any interactive assistance. Even so, the defendants argue pen-and-paper should be included in the relevant product market because it acts as a "significant competitive constraint" on DDIY. Defs.' Post–Trial Mem. at 11. The defendants' argument relies primarily on two factors. First, the defendants' cite the results of a 2011 email survey of TaxACT customers. *See id.* For reasons detailed in the following section, the Court declines to rely on this email survey. Second, the defendants point to documents and testimony indicating that TaxACT has considered possible diversion to pen-and-paper in setting its prices. *See id.* at 11–12.

The Court finds that pen-and-paper is not part of the relevant market because it does not believe a sufficient number of consumers would switch to pen-and-paper in response to a small, but significant increase in DDIY prices. The possibility of preparing one's own tax return necessarily constrains the prices of other methods of preparation at some level. For example, if the price of DDIY and assisted products were raised to $1 million per tax return, surely all but the most well-heeled taxpayers would switch to pen-and-paper. Yet, at the more practical price increase levels that trigger antitrust concern—the typical five to ten percent price increase of the SSNIP test—pen-and-paper preparation is unlikely to provide a meaningful restraint for DDIY products, which currently sell for an average price of $44.13. GX 121 at 57.

The government well illustrated the overly broad nature of defendants' proposed relevant market by posing to the defendants' expert the hypothetical question of whether "sitting at home and drinking chicken soup [would be] part of the market for [manufactured] cold remedies?" Meyer, TT, 9/13/11 a.m., at 65. The defendants' expert responded that the real "question is if the price of cold medicines went up sufficiently, would people turn to chicken soup?" *Id.* As an initial matter, in contrast to the defendants' expert, the Court doubts that it would ever be legally appropriate to define a relevant product market that included manufactured cold remedies and ordinary chicken soup. This conclusion flows from the deep functional differences between those products. Setting that issue aside, however, a price has increased "sufficiently" to trigger antitrust concern at the level of a five to ten percent small, but significant non-transitory increase in price. Just as chicken soup is unlikely to constrain the price of manufactured cold remedies sufficiently, the Court concludes that a SSNIP in DDIY would not be constrained by people turning to pen-and-paper. First, the share of returns prepared via pen-and-paper has dwindled over the past decade, as the DDIY market has grown. Bennett, TT, 9/6/11 a.m., at 118; GX 296 (Houseworth Dep.) at 66–68. Second, while pen-and-paper filers have been a net source of new customers for DDIY companies, both HRB and {redacted} executives have testified that they do not believe their DDIY products compete closely with pen-and-paper methods. {redacted} (Dep.) at 37:20–38:10; *see* GX 296 (Houseworth Dep.) 89–90. Third, courts in antitrust cases frequently exclude similar “self-supply” substitutes from relevant product markets. *See, e.g.,* ***58** *FTC v. H.J. Heinz Co.,* 116 F.Supp.2d 190, 195 (D.D.C.2000), *rev'd on other grounds,* 246 F.3d 708 (D.C.Cir.2001) (noting that homemade baby food and breast milk should not be included in the jarred baby food market even though substitution was possible because “the Supreme Court's interchangeability test refers to *products.*”); *CCC Holdings,* 605 F.Supp.2d at 41–42 (excluding books that can be used to perform insurance loss valuations by hand from market for loss valuation software); *United States v. Visa U.S.A. Inc.,* 163 F.Supp.2d 322, 338 (S.D.N.Y.2001) (excluding cash and checks from general purpose credit card market).

The main case the defendants rely on to show that “self-supply” substitutes should be included in the relevant market involved a consumer market consisting of vertically integrated companies and explicitly distinguished cases, such as this one, involving markets of individual consumers. In *United States v. Sungard Data Systems, Inc.,* Judge Huvelle found that disaster recovery computer systems developed internally by companies were in the same relevant product market as shared data recovery systems provided by outside vendors. *Sungard,* 172 F.Supp.2d at 187–89. The *Sungard* court, however, distinguished the case before it—which involved vertical integration—from the situation in *Heinz,* the case involving the market for jarred baby food, because “homemade baby food is not an aspect of vertical integration ... [and] individual consumers cannot vertically integrate by producing a product that they would otherwise have to purchase.” *Id.* at 187 n. 15. In finding that in-house computer systems were included in its relevant product market, the *Sungard* court cited the following example from Areeda & Hovenkamp ¶ 535e regarding vertical integration:

> If iron ore is the relevant market and if shares are best measured there by sales, then internally used ore—so-called captive output—is part of the ore market even though it is not sold as such.
>
> In measuring the market power of a defendant selling iron ore, the ore used internally by other firms constrains the defendant's ability to profit by raising ore prices to monopoly levels. The higher ore price may induce an integrated firm to expand its ore production—to supply others in direct competition with the alleged monopolist or to expand its own steel production and thereby reduce the demand of other steel makers for ore, or both. Hence, captive output constrains the defendant regardless of whether integrated firms sell their ore to other steel makers previously purchasing from the defendant. In sum, the integrated firm's ore output belongs in the market.

Id. at 186 n. 14. This rationale for including “self-supply” in a relevant product market does not appear to apply to the DDIY market in which the consumers are individuals and not also potential traders or producers.

While some diversion from DDIY to manual filing may occur in response to a SSNIP, the Court finds that it would likely be limited and marginal. The functional experience of using a DDIY product is meaningfully different from the self-service task of filling out tax forms independently. Manual completion of a tax return requires different tools, effort, resources, and time investment by a consumer than use of either DDIY or assisted methods. The following discussion from *United States v. Visa U.S.A. Inc.* regarding why cash and checks should not be included in the credit card market is instructive here:

> [A]lthough it is literally true that, in a general sense, cash and checks compete with general purpose cards as an option for payment by consumers and that ***59** growth in payments via cards takes share from cash and checks in some instances, cash and checks do not drive many of the means of competition in the general purpose card market. In this respect, [the expert's] analogy of the general purpose card market to that for airplane travel is illustrative. [The expert] argues that while it is true that at the margin there is some competition for customers among planes, trains, cars and buses, the reality is that airplane travel is a distinct product in which airlines are the principal drivers of competition. Any airline that had monopoly power over airline travel could raise prices or limit output without significant concern about competition from other forms of transportation. The same holds true for competition among general purpose credit and charge cards.

Visa U.S.A. Inc., 163 F.Supp.2d at 338. Here, the same analogy to airplane travel holds true for competition among DDIY providers, who provide a distinct product for completion of tax returns. Indeed, the pen-and-paper method, in which the consumer essentially relies on his or her own labor to prepare a tax return, is perhaps most analogous to walking as opposed to purchasing a ride on any means of transportation. In sum, filling out a tax return manually is not reasonably interchangeable with DDIY products that effectively fill out the tax return with data input provided by the consumer.

Inclusion of all possible methods of tax preparation, including pen-and-paper, in the relevant product market also violates the principle that the relevant product market should ordinarily be defined as the smallest product market that will satisfy the hypothetical monopolist test. *See* Merger Guidelines § 4.1.1 ("When the Agencies rely on market shares and concentration, they usually do so in the smallest relevant market satisfying the hypothetical monopolist test."); *see also* Warren–Boulton, TT, 9/8/11 p.m., at 35–36. Indeed, the defendants' inclusion of pen-and-paper in the relevant market ignores at least one obvious, smaller market possibility that they might have proposed—the combined market of all DDIY and assisted tax preparation products. It is hardly plausible that a monopolist of this market—to which the only alternative would be pen-and-paper—could not impose a SSNIP.

The defendants' proposed relevant market of all methods of tax return preparation is so broadly defined that, as the plaintiff's expert testified, there are no conceivable alternatives besides going to jail, fleeing to Canada, or not earning any taxable income. Warren–Boulton, TT, 9/8/11 p.m., at 35–36. As the plaintiff's expert put it, "if you're talking about the market for all tax preparation, you're talking about a market where, in economist terms, demand is completely [in]elastic. There are no alternatives." *Id.* at 35. In such circumstances, the usual tools of antitrust analysis—such as the hypothetical monopolist test—cease being useful because it is self-evident that a monopolist of all forms of tax preparation, including self-preparation, could impose a small, but significant price increase. Indeed, a monopolist in that situation could essentially name any price since taxpayers would have no alternative but to pay it. As the plaintiff's expert testified, defining a market that broadly

> negates the entire purpose of defining a relevant market in an antitrust case. You want to define a relevant market in an antitrust case so then [you can calculate] shares and the change in shares makes sense. I don't want to go to infinity ... I want to define a relevant market under ... the smallest market principle, which is I want to define the ***60** relevant market so that if a hypothetical monopolist ... did manage to control all of those products, they would impose a significant price increase, large enough to be of concern but not so large as to make the whole exercise pointless.

Id. at 35–36. The Court agrees with this assessment and finds the defendants' proposed relevant market to be overbroad.

3. The Economic Expert Testimony Tends To Confirm That DDIY Is The Relevant Product Market.

Both the plaintiff and the defendants presented testimony from expert economists to support their view of the relevant product market.[14] In addition to their testimony at the hearing, these expert witnesses also provided a detailed expert report and an affidavit summarizing their analysis and conclusions.

The Court finds that the analysis performed by the plaintiff's expert tends to confirm that DDIY is a relevant product market, although the available data in this case limited the predictive power of the plaintiff's expert's economic models. The Court also finds that it cannot draw any conclusions from defendants' expert's analysis because of severe shortcomings in the underlying consumer survey data upon which the defendants' expert relied.

a. Plaintiff's Expert—Dr. Warren–Boulton

The plaintiff's expert, Dr. Warren–Boulton, found the relevant product market to be DDIY. He determined that a hypothetical monopolist of DDIY products could profitably impose a SSNIP for at least one DDIY product, and that consumer substitution to assisted methods or pen-and-paper would be insufficient to defeat the SSNIP. GX 121 (Warren–Boulton Rep.) at 12.

Dr. Warren–Boulton began his analysis by postulating that DDIY was the relevant product market and then he used two principal analytical tests to confirm the validity of that assumption. He began by testing DDIY as a relevant market for a few reasons. First, he concluded that the parties' DDIY products are substantially similar in terms of functionality. GX 121 (Warren–Boulton Rep.) at 12–18. Second, he concluded from his review of the defendants' business documents that they viewed DDIY as a discrete product market when competing in the ordinary course of business. *Id.* Third, he ruled out including pen-and-paper and assisted products in the relevant product market based on a consideration of various data. *Id.* at 24–32.

Dr. Warren–Boulton's decision to begin the relevant market analysis with DDIY ***61** was appropriate. *See* Areeda & Hovenkamp ¶ 536, at 287 ("[T]wo products are provisionally part of the same market [for hypothetical monopolist analysis] when they employ similar technologies and similar costs and customers use them interchangeably ... In cases of doubt, [products] should generally be excluded from the provisional market, for incorrect exclusions will ultimately be brought into the market via the price increase methodology.”). The parties' DDIY products all provide a fundamentally similar service and a similar user experience for the consumer when compared with other methods of tax preparation. The DDIY consumer sits down at a computer and interacts with the DDIY software, which prompts the consumer for information and ultimately completes the consumer's tax return. This experience is qualitatively different than that of hiring a tax professional or figuring out how to complete one's own tax return manually. Various other evidence in the record also supports the fundamental functional similarity of the technology underlying the parties' DDIY products —perhaps most notably the testimony that post-merger, HRB plans to migrate {redacted} onto TaxACT's software “engine” {redacted}. *See* Dunn, TT, 9/8/11 p.m. (sealed), at 16–17.

As discussed in detail above, various documentary evidence suggests that the parties treat DDIY as a distinct product market in the ordinary course of business.

Dr. Warren–Boulton also considered whether the pen-and-paper and assisted methods should be included in the provisional relevant market, as the defendants contend, and concluded that they should not be.

Dr. Warren–Boulton ruled out including pen-and-paper in the relevant product market, concluding instead that historical tax return data reflects “a gradual migration of customers to [DDIY] from more traditional methods like pen-and paper.” GX 121 (Warren–Boulton Rep.) at 24. The percentage of returns prepared by pen-and-paper has fallen considerably over the last decade, while the percentage of DDIY has grown. *Id.* Changes in the yearly percentage shares of taxpayers using pen-and-paper do not appear correlated to changes in the yearly average price of DDIY. *Id.* at 27. Finally, based on IRS data, Dr. Warren–Boulton observed that taxpayers who switched from DDIY to pen-and-paper for tax seasons 2008 and 2009 on average experienced a decrease in tax return complexity, suggesting that much switching from DDIY products to pen-and-paper is driven by such complexity decreases.[15]

Dr. Warren–Boulton also ruled out including the assisted tax preparation methods in the relevant market based on consideration of several factors. He reviewed HRB documents that conclude that growth in DDIY has not come at the expense of HRB's assisted business. *Id.* at 28. Testimony from HRB employees, including the former CEO, also reinforced the same conclusion. *Id.* at 28–29. He also cited HRB internal studies, which concluded that consumers who have switched from DDIY to assisted are likely to have experienced a change in tax complexity. He found that HRB's internal conclusion was consistent with IRS switching data, which ***62** also indicated a correlation between switching from DDIY to assisted and an increase in tax complexity. *Id.* at 29–30. Finally, Dr. Warren–Boulton noted that, based on data from tax years 2004–2009, increases in the relative price of assisted products were not associated with decreases in the relative market share of assisted products and increases in the relative market share of DDIY, as might be expected if DDIY and assisted prices moved in a single, price-responsive market. *Id.* at 32.

Therefore, having determined that the best provisional relevant market is DDIY and not all methods of tax preparation, Dr. Warren–Boulton then performed two economic tests to confirm that a hypothetical monopolist of all DDIY products could profitably impose a SSNIP. If these economic tests indicated that a hypothetical monopolist could not profitably impose a SSNIP, then the tests would call for the relevant market to be expanded. The tests, however, validated the relevant market as DDIY, as detailed below.

The economic tests Dr. Warren–Boulton applied relied heavily upon switching data from the IRS. Switching refers to the number of consumers who switch between different products for any reason. In any given year, many taxpayers switch from the tax preparation method they used in the prior year to a new method. Since the IRS processes all U.S. tax returns each year and tracks data about the methods of tax preparation that taxpayers used, there is ample, reliable data that market analysts can use to see how many taxpayers switched between methods each year. The IRS data, however, provides little direct insight about *why* any given taxpayer switched methods of preparation. The switch could have been for reasons of price, convenience, changes in the consumer's personal situation, an increase or decrease in tax complexity, a loss of confidence in the prior method of preparation, or any other reason.

As opposed to switching, diversion refers to a consumer's response to a measured increase in the price of a product. In other words, diversion measures to what extent consumers of a given product will switch (or be "diverted") to other products in response to a price increase in the given product. The IRS switching data does not directly measure diversion because switching can occur for any number of reasons, many of which may not involve price.

Unfortunately, no direct, reliable data on diversion exists in this case. The plaintiff's expert argues, however, that the IRS switching data can provide at least some estimate of diversion. While this approach is not without its limitations, as discussed further below, the Court finds that the switching data is at least somewhat indicative of likely diversion ratios. Moreover, the IRS data is highly reliable because (1) the sample size is enormous, since it encompasses over 100 million taxpayers, and (2) the data reflects actual historical tax return filing patterns as opposed to predicted behavior.[16]

***63** The defendant's expert, who criticizes reliance on this switching data, suggests instead that a better analysis can be based upon simulated diversion data derived from consumer surveys commissioned by the defendants. As described more fully below, however, the shortcomings of these survey-derived diversion data are so substantial that the Court cannot rely on them.

i. Critical Loss Analysis

The first economic test Dr. Warren–Boulton performed is known as a "critical loss" analysis. This test attempts to calculate "the largest amount of sales that a monopolist can lose before a price increase becomes unprofitable." *Swedish Match,* 131 F.Supp.2d at 160. Dr. Warren–Boulton calculated that for a 10 percent price increase in DDIY, the price increase would be profitable if the resulting lost sales did not surpass 16.7 percent.[17] GX 121 (Warren–Boulton Rep.) at 34.

Dr. Warren–Boulton then sought to compare this critical loss threshold with "aggregate diversion ratios." The aggregate diversion ratio for any given product represents the proportion of lost sales that are recaptured by all other firms in the proposed market as the result of a price increase. Since these lost sales are recaptured within the proposed market, they are not lost to the hypothetical monopolist. According to Dr. Warren–Boulton, economists have shown that if the aggregate diversion ratio to products inside the proposed relevant market exceeds the critical loss threshold, then the critical loss analysis indicates that a SSNIP at that level would be profitable for a hypothetical monopolist. *Id.* at 34 (citing Michael Katz and Carl Shapiro, *Critical Loss: Let's Tell the Whole Story,* antitrust (Spring 2003) at 49–56); *see also* Warren–Boulton, TT, 9/9/11 p.m., at 33–34.

Because no diversion data is available, Dr. Warren–Boulton relied instead on IRS switching data to estimate aggregate diversion ratios. *Id.* These data show that of the taxpayers who left HRB's DDIY products between tax year 2007 and 2008,[18] 57 percent went to other DDIY providers. Of those who left TaxACT, 53 percent stayed in DDIY, and for TurboTax, 39 percent stayed in DDIY. *Id.* at 34–35. Since these numbers are all well above the 16.7 percent critical loss threshold, Dr. Warren–Boulton concluded a 10 percent SSNIP in the DDIY market would be profitable for a hypothetical monopolist.

In cross-examining Dr. Warren–Boulton, the defendants suggested that the critical loss test is meaningless because it would seem to validate numerous different candidate markets consisting of various assortments of tax preparation businesses. Warren–Boulton, TT, 9/9/11 p.m., at 20–42. For example, the defendants demonstrated that the test could also validate a market consisting of just HRB and Intuit or a market consisting of just TaxACT and Intuit. *See* DX 9802. Dr. Warren–Boulton ***64** noted in his testimony, however, that such markets are "smaller, irrelevant" markets for evaluating the proposed transaction between HRB and TaxACT. Warren–Boulton, TT, 9/9/11 p.m., at 41; *see also* Areeda & Hovenkamp ¶ 533c, at 254 ("[C]ourts correctly search for a 'relevant market'—that is a market relevant to the particular legal issue being litigated."). The fact that critical loss analysis would validate other groupings of businesses does not undermine Dr. Warren–Boulton's reliance on it to validate DDIY as the relevant market in this case.[19] Indeed, rather than urging a smaller relevant market definition, the defendants urged the Court to define the market much more broadly. Nonetheless, the Court appreciates the defendants' point that the critical loss test alone cannot answer the relevant market inquiry. While some inappropriate proposed relevant markets would be ruled out by the critical loss test, the fact that the test could still confirm multiple relevant markets means that the Court must rely on additional evidence in reaching the single, appropriate market definition.

ii. Merger Simulation

In addition to the critical loss analysis, Dr. Warren–Boulton also performed an economic simulation of a merger among the HRB, TaxACT, and Intuit. GX 121 (Warren–Boulton Rep.) at 35. This simulation, known as a Bertrand model, predicted that a monopolist of the DDIY products of these three companies would find it profit-maximizing to raise TaxACT's price by 83 percent, HRB's price by 37 percent and TurboTax's price by 11 percent absent efficiencies. *Id.* Dr. Warren Boulton concluded that this simulation also confirms that DDIY is the relevant product market.[20]

iii. Critiques of Dr. Warren–Boulton's Analysis

The defendants' expert, Dr. Meyer, critiques Dr. Warren–Boulton's analysis in numerous ways. Her most fundamental critique is that his reliance on switching data as a proxy for diversion is flawed because switching can occur for any number of reasons and, therefore, it is not necessarily indicative of what products consumers would switch to in response to a price increase. DX 17 (Meyer Rep.) at 59–60. Dr. Meyer is certainly correct in this critique. Dr. Warren–Boulton, however, testified forthrightly about the limitations involved in relying on switching data as a proxy for diversion:

> Using migration [i.e., switching] doesn't really answer, or it doesn't answer the precise question of [the] merger guidelines, ***65** which of course is, where would you go if there was a small but significant price increase? It basically asks the question, where did you go? And you could go for a lot of reasons. You could go because the price has changed, you could go because the quality changes, you could go because you changed. Complexity changes. And there's a lot of evidence in the record that people switch because of changes in their own complexity. But using migration percentages, or using those gives you, I think, a reasonable second estimate of diversion ratios, because it's really asking the question, you know, if you went to some—if for some reason you decided to go from HRB to TaxACT, for all those reasons, is that roughly about the same percentages if you went due to a price increase?

Warren–Boulton, TT, 9/9/11 a.m., at 13–14. Thus, switching data does not necessarily indicate diversion for the reasons both experts have identified. In light of all the evidence in the record and the general similarity of DDIY products, the Court credits Dr. Warren–Boulton's conclusion that it was reasonable to use switching data as a proxy for diversion, especially since no more refined historical data apparently exists. Bearing in mind the shortcomings of the switching data, the Court will not treat Dr. Warren–Boulton's hypothetical monopolist analysis as conclusive. The Court will treat it as another data point suggesting that DDIY is the correct relevant market, however.

Another major critique of Dr. Warren–Boulton's hypothetical monopolist analysis—and one that the defendants repeatedly emphasized at the hearing—is that Dr. Warren–Boulton decided "arbitrarily to *exclude* some alternatives that are closer substitutes than the products that he *included.*" DX 17 (Meyer Rep.) at 70; *see* Meyer, TT, 9/12/11 p.m., at 20–22. As Dr. Meyer put it at the hearing, "Dr. Warren–Boulton's relevant market is a miscellaneous set of unconnected links, because it doesn't include ... the closest substitute to H & R Block [At Home], which is assisted tax preparation. It doesn't include pen and paper, which is the closest substitute to TaxACT." Meyer, TT, 9/12/11 p.m., at 24–25. Dr. Meyer identified the "closest substitutes" to the merging parties' products using simulated diversion data. As discussed below, the Court finds this data unreliable and declines to rely upon it. Dr. Meyer opines, however, that Dr. Warren–Boulton failed to include the closest substitutes for the defendants' products in his market, even if switching data is treated as a proxy for diversion, as Dr. Warren–Boulton suggests. For example, Dr. Meyer states that "11.2% of TaxACT's customers in TY2007 switched to assisted preparation in TY2008, while only 2.7% switched to H & R Block At Home and 9.1% switched to TurboTax." DX 17 (Meyer Rep.) at 72. Thus, the defendants contend Dr. Warren–Boulton violated the following principle from the Merger Guidelines: "When applying the hypothetical monopolist test to define a market around a product offered by one of the merging firms, if the market includes a second product, the Agencies will normally also include a third product if that third product is a closer substitute for the first product than is the second product." *Id.* at 72 (quoting Merger Guidelines § 4.1.1).

The government persuasively illustrated the key flaw in this critique during the cross-examination of the defendants' expert. *See* Meyer, TT, 9/13/11 a.m., at 90–96. Simply put, when determining the "closest substitutes" for products within the DDIY category, Dr. Meyer looked at diversion to individual DDIY brands, such as TurboTax and H & R Block At Home, ***66** but when assessing substitutes outside the DDIY category, Dr. Meyer lumped all products and methods together into large, aggregated market categories, such as "assisted" or "pen-and-paper." *See id.* If, instead, DDIY products are grouped together as an aggregated category, similar to the treatment of assisted and pen-and-paper in Dr.

Meyer's analysis, then the IRS switching data would indicate that other DDIY products are the closest substitutes for both the DDIY products of HRB and TaxACT. *See* GTX 15, 16 (illustrating this analysis). For HRB, the numbers show 56.8 percent switching to other DDIY, 36.9 percent to assisted, and 6.3 percent to pen-and-paper. GTX 15. For TaxACT, the numbers show 52.7 percent switching to other DDIY, 40.1 percent to assisted, and 7.3 percent to pen-and-paper. GTX 16.

Some of Dr. Meyer's additional critiques have more merit. For example, one datum Dr. Warren–Boulton relied on in his analysis was the outcome of an advertising study showing that HRB's sales {were affected} in cities where TaxACT pursued an advertising campaign. *See* GX 121 (Warren–Boulton Rep.) at 43. The Court accepts Dr. Meyer's critique that few conclusions can be drawn from this observation because the observed correlation could have been due to other variables—for example, the advertising of a third competitor like TurboTax. *See* DX 17 (Meyer Rep.) at 69. Similarly, Dr. Warren–Boulton's observations that changes in relative market share of DDIY, assisted, and pen-and-paper do not appear correlated to changes in relative price could also have been affected by confounding variables. *Id.* at 67.

b. Defendants' Expert—Dr. Meyer

Dr. Meyer found the relevant product market to be all methods of tax preparation, including DDIY, assisted, and pen-and-paper. Her conclusion rested on various factors, including an analysis of documents and testimony. *See, e.g., id.* at 15. This Court, however, has already discussed its own analysis of the relevant documents and testimony above. Therefore, the Court will focus now on Dr. Meyer's analysis of pricing data and, in particular, her use of and reliance on data derived from customer surveys commissioned by the defendants.

Dr. Meyer found that assisted preparation competes with DDIY in part because the assisted method is the most popular method of tax preparation across all complexity levels. *See id.* at 12–13. Dr. Meyer concedes, however, that "taxpayers with the most complex tax returns are the most likely to use [assisted preparation]." *Id.* Indeed, her data show that this effect is pronounced, with approximately 70 percent of filers of complex returns using assisted and approximately 44 percent of filers of simple returns using assisted. *Id.* DDIY, by contrast, accounts for approximately 37 percent of simple returns and 23 percent of complex returns. *Id.* If anything, these data indicate that assisted products are linked to the needs of consumers with complex returns, suggesting a partially different consumer profile from DDIY products.

Dr. Meyer also noted that the pricing of DDIY and assisted products overlaps, but her analysis of this overlap rests primarily on comparing high-end DDIY products, such as HRB's Best of Both product,[21] ***67** with low-end assisted products, such as Jackson Hewitt's offering of limited, simple return preparation at Wal–Mart. *See id.* at 13–14. Dr. Meyer concedes that the median price of assisted is higher than the median DDIY price, *see id.* at 13, and that is the more useful point of comparison.

Apart from these comparisons and her conclusions about how industry participants view the market based on her review of documents and testimony in the record, Dr. Meyer's definition of the relevant market rests primarily on her analysis of simulated diversion data obtained from a "pricing simulator" created for HRB in 2009 and an email survey conducted by TaxACT in 2011. *See id.* at 17–20. These two sources for her conclusions are discussed seriatim below.

i. Pricing Simulator

Dr. Meyer asserts in her report that the pricing simulator "created for HRB in 2009, provides the only direct test of the likely diversion from HRB's [DDIY] products in reaction to a change in price." *Id.* at 17. The simulator itself is a pricing model that runs as a dynamic Excel spreadsheet. *See* Meyer, TT, 9/13/11 a.m., at 42. Dr. Meyer's report in several instances relies upon an internal HRB Powerpoint presentation that reflects the simulator's data output under several different scenarios. *See, e.g.,* DX 17 (Meyer Rep.) at 37 n. 155 (citing the Powerpoint). As Dr. Meyer describes, the "simulator was prepared using a discrete choice survey of 6,119 respondents." *Id.* at 17. She explains that "[t]he respondents were shown five pricing scenarios, and the options included online DIY options, software DIY options, assisted tax preparation options, and other DIY options (including pen-and-paper and friends/family)." *Id.* Dr. Meyer further states that the "pricing of the various options changed across scenarios" and a "conjoint analysis was conducted to analyze the effect of a change in the price of each product on its own sales and the sales of the other tax preparation options." *Id.*

Based on the pricing simulator's results, Dr. Meyer calculated diversion ratios for DDIY products. Dr. Meyer found that "the largest diversion from HRB's [DDIY products], in the event of a price increase, is to CPAs and accountants." *Id.* at 18. She found the "second largest diversion from HRB's [DDIY products]" was to pen-and-paper. *Id.* at 19–20. In addition, "the fourth largest diversion is to HRB retail stores." *Id.* at 18. Accordingly, Dr. Meyer concluded that assisted preparation and pen-and-paper were the closest substitutes to HRB's DDIY products and should be included in the relevant market.

There is a critical flaw in the design of the pricing simulator, however, that renders conclusions based on its output unreliable. Despite Dr. Meyer's assertion that the "pricing of the various options changed across [the] scenarios" presented to the survey respondents, not all of the options in the survey underlying the simulator actually had prices associated with them. *See* Meyer, TT, 9/13/11 a.m., at 27–28. Several "non-priced choice options" were available to the survey respondents and these non-priced options included, importantly, "CPA or Accountant," "H & R Block Retail Office," and "Paper & Pencil." DX 9231 (May 2009 Pricing Simulator Powerpoint) at 4. Thus, while the pricing of the various options changed *for some products* across the different scenarios presented in the survey, no prices at all were associated with these critical "non-priced choice options."

The fact that the pricing simulator survey failed to assign any prices to these ***68** particular products is, of course, especially significant given Dr. Meyer's findings that the highest diversion from HRB DDIY was to CPAs and then to pen-and-paper. DX 17 (Meyer Rep.) at 18. Indeed, the conclusion that the largest diversion from HRB's DDIY products would be to CPAs is puzzling on its face. This outcome is counterintuitive because CPAs in general tend to be the most expensive form of tax preparation assistance, while DDIY tends to be the least expensive. *See* GTX 14. The Court finds that these surprising results are most likely due to the fact that the survey did not, in fact, assign any price at all to the CPA option. Due to this flaw in the survey's design, respondents may well have selected the CPA option and the other non-priced options without even attempting to consider price as a factor in their decision. Accordingly, the Court finds that it simply cannot rely on the diversion ratios predicted by the simulator.

Additional problems with the pricing simulator also render its output unreliable. As Dr. Warren–Boulton noted in his rebuttal of Dr. Meyer's report, the compilation of pricing simulator data which Dr. Meyer relied upon to calculate her diversion ratios contains results that appear to violate what is "[p]erhaps the most fundamental principle in economics." *See* GX 665 (Warren–Boulton Reply Rep.) at 9–10. Increasing the price of one HRB DDIY product in the simulation, TaxCut Online Basic, appears to increase the quantity of the product sold, holding other variables constant. *Id.* This anomaly violates the fundamental economic principle that "demand curves almost always slope downward," which holds that, all other things being equal, consumers buy less of a product when the price goes up. *See id.* In another anomalous result, Dr. Warren–Boulton found that, based on the simulator data, cutting the price of TaxCut Online Basic from $29.95 to $14.95 approximately doubles its predicted market share, but cutting the price only to $19.95 greatly reduces its market share.[22] *Id.* Dr. Warren–Boulton also found that analysis of different print outs of simulator data in the HRB Powerpoint may yield inexplicably different results. For example, relying on the data on one page of the simulator Powerpoint, Dr. Meyer determined that the "the diversion rate from HRB to TaxACT is only 1.6 percent." DX 17 (Meyer Rep.) at 37. Yet, Dr. Warren–Boulton applied the same methodology for calculating the diversion rate to the simulator data reflected on another slide of the same Powerpoint purporting to show the same simulator data as applied to a different scenario. This calculation yielded the "wildly different estimate" of a 32.4 percent diversion rate from HRB to TaxACT. *See* GX 665 (Warren–Boulton Reply Rep.) at 10. These inconsistent and anomalous results provide additional reasons to discredit the diversion ratios Dr. Meyer predicted from the simulator data.

ii. 2011 Email Survey

Dr. Meyer's analysis also relied on a 2011 email survey of TaxACT customers commissioned by the defendants.[23] *See* ***69** DX 17 (Meyer Rep.) at 20, 38. In April 2011, TaxACT and HRB jointly commissioned this survey "to determine to which products TaxACT's customers would switch if those customers were displeased with TaxACT because of price, quality, or functionality." *Id.* at 20. The survey asked one primary question: "If you had become dissatisfied with TaxACT's price, functionality, or quality, which of these products or services would you have considered using to prepare your federal taxes?" GX 604 (Survey Summary) at 1. The survey then offered the respondents a list of other products or services from which to choose and instructed them to select all applicable options. *Id.* The list of options that respondents were given varied somewhat depending on the respondents' filing status and the payments they had made for their 2011 tax returns.[24] *Id.* A follow-up question asked the respondents to narrow their selections to a single choice. *Id.*

The research firm conducting the survey initially sent out 46,899 email requests to TaxACT customers inviting them to participate in the survey and then subsequently targeted 24,898 customers who had purchased a federal tax return product but not a state product. *Id.* Survey respondents were also asked screening questions to determine their membership in one of four categories of customers: (1) those who paid to complete both a federal and state tax return; (2) those who completed a free federal return and paid to complete a state return; (3) those who completed a paid federal return but did not complete a state return; and (4) those who completed a free federal return and did not complete a state return. *Id.*

A total of 1,089 customers responded to the survey. *Id.* at 1–3. The response rates for the four categories of customers were: (1) 2.45 percent for paid federal/paid state filing (422); (2) 2.08 percent for free federal/paid state filing (245); (3) 0.6 percent for paid federal/no state filing (182); and (4) 1.7 percent for free federal/no state filing (240). *Id.*

Dr. Meyer opined that "this survey is closer to the concept of a diversion ratio than are data on overall switching between products." DX 17 (Meyer Rep.) at 20 n. 85. Based on the survey's results, she concluded that the survey "provides direct evidence that digital DIY products compete with pen-and-paper" because the percentage of TaxACT customers who reported that, if they were dissatisfied with TaxACT, they would switch to pen-and-paper in each group ranged from 27 to 34 percent. DX 17 (Meyer Rep.) at 20. Dr. Meyer also noted that the survey showed that few TaxACT customers would switch to H & R Block At Home, since only 4 to 10 percent of respondents selected that option. *Id.* at 38. Accordingly, Dr. Meyer ***70** found this outcome indicative that "HRB is not a particularly close competitor to TaxACT." *Id.*

In response to Dr. Meyer's reliance upon this survey, the government submitted a rebuttal expert report from Dr. Ravi Dhar, a professor of management at Yale University, which credibly critiques the survey on several levels.[25] GX 623 (Dhar Rep.). Most fundamentally, the government points out that the phrasing of the survey question—which asks about dissatisfaction with "TaxACT's price, functionality, or quality"—appears to ask a hypothetical question about *switching,* not diversion based solely on a price change. Since the phrasing of the survey question conflates customer concerns about price, functionality, or quality, the government argues that the survey cannot shed any light on customer reactions to price changes alone. *See id.* at 5. Further, to the extent that the wording of the question addresses price, it does not ask about a change in price, but rather suggests a change in the customer's satisfaction with TaxACT's existing price. *See id.*

At the hearing, Dr. Meyer explained that she viewed the email survey data as "closer to diversion than is pure switching data" because switching could occur for any reason at all, while the survey only asked about potential switching due to dissatisfaction with "price, functionality, or quality." Meyer, TT, 9/13/11 a.m., at 87. Yet the Court finds that almost any reason for switching from a product could be characterized as dissatisfaction with the "functionality" or "quality" offered by the product in some respect. Therefore, the survey question does not come much closer to identifying diversion ratios than pure switching data does. Moreover, since there is extensive IRS data reflecting actual switching behavior in the marketplace—as opposed to the hypothetical switching behavior asked about in the email survey—the Court will not rely on the "diversion ratios" suggested by the 2011 email survey.

Furthermore, additional defects in the 2011 email survey's methodology also render the reliability of its findings questionable. First, the high level of non-response to the defendants' email invitations to participate in the survey could have biased the results. Dr. Dhar explained that the "level of nonresponse ... is extremely high (more than 98%)" and that the "extremely low response rates makes it difficult to determine whether the results were impacted by a certain segment who were systematically more likely to respond to the survey (e.g., those who were price sensitive or time insensitive) in relation to those who did not respond." GX 623 (Dhar Rep.) at 10. The Court agrees that non-response bias is a potential pitfall of the survey. *See University of Kansas v. Sinks,* No. 06–2341, 2008 WL 755065, at *4 (D.Kan. Mar. 19, 2008) (noting, in trademark case, that a consumer survey response rate of "2.16% appears, by any standard, to be quite low."). Second, by providing survey respondents with a pre-selected list of alternative options, rather than letting respondents respond organically, the survey leads respondents to think about the market for tax preparation services in the same terms that the defendants do, which may have led respondents to select options they otherwise would not have selected. Since the survey's question essentially asks about hypothetical switching, and since the actual IRS switching data in this case reflect a much larger ***71** sample size without the methodological deficiencies of the 2011 survey, the Court declines to rely on the purported diversion ratios calculated from the email survey.

On the whole, the Court views Dr. Warren–Boulton's expert analysis as more persuasive than Dr. Meyer's.[26] First, Dr. Warren–Boulton's testimony was generally more credible than Dr. Meyer's.[27] Second, the diversion ratios that Dr. Meyer calculated from the pricing simulator and the 2011 email survey are unreliable, as discussed above. Without these simulated diversion ratios, little remains of Dr. Meyer's expert conclusions apart from her analysis of documents in the record.

Dr. Warren–Boulton's analysis is not without its limitations. The main shortcoming for his approach is that he relied on switching data as a proxy for diversion. Since there is evidence in the record that switching among different products in the broader tax preparation industry occurs for reasons other than price competition, switching cannot serve as a complete proxy for diversion. Even so, the Court credits Dr. Warren–Boulton's conclusion that switching data can provide a "reasonable second estimate" of diversion ratios here. Therefore, the Court finds that Dr. Warren–Boulton's analysis tends to confirm that the relevant market is DDIY, although the Court would not rely on his analysis exclusively. As explained above, however, the full body of evidence in this case makes clear that DDIY is the correct relevant market for evaluating this merger.

B. Likely Effect on Competition

1. The Plaintiff's Prima Facie Case

Having defined the relevant market as DDIY tax preparation products, "the Court must next consider the likely effects of the proposed acquisition on competition within that market." *Swedish Match,* 131 F.Supp.2d at 166. The government must now make out its prima facie case by showing "that the merger would produce 'a firm controlling an undue percentage share of the relevant market, and [would] result[ ] in a significant increase in the concentration of firms in that market.' " *Heinz,* 246 F.3d at 715 (quoting *Philadelphia Nat'l Bank,* 374 U.S. at 363, 83 S.Ct. 1715). "Such a showing establishes a 'presumption' that the merger will substantially lessen competition." *Id.*

"Market concentration, or the lack thereof, is often measured by the Herfindahl–Hirschmann Index ('HHI')." *Id.* at 716. "The HHI is calculated by totaling the squares of the market shares of every firm in the relevant market. For example, a market with ten firms having market shares of 20%, 17%, 13%, 12%, 10%, 10%, 8%, 5%, 3% and 2% has an HHI of 1304 ($20^2 + 17^2 + 13^2 + 12^2 + 10^2 + 10^2 + 8^2 + 5^2 + 3^2 + 2^2$)." *Id.* at 715 n. 9. Sufficiently large HHI figures establish the government's prima facie case that a merger is anticompetitive. *Id.* Under the Horizontal Merger Guidelines, markets with an HHI above 2500 are considered "highly concentrated" and mergers "resulting in highly concentrated markets that involve an increase in the HHI of more than 200 points will be presumed to ***72** be likely to enhance market power." Merger Guidelines § 5.3.

In this case, market concentration as measured by HHI is currently 4,291, indicating a highly concentrated market under the Merger Guidelines. GX 121 (Warren–Boulton Rep.) at 38. The most recent measures of market share show Intuit with 62.2 percent of the market, HRB with 15.6 percent, and TaxACT with 12.8 percent. GX 27. These market share calculations are based on data provided by the IRS for federal tax filings for 2010, the most recent data available.

The defendants argue that market share calculations based exclusively on federal filing data are insufficient to meet the plaintiff's burden in establishing its alleged relevant product market, which includes both federal and state filings. Defs.' Post–Trial Mem. at 12–13. The Court rejects this argument. State tax return products are typically sold as add-ons to or in combination with federal return products and the Court finds that there is little reason to conclude that the market share proportions within the state DDIY segment would be significantly different from federal DDIY. *See* GX 600 at 8 (HRB market research study stating that "[t]he desire to file State and Federal taxes together, and, inherently, for ease/ convenience overruled all other rationales for the method chosen for State taxes."). While, as defendants point out, many customers of federal tax return DDIY products do not also purchase state returns, that may be because they live in states without income tax or because their state returns are simple enough to prepare very easily without assistance. *See* Dunn, TT, 9/8/11 a.m., at 48–49. A reliable, reasonable, close approximation of relevant market share data is sufficient, however. *FTC v. PPG Indus., Inc.,* 798 F.2d 1500, 1505 (D.C.Cir.1986). Further, the defendants' own ordinary course of business documents analyze the market based on IRS federal e-file data, without reference to state filings, even though the defendants' clearly sell state tax return products. *See, e.g.,* GX 27.

The proposed acquisition in this case would give the combined firm a 28.4 percent market share and will increase the HHI by approximately 400, resulting in a post-acquisition HHI of 4,691. *Id.* These HHI levels are high enough to create a presumption of anticompetitive effects. *See, e.g., Heinz,* 246 F.3d at 716 (three-firm to two-firm merger that would have increased HHI by 510 points from 4,775 created presumption of anticompetitive effects by a "wide margin"); *Swedish Match,* 131 F.Supp.2d at 166–67 (60 percent market share and 4,733 HHI established presumption). Accordingly, the government has established a prima facie case of anticompetitive effects.

"Upon the showing of a *prima facie* case, the burden shifts to defendants to show that traditional economic theories of the competitive effects of market concentration are not an accurate indicator of the merger's probable effect on competition in these markets or that the procompetitive effects of the merger are likely to outweigh any potential anticompetitive effects." *CCC Holdings,* 605 F.Supp.2d at 46. "The courts have not established a clear standard that the merging parties must meet in order to rebut a prima facie case, other than to advise that '[t]he more compelling the prima facie case, the more evidence the defendant must present to rebut [the presumption] successfully.' " *Id.* at 46–47 (quoting *Baker Hughes,* 908 F.2d at 991). Even in cases where the government has made a strong prima facie showing:

> [i]mposing a heavy burden of production on a defendant would be particularly anomalous where, as here, it is easy to ***73** establish a prima facie case. The government, after all, can carry its initial burden of production simply by presenting market concentration statistics. To allow the government virtually to rest its case at that point, leaving the defendant to prove the core of the dispute, would grossly inflate the role of statistics in actions brought under section 7. The Herfindahl–Hirschman Index cannot guarantee litigation victories.

Baker Hughes, 908 F.2d at 992. Thus, ultimately, "[t]he Supreme Court has adopted a totality-of-the-circumstances approach to the [Clayton Act], weighing a variety of factors to determine the effects of particular transactions on competition." *Id.* at 984. With these observations in mind, the Court will evaluate the parties' evidence and arguments about the likely effect of the transaction on competition in the DDIY market.

2. Defendants' Rebuttal Arguments

a. Barriers to Entry

Defendants argue that the likelihood of expansion by existing DDIY companies besides Intuit, HRB, and TaxACT will offset any potential anticompetitive effects from the merger. Courts have held that likely entry or expansion by other competitors can counteract anticompetitive effects that would otherwise be expected. *See Heinz,* 246 F.3d at 717 n. 13 ("Barriers to entry are important in evaluating whether market concentration statistics accurately reflect the pre- and likely post-merger competitive picture."); *Baker Hughes,* 908 F.2d at 987 ("In the absence of significant barriers, a company probably cannot maintain supracompetitive pricing for any length of time."). According to the Merger Guidelines, entry or expansion must be "timely, likely, and sufficient in its magnitude, character, and scope to deter or counteract the competitive effects of concern." Merger Guidelines § 9; *see also CCC Holdings,* 605 F.Supp.2d at 47; *United States v. Visa USA, Inc.,* 163 F.Supp.2d 322, 342 (S.D.N.Y.2001) (entry must be "timely, likely, and [of a] sufficient scale to deter or counteract any anticompetitive restraints"). "Determining whether there is ease of entry hinges upon an analysis of barriers to new firms entering the market or existing firms expanding into new regions of the market." *CCC Holdings,* 605 F.Supp.2d at 47 (quoting *FTC v. Cardinal Health, Inc.,* 12 F.Supp.2d 34, 55 (D.D.C.1998)). In this case, the parties essentially agree that the proper focus of this inquiry is on the likelihood of expansion by existing competitors rather than new entry into the market.[28] *See* Defs.' Post–Trial Mem. at 21–22. Since the government has established its prima facie case, the defendants carry the burden to show that ease of expansion is sufficient "to fill the competitive void that will result if [defendants are] permitted to purchase" their acquisition target. *Swedish Match,* 131 F.Supp.2d at 169.

In describing the competitive landscape, the defendants note there are eighteen companies offering various DDIY products through the FFA. Defs.' Post–Trial Mem. at 22. Most of these companies are very small-time operators, however. ***74** The defendants acknowledge this fact, but nevertheless contend that the companies "TaxSlayer and TaxHawk are the two largest and most poised to replicate the scale and strength of TaxACT." *Id.* at 23. Witnesses from TaxSlayer and TaxHawk were the only witnesses from other DDIY companies to testify at the hearing. As such, the Court's ease of expansion analysis will focus on whether these two competitors are poised to expand in a way that is "timely, likely, and sufficient in its magnitude, character, and scope to deter or counteract" any potential anticompetitive effects resulting from the merger.

TaxHawk runs five different websites, including FreeTaxUSA.com, that all market the same underlying DDIY product. Kimber, TT, 9/12/11 a.m., at 12, 40. TaxHawk was founded in 2001, three years after TaxACT, although it has a significantly smaller market share of 3.2 percent. *Id.* at 11; GX 27. TaxHawk's vice-president and co-founder, Mr. Dane Kimber, testified that the company has the technical infrastructure to grow by five to seven times the number of customers in any given year. Kimber, TT, 9/12/11 a.m., at 21. TaxHawk's marketing strategy relies substantially on search engine advertising and search term optimization, including by using the FreeTaxUSA.com domain name, which contains the keywords "free" and "tax." *See id.* at 19–27. Despite having been in business for a decade, its products are functionally more limited than those of Intuit, HRB, and TaxACT in various ways. *See* PFF ¶ 185. Although TaxHawk services the forms that cover most taxpayers, its program does not service all federal forms, it excludes two states' forms in their entirety, and it does not service city income tax forms for major cities that have income taxes—notably, New York City. Kimber, TT, 9/12/11 a.m., at 44. In fact, Mr. Kimber testified that the company would likely need another decade before its DDIY products could fully support all the tax forms. *Id.* at 45. The reason is that TaxHawk is what Mr. Kimber "like[s] to call ... a 'lifestyle' company. We like the lifestyle we have as owners. We want our employees to have a life, if you will. I do feel we have the expertise to [expand functionality] more rapidly, but we choose not to." *Id.* Mr. Kimber also testified that TaxHawk had suddenly experienced an unprecedented growth rate of over 60 percent since April 2011, *id.* at 20–21, but that the company had not done any analysis to attempt to explain this unanticipated (and presumably welcome) growth. *Id.* at 39.

TaxHawk's relaxed attitude toward its business stands in stark contrast to the entrepreneurial verve that was apparent throughout the testimony of Mr. Dunn and that has been rewarded by the impressive growth of TaxACT over the years. In short, TaxHawk is a very different company from TaxACT. TaxHawk is a small company that has developed a string of search-engine-optimized DDIY websites, which deliver a sufficient income stream to sustain its owners' comfortable lifestyle, without requiring maximal effort on their part. While TaxHawk's decision to prioritize a relaxed lifestyle over robust competition and innovation is certainly a valid one, expansion from TaxHawk that would allow it to compete "on the same playing field" as the merged company appears unlikely. *Chicago Bridge & Iron Co. N.V. v. FTC,* 534 F.3d 410, 430 (5th Cir.2008).

After TaxHawk, TaxSlayer is the next largest DDIY competitor, with a 2.7 percent market share. GX 27. TaxSlayer.com launched in 2003, although the same company started selling a software product to tax professionals several years earlier. Rhodes, TT, 9/12/11 a.m., at 71. TaxSlayer is part of the same corporate family as Rhodes Murphy, a tax firm that provides assisted tax preparation through ***75** sixteen retail offices in the Augusta, Georgia area. *Id.* The company is a family business and James Brian Rhodes, the product manager of TaxSlayer and the son of the company's founder, testified at the hearing. *Id.* at 70, 73. Mr. Rhodes testified that, in the event of an increase in TaxACT's prices or a decrease in its quality, he "believe[s] that [TaxSlayer is] poised and ready to take those customers who would want to go elsewhere for lower prices." *Id.* at 81. TaxSlayer's marketing strategy relies heavily on sponsorship of sporting events, including the Gator Bowl and NASCAR. *Id.* at 75. TaxSlayer typically invests {a significant amount of its budget in marketing}. Rhodes, TT, 9/12/11 a.m. (sealed), at 86, 92. For example, TaxSlayer plans to spend ${redacted} on marketing in 2012 based on 2011 revenues of ${redacted}. *Id.* at 84, 87. Despite this {high} level of marketing spending, TaxSlayer's DDIY market share has not changed substantially since 2006, despite steady growth in TaxSlayer's revenue and number of units sold. *See id.* at 94–96; GX 21–7 (IRS e-file share data chart showing 2.5 percent share for TaxSlayer in 2006 and 2.7 percent in 2010). Rather, TaxSlayer's growth in unit sales and revenue has come from maintaining the same slice of an expanding pie—the growing DDIY market. *See* GX 21–7.

TaxSlayer's stable market share despite its {significant} marketing expenditure as a proportion of revenue points to what the government considers the key barrier to entry in this market—the importance of reputation and brand in driving consumer behavior in purchasing DDIY products. Simply put, tax returns are highly personal documents that carry significant financial and legal consequences for consumers. Consumers, therefore, must trust and have confidence in their tax service provider. As one of TaxACT's bankers put it a confidential memorandum, "[t]ax filers must have confidence that sensitive data is being handled with care and that returns are processed in a secure, error-free and timely manner." GX 125 at 12.

Building a reputation that a significant number of consumers will trust requires time and money. As HRB's former CEO noted, it takes millions of dollars and lots of time to develop a brand. Bennett, TT, 9/6/11 p.m., at 30. TaxACT's offering memoranda also point to the difficulty in building a brand in the industry as a barrier to competition. *See* GX 28–24 at 2SSCORPe–2419 (2009 memorandum stating "With over 11 years of building reliable, robust software solutions, 2SS has created a valuable brand within the online tax preparation market which Management believes would take years of competitive investment to replicate."). In the DDIY industry, the Big Three incumbent players spend millions on marketing and advertising each year to build and maintain their brands, dwarfing the combined spending of the smaller companies. For example, in tax year 2009, Intuit, HRB, and TaxACT collectively spent approximately {over $100 million} on marketing and advertising. GX 29 (Intuit Decl.) ¶ 38; GX 61–22 at 3; GX 138 at 37. By contrast, {TaxSlayer and TaxHawk spent a significantly smaller amount}.[29] Rhodes, ***76** TT, 9/12/11 a.m. (sealed), at 95; GX 25 (TaxHawk Decl.) ¶ 14.

Even TaxACT's successful business strategy has been premised on the notion that it cannot outspend Intuit and HRB on marketing. Dunn, TT, 9/7/11 p.m., at 71–72. The massive marketing expenditures of the two major DDIY firms create high per customer acquisition costs and limit the easy marketing channels that are open to smaller competitors. *See, e.g., id.* at 88–89 (noting that "Web advertising is the most competitive ... I think [TaxACT is] going to get shut out on Yahoo [the popular web portal]. I think Intuit is going to buy it lock, stock and barrel," and explaining that this outcome would hurt TaxACT's business if it doesn't find effective alternative advertising venues). Rather than attempting to outspend HRB and Intuit, TaxACT's growth strategy has largely depended on providing "great customer service, a great product, and a great customer experience" and then relying on word-of-mouth referrals to spread the awareness of the brand. *Id.* at 71–72. This process is inherently time-consuming and difficult to replicate.

In support of their argument that TaxSlayer and TaxHawk are poised to expand in response to a price increase, the defendants emphasize that these companies "are at about the same position in terms of customer base as TaxACT was in 2002, which was the year before it did the Free For All [offer on] the FFA." Meyer, TT, 9/12/11 p.m., at 130. The government points out, however, that there are two flaws in this comparison, even assuming that TaxSlayer and TaxHawk were TaxACT's competitive equals. First, while these companies may have a similar number of customers to TaxACT in 2002 in absolute terms, TaxACT's market share at 8 percent was already significantly larger than the market shares of these firms today, despite the fact that TaxACT had been in the market for fewer years. *See* GTX 17.

Second, the DDIY market has matured considerably since 2002, in parallel with the general ripening of various online industries during the past decade. Notably, the pool of pen-and-paper customers has dwindled as DDIY preparation has grown. Thus, the "low hanging fruit" of DDIY customer acquisition may have been plucked. *See* GX 296 (Houseworth Dep.) at 66–68 (noting that "there's probably only two or three years of continued mid teens category growth for online" because of the shrinking pool of new potential customers that can be converted from the pen-and-paper method). This trend suggests existing market shares may become further entrenched and that growing market share may be even harder, especially because there are barriers to switching from one DDIY product to another. For example, the hearing evidence showed that it is difficult to import prior-year tax return data across DDIY brands. If a taxpayer uses, say, TurboTax or TaxACT in one year, then when the taxpayer returns the next year, the program can automatically import the prior year's data, which is not only convenient but can also help the taxpayer identify useful tax information, such as carry forwards and available deductions. Dunn, TT, 9/8/11 a.m., at 111–14. Currently, it is not possible to import much of this data if the taxpayer switches to a competitor's product. *Id.* Thus, this feature lends a "stickiness" to each particular DDIY product once a customer has used it.

Upon consideration of all of the evidence relating to barriers to entry or expansion, the Court cannot find that expansion is likely to avert anticompetitive effects from the transaction. The Court will next consider whether the evidence supports a likelihood ***77** of coordinated or unilateral anticompetitive effects from the merger.

b. Coordinated Effects

Merger law "rests upon the theory that, where rivals are few, firms will be able to coordinate their behavior, either by overt collusion or implicit understanding in order to restrict output and achieve profits above competitive levels." *CCC Holdings,* 605 F.Supp.2d at 60 (quoting *Heinz,* 246 F.3d at 715). The government argues that the "elimination of TaxACT, one of the 'Big 3' Digital DIY firms" will facilitate tacit coordination between Intuit and HRB. Pl.'s Post–Trial Mem. at 15. "Whether a merger will make coordinated interaction more likely depends on whether market conditions, on the whole, are conducive to reaching terms of coordination and detecting and punishing deviations from those terms." *CCC Holdings,* 605 F.Supp.2d at 60 (internal quotation omitted). Since the government has established its prima facie case, the burden is on the defendants to produce evidence of "structural market barriers to collusion" specific to this industry that would defeat the "ordinary presumption of collusion" that attaches to a merger in a highly concentrated market. *See Heinz,* 246 F.3d at 725.

The defendants argue the primary reason that coordinated effects will be unlikely is that Intuit will have no incentive to compete any less vigorously post-merger. The defendants assert that the competition between Intuit and HRB's retail stores would be "fundamentally nullified if Intuit decided to reduce the competitiveness of TurboTax." Defs.' Post–Trial Mem. at 17. Further, defendants contend that Intuit has no incentive to reduce the competitiveness of its free product because it views its free product as a critical driver of new customers. *Id.* at 17–18 Therefore, the defendants conclude that if HRB does not compete as aggressively as possible with its post-merger products, it will lose customers to Intuit. *Id.* at 18.

The most compelling evidence the defendants marshal in support of these arguments consists of documents and testimony indicating that Intuit engaged in a series of "war games" designed to anticipate and defuse new competitive threats that might emerge from HRB post-merger. *See* GX 293 (Intuit Dep.) at 98–101; DX 84. The documents and testimony do indicate that Intuit and HRB will continue to compete for taxpayers' patronage after the merger—indeed, in the DDIY market, they would be the only major competitors. This conclusion, however, is not necessarily inconsistent with some coordination. As the Merger Guidelines explain, coordinated interaction involves a range of conduct, including unspoken understandings about *how* firms will compete or refrain from competing. *See* Merger Guidelines § 7.

In this case, the government contends that coordination would likely take the form of mutual recognition that neither firm has an interest in an overall "race to free" in which high-quality tax preparation software is provided for free or very low prices. Indeed, the government points to an outline created as part of the Intuit "war games" regarding post-merger competition with HRB that also indicates an Intuit employee's perception that part of HRB's post-merger strategy would be to "not escalate free war: Make free the starting point not the end point for customers." GX 293–13 at INT–DOJ0015942.[30] Since, as defendants point ***78** out, DDIY companies have found "free" offers to be a useful marketing tool, it is unlikely that free offers would be eliminated. Rather, the government argues, it is more likely that HRB and Intuit may find it "in their mutual interest to reduce the quality of their free offerings ... offer a lower quality free product and maintain higher prices for paid products...." PFF ¶ 141.

The government points to a highly persuasive historical act of cooperation between HRB and Intuit that supports this theory. *Cf.* Merger Guidelines § 7.2 ("[M]arket conditions are conducive to coordinated interaction if firms representing a substantial share in the relevant market appear to have previously engaged in express collusion."). After TaxACT launched its free-for-all offer in the FFA, Intuit proposed that the firms in the market limit their free FFA offers, a move which TaxACT opposed and which Mr. Dunn believed was an illegal restraint on trade. Dunn, TT, 9/7/11 p.m., at 79. HRB, Intuit, and others then joined together and successfully lobbied the IRS for limitations on the scope of the free offers through the FFA—limitations that remain in place today. Ernst, TT, 9/7/11 a.m., at 26–27; Warren–Boulton, TT, 9/9/11 p.m., at 78. This action illustrates how the pricing incentives of HRB and Intuit differ from those of TaxACT and it also shows that HRB and Intuit, although otherwise competitors, are capable of acting in concert to protect their common interests.

The defendants also argue that coordinated effects are unlikely because the DDIY market consists of differentiated products and has low price transparency. *See CCC Holdings,* 605 F.Supp.2d at 62 (recognizing the importance of price transparency to the likelihood of coordinated effects). To the contrary, the record clearly demonstrates that the players in the DDIY industry are well aware of the prices and features offered by competitors. Since DDIY products are marketed to a large swath of the American population and available via the Internet, DDIY firms can easily monitor their competitors' offerings and pricing. The fact that competitors may offer various discounts and coupons to some customers via email hardly renders industry pricing "not transparent," as defendants submit. *See* Defs.' Post–Trial Mem. at 21. Moreover, while collusion may, in some instances, be more likely in markets for homogenous products than differentiated products, product differentiation in this market would not necessarily make collusion more difficult. *See Heinz,* 246 F.3d at 716–17, 724–25 (finding likelihood of coordinated effects in product market differentiated by brand); *see also CCC Holdings,* 605 F.Supp.2d at 65 n. 42 ("[T]acit collusion may be easier when products are differentiated.") (quoting Lawrence A. Sullivan & Warren S. Grimes, *The Law of Antitrust: An Integrated Handbook,* § 11.2e1, at 635 (2d ed. 2006)).

Other indicia of likely coordination are also present in the DDIY market. Transactions ***79** in the market are small, numerous, and spread among a mass of individual consumers, each of whom has low bargaining power; prices can be changed easily; and there are barriers to switching due to the "stickiness" of the DDIY products. *See CCC Holdings,* 605 F.Supp.2d at 65–66 (discussing these factors as characteristic of markets conducive to coordination); *see also supra* Section III.B.2.a (discussing the difficulty of importing data as a barrier to switching from one DDIY product to another).

Finally, the Court notes that the "merger would result in the elimination of a particularly aggressive competitor in a highly concentrated market, a factor which is certainly an important consideration when analyzing possible anti-competitive effects." *Staples,* 970 F.Supp. at 1083; *see also FTC v. Libbey,* 211 F.Supp.2d 34, 47 (D.D.C.2002). The evidence presented at the hearing from all parties demonstrated TaxACT's impressive history of innovation and competition in the DDIY market. Mr. Dunn's trial testimony revealed him to be a dedicated and talented entrepreneur and businessman, with deep knowledge and passion for providing high-quality, low-cost tax solutions. TaxACT's history of expanding the scope of its high-quality, free product offerings has pushed the industry toward lower pricing, even when the two major players were not yet ready to follow—most notably in TaxACT's introduction of free-for-all into the market.

The government presses the argument that TaxACT's role as an aggressive competitor is particularly important by urging this Court to find that TaxACT is a "maverick." *See* Pl.'s Post–Trial Mem. at 18–19. In the context of antitrust law, a maverick has been defined as a particularly aggressive competitor that "plays a disruptive role in the market to the benefit of customers." Merger Guidelines § 2.1.5. The most recent revision of the Merger Guidelines endorses this concept and gives a few examples of firms that may be industry mavericks, such as where "one of the merging firms may have the incentive to take the lead in price cutting or ... a firm that has often resisted otherwise prevailing industry norms to cooperate on price setting or other terms of competition." *Id.*

The parties have spilled substantial ink debating TaxACT's maverick status. The arguments over whether TaxACT is or is not a "maverick"—or whether perhaps it once was a maverick but has not been a maverick recently—have not been particularly helpful to the Court's analysis. The government even put forward as supposed evidence a TaxACT promotional press release in which the company described itself as a "maverick." *See* GX 28–6. This type of evidence amounts to little more than a game of semantic gotcha. Here, the record is clear that while TaxACT has been an aggressive and innovative competitor in the market, as defendants admit, TaxACT is not unique in this role. Other competitors, including HRB and Intuit, have also been aggressive and innovative in forcing companies in the DDIY market to respond to new product offerings to the benefit of consumers. *See* Defs.' Post–Trial Mem. at 20.

The government has not set out a clear standard, based on functional or economic considerations, to distinguish a maverick from any other aggressive competitor. At times, the government has emphasized TaxACT's low pricing as evidence of its maverick status, while, at other times, the government seems to suggest that almost any competitive activity on TaxACT's part is a "disruptive" indicator of a maverick. For example, the government claims that "[m]ost recently, TaxACT continued to disrupt the Digital DIY market by entering the boxed retail software segment of the ***80** market, which had belonged solely to HRB and [Intuit]." Pl.'s Post–Trial Mem. at 19. Credible evidence at the hearing, however, showed {otherwise}. *See* Dunn, TT, 9/8/11 p.m. (sealed), at 4. Moreover, the Court credits Mr. Dunn's explanation that TaxACT has little interest in selling boxed retail software because he believes this market segment is {redacted} not particularly significant. *See* Dunn, TT, 9/7/11 p.m. (sealed), at 123 ({redacted}).

What the Court finds particularly germane for the "maverick" or "particularly aggressive competitor" analysis in this case is this question: Does TaxACT consistently play a role within the competitive structure of this market that constrains prices? *See Staples,* 970 F.Supp. at 1083 (finding "merger would result in the elimination of a particularly aggressive competitor in a highly concentrated market" where the merger would remove competition between "the two lowest cost and lowest priced firms" in the market); Merger Guidelines § 2.1.5 (noting maverick concerns may arise where "one of the merging firms may have the incentive to take the lead in price cutting or [with] ... a firm that has often resisted otherwise prevailing industry norms to cooperate on price setting or other terms of competition."). The Court finds that TaxACT's competition does play a special role in this market that constrains prices. Not only did TaxACT buck prevailing pricing norms by introducing the free-for-all offer, which others later matched, it has remained the only competitor with significant market share to embrace a business strategy that relies primarily on offering high-quality, full-featured products for free with associated products at low prices.

Moreover, as the plaintiff's expert, Dr. Warren–Boulton, explained, the pricing incentives of the merged firm will differ from those of TaxACT pre-merger because the merged firm's opportunity cost for offering free or very low-priced products will increase as compared to TaxACT now. *See* Warren–Boulton, 9/9/11 p.m., at 14–16. In other words, the merged firm will have a greater incentive to migrate customers into its higher-priced offerings—for example, by limiting the breadth of features available in the free or low-priced offerings or only offering innovative new features in the higher-priced products. *See* Commentary on the Horizontal Merger Guidelines (2006) at 24 (noting the importance of asking "whether the acquired firm has behaved as a maverick and whether the incentives that are expected to guide the merged firm's behavior likely would be different.").

While the defendants oppose the government's maverick theory, they do not deny that TaxACT has been an aggressive competitor. Indeed, they submit that "that's why H & R Block wants to buy them." Defs.' Closing Argument, TT, 10/3/11 a.m., at 132. HRB contends that the acquisition of TaxACT will result in efficiencies and management improvements that "will lead to better, more effective, and/or cheaper H & R Block digital products post-merger" that are better able to compete with Intuit. Defs.' Post–Trial Mem. at 17. This argument is quite similar to the argument of the defendants in *Heinz,* which some commentators have described as arguing that the merger would create a maverick. *Heinz,* 246 F.3d at 720–22; *see* Jonathan B. Baker, *Mavericks, Mergers, and Exclusion: Proving Coordinated Competitive Effects Under the Antitrust Laws,* 77 N.Y.U. L.Rev. 135, 184 (2002). While the district court in *Heinz* accepted this argument that the merger would enhance rather than stifle competition, the D.C. Circuit reversed, finding that the "district court's analysis [fell] short of the findings necessary for a successful efficiencies defense" in that case. *Heinz,* 246 F.3d at 721. As ***81** explained more fully in Section III.B.2.d below, the defendants' efficiency arguments fail here for some of the same reasons the D.C. Circuit identified in *Heinz.*

Finally, the defendants suggest that coordinated effects are unlikely because of the ease of expansion for other competitors in the market. As detailed above in the Court's discussion of barriers to entry and expansion, the Court does not find that ease of expansion would counteract likely anticompetitive effects.

Accordingly, the defendants have not rebutted the presumption that anticompetitive coordinated effects would result from the merger. To the contrary, the preponderance of the evidence suggests the acquisition is reasonably likely to cause such effects. *See id.* at 711–12 (finding, in market characterized by high barriers to entry and high HHI figures, that "no court has ever approved a merger to duopoly under similar circumstances.").

c. Unilateral Effects

A merger is likely to have unilateral anticompetitive effect if the acquiring firm will have the incentive to raise prices or reduce quality after the acquisition, independent of competitive responses from other firms. *See Swedish Match,* 131 F.Supp.2d at 169; Merger Guidelines § 6 ("The elimination of competition between two firms that results from their merger may alone constitute a substantial lessening of competition."). "The extent of direct competition between the products sold by the merging parties is central to the evaluation of unilateral price effects." Merger Guidelines § 6.1. As Judge Collyer in *CCC Holdings* explained:

> Unilateral effects in a differentiated product market are likely to be profitable under the following conditions: (1) the products must be differentiated; (2) the products controlled by the *merging* firms must be close substitutes, *i.e.,* "a substantial number of the customers of one firm would turn to the other in response to a price increase"; (3) other products must be sufficiently different from the products offered by the merging firms that a merger would make a small but significant and non-transitory price increase profitable for the merging firm; and (4) repositioning must be unlikely.

605 F.Supp.2d at 68 (citing *Oracle,* 331 F.Supp.2d at 1117–18).[31] Since the Court has already found that the preponderance of the evidence shows a reasonable likelihood

of coordinated effects, the Court need not reach the issue of unilateral effects. *See id.* at 67. The Court will discuss it, however, since there has been substantial argument on this topic and the Court's findings regarding unilateral effects bolster the conclusion that this proposed merger would violate Section 7 of the Clayton Act. As with coordinated effects, since the government has established its prima facie case, the burden is on the defendants to produce evidence showing that the presumption of anticompetitive effects that attaches to a merger in a highly concentrated market is unfounded, but the ultimate burden of proof remains with the government.

i. Elimination of Direct Competition Between the Merging Parties

The government argues that unilateral effects are likely because the merger will eliminate head-to-head competition between HRB and TaxACT that has benefited taxpaying American consumers. Much ***82** of the evidence indicating direct competition between HRB and TaxACT is discussed above in relation to the market definition. *See supra* Section III.A. The government emphasizes that HRB has lowered its DDIY prices to better compete with free online products, the category pioneered by TaxACT, and has directly considered TaxACT's prices in setting its own prices. *See* GX 53 at 2, 8; GX 188; GX 199 at 5–9. HRB has also determined the nature of its free offerings in response to competitive activity from TaxACT. *See, e.g.,* GX 304 at 5 (HRB changed timing of FFA offering in response to TaxACT's offer); GX 44 (recognizing need to compete with TaxACT offerings); GX 79 (comparing contemplated free product description on HRB's website with TaxACT's website); GX 51 at 4 (noting launch of free online products intended "[t]o match competitor offerings and stem online share loss to Intuit and TaxACT"). The government also points to HRB documents that appear to acknowledge that TaxACT has put downward pressure on HRB's pricing ability. *See* GX 296–16 at 20–21 (noting TaxACT's association with the "commoditization of online space" and downward price pressure from commoditization); GX 20 at 11 ({redacted}). From all of this evidence, and the additional evidence discussed in this opinion, it is clear that HRB and TaxACT are head-to-head competitors.

ii. Pledge to Maintain TaxACT's Current Prices

Defendants press a few different arguments against a finding of likely unilateral anticompetitive effects. First, the defendants have pledged to maintain TaxACT's current prices for three years.[32] While the Court has no reason to doubt that defendants would honor their promise, this type of guarantee cannot rebut a likelihood of anticompetitive effects in this case. *See Cardinal Health,* 12 F.Supp.2d at 64 (finding that "even with such guarantees [to maintain prices], the mergers would likely result in anti-competitive prices."). Even if TaxACT's list price remains the same, the merged firm could accomplish what amounts to a price increase through other means. For example, instead of raising TaxACT's prices, it could limit the functionality of TaxACT's products, reserving special features or innovations for higher priced, HRB-branded products. The merged firm could also limit the availability of TaxACT to consumers by marketing it more selectively and less vigorously. Indeed, the defendants concede that one immediate effect of the merger will be the removal of TaxACT from the IRS-sponsored FFA website, a marketing channel whose importance the defendants themselves emphasize in their argument regarding barriers to expansion. *See* Dunn, TT, 9/7/11 p.m., at 76–77; Defs.' Post–Trial Mem. at 22.

iii. Value Versus Premium Market Segments

Second, defendants argue that HRB and TaxACT are not particularly close competitors. The defendants contend that HRB and TaxACT largely compete in distinct segments of the market—with HRB in the higher-priced, "premium" segment and TaxACT in the lower-priced, "value" segment.[33] The defendants also argue that ***83** there can be no unilateral effects because the evidence shows that both TaxACT and HRB are closer competitors to TurboTax than to each other. Defs.' Post–Trial Mem. at 15.

As part of the argument that HRB and TaxACT focus on separate value and premium segments, the defendants argued that for several years in the mid–2000s, HRB was trapped in the "murky middle" between TaxACT's value offerings and Intuit's premium offerings. *See* DX 17 (Meyer Rep.) at 29; Meyer, TT, 9/13/2011 a.m., at 103–107. The defendants argue that, in recent years, HRB has positioned itself more clearly as a premium provider, as evidenced by the fact that the list price of its online federal plus state DDIY product has tracked Intuit's price more closely since 2010. *See* DX 17 (Meyer Rep.) at 29. This comparison is misleading because it focuses solely on the comparison of the list prices for the companies' highest-priced products. *See id.* at 29 n. 116. During the past few years, while HRB has increased the list price of its top-priced DDIY offering, it has also more heavily marketed free products. *See* GX 51 at 4; *see also* Meyer, TT, 9/13/2011 a.m., at 105–106. Accordingly, since 2008, HRB's average DDIY sales price has declined, while the average revenue per paid customer has remained roughly the same. *See* GX 296–7 ("Digital Tax Solutions FY11 Actual Deep Dive") at 1; Meyer, TT, 9/13/11 a.m., at 107–108.

Further, the evidence discussed above indicating direct price and feature competition between HRB and TaxACT negates the conclusion that they operate in separate value and premium segments of the market. There are certainly occasional references to different pricing levels in the defendants' documents. *See* GX 20 at 11 (HRB document noting {redacted}) (emphasis added). This hardly means that the companies are not in close competition, however. Rather, as Mr. Dunn's testimony reflects, TaxACT competes with capital-rich HRB and Intuit by offering high-quality products at substantially lower prices. *See* Dunn, TT, 9/7/11 p.m., at 71–72 (noting that rather than attempting to outspend its richer competitors on marketing, TaxACT's growth strategy has depended on providing "great customer service, a great product, and a great customer experience" for a much lower price, including free). *Id.* This type of healthy competition benefits taxpaying consumers.

The fact that Intuit may be the closest competitor for both HRB and TaxACT also does not necessarily prevent a finding of unilateral effects for this merger. *See* Areeda & Hovenkamp, ¶ 914, 77–80 (explaining that the merging parties need not be the closest rivals for there to be unilateral anticompetitive effects); *see also* Commentary on the Horizontal Merger Guidelines (2006) at 28 ("A merger may produce significant unilateral effects even though a non-merging product is the 'closest' substitute for every merging product ..."). Using a simple estimate of diversion based on market share would indeed suggest that HRB and TaxACT are each other's second closest rivals after Intuit.[34] ***84** *See* GX 121 (Warren–Boulton Rep.) at 44 (explaining that using market share to estimate diversion is a "benchmark" assumption in standard empirical models of consumer demand).

iv. Merged Company's Combined Market Share

Another argument that the defendants present against a likelihood of unilateral effects is that, in their view, unilateral effects cannot be demonstrated where the combined firm's market share does not surpass a certain threshold. The defendants point out that in *Oracle,* the court stated that "[a] presumption of anticompetitive effects from a combined share of 35% in a differentiated products market is unwarranted. Indeed, the opposite is likely true." 331 F.Supp.2d at 1123. The *Oracle* court stated that "[t]o prevail on a differentiated products unilateral effects claim, a plaintiff must prove a relevant market in which the merging parties would have essentially a monopoly or dominant position." *Id.* Some commentators have criticized this standard, however, because "impermissible price increases ... can be achieved on far lower market shares" than *Oracle's* standard evidently requires. Areeda & Hovenkamp ¶ 914, at 84. Indeed, Judge Brown's subsequent opinion from this Circuit in *Whole Foods* implied that a market definition itself may not even be required for proving a Section 7 violation based on unilateral effects. *See* *Whole Foods,* 548 F.3d at 1036. In a footnote, Judge Brown explained that "a merger between two close competitors can sometimes raise antitrust concerns due to unilateral effects in highly differentiated markets. In such a situation, it might not be necessary to understand the market definition to conclude a preliminary injunction should issue."[35] ***85** *Id.* at n. 1 (citation omitted). The Court therefore declines the defendants' invitation, in reliance on *Oracle,* to impose a market share threshold for proving a unilateral effects claim.[36]

v. Post–Merger Dual Brand Strategy

HRB's plans for the post-merger company raise anticompetitive questions. Post-merger, HRB's stated plan is to maintain both the HRB and TaxACT brands—with the HRB-brand focusing on higher priced—products and the TaxACT brand focusing on the lower-priced products. *See* Bennett, TT, 9/6/11 a.m., 101–102; DX 1005 at 1. HRB's general pre-merger pricing strategy has been to price its products a bit below Intuit's products. Bennett, TT, 9/6/11 a.m., at 99. Part of HRB's post-merger strategy, however, appears to involve raising prices on HRB-branded products. Under this two-brand strategy, HRB would price its "premium" HRB-branded products equal to or above Intuit's prices. *See* Bennett, TT, 9/6/11 a.m., 101–102; DX 1005 at 1. At the same time, the company would "offer TaxACT as its free and value brand." DX 17 (Meyer Rep.) at 78. Yet, the defendants have never convincingly explained how this two-brand strategy would work in practice because defendants have repeatedly emphasized how important "free" product offerings are for all DDIY brands. *See* DFF ¶ 185 ("Free is a highly profitable method of acquiring customers for H & R

Block."); DX 600 at 10 (HRB Board of Directors presentation for merger approval stating that after the merger TaxACT would be the "low cost value provider focused on free" but that the company would "[c]ontinue to offer a free product in the HRB brand to drive client acquisition").

Part of the government's concern with HRB's two-brand strategy is that the incentives for the combined firm in marketing and developing the TaxACT product would be quite different from the incentives that exist in the current market. HRB may feel comfortable raising its "premium" prices because it knows that consumers looking for lower-cost DDIY options would be most likely to migrate to TaxACT, the established "value leader" in the market. Since HRB will also control TaxACT post-merger, however, HRB can still ensure that TaxACT's value proposition does not get "too good" and undermine the paid HRB products with the highest profit margins. For example, HRB might restrict the features of TaxACT's free and low-cost products to ensure they do not cannibalize sales of HRB's higher priced offerings. Indeed, assuming that there are high barriers to entry and expansion, this strategy would appear logical because it would maximize HRB's profit per customer. Post-merger, TaxACT will not have the same incentives it has today to develop robust free and low-cost offerings that can compete with the functionality offered by HRB and Intuit. *See* Warren–Boulton, TT, 9/8/11 p.m., at 32–33. Thus, this merger could potentially have the effect of stifling price and feature competition compared with maintaining TaxACT as an independent firm.

***86 vi. Merger Simulation Shows Likely Unilateral Price Increase**

The government's expert economist, Dr. Warren–Boulton, did a merger simulation analysis that suggests a unilateral price increase is likely. Warren–Boulton, TT, 9/9/11 a.m., at 5–11; GX 121 (Warren–Boulton Rep.) at 52. The key factors in this simulation are HRB and TaxACT's price-cost margins and the diversion ratios between their products. *Cf.* Swedish Match, 131 F.Supp.2d at 169 ("High margins and high diversion ratios support large price increases, a tenet endorsed by most economists.").

(a). Diversion Ratios Between the Merging Parties' DDIY Products

As explained above, the diversion rate from TaxACT to HRB measures the proportion of customers that would leave TaxACT in response to a price increase and switch to HRB. Dr. Warren–Boulton's report explains that higher diversion rates between merging parties "allow the firms to recapture more lost sales following a price increase, and therefore lead to greater upward pricing pressure and post-merger unilateral price increases." GX 121 (Warren–Boulton Rep.) at 44. Dr. Warren–Boulton estimated diversion ratios from two sources: the parties' DDIY market share data and the IRS switching data.[37] *Id.* at 44–48.

By assuming diversion rates in accordance with market share, Dr. Warren–Boulton estimated the diversion rate from TaxACT to HRB to be 12 percent and from HRB to TaxACT to be 14 percent. *Id.* at 44–45. Dr. Warren–Boulton notes that these diversion estimates likely underestimate what the actual post-merger diversion rates will be since the merged company will likely implement marketing strategies to keep customers within the umbrella of the combined company. *Id.* at 45.

Dr. Warren–Boulton estimated diversion ratios using IRS switching data as well. As discussed above in Section III.A.3.a, he also used this switching data to test the relevant market definition. As previously noted in that prior discussion, switching data is not equivalent to diversion, since diversion measures switching in response to a price increase as opposed to all switching generally. In particular, Dr. Warren–Boulton found that switching data is especially likely to overstate diversion from DDIY products to assisted preparation. *Id.* at 46–47. Therefore, Dr. Warren–Boulton discounted the switching rates from DDIY to assisted by half to correct for this effect.[38] *Id.* After this correction, Dr. Warren–Boulton calculated estimated diversion rates from TaxACT to HRB and from HRB to TaxACT of 12 percent. *Id.* at 47–48.

(b). Price–Cost Margins

The next step in his analysis was to estimate the firms' price-cost margins. "All else equal, higher margins lead to greater unilateral price increases because ***87** the value of recaptured sales is higher." *Id.* at 48. Using a procedure described in his report, Dr. Warren–Boulton estimated {that the merging parties have high margins}. *Id.* at 49. The merger simulation also required quantities of units sold and average revenue per unit. Dr. Warren–Boulton obtained this data from the companies' submissions. *Id.* at 50.

(c). Simulation Results

Using all of these data, Dr. Warren–Boulton performed a linear demand Bertrand model simulation. *Id.* at 51. Unless there are significant efficiencies from the merger that are passed on to consumers, this simulation predicts a unilateral price increase.[39] *Id.* at 52. Assuming diversion ratios according to market share, the model predicts TaxACT's price will increase by 12.2 percent and HRB's price by 2.5 percent. *Id.* Assuming diversion ratios based on the IRS switching data as discussed above, the model predicts TaxACT's price will increase by 10.5 percent and HRB's price by 2.2 percent. *Id.*

(d). Critique of the Simulation's Unilateral Effects Results

The defendants attack Dr. Warren–Boulton's simulation on several grounds. The defendants reiterate their critique that switching data is an inappropriate proxy for diversion data. Further, defendants criticize the way in which Dr. Warren–Boulton discounted the switching rates from DDIY products to assisted preparation. *See* Warren–Boulton, TT, 9/9/9 p.m., at 60–65. In addition, the defendants contend that Dr. Warren–Boulton's simulator model is flawed because it will always predict a price increase with any positive diversion and because the model is "static," does not take various factors into account, such as the parties' different products, innovation, and marketing, and would never predict that a firm would offer free products, even though free products are a staple of the industry. DX 17 (Meyer Rep.) at 74–75.

The Court agrees that Dr. Warren–Boulton's discounting by half of the switching data from DDIY to assisted appears imprecise. Dr. Warren–Boulton clarified in his report, however, that "the model still predicts significant unilateral harm when non-discounted switching rates are used to approximate diversion rates." GX 121 (Warren–Boulton Rep.) at 47. Further, and more importantly, Dr. Warren–Boulton also estimated diversion ratios based on market share and the Court has concluded above that DDIY is the appropriate relevant product market.[40]

As for the defendants' critiques about Dr. Warren–Boulton's economic model itself, Dr. Warren–Boulton addressed these directly. First, insofar as the model will predict at least some price increase absent efficiencies with any positive diversion ratios, Dr. Warren–Boulton explained that outcome is fully consistent with correct economic theory. GX 665 (Warren–Boulton Reply Rep.) at 14 ("Economic theory concludes that absent merger specific efficiencies, a merger between competing firms will cause the merging firms to increase their prices by at least some ***88** amount. Thus, it is not a deficiency, but a strength, of merger simulation models that they reflect this aspect of economic reality."). In response to the critique that his "static" model would never predict that companies would offer free products, Dr. Warren–Boulton contends that because free DDIY products are often packaged with other paid products, these "free" products actually provide the companies with a positive average revenue per free unit, which his model does take into account. *See id.* at 14–15. As for the remaining critiques that the model does not factor in marketing or innovation, Dr. Warren–Boulton replies that any model is inherently a simplification of the real world, but there is no reason to assume these factors negate the price effect findings of the model. *Id.*

The Court finds that the merger simulation model used by the government's expert is an imprecise tool, but nonetheless has some probative value in predicting the likelihood of a potential price increase after the merger. The results of the merger simulation tend to confirm the Court's conclusions based upon the documents, testimony, and other evidence in this case that HRB and TaxACT are head-to-head competitors, that TaxACT's competition has constrained HRB's pricing, and that, post-merger, overall prices in the DDIY products of the merged firms are likely to increase to the detriment of the American taxpayer.

vii. Repositioning Unlikely to Defeat Unilateral Price Increase

Repositioning by smaller competitors in response to a unilateral price increase is unlikely for the same reasons discussed above regarding barriers to entry and expansion. *See* Merger Guidelines § 6.1 ("Repositioning is a supply-side response that is evaluated much like entry, with consideration given to timeliness, likelihood, and sufficiency.").

Repositioning by Intuit is also unlikely due to the coordinated effects incentives discussed above. The Merger Guidelines make clear that a unilateral price increase may be defeated where "non-merging firms [are] able to reposition their products to offer close substitutes for the products offered by the merging firms." Merger Guidelines § 6.1. Since the Court has already found that HRB and Intuit would have coordinated pricing incentives post-merger, that finding implies that repositioning by Intuit would not prevent HRB from raising prices. By relying on its finding of coordinated effects to predict the likelihood of repositioning by Intuit, the Court acknowledges that its unilateral effects finding is not strictly "unilateral" in the sense that it does take coordination into account. The case law and the Merger Guidelines, however, require that "repositioning" be considered in assessing unilateral effects, and the repositioning inquiry necessarily entails a consideration of the likely actions of other competitors in response to a price increase. *See CCC Holdings, Inc.,* 605 F.Supp.2d at 67 (noting that the distinction between coordinated and unilateral effects "has more significance in law than it does in economics" and citing expert testimony describing the distinction as "artificial").

viii. Finding Unilateral Anticompetitive Effects Likely

On balance, and considering the evidence as a whole, the Court finds that, absent efficiencies, the plaintiff has demonstrated a reasonable likelihood of unilateral effects by a preponderance of the evidence. *See Swedish Match,* 131 F.Supp.2d at 169 (finding likelihood of unilateral price increase where merger would eliminate one of the larger merging firm's "primary ***89** direct competitors," "the third largest selling" brand "that has consistently played a role in constraining the price" of the larger firm's products); *see also Staples,* 970 F.Supp. at 1083 (finding anticompetitive effects where the "merger would eliminate significant head-to-head competition between the two lowest cost and lowest priced firms in the ... market.").

The Court will now turn to the defendants' final rebuttal argument—the existence of significant, merger-specific efficiencies.

d. Post–Merger Efficiencies

One of the key benefits of a merger to the economy is its potential to generate efficiencies. *See Heinz,* 246 F.3d at 720. As the Merger Guidelines recognize, merger-generated efficiencies can "enhance the merged firm's ability and incentive to compete, which may result in lower prices, improved quality, enhanced service, or new products." Merger Guidelines § 10. Courts have recognized that a showing of sufficient efficiencies may rebut the government's showing of likely anticompetitive effects. *Heinz,* 246 F.3d at 720. High market concentration levels require "proof of extraordinary efficiencies," however, and courts "generally have found inadequate proof of efficiencies to sustain a rebuttal of the government's case." *Id.* (citation omitted).

"[T]he court must undertake a rigorous analysis of the kinds of efficiencies being urged by the parties in order to ensure that those 'efficiencies' represent more than mere speculation and promises about post-merger behavior." *Id.* at 721. As the Merger Guidelines explain, "[c]ognizable efficiencies are merger-specific efficiencies that have been verified and do not arise from anticompetitive reductions in output or service." Merger Guidelines § 10. Efficiencies are inherently "difficult to verify and quantify" and "it is incumbent upon the merging firms to substantiate efficiency claims" so that it is possible to "verify by reasonable means the likelihood and magnitude of each asserted efficiency, how and when each would be achieved (and any costs of doing so), how each would enhance the merged firm's ability and incentive to compete, and why each would be merger-specific." *Id.* In other words, a "cognizable" efficiency claim must represent a type of cost saving that could not be achieved without the merger and the estimate of the predicted saving must be reasonably verifiable by an independent party.

The defendants claim that "H & R Block's primary motivation for the TaxACT acquisition is to achieve significant synergies that will enable H & R Block to provide better products at a lower price and to compete more effectively."[41] Defs.' Post–Trial Mem. at 24. The defendants predict that they will achieve over ${redacted} million in annual efficiencies in ten different areas.[42] *Id.* at 24–25.

The chart below summarizes the defendants' claimed efficiencies and predicted annual cost savings:

Efficiency	Description	Estimated Annual Cost Saving
1. Online IT	{redacted}	${redacted} million

2. Emerald Card	Allowing TaxACT's prepaid debit card offerings to be fulfilled through HRB's bank	${redacted} million
3. H & R Block Bank Refund Anticipation Checks	Funding TaxACT's refund anticipation checks through HRB's bank	${redacted} million
4. {redacted}	{redacted}	${redacted} million
5. {redacted}	{redacted}	${redacted} million
6. {redacted}	{redacted}	${redacted} million
7. Corporate Website	{redacted}	${redacted} million
8. Software IT	{redacted}	${redacted} million
9. Download Fulfillment	{redacted}	${redacted} million
10. {redacted}	{redacted}	${redacted} million

***90** DFF ¶ 292; *see also* DX236–007.

Dr. Mark E. Zmijewski, an expert witness for the government, analyzed the defendants' alleged efficiencies and concluded that—with the exception of {one efficiency related to eliminating third-party contracts}—the proposed efficiencies identified by the defendants are either not merger-specific or not verifiable.[43] *See generally* GX 664 (Zmijewski Rep.).

The Court agrees with Dr. Zmijewski that the defendants have not demonstrated that their claimed efficiencies are merger-specific. If a company could achieve certain cost savings without any merger at all, then those stand-alone cost savings cannot be credited as merger-specific efficiencies. The defendants must show that their "efficiencies ... cannot be achieved by either company alone because, if they can, the merger's asserted benefits can be achieved without the concomitant loss of a competitor." *Heinz,* 246 F.3d at 722. For example, if HRB's {redacted} are not running in the most efficient, cost-effective manner, it is hard to see why a merger with TaxACT is necessary to improve their cost structure. The reasons HRB claims it has higher {redacted} costs than TaxACT include (1) that TaxACT has lower labor costs in Cedar Rapids than HRB has in Kansas City and (2) that TaxACT is simply more cost conscious. Bowen, TT, 9/15/11 p.m., (sealed), at 104–105. Plainly, then, HRB could therefore achieve at least some of the {redacted} cost savings on its own—by relocating {redacted} and taking a more cost conscious attitude toward them. Likewise, the efficiencies related to bringing HRB's outsourced {redacted} functions in-house are unlikely to be wholly merger-specific.

Similarly, the defendants' IT-related efficiencies, which account for the largest efficiency claims, are not entirely merger-specific either. Both TaxACT and HRB witnesses testified that {redacted}—suggesting that the platform consolidation would result in at least some merger-specific efficiencies. *See* Dunn, TT, 9/8/11 p.m. (sealed), at 16–17; Bowen, TT, 9/15/11 p.m. (sealed), at 67–68. One way in which {redacted}. Dunn, TT, 9/8/11 p.m. (sealed), at 16–17; Bowen, TT, 9/15/11 p.m. (sealed), at 67–68; Bowen, TT, 9/19/11 a.m., at 12. Thus, the IT consolidation efficiency actually can be thought of as entailing two distinct consolidations: (1) ***91** {redacted} and (2) HRB's platform will be merged with TaxACT's platform. Bowen, TT, 9/19/11 a.m., at 12. Yet the claimed IT efficiency is not discounted for whatever savings HRB could obtain by {performing the first consolidation} on its own—an option the company considered in the past but did not adopt—and the defendants did not present evidence explaining why, as a technical matter, {performing the first consolidation} would not be feasible or, in fact, would not be more feasible than {the double consolidation}. Bowen, TT, 9/19/11 a.m., at 12; 9/15/11 p.m. (sealed) at 75. The IT efficiencies also apparently account for cost reductions associated with TaxACT's more cost-conscious culture and practices. *See* Dunn, TT, 9/8/11 a.m. (sealed), at 5 ("for Block to achieve these [efficiencies] would require them to come up with an entirely different corporate culture {redacted}.").

Even if the efficiencies were entirely merger-specific, many of them are also not independently verifiable. As Dr. Zmijewski explained, for the various efficiencies that involve the activities now performed by HRB or its vendors that are proposed to be transferred to TaxACT, TaxACT's predicted cost figures for taking over these activities were not based on an analysis of facts that could be verified by a third party. Instead, TaxACT based its cost estimates on management judgments. GX 664 (Zmijewski Rep.) at 22–25. By comparison, HRB's estimated costs for the relevant activities were rooted in accounting and planning documents prepared in the ordinary course of business.

The testimony at the hearing confirmed that TaxACT's recurring cost estimates were largely premised on its managers experiential judgment about likely costs, rather than a detailed analysis of historical accounting data. *See, e.g.,* Dunn, TT, 9/8/11 p.m. (sealed), at 28–31. While reliance on the estimation and judgment of experienced executives about costs may be perfectly sensible as a business matter, the lack of a verifiable method of factual analysis resulting in the cost estimates renders them not cognizable by the Court. If this were not so, then the efficiencies defense might well swallow the whole of Section 7 of the Clayton Act because management would be able to present large efficiencies based on its own judgment and the Court would be hard pressed to find otherwise. The difficulty in substantiating efficiency claims in a verifiable way is one reason why courts "generally have found inadequate proof of efficiencies to sustain a rebuttal of the government's case." *Heinz,* 246 F.3d at 720 (citation omitted); *see also Staples,* 970 F.Supp. at 1089 (finding "defendants failed to produce the necessary documentation for verification" of efficiencies).

Particular scrutiny of HRB's efficiencies claims is also warranted in light of HRB's historical acquisitions. In 2006, HRB acquired a software company called TaxWorks, which was renamed "RedGear." Bowen, TT, 9/15/11 p.m. (sealed), at 84. For the RedGear acquisition, which was much smaller in scale than the proposed TaxACT deal, HRB projected a total of $ {redacted} million in efficiencies over three years. GX 1459 (February 2009 "Taxworks Financial Analysis") at 5. HRB failed to achieve these {efficiencies} {redacted}. *Id.* In this case, the efficiency estimates are much more aggressive, in that defendants are claiming approximately ${redacted} million in efficiencies for 2013 and ${redacted} million in annual savings going forward thereafter, as opposed to ${redacted} million over three years. *See* Bowen, TT, 9/15/11 p.m. (sealed), at 77–78. While HRB has attempted to learn from the mistakes of the RedGear acquisition, *id.* at 85–87, the Court finds that this history only underscores ***92** the need for any claimed efficiencies to be independently verifiable in order to constitute evidence that can rebut the government's presumption of anticompetitive effects.

Considering all of the evidence regarding efficiencies, the Court finds that most of the defendants' claimed efficiencies are not cognizable because the defendants have not demonstrated that they are merger-specific and verifiable.[44]

IV. CONCLUSION

The Court concludes that the proposed merger between HRB and TaxACT violates Section 7 of the Clayton Act because it is reasonably likely to cause anticompetitive effects. The law of this Circuit supports this conclusion. In *Heinz,* the Court of Appeals reversed a district court's denial of a preliminary injunction against a merger involving the second- and third-largest jarred baby food companies. 246 F.3d at 711–12. After noting the high barriers to entry and high HHI figures that characterized the market, the D.C. Circuit observed that "[a]s far as we can determine, no court has ever approved a merger to duopoly under similar circumstances." *Id.* at 717. The situation in this case is similar. The government established a prima facie case indicating that anticompetitive effects are likely to result from the merger. The defendants have not made a showing of evidence that rebuts the presumption of anticompetitive effects by demonstrating that the government's market share statistics give an inaccurate account of the merger's probable effects on competition in the relevant market. To the contrary, the totality of the evidence confirms that anticompetitive effects are a likely result of the merger, which would give H & R Block and Intuit control over 90 percent of the market for digital do-it-yourself tax preparation products.

Accordingly, the Court will enjoin H & R Block's proposed acquisition of TaxACT. An appropriate Order will accompany this Memorandum Opinion.

All Citations

833 F.Supp.2d 36, 2011-2 Trade Cases P 77,678

Footnotes

1 The Court provided this Memorandum Opinion to the parties in final form on October 31, 2011, but public release was delayed to ensure that no confidential business information that had been submitted under seal was released. Based on input from the parties, confidential business information has been redacted from the opinion, with such redactions reflected by the insertion of the text "{redacted}." In some instances, redacted confidential business information has been replaced by more general language that reflects the same underlying concepts without revealing the confidential business information. Such substitutions are indicated by braces surrounding the substituted text.

2 In this opinion, the Court will use the abbreviations "GX", "GTX", "DX", and "DTX" to refer to the government's exhibits, the government's trial exhibits, the defendants' exhibits, and the defendants' trial exhibits, respectively. "TT" refers to trial testimony. "PFF" refers the plaintiff's proposed findings of fact. "DFF" refers to the defendants' proposed findings of fact.

3 The denomination of different years in the tax industry can be somewhat confusing. Tax returns are typically due in the month of April following the relevant tax year. Thus, each "tax season" refers to the period when returns for the prior "tax year" are generally completed. For example, "tax season 2010" refers to returns filed primarily in early 2010, corresponding to income earned in "tax year 2009."

4 The business model of offering free products and then soliciting customers to purchase additional, related features or services is sometimes referred to as "freemium." *See* GX 130 ("H & R Block Strategic Planning Working Session, April 16 & 17, 2010") at 103 (" 'Freemium' is a known market dynamic that has arisen in multiple product categories and will continue to grow.").

5 Two current Supreme Court justices, in their prior capacities as judges on the Court of Appeals, participated in the D.C. Circuit's ruling in *Baker Hughes.* Then–Judge Clarence Thomas wrote the opinion and then-Judge Ruth Bader Ginsburg joined in it.

6 In their closing argument, the defendants chided the government for citing Clayton Act Section 7 cases brought by the Federal Trade Commission for the relevant standard to apply in this case rather than citing to *United States v. Baker Hughes Inc.,* 908 F.2d 981, 982–83 (D.C.Cir.1990), a case brought by the DOJ. Since this Circuit's FTC precedents themselves rely heavily on the analytical approach set forth in *Baker Hughes,* the defendants' distinction on this point is ultimately of little import. *See FTC v. H.J. Heinz Co.,* 246 F.3d 708, 715 (D.C.Cir.2001) ("In *United States v. Baker Hughes Inc.,* 908 F.2d 981, 982–83 (D.C.Cir.1990), we explained the analytical approach by which the government establishes a section 7 violation."). While a lesser showing is required to obtain preliminary relief in an FTC preliminary injunction case, as opposed to a full merits trial like this case, the Court must apply the *Baker Hughes* analytical framework in either type of Section 7 case.

7 "A relevant market has two components: (1) the relevant product market and (2) the relevant geographic market.... The 'relevant geographic market' identifies the geographic area in which the defendants compete in marketing their products or services." *FTC v. CCC Holdings, Inc.,* 605 F.Supp.2d 26, 37 (D.D.C.2009). The parties have stipulated that the relevant geographic market in this case is worldwide. Joint Pre–Hearing Statement ¶ IX, C, 12. DDIY products are provided online and can be used by any individual worldwide—either within the United States or abroad—who needs to prepare and file a U.S. tax return. The products at issue in this case are not used for preparation of foreign tax returns. *See* Pl.'s Mot. For Prelim. Inj. at 29–30. The Court accepts the parties' stipulation as to the relevant geographic market.

8 Courts have sometimes referred to such markets-within-markets as "submarkets." *See Brown Shoe,* 370 U.S. at 325, 82 S.Ct. 1502; *Whole Foods,* 548 F.3d at 1037–38 (Brown, J.). Other courts and commentators have criticized this "submarket" terminology as unduly confusing, however. *See* 5C Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law ¶ 533, at 251 (3d ed. 2007) ("Courts sometimes describe the closest substitutes as a 'submarket' within a larger 'market' of less-close substitutes. Although degrees of constraint do in fact vary, the 'market' for antitrust purposes is the *one* relevant to the particular legal issue at hand.") (internal citations omitted); *Geneva Pharms. Tech. Corp. v. Barr Labs., Inc.,* 386 F.3d 485, 496 (2d Cir.2004) ("The term 'submarket' is somewhat of a misnomer, since the 'submarket' analysis simply clarifies whether two products are in fact 'reasonable' substitutes and are therefore part of the same market.").

9 The D.C. Circuit's decision in *Whole Foods* lacked a majority opinion. *See Whole Foods,* 548 F.3d at 1061 n. 8 (Kavanaugh, J., dissenting). Judges Brown and Tatel filed separate opinions concurring in the judgment to reverse the District Court and Judge Kavanaugh, in dissent, would have affirmed. *See id.* at 1032 (Brown, J.); *id.* at 1041 (Tatel, J.); *id.* at 1051 n. 1 (Kavanaugh, J., dissenting). Thus, in referring to the opinions in *Whole Foods,* the Court will indicate the name of the Judge whose opinion is cited.

10 The Merger Guidelines are not binding upon this Court, but courts in antitrust cases often look to them as persuasive authority. *See Staples,* 970 F.Supp. at 1081–82.

11 The defendants' primary argument for inclusion of both assisted and pen-and-paper in the relevant market is based upon their economic expert's analysis of data derived from two consumer surveys commissioned by the defendants. The Court will analyze the arguments of the defendants' expert economist separately below.

12 *See* GX 128 (HRB "TS 10 Market Dynamics" presentation) at 38 { redacted}; *see also id.* {redacted}; GX 293 (Intuit Dep.) at 21:9–14 ("The average price of a tax store is in the range of $200."); Bennett, TT, 9/6/11 p.m., at 100 (estimating $150 range for assisted returns offered at Jackson Hewitt and HRB offices at Wal–Mart locations).

13 By "net-net," Mr. Bennett meant that while there is customer switching between the DDIY and assisted businesses, the total share of customers in each has been relatively stable over the past few years, such that Mr. Bennett could conclude that the two business lines "do not steal customers back and forth net." Bennett, TT, 9/6/11 a.m., at 108.

14 The plaintiff presented expert testimony on market definition from Frederick R. Warren–Boulton, an economist at MiCRA, an economics consulting and research firm. GX 121 (Warren–Boulton Rep.) at 1. Dr. Warren–Boulton holds a B.A. from Yale University, a Ph.D. in economics from Princeton University, and formerly served as the chief economist for the Antitrust Division of the U.S. Department of Justice. *Id.* Dr. Warren–Boulton has previously served as an expert witness in other antitrust cases, including cases challenging the possible anticompetitive effects of a merger or acquisition. *Id.* (noting involvement in *FTC v. Staples, Inc.,* 970 F.Supp. 1066, 1074 (D.D.C.1997)).

The defendants presented expert testimony from Christine Siegwarth Meyer, an economist at National Economic Research Associates, Inc., an economics consulting and research firm. DX 17 (Meyer Rep.) at 1. Dr. Meyer holds a B.A. from the United States Military Academy at West Point, a Ph.D. in economics from the Massachusetts Institute of Technology, and has taught economics at the university level. *Id.* Dr. Meyer has not previously provided expert testimony regarding the possible anticompetitive effects of a merger or acquisition. Meyer, TT, 9/13/11 a.m., at 39.

15 Switching, as discussed further below, refers to the switching of consumers between different products for any reason. The IRS categorizes tax returns into one of three complexity categories: Simple, Intermediate, and Complex. Accordingly, the IRS data only reflects complexity changes that are sufficient to result in assignment to a different one of the three categories.

16 One limitation in the IRS data set is that if a taxpayer uses a DDIY product to prepare the return, but then prints and mails the return instead of e-filing it, the IRS does not attribute the filing to the DDIY provider and instead lists it in a generic "v-coded" pool of returns. At the hearing, the defendants' criticized the IRS switching data set as problematic on these grounds, suggesting that up to 30 million returns may be "v-coded." *See* Warren–Boulton, TT 9/20/11 a.m., at 21–22. As Dr. Warren–Boulton fully addressed in his expert report, however, a "conservative method for dealing with this issue is to drop all v-coded returns from the analysis," which would still leave well over 100 million returns in the IRS data set. *Id.;* GX 121 (Warren–Boulton Rep.) at 47. The defendants did not identify any reason the v-coded data would be likely to skew the data set. Thus, even if the v-coded data is disregarded, the IRS data set remains extensive and reliable. It is also worth noting that the IRS data does not distinguish between the DDIY providers' various products, so only firm-level switching rates are available. GX 121 (Warren–Boulton Rep.) at 47

17 The formula for critical loss is L = X/(X + M), where L is the critical loss, X is the percentage price increase, and M is the hypothetical monopolist's gross margin. Assuming a 50 percent margin, which Dr. Warren–Boulton claims is a conservative estimate for firms in the DDIY market, then the critical loss for a 10 percent SSNIP is 16.7 percent. 16.7 percent is the result of applying 10 percent and 50 percent in the formula X/(X+M): .167 = .1/(.1+.5).

18 These are the last two years for which this data was available.

19 The defendants also referred obliquely in cross examination to an academic debate surrounding the proper way to perform critical loss analysis. Warren–Boulton, TT, 9/9/11 p.m., at 23. Dr. Warren–Boulton acknowledged his awareness of the existence of this debate and the defendants' counsel did not pursue the topic further. *Id.* The Court has no basis for disputing Dr. Warren–Boulton's application of critical loss analysis based merely on the existence of unspecified academic critiques. The Court notes that the critical loss analysis is specifically endorsed by the Merger Guidelines as a method for implementing the SSNIP test, *see* Merger Guidelines § 4.1.3, and has been accepted by courts as a standard methodology. *See* *FTC v. CCC Holdings Inc.,* 605 F.Supp.2d 26, 40 n. 16 (D.D.C.2009) ("Critical loss analysis is a standard tool used by economists to study potentially relevant markets."). The court in *CCC Holdings* ultimately did not rely on the expert's application of critical loss analysis due to what the court deemed a "gap" or oversight in the expert's reasoning, but the court nonetheless adopted the same relevant product market that the critical loss analysis had validated. *See* *id.* at 40–41.

20 Dr. Warren–Boulton's merger simulation is addressed further below in the Court's discussion of unilateral effects in Section III.B.2.c.

21 The Best of Both product, as the name implies, actually combines aspects of DDIY and assisted. It enables a return completed on HRB's DDIY product to be reviewed by a tax professional. *See* DX 17 (Meyer Rep.) at 13 n. 44. Thus, it is hardly surprising that this "hybrid" product, which features such exhaustive service, is priced more expensively than a typical DDIY product.

22 Dr. Meyer testified at the hearing that these anomalies are not reflected in the underlying simulator Excel data, but rather appear only in the printouts of simulator data contained in the internal HRB Powerpoint. In addition, Dr. Meyer explained that she redid her calculations excluding the anomalous data and came up with the same conclusions. *See* Meyer, TT, 9/12/11 p.m., at 45–47. Dr. Meyer never identified the source or cause of the anomalies, however. *Id.* at 49.

23 Prior to the hearing in this case, the government filed a motion in limine to exclude this survey from evidence and to limit Dr. Meyer's opinion to the extent it relied on the survey. *See* ECF No. 60. The government argued that the survey's wording and methodology made it inherently unreliable and therefore inadmissible. While the Court noted that the government had identified a number of defects in the methodology and wording of the survey, the Court concluded that these defects did not undermine the survey and the expert's reliance on it so overwhelmingly as to render the survey inadmissible, especially in a bench trial. *See* Memorandum Opinion and Order on Motion in Limine, September 6, 2011, ECF No. 84.

24 The response options varied among four different categories of filers, which are discussed further below. For example, the list of options presented to filers who completed a free federal tax return and no state return were: "I would prepare myself without help," "TurboTax Free Edition," "H & R Block at Home Free Edition," "Free TaxUSA Free Edition," "Complete Tax Free Basic," "An Accountant," "I would use a product on FFA [i.e., Free File Alliance]," "TaxSlayer Free Edition," "Jackson Hewitt Free Basic," "Tax$imple Free Basic," and "Other." GX604 at 2.

25 Dr. Dhar did not testify in person at the hearing, but provided an expert report and affidavit.

26 Of course, the Court remains cognizant that the plaintiff bears the burden of proof in demonstrating the relevant market.

27 For example, Dr. Meyer's description of the pricing simulator survey as one in which the "pricing of the various options changed across scenarios" was inaccurate insofar as several of the most significant products for the purposes of Dr. Meyer's analysis did not have any prices associated with them at all. *See* discussion *supra.*

28 New entrants to the market would not only face all of the barriers to expansion already faced by the existing small firms offering DDIY products, they would also have to develop their own products, including a software platform and a sufficient level of tax expertise. For entry to be considered timely, it typically must occur within approximately two years post-merger. *See* Commentary on the Horizontal Merger Guidelines (2006) at 45–46 (discussing prior Merger Guidelines § 3.2, which specified that timely entry should occur within two years). It is unlikely that an entirely new entrant to the market could compete meaningfully with the established DDIY firms within that time frame.

29 The defendants attempt to reframe this disparity by noting that their calculation of TaxSlayer's projected tax season 2015 marketing budget would slightly surpass the amount of TaxACT's actual 2011 marketing budget. Defs.' Post–Trial Mem. at 23. Setting aside the validity of the defendants' aggressive projections of TaxSlayer's 2015 budget, a proper comparison would have to be founded upon a comparable projection of TaxACT's 2015 budget—not TaxACT's actual 2011 numbers, for which the relevant comparison is TaxSlayer's 2011 numbers.

30 The government also cites an informal analysis written by Adam Newkirk, an analyst for HRB's DDIY business. Mr. Newkirk's analysis hypothesized that one possible reason for HRB to acquire TaxACT was that HRB and Intuit would jointly control a large DDIY market share post-merger and would "both obviously have great incentive to keep this channel profitable," while other potential purchasers of TaxACT "could decide to cut prices even further...." *See* Newkirk, TT, 9/7/11 a.m., at 100; GX 18. The Court finds that the government overemphasized the importance and relevance of Mr. Newkirk's analysis. The hearing testimony showed that Mr. Newkirk is a data analyst who had no decision-making role or authority in relation to the merger and that his discussion about the rationales for the merger was informal speculation. *See* Newkirk, TT, 9/7/11 p.m., at 42–44. Even so, this reasoning—independently reached by Intuit—is essentially a précis of the government's coordinated effects concern.

31 The first criterion in this analysis is satisfied because it is undisputed that DDIY products are differentiated.

32 Before the hearing, the plaintiff filed a motion in limine to exclude evidence relating to this guarantee. ECF No. 44. Following oral argument at the pre-hearing conference, the plaintiff withdrew this motion. *See* Minute Entry dated September 2, 2011.

33 In the defendants' submissions to the Antitrust Division of the DOJ prior to this litigation, the defendants appeared to emphasize this "value" and "premium" distinction as the basis for their definition of the relevant market. *See* GX 135 at 14–15; GX 629 at 18–30. As a result, the government accuses the defendants of having "tacked back and forth" regarding their proposed relevant market definition. Pl.'s Post–Trial Mem. at 1–2. While the Court agrees that the import of the hearing testimony about value and premium products was not always clear, the defendants' counsel clarified during closing arguments that the "only real relevance" of the premium versus value distinction was to show that HRB and TaxACT are not closest the competitors for the purposes of unilateral effects analysis. Defs.' Closing Argument, TT, 10/3/2011 a.m., at 93–94.

34 The relevance of the diversion estimates provided by the expert economists to the unilateral effects analysis is discussed more fully below.

35 "As a matter of applied economics, evaluation of unilateral effects does not require a market definition in the traditional sense at all." Areeda & Hovenkamp ¶ 913a, at 66. This is so because unilateral effects analysis focuses on measuring a firm's market power directly by "estimating the change in residual demand facing the post-merger firm. 'Residual demand' refers to the demand for a firm's goods after the output of all other competing firms has been taken into account." *Id.* at 63. If market power itself can be directly measured or estimated reliably, then in theory market definition is superfluous, at least as a matter of economics, because "[i]dentifying a market and computing market shares provide an indirect means for measuring market power." *Id.* ¶ 532a at 242–43; *see also id.* ¶ 521c. The 2010 revisions to the Merger Guidelines also appear to reflect this understanding. *See* Merger Guidelines § 4 ("The Agencies' analysis need not start with market definition. Some of the analytical tools used by the Agencies to assess competitive effects do not rely on market definition, although evaluation of competitive alternatives available to customers is always necessary at some point in the analysis."). As a legal matter, however, a market definition may be required by Section 7 of the Clayton Act. *See Brown Shoe,* 370 U.S. at 324, 82 S.Ct. 1502 ("[D]etermination of the relevant market is a necessary predicate to a finding of a violation of the Clayton Act because the threatened monopoly must be one which will substantially lessen competition 'within the area of effective competition.' Substantiality can be determined only in terms of the market affected. The 'area of effective competition' must be determined by reference to a product market (the 'line of commerce') and a geographic market (the 'section of the country').") (internal citation omitted); *see also Heinz,* 246 F.3d at 719 n. 17 ("Courts interpret 'line of commerce' [in the language of the Clayton Act] as synonymous with the relevant product market."). The Court is not aware of any modern Section 7 case in which the court dispensed with the requirement to define a relevant product market, although Judge Brown's opinion in *Whole Foods* may be read to endorse this possibility in accordance with the evolving understandings in economics. *See Whole Foods,* 548 F.3d at 1036 (Brown, J.) (stating that the *Baker Hughes* analytical

framework, which “rests on defining a market and showing undue concentration in that market,” “does not exhaust the possible ways to prove a § 7 violation on the merits”).

36 The Commentary on the Merger Guidelines, for its part, explains that while “[a]s an empirical matter, the unilateral effects challenges made by the Agencies nearly always have involved combined shares greater than 35%,” “the Agencies may challenge mergers when the combined share falls below 35% if the analysis of the mergers' particular unilateral competitive effects indicates that they would be likely substantially to lessen competition.” Commentary on the Horizontal Merger Guidelines (2006) at 26. “Combined shares less than 35% may be sufficiently high to produce a substantial unilateral anticompetitive effect if the products are differentiated and the merging products are especially close substitutes....” *Id.*

37 Dr. Warren–Boulton declined to rely on the defendants' proposed diversion data, derived from their consumer surveys, for the reasons already discussed *supra* in Section III.A.3.

38 As a basis for this conclusion that switching data overstates diversion and for his choice to discount the DDIY-to-assisted switching rate by half, Dr. Warren–Boulton relies upon HRB documents that suggest that more than half of switching from DDIY to assisted occurs for reasons unrelated to price, such as a change in tax complexity. GX 121 (Warren–Boulton Rep.) at 46 n. 128 (citing GX 635, GX 126). He also relies on IRS data showing that customers switching from DDIY to assisted were twice as likely to have a complexity increase as taxpayers who stayed within DDIY. *Id.* at 47.

39 As discussed in Section III.B.2.d below, the Court finds most of defendants' claimed efficiencies are not merger-specific or unverifiable.

40 The defendants suggest that Dr. Warren–Boulton's reliance on market share as an estimate of diversion ratios is somewhat circular in that his market shares derive from his market definition, which, in turn, relied on his use of switching data as a proxy for diversion ratios. DX 17 (Meyer Rep.) at 76. As discussed above, however, the Court's finding that DDIY is the correct relevant product market is not dependent on Dr. Warren–Boulton's analysis.

41 “Cognizable efficiencies” are a subset of “synergies.” “Synergies” refer more generally to any business performance benefits that result from the merger of two companies. *See* Zmijewski, TT, 9/19/11 a.m., at 99.

42 Originally, the defendants claimed 11 efficiencies, including an efficiency related to {redacted}. This task is “really not an efficiency” but “an additional cost,” Dunn, TT, 9/8/11 p.m. (sealed) at 7, and defendants do not reference it in their proposed findings of fact. DFF ¶ 291.

43 Dr. Zmijewski is a professor of accounting and deputy dean at The University of Chicago Booth School of Business and a founder and principal of Navigant Economics, a consulting firm. GX 664 (Zmijewski Rep.) at 5. He holds a Ph.D. in accounting. *Id.*

44 In addition, the defendants have not addressed how much of the claimed efficiencies would be passed through to consumers. *See Staples,* 970 F.Supp. at 1090 (analyzing projected pass-through rate for claimed efficiencies).

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CANADA

CONSOLIDATION

Competition Act

R.S.C., 1985, c. C-34

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R.S.C., 1985, c. C-34

An Act to provide for the general regulation of trade and commerce in respect of conspiracies, trade practices and mergers affecting competition

Short Title

Short title

1 This Act may be cited as the *Competition Act*.

R.S., 1985, c. C-34, s. 1; R.S., 1985, c. 19 (2nd Supp.), s. 19.

PART I

Purpose and Interpretation

Purpose

Purpose of Act

1.1 The purpose of this Act is to maintain and encourage competition in Canada in order to promote the efficiency and adaptability of the Canadian economy, in order to expand opportunities for Canadian participation in world markets while at the same time recognizing the role of foreign competition in Canada, in order to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the Canadian economy and in order to provide consumers with competitive prices and product choices.

R.S., 1985, c. 19 (2nd Supp.), s. 19.

Interpretation

Definitions

2 (1) In this Act,

article means real and personal property of every description including

(a) money,

L.R.C., 1985, ch. C-34

Loi portant réglementation générale du commerce en matière de complots, de pratiques commerciales et de fusionnements qui touchent à la concurrence

Titre abrégé

Titre abrégé

1 *Loi sur la concurrence*.

L.R. (1985), ch. C-34, art. 1; L.R. (1985), ch. 19 (2^e suppl.), art. 19.

PARTIE I

Objet et définitions

Objet

Objet

1.1 La présente loi a pour objet de préserver et de favoriser la concurrence au Canada dans le but de stimuler l’adaptabilité et l’efficience de l’économie canadienne, d’améliorer les chances de participation canadienne aux marchés mondiaux tout en tenant simultanément compte du rôle de la concurrence étrangère au Canada, d’assurer à la petite et à la moyenne entreprise une chance honnête de participer à l’économie canadienne, de même que dans le but d’assurer aux consommateurs des prix compétitifs et un choix dans les produits.

L.R. (1985), ch. 19 (2^e suppl.), art. 19.

Définitions

Définitions

2 (1) Les définitions qui suivent s’appliquent à la présente loi.

article Biens meubles et immeubles de toute nature, y compris :

(e) the combination does not prevent or lessen or is not likely to prevent or lessen competition except to the extent reasonably required to undertake and complete the project or program.

Limitation

(2) For greater certainty, this section does not apply in respect of the acquisition of assets of a combination.

R.S., 1985, c. 19 (2nd Supp.), s. 45.

Exception where gains in efficiency

96 (1) The Tribunal shall not make an order under section 92 if it finds that the merger or proposed merger in respect of which the application is made has brought about or is likely to bring about gains in efficiency that will be greater than, and will offset, the effects of any prevention or lessening of competition that will result or is likely to result from the merger or proposed merger and that the gains in efficiency would not likely be attained if the order were made.

Factors to be considered

(2) In considering whether a merger or proposed merger is likely to bring about gains in efficiency described in subsection (1), the Tribunal shall consider whether such gains will result in

(a) a significant increase in the real value of exports; or

(b) a significant substitution of domestic products for imported products.

Restriction

(3) For the purposes of this section, the Tribunal shall not find that a merger or proposed merger has brought about or is likely to bring about gains in efficiency by reason only of a redistribution of income between two or more persons.

R.S., 1985, c. 19 (2nd Supp.), s. 45.

Limitation period

97 No application may be made under section 92 in respect of a merger more than one year after the merger has been substantially completed.

R.S., 1985, c. 19 (2nd Supp.), s. 45; 2009, c. 2, s. 430.

e) l’association d’intérêts n’a pas, sauf dans la mesure de ce qui est raisonnablement nécessaire pour que le projet ou programme soit entrepris et complété, l’effet d’empêcher ou de diminuer la concurrence ou n’aura vraisemblablement pas cet effet.

Restriction

(2) Il est entendu que le présent article ne s’applique pas à l’égard de l’acquisition d’éléments d’actif d’une association d’intérêts.

L.R. (1985), ch. 19 (2^e suppl.), art. 45.

Exception dans les cas de gains en efficience

96 (1) Le Tribunal ne rend pas l’ordonnance prévue à l’article 92 dans les cas où il conclut que le fusionnement, réalisé ou proposé, qui fait l’objet de la demande a eu pour effet ou aura vraisemblablement pour effet d’entraîner des gains en efficience, que ces gains surpasseront et neutraliseront les effets de l’empêchement ou de la diminution de la concurrence qui résulteront ou résulteront vraisemblablement du fusionnement réalisé ou proposé et que ces gains ne seraient vraisemblablement pas réalisés si l’ordonnance était rendue.

Facteurs pris en considération

(2) Dans l’étude de la question de savoir si un fusionnement, réalisé ou proposé, entraînera vraisemblablement les gains en efficience visés au paragraphe (1), le Tribunal évalue si ces gains se traduiront :

a) soit en une augmentation relativement importante de la valeur réelle des exportations;

b) soit en une substitution relativement importante de produits nationaux à des produits étrangers.

Restriction

(3) Pour l’application du présent article, le Tribunal ne conclut pas, en raison seulement d’une redistribution de revenu entre plusieurs personnes, qu’un fusionnement réalisé ou proposé a entraîné ou entraînera vraisemblablement des gains en efficience.

L.R. (1985), ch. 19 (2^e suppl.), art. 45.

Prescription

97 Le commissaire ne peut présenter une demande en vertu de l’article 92 à l’égard d’un fusionnement qui est essentiellement complété depuis plus d’un an.

L.R. (1985), ch. 19 (2^e suppl.), art. 45; 2009, ch. 2, art. 430.

(c) the agreement referred to in paragraph (a) restricts the range of activities that may be carried on pursuant to the combination, and contains provisions that would allow for its orderly termination.

R.S., 1985, c. 19 (2nd Supp.), s. 45.

b) aucun changement dans le contrôle respectif sur les parties à l'association d'intérêts ne résulte de l'association en question;

c) l'entente visée à l'alinéa a) restreint l'éventail des activités qui peuvent être exercées en application de l'association d'intérêts et prévoit sa propre expiration selon un mode organisé.

L.R. (1985), ch. 19 (2e suppl.), art. 45.

General

General exemptions

113 The following classes of transactions are exempt from the application of this Part:

(a) a transaction all the parties to which are affiliates of each other;

(a.1) a transaction in respect of which the Minister of Finance has certified to the Commissioner under paragraph 94(b) that it is, or would be, in the public interest;

(b) a transaction in respect of which the Commissioner has issued a certificate under section 102;

(c) a transaction in respect of which the Commissioner or a person authorized by the Commissioner has waived the obligation under this Part to notify the Commissioner and supply information because substantially similar information was previously supplied in relation to a request for a certificate under section 102; and

(d) such other classes of transactions as may be prescribed.

R.S., 1985, c. 19 (2nd Supp.), s. 45; 1991, c. 45, s. 550, c. 46, s. 594, c. 47, s. 717; 1999, c. 2, ss. 30, 37; 2001, c. 9, s. 580.

Dispositions générales

Exceptions d'application générale

113 La présente partie ne s'applique pas aux catégories suivantes de transactions :

a) une transaction impliquant exclusivement des parties qui sont toutes affiliées entre elles;

a.1) une transaction à propos de laquelle le ministre des Finances certifie au commissaire en vertu de l'alinéa 94b) qu'elle est ou serait dans l'intérêt public;

b) une transaction à l'égard de laquelle le commissaire a remis un certificat en vertu de l'article 102;

c) une transaction à l'égard de laquelle le commissaire ou son délégué a renoncé à l'avis et à la fourniture de renseignements prévus par la présente partie parce que des renseignements essentiellement semblables ont été fournis antérieurement relativement à la demande de certificat prévue à l'article 102;

d) toute autre catégorie de transactions que prévoient les règlements.

L.R. (1985), ch. 19 (2e suppl.), art. 45; 1991, ch. 45, art. 550, ch. 46, art. 594, ch. 47, art. 717; 1999, ch. 2, art. 30 et 37; 2001, ch. 9, art. 580.

Anti-avoidance

Application of sections 114 to 123.1

113.1 If a transaction or proposed transaction is designed to avoid the application of this Part, sections 114 to 123.1 apply to the substance of the transaction or proposed transaction.

2022, c. 10, s. 271.

Anti-évitement

Application des articles 114 à 123.1

113.1 Lorsqu'une transaction ou une transaction proposée est conçue dans le but d'éviter l'application de la présente partie, les articles 114 à 123.1 s'appliquent à l'objet de la transaction ou de la transaction proposée.

2022, ch. 10, art. 271.

Notice and Information

Notice of proposed transaction

114 (1) Subject to this Part, the parties to a proposed transaction shall, before the transaction is completed,

Avis et renseignements

Avis relatifs aux transactions proposées

114 (1) Sous réserve de la présente partie, les parties à une transaction proposée sont tenues, avant que celle-ci notify the Commissioner that the transaction is proposed and supply the Commissioner with the prescribed information in accordance with this Part, if

(a) a person, or two or more persons pursuant to an agreement or arrangement, propose to acquire assets in the circumstances set out in subsection 110(2), to acquire shares in the circumstances set out in subsection 110(3) or to acquire an interest in a combination in the circumstances set out in subsection 110(6);

(b) two or more entities propose to amalgamate in the circumstances set out in subsection 110(4); or

(c) two or more persons propose to form a combination in the circumstances set out in subsection 110(5).

soit complétée, d’aviser le commissaire du fait que la transaction est proposée et de fournir à celui-ci les renseignements réglementaires conformément à la présente partie, si :

a) une ou plusieurs personnes, en conséquence d’un accord ou d’un arrangement, se proposent d’acquérir des éléments d’actif dans les circonstances visées au paragraphe 110(2), d’acquérir des actions dans les circonstances visées au paragraphe 110(3) ou d’acquérir des titres de participation dans une association d’intérêts dans les circonstances visées au paragraphe 110(6);

b) au moins deux entités se proposent de fusionner dans les circonstances visées au paragraphe 110(4);

c) au moins deux personnes se proposent de former une association d’intérêts dans les circonstances visées au paragraphe 110(5).

Additional information

(2) The Commissioner or a person authorized by the Commissioner may, within 30 days after receiving the prescribed information, send a notice to the person who supplied the information requiring them to supply additional information that is relevant to the Commissioner’s assessment of the proposed transaction.

Renseignements supplémentaires

(2) Le commissaire ou son délégué peut, dans les trente jours suivant la réception des renseignements réglementaires, envoyer à la personne qui les a fournis un avis exigeant qu’elle lui fournisse des renseignements supplémentaires nécessaires à l’examen par le commissaire de la transaction proposée.

Contents of notice

(2.1) The notice shall specify the particular additional information or classes of additional information that are to be supplied.

Contenu de l’avis

(2.1) L’avis précise les renseignements supplémentaires ou catégories de renseignements supplémentaires à fournir.

Unsolicited bid

(3) If a proposed transaction is an unsolicited or hostile take-over bid in respect of an entity and the Commissioner receives prescribed information supplied under subsection (1) by a person who has commenced or has announced an intention to commence a take-over bid, the Commissioner shall, if he or she has not already received the prescribed information from the entity, immediately notify the entity that the Commissioner has received the prescribed information from that person and the entity shall supply the Commissioner with the prescribed information within 10 days after being so notified.

Offre non sollicitée

(3) Dans le cas où la transaction proposée est une offre d’achat visant à la mainmise non sollicitée ou hostile concernant une entité, si le commissaire reçoit les renseignements réglementaires prévus au paragraphe (1) d’une personne qui a commencé — ou a annoncé son intention de commencer — une offre d’achat visant à la mainmise et qu’il n’a toujours pas reçu de l’entité les renseignements réglementaires, il en avise immédiatement l’entité et celle-ci est alors tenue de les produire auprès de lui dans les dix jours suivant la réception de cet avis.

Notice and information

(4) Any of the persons required to give notice and supply information under this section may

(a) if duly authorized to do so, give notice or supply information on behalf of and in lieu of any of the others who are so required in respect of the same transaction; or

Avis et renseignements

(4) Une des personnes tenues de donner l’avis et de fournir les renseignements prévus par le présent article peut :

a) à condition d’y être valablement autorisée, donner l’avis ou fournir les renseignements pour le compte et au lieu des autres personnes qui y sont tenues à l’égard de la même transaction;

(b) give notice or supply information jointly with any of those others.

R.S., 1985, c. 19 (2nd Supp.), s. 45; 1999, c. 2, s. 31, c. 31, s. 53(F); 2009, c. 2, s. 437; 2018, c. 8, s. 120; 2022, c. 10, s. 272.

Prior notice of acquisitions

115 (1) It is not necessary to comply with section 114 in respect of a proposed acquisition of voting shares or of an interest in a combination where a limit set out in subsection 110(3) or (6) would be exceeded as a result of the proposed acquisition within three years immediately following a previous compliance with section 114 required in relation to the same limit.

Notice of future acquisition

(2) Where a person or persons who propose to acquire voting shares or an interest in a combination are required to comply with section 114 because the twenty or thirty-five per cent limit set out in subsection 110(3) or the thirty-five per cent limit set out in subsection 110(6) would be exceeded as a result of the acquisition, the person or persons may, at the time of the compliance, give notice to the Commissioner of a proposed further acquisition of voting shares or of an interest in a combination that would result in a fifty per cent limit set out in that subsection being exceeded, and supply the Commissioner with a detailed description in writing of the steps to be carried out in the further acquisition.

Exemption for further acquisitions of voting shares

(3) It is not necessary to comply with section 114 in respect of a proposed further acquisition referred to in subsection (2) if

(a) notice of the further acquisition is given to the Commissioner under subsection (2) and it is carried out in accordance with the description supplied under that subsection; and

(b) an additional notice of the further acquisition is given to the Commissioner in writing within twenty-one, and at least seven, days before the further acquisition.

b) donner l’avis ou fournir les renseignements conjointement avec l’une des autres personnes.

L.R. (1985), ch. 19 (2e suppl.), art. 45; 1999, ch. 2, art. 31, ch. 31, art. 53(F); 2009, ch. 2, art. 437; 2018, ch. 8, art. 120; 2022, ch. 10, art. 272.

Avis d’acquisition antérieure

115 (1) Il n’est pas nécessaire de se conformer à l’article 114 à l’égard d’une acquisition proposée d’actions comportant droit de vote ou de titres de participation dans une association d’intérêts dans les cas où une limite prévue aux paragraphes 110(3) ou (6) serait dépassée en conséquence de l’acquisition proposée dans les trois ans qui suivent le moment où l’on s’est conformé à l’article 114 à l’égard de la même limite.

Avis d’acquisition future

(2) Dans les cas où une ou des personnes qui proposent d’acquérir des actions comportant droit de vote ou des titres de participation dans une association d’intérêts sont tenues de se conformer à l’article 114 en raison du fait que la limite de vingt ou de trente-cinq pour cent fixée au paragraphe 110(3) ou la limite de trente-cinq pour cent fixée au paragraphe 110(6) serait dépassée en conséquence de l’acquisition, cette ou ces personnes peuvent, au moment de répondre aux exigences de cet article, aviser le commissaire d’une acquisition additionnelle proposée d’actions comportant droit de vote ou des titres de participation dans une association d’intérêts dans les cas où la conséquence de cette acquisition additionnelle serait le dépassement d’une limite de cinquante pour cent prévue à ce paragraphe, ainsi que lui fournir, par écrit, une description détaillée des démarches qui seront entreprises dans le cadre de l’acquisition additionnelle.

Exception : acquisitions ultérieures d’actions comportant droit de vote

(3) Il n’est pas obligatoire de se conformer à l’article 114 à l’égard d’une acquisition additionnelle proposée visée au paragraphe (2) si :

a) un avis de l’acquisition additionnelle proposée est donné au commissaire aux termes du paragraphe (2) et si celle-ci est mise en œuvre conformément à la description fournie en application de ce paragraphe;

b) un avis supplémentaire écrit de l’acquisition additionnelle est, dans les vingt et un jours de cette acquisition, mais au moins sept jours avant celle-ci, donné par écrit au commissaire lors de cette acquisition.

Limitation

(4) Subsection (3) does not apply in respect of a further acquisition unless the further acquisition is completed within one year after notice of it is given under subsection (2).

R.S., 1985, c. 19 (2nd Supp.), s. 45; 1999, c. 2, ss. 32, 37.

If information cannot be supplied

116 (1) If any of the information required under section 114 is not known or reasonably obtainable, or cannot be supplied because of the privilege that exists in respect of lawyers and notaries and their clients or because of a confidentiality requirement established by law, the entity or individual who is supplying the information may, instead of supplying the information, inform the Commissioner under oath or solemn affirmation of the matters in respect of which information has not been supplied and the reason why it has not been supplied.

If information not relevant

(2) If any of the information required under section 114 could not, on any reasonable basis, be considered to be relevant to an assessment by the Commissioner as to whether the proposed transaction would or would be likely to prevent or lessen competition substantially, the entity or individual who is supplying the information may, instead of supplying the information, inform the Commissioner under oath or solemn affirmation of the matters in respect of which information has not been supplied and why the information was not considered relevant.

If information previously supplied

(2.1) If any of the information required under section 114 has previously been supplied to the Commissioner, the entity or individual who is supplying the information may, instead of supplying it, inform the Commissioner under oath or solemn affirmation of the matters in respect of which information has previously been supplied and when it was supplied.

Commissioner may require information

(3) If an entity or individual chooses not to supply the Commissioner with information required under section 114 and so informs the Commissioner in accordance with subsection (2) or (2.1) and the Commissioner or a person authorized by the Commissioner notifies that entity or individual, within seven days after the Commissioner is so informed, that the information is required, the entity

Restrictions

(4) Le paragraphe (3) ne s'applique pas à l'égard d'une acquisition additionnelle sauf si cette dernière est complétée dans un délai de un an à compter de l'avis donné à son égard aux termes du paragraphe (2).

L.R. (1985), ch. 19 (2e suppl.), art. 45; 1999, ch. 2, art. 32 et 37.

Cas où les renseignements ne peuvent être fournis

116 (1) Dans les cas où l'un ou l'autre des renseignements exigés en vertu de l'article 114 n'est pas connu, ne peut pas être obtenu raisonnablement ou ne peut pas être fourni en raison du secret professionnel de l'avocat ou du notaire et de son client ou d'une norme de confidentialité établie par le droit, l'entité ou la personne physique qui fournit les renseignements peut, au lieu de fournir les renseignements en question, faire connaître au commissaire, sous serment ou affirmation solennelle, les questions au sujet desquelles des renseignements n'ont pas été fournis ainsi que les motifs pour lesquels ils ne l'ont pas été.

Cas où les renseignements ne sont pas pertinents

(2) Dans les cas où l'un ou l'autre des renseignements exigés en vertu de l'article 114 ne pouvaient, en toute raison, être jugés pertinents aux fins de l'examen que fait le commissaire de la question de savoir si la transaction proposée empêcherait ou diminuerait sensiblement la concurrence ou aurait vraisemblablement cet effet, l'entité ou la personne physique qui fournit les renseignements peut, au lieu de fournir les renseignements en question, aviser le commissaire, sous serment ou affirmation solennelle, des questions au sujet desquelles des renseignements n'ont pas été fournis ainsi que des motifs pour lesquels ils n'ont pas été considérés comme pertinents.

Cas où les renseignements ont été fournis antérieurement

(2.1) L'entité ou la personne physique qui a fourni antérieurement au commissaire des renseignements exigés en vertu de l'article 114 peut, au lieu de les fournir, informer celui-ci de ce fait, sous serment ou affirmation solennelle, en lui indiquant l'objet de ces renseignements et la date à laquelle ils ont été fournis.

Demande de renseignements par le commissaire

(3) L'entité ou la personne physique qui choisit de ne pas fournir au commissaire les renseignements exigés en vertu de l'article 114 et qui l'informe de ce fait en conformité avec les paragraphes (2) ou (2.1) est néanmoins tenue de or individual shall supply the Commissioner with the information.

R.S., 1985, c. 19 (2nd Supp.), s. 45; 1999, c. 2, ss. 33, 37; 2009, c. 2, s. 438; 2018, c. 8, s. 121.

Saving

117 (1) Nothing in section 114 requires

(a) any individual who is a director of a corporation to supply information that is known to that individual by virtue only of their position as a director of an affiliate of the corporation that is neither a wholly-owned affiliate nor a wholly-owning affiliate of the corporation; or

(b) any individual who, in respect of an entity other than a corporation, serves in a capacity similar to that of a director to supply information that is known to that individual by virtue only of their serving in that capacity with respect to an affiliate of the entity that is neither a wholly-owned affiliate nor a wholly-owning affiliate of the entity.

Wholly-owned affiliate

(2) For the purposes of subsection (1), one corporation is the wholly-owned affiliate of another corporation if all its outstanding voting shares, other than shares necessary to qualify persons as directors, are beneficially owned by that other corporation directly, or indirectly through one or more affiliates where all the outstanding voting shares of the affiliates, other than shares necessary to qualify persons as directors, are beneficially owned by that other corporation or each other.

Wholly-owning affiliate

(3) For the purposes of subsection (1), one corporation is the wholly-owning affiliate of another corporation if it beneficially owns all the outstanding voting shares of that other corporation, other than shares necessary to qualify persons as directors, directly, or indirectly through one or more affiliates where all the outstanding voting shares of the affiliates, other than shares necessary to qualify persons as directors, are beneficially owned by the corporation or each other.

R.S., 1985, c. 19 (2nd Supp.), s. 45; 2018, c. 8, s. 122.

le faire si le commissaire ou son délégué exige les renseignements dans les sept jours suivant la date à laquelle il est informé de ce choix.

L.R. (1985), ch. 19 (2e suppl.), art. 45; 1999, ch. 2, art. 33 et 37; 2009, ch. 2, art. 438; 2018, ch. 8, art. 121.

Exclusion

117 (1) L'article 114 n'a pas pour effet d'imposer :

a) à la personne physique qui est administrateur d'une personne morale l'obligation de fournir des renseignements qui sont parvenus à sa connaissance uniquement parce qu'elle occupe le poste d'administrateur d'une affiliée de la personne morale en question, à condition que cette affiliée ne soit pas une affiliée en propriété exclusive ou une affiliée-propriétaire exclusive de cette personne morale;

b) à la personne physique qui exerce des fonctions semblables à celles d'un administrateur à l'égard d'une entité autre qu'une personne morale l'obligation de fournir des renseignements qui sont parvenus à sa connaissance uniquement parce qu'elle exerce de telles fonctions à l'égard d'une affiliée de l'entité en question, à condition que cette affiliée ne soit pas une affiliée en propriété exclusive ou une affiliée-propriétaire exclusive de cette entité.

Affiliée en propriété exclusive

(2) Pour l'application du paragraphe (1), une personne morale est une affiliée en propriété exclusive d'une autre personne morale si cette autre personne morale est, directement, la véritable propriétaire de l'ensemble des actions comportant droit de vote en circulation de cette personne morale, à l'exclusion des actions qu'il faut détenir pour devenir administrateur, ou si elle l'est, indirectement, par l'intermédiaire d'une ou de plusieurs affiliées dans les cas où, à l'exclusion des actions qu'il faut détenir pour devenir administrateur, l'ensemble des actions comportant droit de vote en circulation de ces affiliées sont détenues en véritable propriété par cette autre personne morale ou par ces affiliées entre elles.

Affiliée-propriétaire exclusive

(3) Pour l'application du paragraphe (1), une personne morale est l'affiliée-propriétaire exclusive d'une autre personne morale si elle est, directement, la véritable propriétaire de l'ensemble des actions comportant droit de vote en circulation de cette autre personne morale, à l'exclusion des actions qu'il faut détenir pour devenir administrateur, ou, si elle l'est, indirectement, par l'intermédiaire d'une ou de plusieurs affiliées dans les cas où l'ensemble des actions comportant droit de vote en circulation de ces affiliées, à l'exclusion des actions qu'il faut détenir pour devenir administrateur, sont détenues en véritable propriété par la personne morale ou par ces affiliées entre elles.

L.R. (1985), ch. 19 (2e suppl.), art. 45; 2018, ch. 8, art. 122.

Information to be certified

118 The information supplied to the Commissioner under section 114 shall be certified on oath or solemn affirmation as having been examined by one of the following individuals and as being, to the best of that individual's knowledge and belief, correct and complete in all material respects:

(a) in the case of a corporation supplying the information, by an officer of the corporation or other person duly authorized by the board of directors or other governing body of the corporation;

(b) in the case of an entity other than a corporation supplying the information, by an individual who serves in a capacity similar to that of an officer of a corporation or other individual duly authorized by the governing body of that entity;

(c) in the case of an individual supplying the information, by that individual.

R.S., 1985, c. 19 (2nd Supp.), s. 45; 1999, c. 2, s. 37; 2018, c. 8, s. 123.

Attestation des renseignements

118 Les renseignements fournis au commissaire en application de l'article 114 sont attestés sous serment ou affirmation solennelle comme ayant été examinés par l'une ou l'autre des personnes physiques ci-après et comme étant, à leur connaissance, exacts et complets sur toute question pertinente :

a) dans le cas où une personne morale les fournit, par un de ses dirigeants ou par toute autre personne physique dûment autorisée par le conseil d'administration ou tout autre organisme dirigeant de la personne morale;

b) dans le cas où une entité non constituée en personne morale les fournit, par une personne physique qui y exerce des fonctions semblables à celles d'un dirigeant d'une personne morale ou par toute autre personne physique dûment autorisée par l'organisme dirigeant de l'entité;

c) dans le cas où une personne physique les fournit, par la personne elle-même.

L.R. (1985), ch. 19 (2e suppl.), art. 45; 1999, ch. 2, art. 37; 2018, ch. 8, art. 123.

Where transaction not completed

119 Where notice is given and information supplied in respect of a proposed transaction under section 114 but the transaction is not completed within one year thereafter or such longer period as the Commissioner may specify in any particular case, section 114 applies as if no notice were given or information supplied.

R.S., 1985, c. 19 (2nd Supp.), s. 45; 1999, c. 2, s. 37.

Cas où la transaction n'est pas réalisée

119 Lorsqu'un avis est donné et que des renseignements sont fournis à l'égard d'une transaction proposée en vertu de l'article 114 mais que la transaction n'est pas complétée dans l'année qui suit ou dans tout délai, supérieur à un an, que peut préciser le commissaire dans chaque cas, l'article 114 s'applique comme si aucun avis n'avait été donné et aucun renseignement fourni.

L.R. (1985), ch. 19 (2e suppl.), art. 45; 1999, ch. 2, art. 37.

120 to 122 [Repealed, 1999, c. 2, s. 34]

120 à 122 [Abrogés, 1999, ch. 2, art. 34]

Completion of Proposed Transactions

Parachèvement des transactions proposées

Time when transaction may not proceed

123 (1) A proposed transaction referred to in section 114 shall not be completed before the end of

(a) 30 days after the day on which the information required under subsection 114(1) has been received by the Commissioner, if the Commissioner has not, within that time, required additional information to be supplied under subsection 114(2); or

Suspension de la transaction

123 (1) La transaction proposée visée à l'article 114 ne peut être complétée avant :

a) l'expiration d'un délai de trente jours à compter de la réception par le commissaire des renseignements exigés en vertu du paragraphe 114(1), si le commissaire n'a pas, avant l'expiration de ce délai, exigé des renseignements supplémentaires en vertu du paragraphe 114(2);

(b) 30 days after the day on which the information required under subsection 114(2) has been received by the Commissioner, if the Commissioner has within the 30-day period referred to in paragraph (a) required additional information to be supplied under subsection 114(2).

b) si le commissaire a, avant l'expiration du délai de trente jours prévu à l'alinéa a), exigé des renseignements supplémentaires en vertu du paragraphe 114(2), l'expiration d'un délai de trente jours à compter de leur réception.

Waiving of waiting period

(2) A proposed transaction referred to in section 114 may be completed before the end of a period referred to in subsection (1) if, before the end of that period, the Commissioner or a person authorized by the Commissioner notifies the parties to the transaction that the Commissioner does not, at that time, intend to make an application under section 92 in respect of that proposed transaction.

Inapplication des délais

(2) La transaction proposée visée à l'article 114 peut être complétée avant l'expiration d'un délai prévu au paragraphe (1) dans les cas où le commissaire ou son délégué, avant l'expiration du délai, avise les parties à la transaction qu'il n'envisage pas, pour le moment, de présenter une demande en vertu de l'article 92 à l'égard de celle-ci.

Acquisition of equity interests

(3) In the case of an acquisition of equity interests to which subsection 114(3) applies, the periods referred to in subsection (1) shall be determined without reference to the day on which the information required under section 114 is received by the Commissioner from the entity whose equity interests are being acquired.

R.S., 1985, c. 19 (2nd Supp.), s. 45; 1999, c. 2, s. 35; 2009, c. 2, s. 439; 2018, c. 8, s. 124; 2022, c. 10, s. 273(E).

Acquisition d'intérêts relatifs à des capitaux propres

(3) Dans le cas d'une acquisition d'intérêts relatifs à des capitaux propres d'une entité à laquelle le paragraphe 114(3) s'applique, les délais prévus au paragraphe (1) sont fixés compte non tenu de la date à laquelle le commissaire reçoit les renseignements exigés en vertu de l'article 114 de l'entité dont les intérêts relatifs à ses capitaux propres font l'objet de l'acquisition.

L.R. (1985), ch. 19 (2e suppl.), art. 45; 1999, ch. 2, art. 35; 2009, ch. 2, art. 439; 2018, ch. 8, art. 124; 2022, ch. 10, art. 273(A).

Failure to comply

123.1 (1) If, on application by the Commissioner, the court determines that a person, without good and sufficient cause, the proof of which lies on the person, has completed or is likely to complete a proposed transaction before the end of the applicable period referred to in section 123, the court may

(a) order the person to submit information required under subsection 114(2);

(b) issue an interim order prohibiting any person from doing anything that it appears to the court may constitute or be directed toward the completion or implementation of the proposed transaction;

(c) in the case of a completed transaction, order any party to the transaction or any other person, in any manner that the court directs, to dissolve the merger or to dispose of assets or shares designated by the court;

(d) in the case of a completed transaction, order the person to pay, in any manner that the court specifies, an administrative monetary penalty in an amount not exceeding $10,000 for each day on which they have failed to comply with section 123, determined by the

Défaut de respecter le délai

123.1 (1) S'il conclut, à la suite d'une demande du commissaire, qu'une personne, sans motif valable et suffisant dont la preuve lui incombe, a complété ou complétera vraisemblablement une transaction proposée avant l'expiration du délai applicable prévu à l'article 123, le tribunal peut :

a) ordonner à la personne de fournir des renseignements exigés en vertu du paragraphe 114(2);

b) rendre une ordonnance provisoire interdisant à toute personne d'accomplir un acte qui, à son avis, pourrait constituer la réalisation ou la mise en œuvre de la transaction proposée ou y tendre;

c) dans le cas d'une transaction complétée, rendre une ordonnance enjoignant à toute personne, que celle-ci soit partie à la transaction ou non, de dissoudre le fusionnement ou de se départir des éléments d'actif et des actions qu'il indique conformément à ses directives;

d) dans le cas d'une transaction complétée, ordonner à la personne de payer, selon les modalités qu'il prévoit, une sanction administrative pécuniaire maximale de 10 000 $ pour chacun des jours au cours duquel elle

CANADA

CONSOLIDATION

CODIFICATION

Telecommunications Act

Loi sur les télécommunications

S.C. 1993, c. 38

L.C. 1993, ch. 38

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Publication of proposed orders

(3) Any order proposed to be made under this section shall be published in the *Canada Gazette* at least sixty days before its proposed effective date, and a reasonable opportunity shall be given to interested persons to make representations to the Minister with respect to the proposed order.

Modification after publication

(4) A proposed order that is modified after publication need not be published again under subsection (3).

PART II

Eligibility to Operate

Canadian Ownership and Control

Definitions

16 (1) The following definitions apply in this section.

entity means a corporation, partnership, trust or joint venture. (*entité*)

joint venture means an association of two or more entities, if the relationship among those associated entities does not, under the laws in Canada, constitute a corporation, a partnership or a trust and if all the undivided ownership interests in the assets of the Canadian carrier or in the voting interests of the Canadian carrier are or will be owned by all the entities that are so associated. (*coentreprise*)

voting interest, with respect to

(a) a corporation with share capital, means a voting share;

(b) a corporation without share capital, means an ownership interest in the assets of the corporation that entitles the owner to rights similar to those enjoyed by the owner of a voting share; and

(c) a partnership, trust or joint venture, means an ownership interest in the assets of the partnership, trust or joint venture that entitles the owner to receive a share of the profits and to share in the assets on dissolution. (*intérêt avec droit de vote*)

Eligibility

(2) A Canadian carrier is eligible to operate as a telecommunications common carrier if

Publication des projets d'arrêté

(3) Les projets d'arrêté visés au présent article sont publiés dans la *Gazette du Canada* au moins soixante jours avant la date prévue pour leur entrée en vigueur, les intéressés se voyant accorder la possibilité de présenter au ministre leurs observations à cet égard.

Idem

(4) Une seule publication suffit, que le projet ait ou non été modifié.

PARTIE II

Admissibilité

Propriété et contrôle canadiens

Définitions

16 (1) Les définitions qui suivent s'appliquent au présent article.

coentreprise Association d'entités dans le cas où leurs rapports ne constituent pas, en vertu des lois canadiennes, une personne morale, une société de personnes ou une fiducie et si les droits de participation indivise à la propriété des actifs de l'entreprise canadienne ou des intérêts avec droit de vote de l'entreprise canadienne appartiennent ou appartiendront à celles-ci. (*joint venture*)

entité Personne morale, société de personnes, fiducie ou coentreprise. (*entity*)

intérêt avec droit de vote

a) Action avec droit de vote d'une personne morale avec capital social;

b) titre de participation d'une personne morale sans capital social qui accorde à son propriétaire des droits semblables à ceux du propriétaire d'une action avec droit de vote;

c) titre de participation d'une société de personnes, d'une fiducie ou d'une coentreprise qui permet à son propriétaire de recevoir une partie des profits et, en cas de dissolution, une partie des actifs. (*voting interest*)

Admissibilité

(2) Est admise à agir comme entreprise de télécommunication l'entreprise canadienne, selon le cas :

(a) it is an entity incorporated, organized or continued under the laws of Canada or a province and is Canadian-owned and controlled;

(b) it owns or operates only a transmission facility that is referred to in subsection (5); or

(c) it has annual revenues from the provision of telecommunications services in Canada that represent less than 10% of the total annual revenues, as determined by the Commission, from the provision of telecommunications services in Canada.

Canadian ownership and control

(3) For the purposes of paragraph (2)(a), an entity is Canadian-owned and controlled if

(a) in the case of a corporation, not less than 80% of the members of the board of directors are individual Canadians;

(b) Canadians beneficially own, directly or indirectly, in the aggregate and otherwise than by way of security only, not less than 80% of the entity's voting interests; and

(c) the entity is not otherwise controlled by persons that are not Canadians.

Prohibition

(4) No Canadian carrier shall operate as a telecommunications common carrier unless it is eligible under this section to operate as such.

Exemption

(5) Paragraph (2)(a) and subsection (4) do not apply in respect of the ownership or operation of

(a) international submarine cables;

(b) earth stations that provide telecommunications services by means of satellites; or

(c) satellites.

Exception

(6) A Canadian carrier that is eligible to operate under paragraph (2)(c) remains eligible to operate even if it has annual revenues from the provision of telecommunications services in Canada that represent 10% or more of the total annual revenues from the provision of telecommunications services in Canada as long as the increase in its annual revenues from the provision of telecommunications services in Canada to 10% or more of the total

a) qui est une entité constituée, organisée ou prorogée sous le régime des lois fédérales ou provinciales et qui est la propriété de Canadiens et sous contrôle canadien;

b) qui n'est propriétaire ou exploitante que d'une installation de transmission visée au paragraphe (5);

c) dont les revenus annuels provenant de la fourniture de services de télécommunication au Canada représentent moins de dix pour cent de l'ensemble des revenus pour l'année, déterminé par le Conseil, provenant de la fourniture de ces services au Canada.

Contrôle et propriété canadiens

(3) Pour l'application de l'alinéa (2)a), est la propriété de Canadiens et est contrôlée par ceux-ci l'entité :

a) dans le cas d'une personne morale, dont au moins quatre-vingts pour cent des administrateurs sont des Canadiens;

b) dont au moins quatre-vingts pour cent des intérêts avec droit de vote sont la propriété effective, directe ou indirecte, de Canadiens, à l'exception de ceux qui sont détenus à titre de sûreté uniquement;

c) qui n'est pas par ailleurs contrôlée par des non-Canadiens.

Interdiction

(4) Il est interdit à l'entreprise canadienne d'agir comme entreprise de télécommunication si elle n'y est pas admise aux termes du présent article.

Exclusion

(5) L'alinéa (2)a) et le paragraphe (4) ne s'appliquent pas en ce qui touche la propriété ou l'exploitation :

a) de câbles sous-marins internationaux;

b) de stations terriennes qui assurent des services de télécommunication par satellites;

c) de satellites.

Exception

(6) L'entreprise canadienne admise à agir comme entreprise de télécommunication au titre de l'alinéa (2)c) demeure ainsi admise même si ses revenus annuels provenant de la fourniture de services de télécommunication au Canada représentent dix pour cent ou plus de l'ensemble des revenus pour l'année provenant de la fourniture de ces services au Canada si l'augmentation de ses revenus annuels provenant de la fourniture de ces annual revenues from the provision of telecommunications services in Canada did not result from the acquisition of control of another Canadian carrier or from the acquisition of assets used by another Canadian carrier to provide telecommunications services.

services au Canada à dix pour cent ou plus de l'ensemble des revenus pour l'année provenant de la fourniture de ces services au Canada ne découlait pas de l'acquisition du contrôle d'une autre entreprise canadienne ni de l'acquisition d'actifs utilisés par une autre entreprise canadienne pour la fourniture de service de télécommunication.

Acquisition

(7) A Canadian carrier to which subsection (6) applies is not authorized to acquire control of a Canadian carrier or acquire assets used by another Canadian carrier to provide telecommunications services.

Acquisition

(7) L'entreprise canadienne visée au paragraphe (6) ne peut acquérir le contrôle d'une autre entreprise canadienne ni acquérir des actifs utilisés par une autre entreprise canadienne pour la fourniture de service de télécommunication.

Notice

(8) A Canadian carrier that is eligible to operate under paragraph (2)(c) shall notify the Commission when it acquires control of another Canadian carrier or acquires assets used by another Canadian carrier to provide telecommunications services.

Avis

(8) L'entreprise canadienne admise à agir comme entreprise de télécommunication au titre de l'alinéa (2)c) avise le Conseil de l'acquisition du contrôle de toute entreprise canadienne ou de l'acquisition des actifs utilisés par une autre entreprise canadienne pour la fourniture de service de télécommunication.

Affiliates

(9) For the purposes of determining annual revenues from the provision of telecommunications services in Canada under this section, the annual revenues of a Canadian carrier include the annual revenues from the provision of telecommunications services in Canada of its affiliates as defined in subsection 35(3).

1993, c. 38, s. 16; 1998, c. 8, s. 2; 2010, c. 12, s. 2184; 2012, c. 19, s. 595.

Affilié

(9) Pour déterminer les revenus annuels provenant de la fourniture de services de télécommunication au Canada pour l'application du présent article, sont également visés les revenus provenant de la fourniture de tels services au Canada par tout affilié — au sens prévu au paragraphe 35(3) — de l'entreprise canadienne.

1993, ch. 38, art. 16; 1998, ch. 8, art. 2; 2010, ch. 12, art. 2184; 2012, ch. 19, art. 595.

International Telecommunications Services Licences

Licence required — classes of telecommunications service providers

16.1 (1) No telecommunications service provider that is of a class specified by the Commission shall provide international telecommunications services except in accordance with an international telecommunications service licence.

Licence required — classes of service

(2) No telecommunications service provider shall, except in accordance with an international telecommunications service licence, provide international telecommunications services that are within a class of telecommunications services specified by the Commission.

1998, c. 8, s. 3.

Licences de services de télécommunication internationale

Licence obligatoire — fournisseurs de services de télécommunication

16.1 (1) Les fournisseurs de services de télécommunication, quand ils appartiennent aux catégories précisées par le Conseil, ne peuvent fournir des services de télécommunication internationale sans une licence de services de télécommunication internationale.

Licence obligatoire — services de télécommunication

(2) Les fournisseurs de services de télécommunication ne peuvent fournir les services de télécommunication internationale d'une catégorie précisée par le Conseil, sauf en conformité avec une licence de services de télécommunication internationale.

1998, ch. 8, art. 3.

Application

16.2 An application for the issuance, renewal or amendment of an international telecommunications service licence must be made in the form and manner and with the information specified by the Commission, and be accompanied by the fee prescribed under subsection 68(1).

1998, c. 8, s. 3.

Issuance of licences

16.3 (1) The Commission may, on application, issue an international telecommunications service licence.

Conditions

(2) The Commission may, in respect of international telecommunications services,

(a) establish licence conditions in respect of classes of telecommunications service providers or classes of international telecommunications services; and

(b) include in a licence conditions that are related to the circumstances of the licensee and that the Commission considers appropriate.

Amendment

(3) The Commission may, on application by any interested person or on its own motion, amend any conditions of a licence.

Term

(4) The term of a licence may not exceed ten years on its issuance or renewal.

Renewal

(5) A licence may be renewed on application by the licensee.

Transfer

(6) A licence is not transferable except with the consent of the Commission.

1998, c. 8, s. 3.

Suspension and revocation of telecommunications service licences

16.4 (1) The Commission may suspend or revoke an international telecommunications service licence whenever the Commission believes on reasonable grounds that the licensee has contravened this Act, the regulations or any condition of the licence, but the licensee must first be given notice in writing of the reasons for the suspension or revocation and a reasonable opportunity to make representations to the Commission.

Demandes

16.2 Les demandes d’attribution, de renouvellement ou de modification d’une licence de services de télécommunication internationale se font selon les modalités prévues par le Conseil et doivent être accompagnées des renseignements exigés par celui-ci ainsi que du paiement des droits fixés aux termes du paragraphe 68(1).

1998, ch. 8, art. 3.

Attribution

16.3 (1) Le Conseil peut attribuer une licence de services de télécommunication internationale sur demande.

Conditions

(2) Il peut, en ce qui concerne les services de télécommunication internationale :

a) prévoir des conditions de la licence pour une catégorie de fournisseurs de services de télécommunication ou une catégorie de services de télécommunication internationale;

b) assortir toute licence des conditions liées à la situation du titulaire qu’il estime indiquées.

Modification

(3) Les conditions peuvent être modifiées soit sur demande d’un intéressé, soit de la propre initiative du Conseil.

Période de validité

(4) La période de validité de la licence délivrée ou renouvelée ne peut excéder dix ans.

Renouvellement

(5) Le renouvellement se fait sur demande du titulaire.

Incessibilité

(6) Sauf sur consentement du Conseil, la licence n’est pas transférable.

1998, ch. 8, art. 3.

Suspension et révocation de licences

16.4 (1) S’il a des motifs raisonnables de croire que le titulaire d’une licence de services de télécommunication internationale a contrevenu à la présente loi, à ses règlements ou aux conditions de la licence, le Conseil peut suspendre ou révoquer celle-ci après, d’une part, avoir donné au titulaire un avis écrit motivant la prise de cette mesure et, d’autre part, lui avoir accordé la possibilité de présenter ses observations.

Consent of licensee

(2) The Commission may suspend or revoke a licence with the consent of, or on application by, the licensee.

1998, c. 8, s. 3.

International Submarine Cable Licences

Licence required

17 No person shall construct or operate an international submarine cable or construct or operate any works or facilities for the purpose of operating an international submarine cable except in accordance with an international submarine cable licence that has been issued to the person and that the person remains eligible under the regulations to hold.

Application

18 An application for the issuance, renewal or amendment of an international submarine cable licence must be made in the prescribed form and manner and be accompanied by the prescribed information and the prescribed fee or a fee calculated in the prescribed manner.

1993, c. 38, s. 18; 1999, c. 31, s. 197(F).

Issuance of licences

19 (1) The Minister may, on application, issue an international submarine cable licence to a person who is eligible under the regulations to hold the licence.

Conditions

(2) An international submarine cable licence may contain such conditions as the Minister considers are consistent with the Canadian telecommunications policy objectives.

Term

(3) The term of an international submarine cable licence may not exceed ten years on issuance of the licence or on renewal.

Amendment, renewal and transfer

(4) An international submarine cable licence may be amended or renewed on application by the licensee, but a licence is not transferable except with the consent of the Minister.

1993, c. 38, s. 19; 1998, c. 8, s. 4.

Consentement du titulaire

(2) Il peut en outre suspendre ou révoquer la licence sur demande du titulaire ou avec son consentement.

1998, ch. 8, art. 3.

Licences de câble sous-marin international

Licence obligatoire

17 Il est interdit d’exploiter ou de construire un câble sous-marin international ou des ouvrages ou installations en vue de son exploitation, sans une licence de câble sous-marin international attribuée par le ministre; l’entreprise doit en outre continuer à demeurer admissible en vertu des règlements.

Demandes

18 Les demandes d’attribution, de renouvellement ou de modification d’une licence de câble sous-marin international sont à faire selon les modalités réglementaires et doivent être accompagnées des renseignements réglementaires et du paiement des droits fixés par règlement ou, le cas échéant, calculés selon le mode de calcul réglementaire.

1993, ch. 38, art. 18; 1999, ch. 31, art. 197(F).

Attribution

19 (1) Le ministre peut attribuer une licence de câble sous-marin international à toute personne admissible en vertu des règlements.

Conditions

(2) Le ministre peut assortir les licences de câble sous-marin international des conditions qu’il estime compatibles avec les objectifs de la politique canadienne de télécommunication.

Période de validité

(3) La période de validité d’une licence de câble sous-marin international ne peut excéder dix ans lors de son attribution ou de son renouvellement.

Modification, renouvellement et incessibilité

(4) La licence de câble sous-marin international peut être modifiée ou renouvelée sur demande du titulaire, mais, sauf sur consentement du ministre, elle n’est pas transférable.

1993, ch. 38, art. 19; 1998, ch. 8, art. 4.

Suspension and revocation of licences

20 (1) The Minister may suspend or revoke an international submarine cable licence whenever the Minister believes on reasonable grounds that the licensee has ceased to be eligible under the regulations or has contravened this Act, the regulations or any condition of the licence but the licensee must first be given notice in writing of the reasons for the suspension or revocation and a reasonable opportunity to make representations to the Minister.

Idem

(2) The Minister may suspend or revoke an international submarine cable licence on application made by or with the consent of the licensee.

Documentary Evidence

Supporting affidavit

21 The Minister may require the furnishing of an affidavit or a solemn declaration attesting to the authenticity of any document provided under this Part or the regulations, or to the truth of any fact stated in any such document or in any application submitted under this Part.

Regulations

Regulations

22 (1) The Governor in Council may, in relation to Canadian carriers' eligibility under section 16 to operate as telecommunications common carriers, make regulations

(a) respecting information that is to be provided, the persons by whom and to whom it is to be provided, the manner in which and the time within which it is to be provided and the consequences of failing to provide it;

(b) respecting the circumstances and the manner in which a Canadian carrier, in order to maintain its eligibility, may control the acquisition and ownership of its voting shares, restrict, suspend or refuse to recognize ownership rights in respect of those shares and require holders of those shares to dispose of them;

(c) authorizing the board of directors of a Canadian carrier to pay a dividend or to make any other distribution with respect to voting shares that would otherwise be prohibited because the shares were held in contravention of section 16 or any regulations made under this subsection where, in the board's opinion, the contravention was inadvertent or of a technical

Suspension et révocation de licences

20 (1) Le ministre peut suspendre ou révoquer une licence de câble sous-marin international s'il a des motifs raisonnables de croire que le titulaire n'est plus admissible en vertu des règlements ou a contrevenu à la présente loi, à ses règlements ou aux conditions de la licence après d'une part, lui avoir donné un préavis écrit qui motive la prise de cette mesure et, d'autre part, lui avoir accordé la possibilité de présenter ses observations.

Idem

(2) Le ministre peut suspendre ou révoquer la licence sur demande du titulaire ou avec son consentement.

Preuve documentaire

Affidavit

21 Le ministre peut exiger, à l'appui de toute demande présentée au titre de la présente partie ou de tout document fourni sous le régime de celle-ci ou des règlements, un affidavit ou une déclaration solennelle attestant la véracité des faits qui y sont relatés ou l'authenticité du document.

Règlements

Règlements

22 (1) Le gouverneur en conseil peut prendre des règlements concernant l'admissibilité des entreprises canadiennes prévue à l'article 16. Il peut notamment prendre des règlements :

a) sur les renseignements à fournir, les personnes par qui et à qui ils doivent être fournis, les modalités de temps ou autres de leur fourniture et les conséquences du défaut de les fournir;

b) sur les circonstances dans lesquelles l'entreprise canadienne peut, pour maintenir son admissibilité, contrôler l'acquisition et la propriété de ses actions avec droit de vote, ainsi que limiter, suspendre ou refuser de reconnaître des droits de propriété à l'égard de celles-ci ou obliger ses actionnaires à en disposer, ainsi que sur les modalités afférentes à la prise de ces mesures;

c) autorisant le conseil d'administration de l'entreprise canadienne à procéder, à l'égard des actions avec droit de vote, à un versement de dividendes ou à toute autre distribution qui seraient par ailleurs interdits en raison de la détention de celles-ci en violation de nature or it would be otherwise inequitable not to pay the dividend or make the distribution;

(d) respecting the circumstances and the manner in which a Canadian carrier may restrict voting rights attached to shares, or suspend or void the exercise of those rights, in order to maintain its eligibility;

(e) respecting the circumstances and the manner in which a Canadian carrier may

(i) sell, redeem or purchase shares held contrary to section 16 or any regulations made under this subsection, and

(ii) deal with the proceeds of sale and reimburse any purchasers of the shares in good faith;

(f) respecting the powers of a Canadian carrier to require disclosure of the beneficial ownership of its shares, the right of the carrier and its directors, officers and employees, and its agents or mandataries, to rely on any required disclosure and the effects of their reliance;

(g) respecting the verification by the Commission of a Canadian carrier's eligibility, the measures the Commission may take to maintain the carrier's eligibility, including exercising the powers of the carrier's board of directors and countermanding its decisions, and the circumstances and manner in which the Commission may take those measures;

(h) respecting the circumstances and manner in which the Commission and its members, officers or employees, or its agents or mandataries, or a Canadian carrier and its directors, officers and employees, and its agents or mandataries, may be protected from liability for actions taken by them in order to maintain the carrier's eligibility;

(i) defining the words *successor* and *Canadian* for the purposes of section 16; and

(j) prescribing anything that is to be prescribed and generally for carrying out the purposes and provisions of section 16 and this subsection.

l'article 16 ou des règlements d'application du présent paragraphe, dans les cas où, selon le Conseil, soit la violation est involontaire ou de nature technique, soit il serait injuste de ne pas procéder au versement ou à la distribution;

d) sur les circonstances dans lesquelles l'entreprise canadienne peut limiter les droits de vote afférents aux actions — ou suspendre ou annuler leur exercice — pour maintenir son admissibilité, ainsi que sur les modalités afférentes à la prise de ces mesures;

e) sur les circonstances dans lesquelles l'entreprise canadienne peut vendre ou racheter les actions détenues en violation de l'article 16 ou des règlements d'application du présent paragraphe, disposer du produit de la vente et rembourser les acheteurs de bonne foi, ainsi que sur les modalités afférentes à la prise de ces mesures;

f) sur les pouvoirs de l'entreprise canadienne lui permettant d'exiger la divulgation de l'identité des véritables propriétaires de ses actions, sur le droit de l'entreprise et de ses administrateurs, dirigeants, employés et mandataires de se fier à cette divulgation, ainsi que sur les effets qui peuvent en résulter;

g) sur la vérification par le Conseil de l'admissibilité de l'entreprise canadienne, ainsi que sur les mesures que celui-ci peut prendre pour maintenir cette admissibilité, notamment l'exercice des pouvoirs du conseil d'administration de l'entreprise et l'annulation des décisions de celui-ci, ainsi que sur les circonstances justifiant la prise de ces mesures et les modalités afférentes à celle-ci;

h) sur les circonstances dans lesquelles le Conseil et ses conseillers, dirigeants, employés ou mandataires ou l'entreprise canadienne et ses administrateurs, dirigeants, employés ou mandataires peuvent être exemptés de toute responsabilité pour les mesures qu'ils ont prises afin de maintenir l'admissibilité de l'entreprise, ainsi que sur les modalités afférentes à l'octroi de cette exemption;

i) en vue de définir les termes *ayant droit* et *Canadiens* pour l'application de l'article 16;

j) en vue de prendre toute mesure d'ordre réglementaire et, d'une façon générale, toute mesure d'application de l'article 16 et du présent paragraphe.

Idem

(2) The Governor in Council may, in relation to international submarine cable licences, make regulations

Idem

(2) Le gouverneur en conseil peut, par règlement relatif aux licences de câble sous-marin international :

Competition Bureau Canada
Bureau de la concurrence Canada

Enforcement Guidelines

Merger Enforcement Guidelines

Canada

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FOREWORD

The Competition Bureau ("the Bureau") has issued these guidelines to provide general direction on its analytical approach to merger review. The guidelines describe, to the extent possible, how the Bureau analyzes merger transactions. Given that merger law applies to a wide variety of factual circumstances, these guidelines are not applied rigidly. As such, this document sets out the Bureau's general approach to merger review and is not a binding statement of how the analysis is carried out in any particular case. The specific facts of a case, as well as the nature of the information and data available, determine how the Bureau assesses a proposed transaction and may sometimes require methodologies other than those noted here.

Merging parties are encouraged to contact the Bureau at an early stage to discuss proposed transactions, and should obtain appropriate legal advice when contemplating a merger.[1] The final interpretation of the *Competition Act* (the "Act") rests with the Competition Tribunal ("the Tribunal") and the courts.[2]

These guidelines supersede previous merger enforcement guidelines and statements made by the Commissioner of Competition ("the Commissioner") or other Bureau officials. These guidelines also supersede the Bureau's *Bulletin on Efficiencies in Merger Review*. The Bureau may revisit certain aspects of these guidelines in the future based on amendments to the Act, decisions of the Tribunal and the courts, developments in the economic literature and the Bureau's case experience.

PART 1: DEFINITION OF MERGER

1.1 Section 91 of the Act defines a "merger" as "...the acquisition or establishment, direct or indirect, by one or more persons, whether by purchase or lease of shares or assets, by amalgamation or by combination or otherwise, of control over or significant interest in the whole or a part of a business of a competitor, supplier, buyer or other person."

1.21 This definition covers any manner in which control over, or a significant interest in, the whole or a part of a business of another person is acquired or established.[3] While these guidelines focus primarily on mergers of firms that supply competing products (horizontal mergers), section 91 also captures mergers of firms that do not compete (non-horizontal mergers, addressed in Part 11, below).

1 See also the Bureau's *Merger Review Process Guidelines*, *Procedures Guide for Notifiable Transactions and Advance Ruling Certificates under the* Competition Act and *Fee and Service Standards Handbook for Mergers and Merger-Related Matters*.

2 *Competition Act*, R.S.C. 1985, c. C-34.

3 As outlined in the Bureau's Competitor Collaboration Guidelines, paragraph 1.2(*a*), a transaction that does not fall within the definition of "merger" may in some instances be subject to review under the civil provision in section 90.1 of the Act. Parties who are uncertain as to whether an agreement will be assessed as a merger or a competitor collaboration are encouraged to consult the *Competitor Collaboration Guidelines* and to contact the Bureau at the earliest opportunity to discuss how the Bureau is likely to assess such an agreement if pursued.

Control

1.3 Acquisition of control constitutes a merger under section 91. With respect to corporations, section 2(4) of the Act defines "control" to mean *de jure* (legal) control—that is, a direct or indirect holding of more than 50 percent of the votes that may be cast to elect directors of the corporation, and which are sufficient to elect a majority of such directors. With respect to partnerships, section 2(4) provides that a partnership is controlled by a person when the person holds an interest in the partnership that entitles the person to receive more than 50 percent of the profits of the partnership or more than 50 percent of its assets on dissolution.

Significant Interest

1.4 The Act does not define what constitutes a "significant interest," as referenced in section 91, leaving this concept to be construed within the broader context of the Act as a whole.

1.5 When determining whether an interest is significant, the Bureau considers both the quantitative nature and qualitative impact of the acquisition or establishment of the interest. Given that the Act is concerned with firms' competitive market behaviour, a "significant interest" in the whole or a part of a business is held qualitatively when the person acquiring or establishing the interest (the "acquirer") obtains the ability to materially influence the economic behaviour of the target business, including but not limited to decisions relating to pricing, purchasing, distribution, marketing, investment, financing and the licensing of intellectual property rights.

1.6 The factors that may be relevant to the Bureau's analysis of whether a particular minority shareholding, an interest in a combination, agreement or other relationship or interest confers material influence (as per paragraph 1.5) include the following:

- voting rights attached to the acquirer's shareholdings or interest in a combination;
- the status of the acquirer of partnership interests (e.g., general or limited partner) and the nature of the rights and powers attached to the partnership interest;
- the holders and distribution of the remaining shares or interests (whether the target business is widely or closely held, and whether the acquirer will be the largest shareholder);
- board composition[4] and board meeting quorum, attendance and historical voting patterns (whether the acquirer will be able to carry or block votes in a typical meeting);
- the existence of any special voting or veto rights attached to the acquirer's shares or interests (e.g., the extent of shareholder approval rights for non-ordinary-course transactions);
- the terms of any shareholder or voting agreements;

4 This includes both the total number of directors and the number of directors who are the acquirer's nominees.

- the dividend or profit share of the minority interest as compared to the acquirer's equity ownership share;
- the extent, if any, of the acquirer's influence over the selection of management or of members of key board committees;
- the status and expertise of the acquirer relative to that of other shareholders;
- the services (management, advisory or other) the acquirer is providing to the business, if any;
- the put, call or other liquidity rights, if any, that the acquirer has and may use to influence other shareholders or management;
- the access the acquirer has, if any, to confidential information about the business; and
- the practical extent to which the acquirer can otherwise impose pressure on the business's decision-making processes.

It is generally the combination of factors – not the presence or absence of a single factor – that is determinative in the Bureau's assessment of material influence.

Notifiable Transactions

1.7 In the absence of any evidence to the contrary, the Bureau presumes that notifiable transactions described in Part IX of the Act constitute the acquisition or establishment of a significant interest in the whole or a part of a business. A transaction is notifiable where the relevant transaction-size and party-size thresholds are exceeded and, in the case of a share acquisition[5], where the shareholding threshold (voting interest of more than 35% for a private corporation or more than 20% for a public corporation) is also exceeded.

Share Acquisitions

1.8 Share acquisitions (whether or not they are notifiable) fall within the scope of section 91 when the acquirer obtains the ability to materially influence the economic behaviour of a business by purchasing shares or other securities. When assessing whether a particular minority shareholding confers material influence, the Bureau conducts a case-by-case analysis of the relationship between the acquirer and the target business, and of the various mechanisms through which the acquirer might exercise influence.

1.9 In the case of *voting shares*, the Bureau considers that a significant interest in a corporation exists when one or more persons directly or indirectly hold enough voting shares

5 Where the transaction involves the acquisition of an interest in a combination, a further threshold also applies. Such a transaction will be notifiable only if the person or persons acquiring the interest, together with their affiliates, would be entitled to receive more than 35% of the profits of the combination (more than 50% if they are already entitled to more than 35%), or 35% of its assets on dissolution (more than 50% if they are already entitled to more than 35%).

- to obtain a sufficient level of representation on the board of directors to materially influence that board, with reference to the factors outlined in paragraph 1.6 and any other relevant factors; or
- to block special or ordinary resolutions of the corporation.

1.10 The Bureau will also consider whether voting shares give the person or persons who hold them the ability to exercise material influence through other mechanisms, with reference to the factors outlined in paragraph 1.6 and any other relevant factors. In the absence of other relationships, direct or indirect ownership of less than 10 percent of the voting interests in a business does not generally constitute ownership of a significant interest.[6] While inferences about situations that result in a direct or indirect holding of between 10 percent and 50 percent of voting interests are more difficult to draw, a larger voting interest is ordinarily required to materially influence a private company than a widely held public company. The merger notification requirements in Part IX of the Act, referred to in paragraph 1.7 above, are triggered at a voting interest of more than 35 percent for private corporations and of more than 20 percent for public corporations.[7]

1.11 When a transaction involves the purchase of *non-voting* shares,[8] the Bureau examines whether the holder of the minority interest can materially influence the economic behaviour of the business despite its inability to vote its shares, with reference to the factors outlined in paragraph 1.6 and any other relevant factors.

1.12 In the case of *convertible securities* or *options*, a significant interest may be acquired or established when these securities are first purchased or created, or at the time they are converted or exercised.[9] To determine whether a purchase constitutes a significant interest, the Bureau examines the nature of and circumstances in which the rights (or potential rights) attached to these securities may be exercised, and the influence that the acquirer may possess through their exercise, or threat of exercise, with reference to the factors outlined in paragraph 1.6 and any other relevant factors.

6 This position is consistent with other Canadian statutes. See, for example, *Bank Act*, S.C. 1991, c. 46, s. 8. (See also *Cooperative Credit Associations Act*, S.C. 1991, c. 48, s. 9; *Insurance Companies Act*, S.C. 1991, c. 47, s. 8; and *Trust and Loan Companies Act*, S.C. 1991, c. 45, s. 8.) The Bureau typically requires disclosure of all holdings that account for 10 percent or more of the voting interests in a business, and may seek information respecting other minority holdings in the course of a merger review.

7 The pre-merger notification provisions are discussed in the Bureau's *Procedures Guide for Notifiable Transactions and Advance Ruling Certificates under the* Competition Act and the *Interpretation Guidelines for Notifiable Transactions under Part IX of the* Competition Act.

8 When *non-voting* shares are convertible (for example, into voting shares), they will also be assessed under paragraph 1.12.

9 A convertible security is a bond, debenture, preferred share or other security that may be exchanged by the owner, usually for common shares of the same company, in accordance with specified conversion terms. An option is a right to buy or sell specific securities or properties at a specified price within a specified time.

Asset Acquisitions

1.13 Asset transactions (whether or not they are notifiable) that generally fall within the scope of section 91 include the purchase or lease of an unincorporated division, plant, distribution facilities, retail outlet, brand name or intellectual property rights from the target company. The Bureau treats the acquisition of any of these essential assets, in whole or in part, as the acquisition or establishment of a significant interest in that business. Further, acquiring a subset of the assets of a business that is capable of being used to carry on a separate business is also considered to be the acquisition or establishment of a significant interest in the business.

Increasing an Existing Interest in a Business

1.14 Persons already holding a significant interest in the whole or a part of a business may trigger the merger provisions of the Act by acquiring or establishing a materially greater ability to influence the economic behaviour of the business.

Interlocking Directorates

1.15 An interlocking directorate may arise where a director of one firm is an employee, executive, partner, owner or member of the board of directors of a second firm, or has another interest in the business of the second firm. An interlocking directorate is generally of interest under section 92 of the Act only when the interlocked firms are competitors, are vertically related, or produce complementary or related products.

1.16 Interlocking directorates may be features of transactions that otherwise qualify as mergers. For example, an interlock results from the merger of firms A and B when an executive of A sits on the board of firm C, and C competes with B. Interlocking directorates may be features of minority interest transactions; for example, a firm that acquires a minority interest in its competitor may also obtain rights to nominate one or more directors to its competitor's board. An interlocking directorate would rarely qualify, in and of itself, as the establishment of a significant interest.

1.17 When assessing whether an interlocked director has the ability to materially influence the economic behaviour of the interlocked firm(s), the Bureau's focus is typically on the access that an interlocked director has to confidential information, and on the director's voting and veto rights in the context of the board composition, quorum and voting rules, including attendance and historical voting patterns.

Other Considerations

1.18 A significant interest can be acquired or established under shareholder agreements, management contracts, franchise agreements and other contractual arrangements involving corporations, partnerships, joint ventures, combinations and other entities, depending on the terms of the arrangements. In addition, loan, supply and distribution arrangements that are not ordinary-course transactions and that confer the ability to materially influence the economic behaviour of the target business (for example, financing arrangements and terms of default relating to such arrangements; long-term contractual arrangements or pre-existing long-term business relationships) may constitute a merger within the meaning of section 91.

1.19 When determining whether an acquisition or establishment of a significant interest constitutes a merger, the Bureau examines the relationship between the parties prior to the transaction or event establishing the interest, the likely subsequent relationship between the parties, the access that an acquirer has and obtains to confidential business information of the target business, and evidence of the acquirer's intentions to affect the behaviour of that business.

PART 2: THE ANTI-COMPETITIVE THRESHOLD

Overview

2.1 As set out in section 92(1) of the Act, the Tribunal may make an order when it finds that a merger "prevents or lessens, or is likely to prevent or lessen, competition substantially." A substantial prevention or lessening of competition results only from mergers that are likely to create, maintain or enhance the ability of the merged entity, unilaterally or in coordination with other firms, to exercise market power.

2.2 In general, when evaluating the competitive effects of a merger, the Bureau's primary concerns are price and output. The Bureau also assesses the effects of the merger on other dimensions of competition, such as quality, product choice, service, innovation and advertising—especially in markets in which there is significant non-price competition. To simplify the discussion, unless otherwise indicated, the term "price" in these guidelines refers to all aspects of firms' actions that affect the interests of buyers. References to an increase in price encompass an increase in the nominal price, but may also refer to a reduction in quality, product choice, service, innovation or other dimensions of competition that buyers value.

2.3 These guidelines describe the analytical framework for assessing market power from the perspective of a seller of a product or service ("product," as defined in section 2(1) of the Act). Market power of sellers is the ability of a firm or group of firms to profitably maintain prices above the competitive level for a significant period of time. The jurisprudence establishes that it is the *ability* to raise prices, not whether a price increase is likely, that is determinative.

2.4 The Bureau also applies this analytical framework to its assessment of the market power of the buyers of a product. Market power of buyers is the ability of a single firm (monopsony power) or a group of firms (oligopsony power)[10] to profitably depress prices paid to sellers (by reducing the purchase of inputs, for example) to a level that is below the competitive price for a significant period of time. Part 9, below, sets out the Bureau's approach to situations of monopsony power.

10 Oligopsony power occurs where market power in the relevant purchasing market is exercised by a coordinated group of buyers. Except where otherwise indicated in these guidelines, the term "monopsony" includes situations of oligopsony.

2.5 The Bureau analyzes competitive effects under two broad headings: unilateral exercise of market power and coordinated exercise of market power. The same merger may involve both a unilateral and a coordinated exercise of market power.

2.6 A unilateral exercise of market power can occur when a merger enables the merged firm to profitably sustain higher prices than those that would exist in the absence of the merger, without relying on competitors' accommodating responses.

2.7 A coordinated exercise of market power can occur when a merger reduces the competitive vigour in a market by, for example, removing a particularly aggressive competitor or otherwise enabling or enhancing the ability of the merged firm to coordinate its behaviour with that of its competitors. In these situations, higher post-merger prices are profitable and sustainable because other competitors in the market have accommodating responses.

2.8 When a merger is not likely to have market power effects, it is generally not possible to demonstrate that the transaction will likely prevent or lessen competition substantially, even though the merger might have implications for other industrial policy objectives that are beyond the scope of the Act.

Lessening of Competition

2.9 A merger may substantially lessen competition when it enables the merged firm, unilaterally or in coordination with other firms, to sustain materially higher prices than would exist in the absence of the merger by diminishing existing competition. This typically occurs with horizontal mergers when there is direct or existing overlap between the operations of the merging firms. This can also occur with non-horizontal mergers, such as those that foreclose rivals from accessing inputs to production.

Prevention of Competition

2.10 Competition may be substantially prevented when a merger enables the merged firm, unilaterally or in coordination with other firms, to sustain materially higher prices than would exist in the absence of the merger by hindering the development of anticipated future competition. This typically occurs when there is no or limited direct overlap between the merging firms' existing businesses, but direct competition between those businesses was expected to develop or increase in the absence of the merger. It may also occur when there is direct overlap between the merging parties' existing business(es) and the competitive effectiveness of one of the merging firms was expected to increase absent the merger, for example, because of the introduction of an improved product.

2.11 In these circumstances, the Bureau examines whether, absent the merger, timely entry or expansion[11] by either of the merging firms would likely occur on a sufficient scale and with sufficient scope to prevent incumbents from exercising market power.[12] "Timely"

11 Throughout these guidelines, the term "entry" also refers to expansion by existing firms.

12 The terms "timely," "likely" and "sufficient" are discussed in further detail in Part 7, below.

means that such entry would have occurred within a reasonable period of time, given the characteristics and dynamics of the market in question.[13] "Likely" refers to the expectation that entry by one of the merging firms would occur. The Bureau also considers whether effective entry by rival firms is likely, and the impact of such rival entry or expansion on prices. "Sufficient" means that, in the absence of the merger, entry by one of the merging firms would have caused prices to materially decrease. It also encompasses a scenario in which the threat of such entry has prevented a material price increase from occurring. The Bureau may examine a merger in terms of prevention of competition when the merger forestalls the entry plans of the acquirer, the target or a potential competitor, or when the merger removes independent control of capacity or an asset that provides or was likely to provide an important source of competitive discipline.

2.12 The following are examples of mergers that may result in a substantial prevention of competition:

- the acquisition of a potential entrant or of a recent entrant that was likely to expand or become a more vigorous competitor;
- an acquisition by the market leader that pre-empts a likely acquisition of the same target by a competitor;
- the acquisition of an existing business that would likely have entered the market in the absence of the merger;
- an acquisition that prevents expansion into new geographic markets;
- an acquisition that prevents the pro-competitive effects associated with new capacity; and
- an acquisition that prevents or limits the introduction of new products.

Substantiality

2.13 When the Bureau assesses whether a merger is likely to prevent or lessen competition substantially, it evaluates whether the merger is likely to provide the merged firm, unilaterally or in coordination with other firms, with the ability to materially influence price. The Bureau considers the likely magnitude and duration of any price increase that is anticipated to follow from the merger. Generally speaking, the prevention or lessening of competition is considered to be "substantial" in two circumstances:

- the price of the relevant product(s) would likely be materially higher in the relevant market than it would be in the absence of the merger ("material price increase"); and
- sufficient new entry would not occur rapidly enough to prevent the material price increase, or to counteract the effects of any such price increase.

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13 Since the harm occasioned by a merger that substantially prevents competition may be sustained over the long term, the Bureau may consider longer time frames when assessing the effects of a prevention of competition than it does when assessing post-merger entry (see Part 7, below).

2.14 The Bureau does not consider a numerical threshold for the material price increase.[14] Instead, it bases its conclusions about whether the prevention or lessening of competition is substantial on an assessment of market-specific factors that could have a constraining influence on price following the merger. Additionally, where the merging firms, individually or collectively, have pre-existing market power, smaller impacts on competition resulting from the merger will meet the test of being substantial.

PART 3: ANALYTICAL FRAMEWORK

3.1 In determining whether a merger is likely to create, maintain or enhance market power, the Bureau must examine the competitive effects of the merger. This exercise generally involves defining the relevant markets and assessing the competitive effects of the merger in those markets. Market definition is not necessarily the initial step, or a required step, but generally is undertaken. The same evidence may be relevant and contribute to both the definition of relevant markets and the assessment of competitive effects. Merger review is often an iterative process in which evidence respecting the relevant market and market shares is considered alongside other evidence of competitive effects, with the analysis of each informing and complementing the other.

3.2 The overall objective of market definition in merger analysis is to identify the set of products that customers consider to be substitutes for those produced by the merging firms and the set or sets of buyers that could potentially face increased market power owing to the merger. Market definition, and the measurement of market share and concentration in the relevant market, is not an end in itself. Consistent with this, section 92(2) of the Act precludes the Tribunal from concluding that a merger is likely to prevent or lessen competition substantially solely on the basis of evidence of concentration or market share. The ultimate inquiry is not about market definition, which is merely an analytical tool – one that defies precision and can thus vary in its usefulness – to assist in evaluating effects. Rather, the ultimate inquiry is about whether a merger prevents or lessens competition substantially. That said, when reviewing a merger, market definition generally sets the context for the Bureau's assessment of the likely competitive effects of a merger.

3.3 In some cases, it may be clear that a merger will not create, preserve or enhance market power under any plausible market definition. Alternatively, it may be clear that anti-competitive effects would result under all plausible market definitions. In both such circumstances, the Bureau need not reach a firm conclusion on the precise metes and bounds of the relevant market(s). Additionally, when a completed merger has resulted in a material price increase, the Bureau may rely on evidence of that increase, taking into account other relevant factors. Cases may also arise in which the choice among several plausible market definitions may have a significant impact on

14 A material price increase is distinct from (and will generally be less than) the "significant and non-transitory price increase" that is used to define relevant markets, as described in Part 4, below. What constitutes a "materially greater" price varies with the industry and the context. For purposes of the statement above, materiality includes not only the magnitude and scope but also the sustainability of the price increase.

market share. In such cases, there may be a greater need for evidence regarding likely competitive effects that is not based on market share and concentration. While the Bureau may elect not to define markets in cases in which other reliable evidence of competitive effects is available, the Bureau will normally identify one or more relevant markets in which competition is prevented or lessened, in any merger enforcement action.

3.4 Section 93 of the Act sets out a non-exhaustive list of discretionary factors that the Tribunal may consider when determining whether a merger prevents or lessens competition substantially, or is likely to do so.[15] These factors, which are largely qualitative, may be relevant to the Bureau's assessment of market definition or of the competitive effects of a merger, or both. These factors are discussed in detail in Parts 4 and 6, below.[16]

3.5 The Bureau may also assess competitive effects from a quantitative perspective using various economic tools. The Bureau has discretion in determining which economic and other analytical tools it uses in particular cases. As the economic tools evolve, so will the Bureau's analytical approach.

3.6 The tools the Bureau uses to assess competitive effects also depend heavily on the facts of each case as well as on the availability of qualitative and quantitative evidence. Qualitative evidence may come from documents created by the merging parties in the ordinary course of business or from first-hand observations of the industry by customers or other market participants. Quantitative evidence may be derived from statistical analyses of price, quantity, costs or other data maintained by the merging parties and/or third parties. In all cases, the Bureau assesses the reliability, robustness and probative value of the evidence gathered.

15 Section 93 provides that the Tribunal "may" have regard to the listed factors, while section 93(*h*) permits the Tribunal to consider any other relevant factor. The Bureau does not consider the section 93 factors in a linear fashion. Rather, these factors form part of the analysis of competitive effects, to the extent they are relevant in a particular case. The Bureau encourages parties in their submissions to focus only on the factors and evidence that are relevant to the assessment of the impact of their merger on competition, rather than to treat the section 93 factors as a "checklist" to address in every case.

16 See also Part 7 on barriers to entry (section 93(*d*)) and Part 13 on "failing firm" (section 93(*b*)).

PART 4: MARKET DEFINITION

Overview

4.1 When the Bureau assesses relevant markets, it does so from two perspectives: the product dimension and the geographic dimension. As a general principle, the Bureau does not assume that the merging parties operate in the same relevant market(s), even when there appears to be some overlap between their products and the geographic areas in which they conduct business. In addition, the relevant market(s) being analyzed for competitive effects may not necessarily correspond to the product categories or service areas established by the merging firms or their rivals for operational purposes.

4.2 Market definition is based on substitutability, and focuses on demand responses to changes in relative prices after the merger. The ability of a firm or group of firms to raise prices without losing sufficient sales to make the price increase unprofitable ultimately depends on buyers' willingness to pay the higher price.[17] The ability of competitive suppliers to respond to a price increase is also important when assessing the potential for the exercise of market power, but the Bureau examines such responses later in the analysis—either when identifying the participants in the relevant market or when examining entry into the relevant market.

4.3 Conceptually, a relevant market is defined as the smallest group of products, including at least one product of the merging parties, and the smallest geographic area, in which a sole profit-maximizing seller (a "hypothetical monopolist") would impose and sustain a small but significant and non-transitory increase in price ("SSNIP") above levels that would likely exist in the absence of the merger.[18] In most cases, the Bureau considers a five percent price increase to be significant and a one-year period to be non-transitory. Market characteristics may support using a different price increase or time period.

4.4 The market definition analysis begins by postulating a candidate market for each product of the merging parties. For each candidate market, the analysis proceeds by determining whether a hypothetical monopolist controlling the group of products in that candidate market would profitably impose a SSNIP, assuming the terms of sale of all other products remained constant.[19] If the price increase would likely cause buyers to switch their purchases to other products in sufficient quantity to render the price increase unprofitable, the postulated candidate market is not the relevant market, and the next-best substitute is added to the candidate market.[20] The analysis

17 The Bureau typically considers product and geographic substitutes that are included in a single relevant market to be "acceptable" within the meaning of section 93(*c*) of the Act. When products within a relevant market are differentiated, some may be closer substitutes than others.

18 A market may consist of a single homogeneous product or a group of differentiated products.

19 Changes in terms of sale of other products in response to the merger are accounted for in the analysis of competitive effects and entry.

20 The next-best substitute is the product that would account for the greatest diversion in demand by buyers

then repeats by determining whether a hypothetical monopolist controlling the set of products in the expanded candidate market would profitably impose a SSNIP. This process continues until the point at which the hypothetical monopolist would impose and sustain the price increase for at least one product of the merging parties in the candidate market. In general, the smallest set of products in which the price increase can be sustained is defined as the relevant product market.

4.5 The same general approach applies to assessing the geographic scope of the market. In this case, an initial candidate market is proposed for each location where a merging party produces or sells the relevant products. As above, if buyers are likely to switch their purchases to sellers in more distant locations in sufficient quantities to render a SSNIP by a hypothetical monopolist unprofitable, the location that is the next-best substitute is added to the candidate market. This process continues until the smallest set of areas over which a hypothetical monopolist would impose and sustain the price increase is identified.

4.6 The base price used to postulate a price increase is typically the prevailing price in the relevant market. The Bureau may elect not to use the prevailing price when market conditions (absent the merger) would likely result in a lower or higher price in the future.[21]

4.7 In general, the base price used to postulate a price increase is whatever is ordinarily considered to be the price of the product in the sector of the industry (e.g., manufacturing, wholesale, retail) being examined.

4.8 In some circumstances, sellers may identify and charge different prices to various targeted sets of buyers ("price discrimination"). Sellers are able to price discriminate when targeted buyers cannot effectively switch to other products or geographic locations, and cannot engage in arbitrage with other buyers by taking advantage of price differences. When price discrimination is feasible, it may be appropriate to define relevant markets with reference to the characteristics of the buyers who purchase the product (assuming they can be delineated) or to the particular locations of the targeted buyers.

4.9 The factors the Bureau considers when analyzing the product and geographic dimensions of market definition are set out below.

in response to the postulated price increase, assuming that the product is available in unlimited quantities at constant prices.

21 When the evidence suggests a change in the future price (absent the merger) can be predicted with confidence, the Bureau may delineate markets based on the likely future price, even when that future price cannot be predicted precisely.

Product Market Definition

4.10 For the purpose of product market definition, what matters is not the identity of sellers, but the characteristics of the products and buyers' ability or willingness to switch from one product to another in response to changes in relative prices.[22] A relevant product market consists of a given product of the merging parties and all substitutes required for a SSNIP to be profitable.

4.11 When detailed data on the prices and quantities of the relevant products and their substitutes are available, statistical measures may be used to define relevant product markets. Demand elasticities indicate how buyers change their consumption of a product in response to changes in the product's price (own-price elasticity) or in response to changes in the price of another identified product (cross-price elasticity). While cross-price elasticities do not in themselves directly measure the ability of a firm to profitably raise prices, they are particularly useful when determining whether differentiated products are substitutes for one another and whether such products are part of the same relevant market.

4.12 Whether or not reliable statistical evidence on demand elasticities is available, the Bureau considers factors that provide evidence of substitutability, including evidence from market participants and the functional indicators highlighted below.

4.13 The views, strategies and behaviour of buyers are often reliable indicators of whether buyers would likely switch to other products in response to a SSNIP. For example, the Bureau examines what buyers have done in the past and what they are likely to do in the future as options become available, for instance, through advances in technology. Information from industry surveys and industry participants, such as competitors and manufacturers of the relevant product, is also taken into account. This information advances the analysis by providing details on historical developments (including the past behaviour of the merging parties and their rivals) and likely future developments in the industry. Pre-existing documents prepared by the merging parties in the ordinary course of business can also be very useful in this regard.

4.14 Various functional indicators help to determine what products are considered substitutes, including end use, physical and technical characteristics, price relationships and relative price levels, as well as buyer switching costs, as discussed below. Buyers may not view products purchased for similar end uses as substitutes. Therefore, functional interchangeability is not sufficient to warrant inclusion of two products in the same relevant market. In general, when buyers place a high value on the actual or perceived unique physical or technical characteristics of a product (including warranties, post-sales service and order turnaround time), it may be necessary to define distinct relevant markets based on these characteristics.

22 In this context, switching refers to "economic substitutability," defined as a change in consumption patterns in response to a price change, holding all other factors constant.

4.15 Switching costs may discourage a sufficient number of buyers from purchasing products that are functionally interchangeable, thereby allowing a hypothetical monopolist to impose a SSNIP. Products are not included in the same relevant market when costs that must be incurred by buyers are sufficient to render switching unlikely in response to a SSNIP. Examples include costs for buyers to retool, re-package, undertake product testing, adapt marketing materials and strategies, terminate a supply contract, learn new procedures or convert essential equipment. Other costs include the expense (and risk) buyers must incur when a product fails to satisfy expectations, which may damage a buyer's reputation as a reseller, or require the shutdown of a production line.

4.16 A relevant market may consist of a group of diverse products that are not themselves substitutes for each other. This occurs when a sole profit-maximizing seller would increase the price of the group of products because a sufficient number of buyers would not respond to the price increase by purchasing the various components separately from different sellers. This reaction may occur when there are significant transaction costs associated with using a number of sellers, including transportation costs and the time required to negotiate with multiple sellers. In these circumstances, the Bureau's examination includes an assessment of these transaction costs, as well as buyers' propensity to purchase a number of products from a single seller and the extent to which they have in the past broken up their purchases of a group of products in response to relative price changes.

Geographic Market Definition

4.17 For the purpose of geographic market definition, what matters is not the identity of the sellers, but buyers' ability or willingness to switch their purchases in sufficient quantity from suppliers in one location to suppliers in another, in response to changes in relative prices. A relevant geographic market consists of all supply points that would have to be included for a SSNIP to be profitable, assuming that there is no price discrimination (as described in paragraph 4.8 above). When price discrimination is present (and buyers and third parties are unable to arbitrage between low and high price areas), geographic markets are defined according to the location of each targeted group of buyers.

4.18 When defining the boundaries of geographic markets, the Bureau generally relies on evidence of substitutability, including evidence from market participants and the functional indicators described below and, when available, empirical analysis.

4.19 The views, strategies and behaviour of buyers in a given geographic area are often reliable indicators of whether buyers would likely switch their purchases to sellers located in other geographic areas in the event of a SSNIP. For example, the Bureau examines what buyers have done in the past and what they are likely to do in the future as options become available through, for instance, advances in technology. Industry surveys and the views, strategies and behaviour of industry participants also inform the analysis by providing information on how buyers of a relevant product in one geographic area respond or have responded to changes in the price, packaging or servicing of the relevant product in another geographic area. The extent to which merging parties and other sellers take distant sellers into account in their business plans, marketing strategies and other documentation can also be a useful indicator for geographic market definition.

4.20 Various functional indicators can assist in determining whether geographic areas are considered to be substitutes, including particular characteristics of the product, switching costs, transportation costs, price relationships and relative price levels, shipment patterns and foreign competition.

4.21 Several price and non-price factors could affect buyers' ability or willingness to consider distant options. Non-price factors include the fragility or perishability of the relevant product, convenience, frequency of delivery, and the reliability of service or delivery.

4.22 As with product market definition, high switching costs may discourage buyers from substituting between geographic areas. In addition, transportation costs play a central role in defining the geographic scope of relevant markets because they directly affect price. For example, when the price of the relevant product in a distant area plus the cost of transporting it to a candidate geographic market exceeds the price in the candidate market including a SSNIP, the relevant market does not generally include the products of sellers located in the distant area.[23]

4.23 Evidence that prices in a distant area have historically either exceeded or been lower than prices in the candidate geographic market by more than the transportation costs may indicate that the two areas are in separate relevant markets, for reasons that go beyond transportation costs.[24] However, before reaching this conclusion, the Bureau determines whether a SSNIP in the candidate geographic market may change the pricing differential to the point that distant sellers may be able to constrain a SSNIP.

4.24 Significant shipments of the relevant product from a distant area into an area in which a price increase is being postulated may suggest that the distant area is in the relevant geographic market. However, pre-merger shipment patterns do not, by themselves, establish the constraining effect of distant sellers and may be insufficient to justify broadening the geographic market. The Bureau undertakes further analysis to determine whether shipments from the distant area would make the SSNIP unprofitable.

23 However, distant firms that have excess capacity may in certain circumstances be willing to ship to another market, even when the net price received is less than the price in their own market.

24 For example, the existence of tariffs or other trade-related factors may create price differentials.

Foreign Competition

4.25 Buyers' willingness or ability to turn to foreign sellers may be affected by buyers' tastes and preferences, and by border-related considerations. Buyers may be less willing or able to switch to foreign substitutes when faced with factors such as exchange rate risk, local licensing and product approval regulations, industry-imposed standards, or initiatives to "buy local" owing to difficulties or uncertainties when crossing the border. Conversely, buyers may be more willing to turn to foreign substitutes when they have ample information about foreign products and how to source them, when foreign sellers or their products have already been placed on approved sourcing lists, or when technology licensing agreements, strategic alliances or other affiliations exist between domestic buyers and foreign firms.

4.26 When it is clear that the sales area of the merging parties and that of foreign sellers both belong in the relevant market (because sufficient buyers would be willing to respond to a SSNIP by turning to these sellers), the boundaries of the market are expanded beyond Canada to include the locations of foreign sellers.[25]

Delineating Geographic Boundaries

4.27 The geographic locations of buyers and sellers are relevant to delineating boundaries, particularly when markets are local or regional in nature. The underlying assumption is that profit-maximizing firms make decisions about where to locate based on the density of their buyer base and try to avoid cannibalizing their own sales when they have two or more locations in close proximity. In this way, demand responses are still key determinants of market boundaries. The Bureau may use spatial competition analysis to help delineate the boundaries of localized geographic markets.[26] The methodology for applying spatial competition analysis depends on the characteristics of the industry and the market under consideration.

4.28 It is important to emphasize that market boundaries in respect of either product or geographic markets are not precise in many instances. In addition, constraints on a merged firm's pricing behaviour can come from both inside and outside the relevant market as defined. These issues are discussed further below.

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25 See section 93(*a*) of the Act. In addition to its relevance to market definition, the extent to which foreign products or foreign competitors provide or are likely to provide effective competition is evaluated in the context of the analysis described in Parts 5, 6 and 7, below.

26 When using spatial competition analysis, the Bureau identifies all locations (such as stores, branches, hubs and outlets) of both the merging parties and their product market competitors, to determine how firms' physical locations are situated relative to one another.

PART 5: MARKET SHARES AND CONCENTRATION

5.1 When engaged in a market definition exercise, the Bureau identifies participants in a relevant market to determine market shares and concentration levels. Such participants include (1) current sellers of the relevant products in the relevant geographic markets and (2) sellers that would begin selling the relevant products in the relevant geographic markets if the price were to rise by a SSNIP. In the latter case, the Bureau considers a firm to be a participant in a relevant market when it does not require significant sunk investments to enter or exit the market and would be able to rapidly and profitably divert existing sales or capacity to begin supplying the market in response to a SSNIP (a "supply response").[27] The Bureau considers situations in which competitive sellers would need to incur significant sunk investments, or would not be able to respond rapidly, in the analysis of entry (see Part 7, below).

Calculating Market Shares

5.2 The Bureau calculates market shares for all sellers who have been identified as participants in the relevant market.

5.3 Market shares can be measured in various ways, for example in terms of dollar sales, unit sales, capacity or, in certain natural resource industries, reserves.[28] When calculating market shares, the Bureau uses the best indicators of sellers' future competitive significance. In cases in which products are undifferentiated or homogeneous (i.e., have no unique physical characteristics or perceived attributes), and firms are all operating at full capacity, market shares based on dollar sales, unit sales and capacity should yield similar results. In such situations, the basis of measurement depends largely on the availability of data.

5.4 When firms producing homogeneous products have excess capacity, market shares based on capacity may best reflect a firm's relative market position and competitive influence in the market. Excess capacity may be less relevant to calculating market shares when it is clear that some of a firm's unused capacity does not have a constraining influence in the relevant market (e.g., because the capacity is high-cost capacity or the firm is not effective in marketing its product). When a regulated or historical incumbent firm is facing deregulation or enhanced competition, shares based on new customer acquisitions may be a better indicator of competitive vigor than are shares based on existing customers.

5.5 As the level of product differentiation in a relevant market increases, market shares calculated on the basis of dollar sales, unit sales and capacity increasingly differ. For

27 When merging firms compete across several markets and face the same competitors in each, the Bureau may use an aggregate description of these markets simply as a matter of convenience.

28 Throughout these guidelines, the term "capacity" means the ability to *produce* or *sell* a product. Capacity to sell refers to marketing and distribution capabilities, such as a sales force, distribution networks and other related infrastructure.

example, if most of the excess capacity in the relevant market were held by discount sellers in a highly differentiated market, the market shares of these sellers calculated on the basis of total capacity would be greater than if they were calculated on the basis of actual unit or dollar sales. In this case, market shares based on total capacity would be a misleading indicator of the relative market position of the discount sellers.[29] In such circumstances, dollar sales may be the better indicator of the size of the total market and of the relative positions of individual firms. Because unit sales may also provide important information about relative market positions, the Bureau often requests both dollar sales and unit sales data from the merging parties and other sellers.[30]

5.6 The Bureau generally includes the total output or total capacity of current sellers located within the relevant market in the calculation of the total size of the market and the shares of individual competitors. However, when a significant proportion of output or capacity is committed to business outside the relevant market and is not likely to be available to the relevant market in response to a SSNIP, the Bureau generally does not include this output or capacity in its calculations.

5.7 For firms that participate in the market through a supply response, the Bureau only includes in the market share calculations the output or capacity that would likely become available to the relevant market without incurring significant sunk investments.

Market Share and Concentration Thresholds

5.8 Consistent with section 92(2) of the Act, information that demonstrates that market share or concentration is likely to be high is not, in and of itself, sufficient to justify a conclusion that a merger is likely to prevent or lessen competition substantially. However, information about market share and concentration can inform the analysis of competitive effects when it reflects the market position of the merged firm relative to that of its rivals. In the absence of high post-merger market share and concentration, effective competition in the relevant market is generally likely to constrain the creation, maintenance or enhancement of market power by reason of the merger.

5.9 The Bureau has established the following thresholds to identify and distinguish mergers that are unlikely to have anti-competitive consequences from those that require a more detailed analysis:

29 Similar results occur as the level of differentiation between sellers increases. For instance, two firms may operate with the same capacity (e.g., number of trucks) but have significantly different revenue streams (because one firm may have many buyers along a truck route, i.e., route density). In such cases, market shares based on capacity and revenues provide different information about relative market positions.

30 While publicly available or readily observable information may be useful for estimating market shares, when credible and possible, the Bureau relies on transaction-level data from individual market participants as the most accurate measure of market shares.

- The Commissioner generally will not challenge a merger on the basis of a concern related to the unilateral exercise of market power when the post-merger market share of the merged firm would be less than 35 percent.
- The Commissioner generally will not challenge a merger on the basis of a concern related to a coordinated exercise of market power when
  - the post-merger market share accounted for by the four largest firms in the market (known as the four-firm concentration ratio or CR4) would be less than 65 percent; or
  - the post-merger market share of the merged firm would be less than 10 percent.

5.10 Mergers that give rise to market shares or concentration that exceed these thresholds are not necessarily anti-competitive. Under these circumstances, the Bureau examines various factors to determine whether such mergers would likely create, maintain or enhance market power, and thereby prevent or lessen competition substantially.

5.11 When other information suggests that current market shares do not reflect the competitive role of one of the merging parties relative to its rivals, the Bureau considers this information when determining whether a merger is likely to prevent or lessen competition substantially. In all cases, examining market shares and concentration is only one part of the Bureau's analysis of competitive effects.

5.12 In addition to the level of market shares or concentration in the relevant market, the Bureau examines the distribution of market shares across competitors and the extent to which market shares have changed or remained the same over a significant period of time.

5.13 All else being equal, the likelihood that a number of firms may be able to bring about a price increase through coordinated behaviour increases as the level of concentration in a market rises and as the number of firms declines.[31] In contrast, coordinated behaviour becomes increasingly difficult as the number or size of firms that have the ability to increase output increases.

5.14 When evaluating market share information, the Bureau considers the nature of the market and the impact of forthcoming change and innovation on the stability of existing market shares.[32] While a small incremental increase in concentration following a merger may suggest that the merger is not likely to have a significant impact on the

31 In addition to the CR4, the Bureau may examine changes in the Herfindahl-Hirschman Index ("HHI") (calculated by summing the squares of the individual market shares of all market participants) to observe the relative change in concentration before and after a merger. While the change in HHIs may provide useful information about changes in the market structure, the Bureau does not use HHI levels to delineate any safe harbour threshold.

32 For example, historical or existing market shares may be less relevant in bidding markets in which rapid fluctuations in market shares are more common. In such cases, the analysis focuses on the likely future effectiveness of independent sources of competition, regardless of their current shares. Bidding and bargaining markets are discussed in additional detail under "Unilateral Effects" in Part 6.

market, the Bureau assesses the growth expectations for one or both of the merging parties to determine whether the merger may eliminate an important competitive force.

PART 6: ANTI-COMPETITIVE EFFECTS

6.1 As noted in Part 3, above, the Bureau may consider market definition and competitive effects concurrently in a dynamic and iterative analytical process. When the market share and concentration thresholds listed in paragraph 5.9, above, are exceeded or when other information suggests that a merger may prevent or lessen competition substantially, the Bureau's assessment of competitive effects based on quantitative analysis and the application of relevant factors, including the factors listed in section 93 of the Act, takes on greater importance. Such an assessment falls under the broad categories of unilateral effects and coordinated effects, as described below.

6.2 When it is clear that the level of effective competition that is to remain in the relevant market is not likely to be reduced as a result of the merger, this alone generally justifies a conclusion not to challenge the merger.

6.3 To determine the ability and effectiveness of remaining competitors to constrain an exercise of market power by the merged firm, the Bureau examines existing forms of rivalry, such as discounting and other pricing strategies, distribution and marketing methods, product and package positioning, and service offerings. Whether the market shares of firms are stable or fluctuate over time is also relevant, as is the extent to which product differentiation affects the degree of direct competition among firms. Further, the Bureau assesses whether competitors are likely to remain as vigorous and effective as they were prior to the merger.

6.4 The extent and quality of excess capacity held by merging and non-merging firms provides useful information about whether the merger could result in the exercise of market power. Excess capacity held by rivals to the merged firm improves their ability to expand output should the merged firm attempt to exercise market power. On the other hand, when the merged firm holds a significant share of excess capacity in the relevant market, this may discourage rivals from expanding.

6.5 The Bureau assesses the competitive attributes of the target business to determine whether the merger will likely result in the removal of a vigorous and effective competitor.[33] In addition to the forms of rivalry discussed above, the Bureau's assessment includes consideration of whether one of the merging parties:

33 See section 93(*f*) of the Act. A firm that is a vigorous and effective competitor often plays an important role in pressuring other firms to compete more intensely with respect to existing products or in the development of new products. A firm does not have to be among the larger competitors in a market in order to be a vigorous and effective competitor. Small firms can exercise an influence on competition that is disproportionate to their size. Mavericks (described in "Coordinated Effects," in Part 6, below) are one type of vigorous and effective competitor.

- has a history of not following price increases or market stabilizing initiatives by competitors, or of leading price reductions;
- provides unique service, warranty or other terms to the market;
- has recently expanded capacity or has plans to do so;
- has recently made gains in market share or is in a position to do so; or
- has recently acquired intellectual property rights or other inputs, or has developed product features that enhance its ability to compete in the market, or will soon do so.

6.6 While the removal of a vigorous and effective competitor through a merger is likely to prevent or lessen competition to some degree, it may not, in itself, provide a sufficient basis for a decision to challenge the merger. Additionally, when a firm removed through a merger is not a vigorous or effective competitor (e.g., owing to financial distress, or declining technologies or markets), this fact is relevant to, but not determinative of, a decision not to challenge a merger.

6.7 The Bureau evaluates the general nature and extent of change and innovation in a market.[34] In addition to assessing the competitive impact of technological developments in products and processes, the Bureau examines change and innovation in relation to distribution, service, sales, marketing, packaging, buyer tastes, purchase patterns, firm structure, the regulatory environment and the economy as a whole.

6.8 The pressures exerted by change and innovation on competitors in a market (including the merging parties) may be such that a material price increase is unlikely to be sustainable, especially when technology or a merger reduces barriers to entry or stimulates or accelerates the change or innovation in question. Such pressures may have important implications for efficient markets in the medium to long term.

6.9 A merger may facilitate the exercise of market power by impeding the process of change and innovation. For example, when a merger eliminates an innovative firm that presents a serious threat to incumbents, the merger may hinder or delay the introduction of new products, processes, marketing approaches, and aggressive research and development initiatives or business methods.

Unilateral Effects

6.10 By placing pricing and supply decisions under common control, a merger can create an incentive to increase price and restrict supply or limit other dimensions of competition. A unilateral exercise of market power occurs when the merged firm can profitably sustain a material price increase without effective discipline from competitive responses by rivals.

6.11 When buyers can choose from among many sellers offering comparable products, a firm's ability to profitably increase its price is limited by buyers diverting their

34 See section 93(*g*) of the Act.

purchases to substitute products in response to the price increase. When two firms in a market merge and the price of one firm's product(s) rises, some demand may be diverted to product(s) of the firm's merger partner, thereby increasing the overall profitability of the price increase and providing the impetus to raise the price. As such, the elimination of competition between firms as a result of a merger may lessen competition substantially.

6.12 Unilateral effects can occur in various market environments, defined by the primary characteristics that distinguish the firms within those markets and determine the nature of their competition. Three types of market environment are described below.

Firms in Differentiated Product Industries

6.13 In markets in which products are differentiated, a merger may create, enhance or maintain the ability of the merged firm to exercise market power unilaterally when the product offerings of the merging parties are close substitutes for one another. In such circumstances, the Bureau assesses how the merger may change the pricing incentives of the individual firms.

6.14 Any firm considering increasing the prices for its products faces a trade-off between higher profits on the sales that it continues to make following the price increase and the profits that it loses on sales that it no longer makes following the price increase, as buyers switch to other firms and/or other products. Any sales that were previously lost to the firm's merging partner will be captured by the merged firm ("diverted sales"). Thus, the incentives to raise prices after the merger are greater the more closely the products of the merging firms compete with each other, and the larger the profit margins on these diverted sales.

6.15 The closeness of competition between the merging firms' products may be measured by the diversion ratio between them.[35] The value of the diverted sales from one merging firm depends on the volume of diverted sales and the profit margin on the diverted sales. The greater the value of the diverted sales, the greater the incentive the merged firm has to raise prices.

6.16 The incentive to raise prices following the merger will typically be greater when the products of the merging firms are close substitutes for a significant number[36] of buyers, when the merger removes a vigorous and effective competitor from the market, or when buyers are not very sensitive to price increases.[37] These are not the only circumstances, however, when the Bureau may be concerned with potential unilateral effects post-merger.

35 The diversion ratio between firm A's product and firm B's product is equal to the fraction of sales lost by firm A to firm B when firm A raises the price of its product. Similarly, the diversion ratio between firm B's product and firm A's product is equal to the fraction of sales lost by firm B to firm A when firm B raises the price of its product. The diversion ratios between firms A and B need not be symmetric.

36 A significant number" in this context need not approach a majority.

37 Buyer sensitivity to price increases may but need not be measured by the own-price elasticity of demand.

6.17 Even when the merging firms are found to have an incentive to increase price after the merger, the likelihood of the merger preventing or lessening competition substantially also depends on the responses of buyers and rival firms. In addition to considering the value of sales currently diverted to rivals, the Bureau evaluates the likely competitive responses of rivals, including whether rivals in the market are likely to expand production, reposition their products or extend their product line to discipline unilateral market power that would otherwise occur as a result of the merger.[38] The Bureau also considers existing sellers that may only occupy a particular niche within the relevant market and whether they provide an alternative for a sufficient number of buyers. In addition, the likelihood and likely impact of entry is considered.

6.18 When assessing the extent of competition between the products of the merging firms, the Bureau examines, among other possible factors, past buyer-switching behaviour in response to changes in relative prices, information based on buyer preference surveys, win-loss records, and estimates of own-price and cross-price elasticities.[39]

Firms in Homogeneous Product Industries

6.19 A post-merger price increase may be profitable if the merger were to remove a seller to whom buyers would otherwise turn in response to a price increase. In markets in which products are relatively undifferentiated (that is, they are homogeneous), such a price increase is more likely to be profitable

- the greater the share of the relevant market the merged firm accounts for;
- the lower the margin on the output that the merged firm withholds from the market to raise price;
- the less sensitive buyers are to price increases; and
- the smaller the response of other sellers offering close substitutes.

6.20 The response of other sellers will be smaller when they have insufficient capacity to increase sales to replace the output withheld by the merged firm post-merger, or substantial amounts of capacity are committed to other buyers under long-term contracts, and capacity cannot be expanded quickly and at relatively low cost. Therefore, the Bureau examines, among other factors, whether capacity constraints limit the effectiveness of remaining sellers by impeding their ability to make their products available in sufficient quantities to counter an exercise of market power by the merged firm.

Bidding and Bargaining Markets

6.21 In some markets, sellers may interact with buyers through bidding or bargaining for the right to supply. Buyers may negotiate with multiple sellers as a means of using one seller to obtain a better price from another seller. Such interactions may take the form of a pure auction or involve repeated rounds of negotiation with a select group

38 This requires a determination of whether expansion, repositioning or product line extension will likely be deterred by risk, sunk costs or other entry barriers.

39 Refer to definitions of own-price and cross-price elasticity in paragraph 4.11, above.

of sellers. A merger between two sellers will prevent buyers from playing these two sellers off against each other to obtain a better price.

6.22 The extent to which this loss of competition will affect the price paid by the buyer depends on how close the merging firms are to each other relative to other bidders and potential suppliers in meeting the buyer's requirements. When there are many bidders or potential suppliers that are equally or similarly situated as the merging parties, a merger involving two sellers is unlikely to prevent or lessen competition substantially.[40]

Coordinated Effects

6.23 A merger may prevent or lessen competition substantially when it facilitates or encourages coordinated behaviour among firms after the merger. The Bureau's analysis of these coordinated effects entails determining how the merger is likely to change the competitive dynamic in the market such that coordination is substantially more likely or effective. A lessening or prevention of competition may result from coordinated behaviour even when the coordination does not involve all the firms in the market.

6.24 Coordination involves interaction by a group of firms (including the merged firm) that is profitable for each firm because of each firm's accommodating reactions to the conduct of the others. Coordinated behaviour may relate to price, service levels, allocation of customers or territories, or any other dimension of competition.

6.25 Coordinated behaviour may involve tacit understandings that are not explicitly negotiated or communicated among firms. Tacit understandings arise from mutual yet independent recognition that firms can, under certain market conditions, benefit from competing less aggressively with one another. Coordinated behaviour may also involve express agreements among firms to compete less vigorously or to refrain from competing. Such agreements may raise concerns under the conspiracy and bid-rigging provisions of the Act.

6.26 Coordinated behaviour is likely to be sustainable only in the following circumstances:

- when firms are able to
    - individually recognize mutually beneficial terms of coordination;
    - monitor one another's conduct and detect deviations from the terms of coordination; and
    - respond to any deviations from the terms of coordination through credible deterrent mechanisms;[41] and

40 As noted in footnote 32 above, historical or existing market shares may be less relevant in bidding markets.

41 These responses, typically known as punishments, may take the form of lowering prices in the relevant market or in other markets.

- when coordination will not be threatened by external factors, such as the reactions of existing and potential competitors not part of the coordinating group of firms or the reactions of buyers.

6.27 Competition is likely to be prevented or lessened substantially when a merger materially increases the likelihood of coordinated behaviour when none existed before, or materially increases the extent or effectiveness of coordination beyond that which already exists. When making this assessment, the Bureau considers a number of factors, including the presence of factors necessary for successful coordination and those that are conducive to coordination. The mere presence of such factors, however, is not sufficient to conclude that there are competition concerns. Rather, at issue is whether the merger impacts these factors in such a way that makes coordination or more effective coordination more likely.

Market Concentration and Entry Barriers

6.28 Market power typically arises in markets characterized by concentration and high barriers to entry. Market concentration is generally a necessary but not sufficient condition for a merger to prevent or lessen competition substantially through coordinated effects. Firms in a concentrated market typically find it easier and less costly to engage in coordinated behaviour because it is easier for members of a small group of firms to recognize terms of coordination, and to monitor one another's conduct and detect and respond to deviations. Barriers to entry are also relevant, since coordinated behaviour among competitors in a concentrated market would unlikely be sustainable if raising prices were to lead to significant effective entry.

Indicia Suggesting that Market Conditions are Conducive to Coordination

6.29 In its analysis of competitive effects, the Bureau examines whether market conditions would likely allow coordinated behaviour to be sustainable after the merger, with reference to the criteria outlined in paragraph 6.26, above. While the presence of certain market conditions (often referred to as facilitating factors) may suggest the ability of firms to overcome impediments to coordinated behaviour, neither the absence nor the presence of any single factor or group of factors determines whether competition is likely to be prevented or lessened substantially.

6.30 When examining whether firms are likely able to independently recognize mutually beneficial terms of coordination, the Bureau considers, among other factors, the degree of product differentiation and cost symmetries among firms. Recognizing terms of coordination that all firms find profitable is easier when products are less differentiated and when firms have similar cost structures. Complex products and differences in product offerings and cost structure tend to make it more difficult for firms to reach profitable terms of coordination. Similarly, markets with rapid and frequent product innovations, or that are in a period of rapid growth, are less conducive to coordinated behaviour.

6.31 Profit-maximizing firms have an incentive to deviate from coordinated behaviour when the expected profits from deviating are greater than the expected profits from engaging in coordination. Therefore, when evaluating whether coordination is likely, the Bureau considers whether certain firms have stronger incentives to deviate as well as factors that could affect incentives to deviate, such as the size and frequency of transactions. When individual transactions are large and infrequent relative to total market demand, deviations from coordinated behaviour are more profitable, making effective coordinated behaviour less likely. Additionally, when individual transactions are large relative to a single firm's total output, this will increase that firm's incentive to deviate from coordinated behaviour.[42]

6.32 The Bureau also considers whether firms can monitor and detect deviations from coordinated behaviour. When so doing, the Bureau evaluates the degree of market transparency that exists. When information about prices, rival firms and market conditions is readily available to market participants, it is easier for rivals to monitor one another's behaviour, which in turn makes effective coordination more likely. The existence of industry organizations that facilitate communication and dissemination of information among market participants may also make it easier for firms to coordinate their behaviour. A complex, multi-stage procurement process may affect the ability of firms to detect deviations from coordinated agreements. Also relevant to the analysis is the stability of firms' underlying costs, as well as the predictability of demand. When costs fluctuate, it may be difficult to detect whether a price change represents a deviation from coordinated behaviour or whether it is a response to a change in cost conditions, which, in turn, makes effective coordination less likely. It may similarly be difficult to detect whether a price change represents a deviation from coordinated behaviour when demand fluctuates unexpectedly.

6.33 The Bureau's evaluation of whether firms can impose credible punishments includes assessing the degree of multi-market exposure among firms and of excess capacity.[43] When firms participate in multiple geographic or product markets, there are greater opportunities for them to discourage deviation from coordinated behaviour because there is broader scope for punishing deviations. Similarly, excess capacity held by firms within the coordinating group can allow such firms to oversupply the market when they detect deviations from the coordinated price, thereby discouraging deviations and making coordination more likely. However, excess capacity may also provide firms with an incentive and an ability to deviate from coordinated behaviour by selling products at lower prices. This could, in turn, make coordinated behaviour less likely. It is therefore important to consider which firms, if any, hold excess capacity as well as their individual economic incentives. A firm may also adopt pricing policies, such

42 These examples assume that coordination does not involve a customer allocation scheme.

43 This includes information about levels of service, innovation initiatives, product quality, product choice and levels of advertising. Market transparency is typically increased by posted pricing, circulation of price books, product, service or packaging standardization, exchanges of information regarding matters such as pricing, output, innovation, bids won and lost, and advertising levels, through a trade association, trade publication or otherwise, public disclosure of this information by buyers or through government sources, and "meet the competition" or "most favoured customer" clauses in contracts.

as most-favoured customer clauses, that commit it to following a low-pricing strategy when other firms reduce their prices.

6.34 A history of collusion or coordination in the market is also relevant to the Bureau's analysis, because previous and sustained collusive or coordinated behaviour indicates that firms have successfully overcome the hurdles to effective coordinated behaviour in the past.

Impact of the Merger on Coordinated Behaviour

6.35 When assessing whether a merger increases the likelihood of coordination, the Bureau considers whether the merger changes the competitive dynamic in a market so as to make coordinated behaviour among firms more likely or effective. A merger that changes the competitive dynamic among firms may lead to coordinated behaviour when none existed prior to the merger, or may materially increase the extent or effectiveness of coordination beyond that which already exists in a market. The Bureau determines whether market conditions are conducive to coordination before the merger and whether the merger is likely to increase the likelihood of coordination. The Bureau also identifies the constraints on coordinated behaviour that existed before the merger to determine whether the merger reduces or eliminates those constraints.

6.36 In highly concentrated markets, effective coordination may be constrained by the number of firms that exist before the merger. A merger could remove this constraint by reducing the number of rivals to the point that the profitability of coordination makes coordination a more achievable strategy than it was prior to the merger.

6.37 When firms differ greatly from one another, effective coordination may be constrained by their inability to behave in a way that each finds profitable. When the effect of the merger is to reduce or eliminate asymmetries between the merged firm and its key rivals, firms may find it easier to coordinate their behaviour in a way that is profitable for each coordinating firm after the merger. Conversely, a merger may increase asymmetries between the merged firm and its rivals, thereby making coordinated behaviour less profitable and therefore less likely.

6.38 Effective coordination may be constrained before the merger by the activities of a particularly vigorous and effective competitor (a "maverick"). A maverick is a firm that plays a disruptive role and provides a stimulus to competition in the market. An acquisition of a maverick may remove this constraint on coordination and, as such, increase the likelihood that coordinated behaviour will be effective.

6.39 Alternatively, a merger may not remove a maverick but may instead inhibit a maverick's ability to expand or enter, or otherwise marginalize its competitive significance, thereby increasing the likelihood of effective coordination.

PART 7: ENTRY

7.1 A key component of the Bureau's analysis of competitive effects is whether timely entry[44] by potential competitors would likely occur on a sufficient scale and with sufficient scope to constrain a material price increase in the relevant market. In the absence of impediments to entry, a merged firm's attempt to exercise market power, either unilaterally or through coordinated behaviour with its rivals, is likely to be thwarted by entry of firms that

- are already in the relevant market and can profitably expand production or sales;
- are not in the relevant market but operate in other product or geographic markets and can profitably switch production or sales into the relevant market; or
- can profitably begin production or sales into the relevant market de novo.

Conditions of Entry

7.2 Entry is only effective in constraining the exercise of market power when it is viable. When entry is likely, timely and sufficient in scale and scope, an attempt to increase prices is not likely to be sustainable as buyers of the product in question are able to turn to the new entrant as an alternative source of supply.

Timeliness

7.3 The Bureau's assessment of the conditions of entry involves determining the time that it would take for a potential entrant to become an effective competitor in response to a material price increase that is anticipated to arise as a result of the merger. In general, the longer it takes for potential entrants to become effective competitors, the less likely it is that incumbent firms will be deterred from exercising market power. For that deterrent effect to occur, entrants must react and have an impact on price in a reasonable period of time. In the Bureau's analysis, the beneficial effects of entry on prices in this market must occur quickly enough to deter or counteract any material price increase owing to the merger, such that competition is not likely to be substantially harmed.

Likelihood

7.4 When determining whether future entry is likely to occur, the Bureau generally starts by assessing firms that appear to have an entry advantage. While other potential sources of competition may also be relevant, typically the most important sources of potential competition are the following:

- fringe firms already in the market;
- firms that sell the relevant product in adjacent geographic areas;

44 As noted previously, throughout these guidelines, the term "entry" also refers to expansion by existing firms. The same factors that constrain new entrants also often constrain significant expansion by fringe firms, even though in many cases expansion costs for existing firms may be lower than entry costs for a new entrant.

- firms that produce products with machinery or technology that is similar to that used to produce the relevant product;
- firms that sell in related upstream or downstream markets;
- firms that sell through similar distribution channels; and
- firms that employ similar marketing and promotional methods.

7.5 A history of entry into and exit from a particular market provides insight into the likelihood of entry occurring in a timely manner and on a sufficient scale to counteract an exercise of market power by a merged firm. It is, however, not the sole determinant of whether this would likely occur.

7.6 The Bureau seeks to determine the extent that entry is likely, given the commitments that potential entrants must make, the time required to become effective competitors, the risks involved and the likely rewards. The Bureau considers any delay or loss that potential entrants expect to encounter before becoming effective competitors, and the resulting sunk costs and risk associated with such entry that reduce the likelihood that entry will occur or be successful. The Bureau also considers the expectations that potential entrants may have of incumbent responses to entry, as well as the likelihood that customers will support an entrant's investments or guarantee it a needed volume of sales. When assessing the likelihood of entry, the Bureau evaluates profitability at post-entry prices, taking into account the effect that new supply would have on market prices. These prices are often the pre-merger price levels. For instance, if a competitor was able to enter a market only on a scale that is below the minimum viable scale, the Bureau would not consider such entry to be likely, since the entrant would be unable to achieve the annual level of sales necessary to achieve profitability at post-entry prices.

Sufficiency

7.7 When considering whether entry is likely to be on a scale and scope that would be sufficient to deter or counteract a material price increase, the Bureau examines what would be required from potential competitors who choose to enter. The Bureau will also consider any constraints or limitations on new entrants' capacities or competitive effectiveness. Entry by firms that seek to differentiate themselves by establishing a niche to avoid direct competition with the merged firm may also not be sufficient to constrain an exercise of market power.

Types of Barriers to Entry

7.8 Barriers to entry affect the timeliness, likelihood and sufficiency of entry. They can take many forms, ranging from absolute restrictions that preclude entry, to sunk costs and other factors that raise the costs and risks associated with entry and thereby deter it.[45] While, in some cases, each individual "barrier" may be insufficient alone to impede entry, the Bureau considers the collective influence of all barriers which, when taken together, can effectively deter entry.

45 While commencing a business may in some cases be easy, new entrants may find it difficult to survive for a variety of reasons, including the strategic behaviour of incumbents.

Regulatory Barriers

7.9 The types of barriers identified in section 93(*d*) of the Act—namely tariff and non-tariff barriers to international trade, interprovincial barriers to trade and regulatory control over entry—can provide incumbents with absolute cost advantages over potential entrants, presenting considerable and, in some cases, insurmountable impediments to entry.

Sunk Costs

7.10 Substantial sunk costs directly affect the likelihood of entry and constitute a significant barrier to entry. Costs are sunk when they are not recoverable if the firm exits the market. In general, since entry decisions are typically made in an environment in which success is uncertain, the likelihood of significant future entry decreases as the absolute amount of sunk entry costs relative to the estimated rewards of entry increases. The Bureau's assessment of sunk costs also focuses on the time required to become an effective competitor and the probability of success, and whether these factors justify making the required investments.

7.11 New entrants must often incur various start-up sunk costs, such as acquiring market information, developing and testing product designs, installing equipment, engaging personnel and setting up distribution systems. New entrants may also face significant sunk costs owing to the need to

- make investments in market-specific assets and in learning how to optimize the use of these assets;
- overcome product differentiation-related advantages enjoyed by incumbents; or
- overcome disadvantages presented by the strategic behaviour of incumbents.

7.12 These potential sources of sunk costs can create significant impediments to entry when they require that potential entrants factor greater costs into their decision-making relative to incumbents who can ignore such costs in their pricing decisions because they have already made their sunk cost commitment.

7.13 The investment required to establish a reputation as a reliable or quality seller is also a sunk cost, constituting a barrier to entry when it is an important element in attracting buyers, particularly in industries in which services are an important element of the product. Under these circumstances, the time to establish a good reputation may make profitable entry more difficult, and therefore delay the competitive impact that an entrant may have in the marketplace.

7.14 Long-term exclusive contracts with automatic renewals, rights of first refusal, most favoured customer or "meet or release" clauses or termination fees may constitute barriers to entry. Contracts with attributes that limit buyer switching may make it difficult for firms to gain a sufficient buyer base to be profitable in one or more markets (even when barriers to entry in the industry are otherwise relatively low) and can thus make entry unattractive. The deterring effects of such contracts are more pronounced when, for example, economies of density or scale are important and make it difficult for new or smaller firms to achieve a minimum efficient scale of operations.

Other Factors That Deter Entry

7.15 In markets in which economies of scale are significant, entry on a small scale may be difficult unless the entrant can successfully exploit a niche. Conversely, entry in such markets on a large scale may expand available capacity to supply beyond market demand, thereby depressing market prices and making entry less attractive.

7.16 Market maturity can also impede entry. Entry may be less difficult and time-consuming in the start-up and growth stages of a market, when the dynamics of competition generally change more rapidly. Mature markets exhibit flat or declining demand, making it more difficult for potential entrants to profitably enter the business because the entrants' sales have to come from existing rivals.

7.17 Other cost advantages for incumbents that may deter entry include those related to transportation costs, control over access to scarce or non-duplicable resources such as technology, land, natural resources and distribution channels, network effects, and capital costs.[46]

PART 8: COUNTERVAILING POWER

8.1 When determining whether a merger is likely to result in a material price increase, the Bureau assesses whether buyers are able to constrain the ability of a seller to exercise market power. This may occur when, for example,

- they can self-supply through vertical integration into the upstream market;
- the promise of substantial orders can induce expansion of an existing smaller supplier and/or can sponsor entry by a potential supplier not currently in the market;
- they can refuse to buy other products produced by the seller;
- they can refuse to purchase the seller's products in other geographic markets where the competitive conditions are different; or
- they can impose costs on the seller (for example, by giving less favourable retail placement to the merged entity's products).

8.2 The Bureau does not presume that a buyer has the ability to exercise countervailing power merely by virtue of its size. There must be evidence that a buyer, regardless of size, will have the ability and incentive to constrain an exercise of market power by the merged firm. Evidence of prior dealings between the buyer and one or more of the merging parties that tends to demonstrate the buyer's relative bargaining strength is of particular relevance. The Bureau also considers the extent to which

46 The need to raise capital may have a significant impact on the likelihood and timeliness of entry.

the merger affects the buyer's ability and incentive to exercise countervailing power. When a merger eliminates a supplier whose presence contributed significantly to a buyer's historical bargaining strength, the buyer may no longer be able to exercise countervailing power after the merger.

8.3 When price discrimination is a feature of the relevant market, it may be possible for some but not all buyers to counter the effects of an exercise of market power. For example, a merged firm may be able to increase prices to buyers that do not have the option to vertically integrate their operations, while other buyers with this option may be able to resist such a price increase. Where only a subset of buyers is able to counter a price increase or other exercise of market power, the Bureau will generally find that countervailing power is insufficient to prevent the merged firm from exercising market power in the relevant market.

PART 9: MONOPSONY POWER

9.1 A merger of competing buyers may create or enhance the ability of the merged firm, unilaterally or in coordination with other firms, to exercise monopsony power. The Bureau is generally concerned with monopsony power when a buyer holds market power in the relevant purchasing market, such that it has the ability to decrease the price of a relevant product below competitive levels with a corresponding reduction in the overall quantity of the input produced or supplied in a relevant market, or a corresponding reduction in any other dimension of competition.[47]

9.2 Consistent with its general analytical framework for merger review, the Bureau considers both market definition-based and other evidence of competitive effects in monopsony cases. The conceptual basis used for defining relevant markets is, mirroring the selling side, the hypothetical monopsonist test. A relevant market is defined as the smallest group of products and the smallest geographic area in which a sole profit-maximizing buyer (a "hypothetical monopsonist") would impose and sustain a significant and non-transitory price decrease below levels that would likely exist in the absence of the merger. The relevant product market definition question is thus whether suppliers, in response to a decrease in the price of an input, would switch to alternative buyers or reposition or modify the product they sell in sufficient quantity to render the hypothetical monopsonist's price decrease unprofitable.

9.3 In order to determine market shares and concentration levels, the Bureau compares the size of the purchases of the relevant product by the merging parties with the total sales of the relevant product. When the merging parties represent only a small percentage of the total purchases of the relevant product, the Bureau generally considers the suppliers to be well-placed to forego sales to the merging parties in

47 Cases where the supply curve is perfectly inelastic, such that a price decrease below competitive levels does not result in a decrease in output but only a wealth transfer, may also give rise to concerns. This scenario should be understood to be generally included in the category of monopsony. Similarly, an output effect is not required in monopoly cases.

favour of other buyers when faced with an attempt to lower prices. As a general rule, the Bureau will not challenge a merger based on monopsony (or oligopsony) power concerns where shares of the relevant upstream market held by the merging parties (and their competitors, in an oligopsony case) fall below the market share safe harbours set out in Part 5 of these guidelines. When the merging parties account for a significant portion of purchases of the relevant product and exceed these market share safe harbours, then it is more likely that the merging parties could exercise monopsony power. In this case, the Bureau considers barriers to entry that may limit or negate the ability of a new buyer to purchase the product, or of an existing buyer to expand its purchases (see Part 7 for a detailed discussion of the Bureau's approach to assessing entry).

9.4 When the merged firm accounts for a significant portion of purchases of the relevant product, and barriers to buying the input are high, the factors that the Bureau considers when attempting to determine whether the merged firm is likely to have the ability to exercise monopsony power include the following:

- whether the merged firm can restrict its purchases by an amount that is large enough to reduce the relevant product's price in the market;
- whether upstream supply of the relevant product is characterized by a large number of sellers and low barriers to entry into buying such that the normal selling price of a supplier is likely competitive;
- whether it seems likely that certain suppliers will exit the market or otherwise reduce production, or will reduce investments in new products and processes in response to the anticipated price decrease;
- whether a reduction in the merged firm's purchases of the relevant (input) product is likely to reduce the profits earned by the merged firm in downstream output markets, and, if so, whether the downstream output profit reduction is large enough to reduce the merged firm's incentive to restrict its purchases; and
- whether a reduction in the merged firm's purchases of the relevant product is likely to reduce its access to adequate supply of the relevant product in the long run.

9.5 When available, the Bureau considers empirical evidence to analyze the effect of historical changes in supply on price and quantity as part of the assessment of whether the merging parties would have the ability to exercise monopsony power.

PART 10: MINORITY INTEREST TRANSACTIONS AND INTERLOCKING DIRECTORATES

10.1 Part 1, above, outlines the factors the Bureau considers when determining whether a minority interest transaction or interlocking directorate confers the requisite level of influence to constitute a merger. Additionally, a minority interest or interlocking directorate may be ancillary to a merger that the Bureau is otherwise reviewing (e.g., when one of the merging parties holds a minority interest in a third competitor prior to the merger).[48] This Part outlines the Bureau's approach to minority interest transactions where the Bureau has jurisdiction under the merger provisions of the Act.

10.2 The Bureau's analysis of minority interests and interlocks that are determined to be mergers under Part 1 of these guidelines involves two distinct steps:

- First, the Bureau conducts a preliminary examination of the transaction as a full merger between the acquirer and the target firm. This exercise is used to screen out benign cases. When the Bureau concludes that a full merger would not likely prevent or lessen competition substantially[49], then a more detailed analysis of the minority interest or interlocking directorate is not generally required.
- When, based on its preliminary examination, the Bureau determines that a full merger would raise possible competition concerns, it then moves to the second step in its analysis, in which it (1) examines the specific nature and impact of the minority shareholding and/or interlocking directorate; and (2) conducts a detailed examination of the likely competitive effects arising from the minority shareholding and/or interlocking directorate.

10.3 A minority interest or interlocking directorate may impact competition by affecting the pricing or other competitive incentives of the target, the acquirer or both. Note that, with respect to interlocking directorates, the Bureau is not generally concerned when board representation in these circumstances occurs solely through "independent" directors when the businesses do not compete.

48 As noted in paragraph 1.16, above, an interlocking directorate alone would rarely constitute a merger although it could; however, interlocks are often features of partial interest transactions that otherwise qualify as a merger. The Bureau considers features of any interlock in its assessment of the competitive effects of a merger. Of particular relevance are the following factors: relationship between the interlocked firms, the role and duty of the interlocked director toward the interlocked firms, board composition and the position of the interlocked director on the boards, information to which the interlocked director has access, any special powers of the interlocked director, including voting or veto rights, and any contractual or practical mechanisms that the interlocked director might use to influence firm policies or decision-making.

49 As noted below in paragraph 12.3, in reviewing a full merger the Bureau may make an assessment of whether the efficiency gains that are likely to be brought about by the merger will be greater than and will offset the anti-competitive effects of that merger. By contrast, minority interest transactions typically do not involve the integration of firms and therefore efficiency gains are not typically considered by the Bureau in reviewing minority interests.

10.4 When assessing the target's pricing or other competitive incentives, the Bureau first considers whether, by virtue of its ability to materially influence the economic behaviour of the target business, the acquirer or interlocked director may induce the target business to compete less aggressively. The Bureau also considers the extent of such influence and the likelihood that competition will be prevented or lessened as a result of its exercise.

10.5 Second, the Bureau considers whether the transaction provides the acquirer or the firm with the interlocked director access to confidential information about the target business. In particular, the Bureau examines the likelihood that such access may facilitate coordination between the two firms, may affect the unilateral competitive conduct of the firm that receives the information, or both.

10.6 With respect to the acquirer, the Bureau considers whether a minority interest or interlock may result in a change to the acquirer's pricing or other competitive incentives. A firm that holds a minority position in a target business that is a competitor might have a reduced incentive to compete with the target business because if the acquirer raises its price and consequently loses sales, it will benefit, through its minority interest, from sales that flow to the target business. In effect, the acquirer will recapture some of the sales diverted to the target business and may thus have a greater incentive to raise its own price than it would absent the minority interest. In its assessment, the Bureau considers the extent of diversion between the acquiring and target firms' products and the profits earned on these diverted sales. The Bureau also examines the likelihood, significance and impact of any such change to the incentives of the acquirer.

PART 11: NON-HORIZONTAL MERGERS

11.1 A horizontal merger is a merger between firms that supply competing products. By contrast, non-horizontal mergers involve firms that do not supply competing products. The two main types of non-horizontal mergers are vertical mergers and conglomerate mergers. A vertical merger is a merger between firms that produce products at different levels of a supply chain (e.g., a merger between a supplier and a customer). A conglomerate merger is a merger between parties whose products do not compete, actually or potentially[50], and are not vertically related. Conglomerate mergers may involve products that are related because they are complementary (e.g., printers and ink cartridges),[51] or because customers buy them together owing to purchasing economies of scale or scope.

50 Mergers between potential competitors are dealt with as prevention of competition cases. See paragraphs 2.10-2.12 above.

51 That is, the goods are economic complements, such that the quantity demanded of one product decreases as the price of the other increases.

11.2 Non-horizontal mergers are generally less likely to prevent or lessen competition substantially than are horizontal mergers. This is because non-horizontal mergers may not entail the loss of competition between the merging firms in a relevant market. Non-horizontal mergers also frequently create significant efficiencies.[52] However, non-horizontal mergers may reduce competition in some circumstances, as outlined below.

11.3 The civil provisions of the Act may be available to address conduct by the merged firm that constitutes a refusal to deal, an abuse of dominance or other reviewable conduct. However, where the Bureau is able to remedy or enjoin a merger that is likely to substantially prevent or lessen competition, it will generally do so in preference to pursuing post-merger remedies under other provisions of the Act.

Unilateral Effects of Non-Horizontal Mergers

11.4 A non-horizontal merger may harm competition if the merged firm is able to limit or eliminate rival firms' access to inputs or markets, thereby reducing or eliminating rival firms' ability or incentive to compete. The ability to affect rivals (and, by extension, competition) in this manner is referred to in these guidelines as "foreclosure."

11.5 Foreclosure may be partial when the merged firm, for example, raises its price to a downstream competitor, thereby raising its rival's costs. Foreclosure may be complete when the merged firm, for example, refuses to supply a downstream competitor.

11.6 When examining the likely foreclosure effects of a non-horizontal merger transaction, the Bureau considers three inter-related questions: (1) whether the merged firm has the ability to harm rivals; (2) whether the merged firm has the incentive (i.e., whether it is profitable) to do so; and (3) whether the merged firm's actions would be sufficient to prevent or lessen competition substantially.

11.7 In the case of vertical mergers, the Bureau looks at four main categories of foreclosure:

- total input foreclosure, which occurs when the merged firm refuses to supply an input to rival manufacturers that compete with it in the downstream market;
- partial input foreclosure, which occurs when the merged firm increases the price it charges to supply an input to rival manufacturers that compete with it in the downstream market;[53]

52 For example, a vertical merger may allow the merged firm to remove or "internalize" existing double marginalization, since there is no longer any need for a mark-up on goods from the upstream firm to its downstream merger partner. With conglomerate mergers, the merged firm may be able to internalize the positive effect of a decrease in the price of one complementary product on the sales of another complementary product. This in turn may increase the output of both products, which is, all other things being equal, pro-competitive.

53 Foreclosure may also be accomplished through non-price means. For example, a merged firm may adopt product standards that are incompatible with those used by rivals, thus requiring rivals to invest in new standards in order to continue to purchase the merged firm's product or making it impossible for rivals to use

- total customer foreclosure, which occurs when the merged firm refuses to purchase inputs from an upstream rival; and
- partial customer foreclosure, which occurs when the merged firm is a distributor and can disadvantage upstream rivals in the distribution/resale of their products.

11.8 In the case of a conglomerate merger, the Bureau considers whether the combination of products in related markets will confer upon the merged firm the ability and incentive to leverage a strong market position from one market to another by means of tying products together. For example, the merged firm may harm its rivals by refusing to sell one product to customers unless customers also buy a second product from it. Assuming that rivals do not sell the same range of products as the merged firm, such tying may foreclose rivals by reducing their ability to compete, thereby preventing or lessening competition substantially.

Coordinated Effects of Non-Horizontal Mergers

11.9 The Bureau also considers whether a non-horizontal merger increases the likelihood of coordinated interaction among firms:

- A merger that leads to a high degree of vertical integration between an upstream market and a downstream retail market, or increases the degree of existing vertical integration, can facilitate coordinated behaviour by firms in the upstream market by making it easier to monitor the prices rivals charge upstream. Vertical mergers could also facilitate coordinated behaviour by firms in a downstream market by increasing transparency (by enabling firms to observe increased purchases of inputs) or by providing additional ways to discourage or punish deviations (by limiting the supply of inputs).
- A conglomerate merger may facilitate coordination by increasing the degree of multi-market exposure among firms (see paragraph 6.33, above).

PART 12: THE EFFICIENCY EXCEPTION

Overview

12.1 Section 96 of the Act provides an efficiency exception to the provisions of section 92. When a merger creates, maintains or enhances market power, section 96(1) creates a trade-off framework in which efficiency gains that are likely to be brought about by a merger are evaluated against the anti-competitive effects that are likely to result. It should be noted that the Bureau's approach is to expeditiously identify those few transactions that may raise material competition concerns and provide quick clearance for remaining transactions to provide commercial certainty and allow parties to achieve any efficiencies as quickly as possible. Consistent with that approach, a thorough assessment of efficiency claims is unnecessary in the vast majority of the Bureau's merger reviews.

the merged firm's product altogether.

12.2 As the starting point, when determining the relevant anti-competitive effects for the purpose of performing the trade-off, the Bureau recognizes the significance of all of the objectives set out in the statutory purpose clause contained in section 1.1 of the Act.

12.3 The Bureau, in appropriate cases and when provided in a timely manner with the parties' evidence substantiating their case, makes an assessment of whether the efficiency gains that are likely to be brought about by a merger will be greater than and will offset the anti-competitive effects arising from that merger, and will not necessarily resort to the Tribunal for adjudication of the issue. However, the parties must be able to validate efficiency claims to allow the Bureau to ascertain the nature, magnitude, likelihood and timeliness of the asserted gains, and to credit (or not) the basis on which the claims are being made.

12.4 In general, categories of efficiencies that are relevant to the trade-off analysis in merger review include the following:

- allocative efficiency: the degree to which resources available to society are allocated to their most valuable use;
- technical (productive) efficiency: the creation of a given volume of output at the lowest possible resource cost; and
- dynamic efficiency: the optimal introduction of new products and production processes over time.

12.5 These categories are examined in reference to both gains in efficiency and anti-competitive effects (which include losses in efficiency).

12.6 For the purpose of the trade-off analysis in litigated proceedings before the Tribunal, the Bureau must show the anti-competitive effects of a merger. As outlined in more detail in paragraph 12.13 below, the merging parties must show all other aspects of the trade-off, including the nature, magnitude, likelihood and timeliness of efficiency gains, and whether such gains are greater than and offset the anti-competitive effects. Whether or not a case proceeds to litigation, the Bureau seeks information from the merging parties and other sources to evaluate gains in efficiencies and anti-competitive effects.

12.7 By incorporating an explicit exception for efficiency gains, Parliament has indicated that the assessment of the competitive effects of the merger under section 92 of the Act is to be segregated from the evaluation of efficiency gains under section 96. That said, cost savings from substantiated efficiency gains may be relevant to the analysis under section 92 of whether the merger is likely to prevent or lessen competition substantially in the following limited sense: the Bureau considers whether, as a result of true cost savings (discussed below under "Types of Efficiencies Generally Included in the Trade-Off"), the parties to the merger are better positioned to compete in a competitive market or are less likely to engage in coordinated behaviour.[54]

12.8 Where efficiencies may be material, merging parties are encouraged to make their efficiency submissions to the Bureau as early as possible in the merger review process. This facilitates an expeditious assessment of the nature, magnitude, likelihood and timeliness of the efficiency gains and of the trade-off between relevant efficiency gains and anti-competitive effects. Having detailed information regarding efficiency claims at an early stage of the process will facilitate the preparation of focused follow-up information requests and/or the targeted use of other information-gathering mechanisms and, subject to confidentiality restrictions, enable the Bureau to test the claims during its market contacts regarding the merger. Submissions regarding anticipated efficiency gains may also assist the Bureau in understanding the rationale underlying the proposed transaction.

Gains in Efficiency

12.9 To be considered under section 96(1), it must be demonstrated that the efficiency gains "would not likely be attained if the order (before the Tribunal) were made." This involves considering the nature of potential orders that may be made, including those that may apply to the merger in its entirety or are limited to parts of the merger. Each of the anticipated efficiency gains is then assessed to determine whether these gains would likely be attained by alternative means if the potential orders are made. Where the order sought is limited to parts of a merger, efficiency gains that are not affected by the order are not included in the trade-off analysis.

12.10 To facilitate the Bureau's review of efficiency claims, parties should provide detailed and comprehensive information that substantiates the precise nature, magnitude, likelihood and timeliness of their alleged efficiency gains, as well as information relating to deductions from gains in efficiency, such as the costs associated with implementing the merger. The information should specifically address the likelihood that such gains would be achieved and why those gains would not likely be achieved if the potential Tribunal orders were made.

12.11 Typically, the Bureau uses industry experts to assist in its evaluation of efficiency claims. To assess efficiency claims, Bureau officers and economists, as well as experts retained by the Bureau, require access to detailed financial and other information.[55] To enable the objective verification of anticipated efficiency gains, efficiency claims should be substantiated by documentation prepared in the ordinary course of business, wherever possible. This includes plant and firm-level accounting statements, internal

54 The impact of efficiencies on a firm's cost structure may render coordination more difficult by enhancing its incentive to compete more vigorously.

55 This includes all pre-existing merger planning documents. Additional information that may be relevant includes (1) information on efficiencies realized from previous mergers involving similar assets; (2) pre-merger documents relating to product and process innovation; and (3) information related to economies of scale, including minimum efficient scale, and economies of scope in production.

studies, strategic plans, integration plans, management consultant studies and other available data. The Bureau may also require physical access to certain facilities and will likely require documents and information from operations-level personnel who can address, among other matters, how their business is currently run and areas where efficiencies would likely be realized.

12.12 Section 96(2) requires the Tribunal to consider whether the merger is likely to bring about gains in efficiency described in section 96(1) that will result in (1) a significant increase in the real value of exports; or (2) a significant substitution of domestic products for imported products. To assist this analysis, firms operating in markets that involve international trade should provide the Bureau with information that establishes that the merger will lead them to increase output owing to greater exports or import substitution.[56]

Burden on the Parties

12.13 The parties' burden includes proving that the gains in efficiency

- are likely to occur. In other words, the parties must provide a detailed explanation of how the merger or proposed merger would allow the merged firm to achieve the gains in efficiency. In doing so, the parties must specify the steps they anticipate taking to achieve the gains in efficiency, the risks involved in achieving these gains and the time and costs required to achieve them.
- are brought about by the merger or proposed merger (i.e., that they are merger-specific). The test under section 96(1) is whether the efficiency gains would likely be realized in the absence of the merger. Thus, if certain gains in efficiency would likely be achieved absent the merger, those gains are not counted for the purposes of the trade-off.
- are greater than and offset the anti-competitive effects. The parties must provide a quantification of the gains in efficiency and a detailed and robust explanation of how the quantification was calculated. They should also, to the extent relevant, provide any information on qualitative efficiencies. While the burden is ultimately on the parties to establish that the gains in efficiency are greater than and offset the anti-competitive effects, in appropriate cases and when provided in a timely manner with the parties' evidence substantiating their case, the Bureau undertakes its own internal assessment of the trade-off before deciding whether to challenge a merger at the Tribunal.
- would not likely be attained if an order under section 92 were made. Gains in efficiency that would likely be achieved, even if an order prohibiting all or part of the merger were made, are not counted for the purposes of section 96.[57]

56 Increased output in this context is generally only possible with an associated decrease in price.

57 For example, if remedying a substantial prevention or lessening of competition required divestitures only in certain markets, cost savings resulting from the rationalization of head office facilities would not be included in the trade-off, assuming that such savings would be achievable despite the divestitures. A portion of head office cost savings may be relevant in this example only if the parties can clearly demonstrate that those cost savings

Types of Efficiencies Generally Included in the Trade-Off: Gains in Productive Efficiency

12.14 Productive efficiencies result from real cost savings in resources, which permit firms to produce more output or better quality output from the same amount of input. In many cases, such efficiencies can be quantifiably measured, objectively ascertained, and supported by engineering, accounting or other data, subject to a discount, as appropriate, for likelihood in practice. Timing differences in the realization of these savings are accounted for by discounting to the present value.

12.15 Productive efficiencies include the following:

- cost savings at the product, plant and multi-plant levels;
- savings associated with integrating new activities within the firm;[58] and
- savings arising from transferring superior production techniques and know-how from one of the merging parties to the other.[59]

12.16 Information respecting gains in efficiency that relate to cost savings should be broken down according to whether they are one-time savings or a recurring savings. When considering cost savings, the Bureau examines claims related to the following:

- economies of scale: savings that arise from product- and plant-level reductions in the average unit cost of a product through increased production;
- economies of scope: savings that arise when the cost of producing more than one product at a given level of output is reduced by producing the products together rather than separately;
- economies of density: savings that arise from more intensive use of a given network infrastructure;
- savings that flow from specialization, the elimination of duplication, reduced downtime, a smaller base of spare parts, smaller inventory requirements and the avoidance of capital expenditures that would otherwise have been required;
- savings that arise from plant specialization, the rationalization of various administrative and management functions (e.g., sales, marketing, accounting, purchasing, finance, production), and the rationalization of research and development activities; and
- savings that relate to distribution, advertising and raising capital.

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would not be achievable if the proposed remedy is granted. Only those gains in efficiency that will be forgone as a result of the remedy will be counted.

58 These include reduced transaction costs associated with contracting for inputs, distribution and services that were previously performed by third parties, but exclude pecuniary savings such as those related to bringing idle equipment into use if such idle capacity will be transferred from the merged firm to third parties.

59 While such legitimate production-related savings may exist, it will generally be difficult to demonstrate that efficiencies will arise owing to "superior management," that savings are specifically attributable to management performance or that they would not likely be sought and attained through alternative means.

Types of Efficiencies Generally Included in the Trade-Off: Gains in Dynamic Efficiency

12.17 The Bureau also examines claims that the merger has or is likely to result in gains in dynamic efficiency, including those attained through the optimal introduction of new products, the development of more efficient productive processes, and the improvement of product quality and service. When possible, the assessment of dynamic efficiencies is conducted on a quantitative basis. This is generally the case if there is information presented by the parties to suggest that a decrease in production costs as a result of an innovation in production technology or an increase in demand for the parties' products as a result of product innovation (leading to a new or improved product) is likely. To supplement quantitative information or where quantitative information is absent, the Bureau conducts a qualitative assessment.

12.18 The specific environment of the industry in question is important in the Bureau's analysis of the competitive effects of a merger on innovation. In light of the complexities and uncertainties associated with the assessment of dynamic efficiency claims, irrespective of the industry, certain types of industry information (in addition to that considered in paragraphs 12.10 and 12.11, above) can be particularly beneficial to the Bureau's assessment of a merger's impact on innovation as they relate to, for example, verifiability, likelihood of success and timeliness. Historical information on the effect of previous mergers in the industry on innovation may be insightful.[60] Such information may relate to a merger's impact on the nature and scope of research and development activities, innovation successes relating to new or existing products or production processes, and the enhancement of dynamic competition.[61] In addition, and only when applicable, the Bureau encourages parties to provide detailed explanations regarding plans to utilize substitute or complementary technologies so as to increase innovation.

Types of Efficiencies Generally Included in the Trade-Off: Deductions to Gains

12.19 Once all efficiency claims have been valued, the costs of retooling and other costs that must be incurred to achieve efficiency gains are deducted from the total value of the efficiency gains that are considered pursuant to section 96(1). Integrating two complex, ongoing operations with different organizational cultures can be a costly undertaking and ultimately may be unsuccessful. Integration costs are deducted from the efficiency gains.[62]

Types of Efficiencies Generally Excluded from the Trade-Off

12.20 Not all efficiency claims qualify for the trade-off analysis. The Bureau excludes the following:

60 Such information may be useful even when previous mergers did not necessarily involve any of the merging parties, since Bureau staff will examine the effect of past industry mergers on innovation through various sources of information, including industry experts and interviews with competitors.

61 In this context, dynamic competition refers to competition based on the successive introduction of new or better products over time.

62 Losses in dynamic efficiency described in paragraph 12.31, below, may also be deducted from gains in efficiency at this stage of the analysis, provided they are not double-counted.

- gains that would likely be attained in any event through alternative means if the potential orders were made (examples include internal growth, a merger with a third party,[63] a joint venture, a specialization agreement, and a licensing, lease or other contractual arrangement);[64]
- gains that would not be affected by an order, when the order sought is limited to part of a merger;
- gains that are redistributive in nature, as provided in section 96(3) of the Act (examples include gains anticipated to arise from increased bargaining leverage that enables the merging parties to extract wage concessions or discounts from suppliers that are not cost-justified, and tax-related gains);[65]
- gains that are achieved outside Canada (examples include productive efficiency gains arising from the rationalization of the parties' facilities located outside Canada that do not benefit the Canadian economy);[66] and
- savings resulting from a reduction in output, service, quality or product choice.

Anti-Competitive Effects

12.21 Section 96(1) requires efficiency gains to be evaluated against "the effects of any prevention or lessening of competition that will result or is likely to result from the merger or proposed merger." The effects to be considered are not limited to resource allocation effects and include all the anti-competitive effects that are likely to arise from a merger, having regard to all of the objectives of the Act. Determination of the relevant anti-competitive effects depends upon the particular circumstances of the merger in question and the markets affected by the merger.

12.22 The Bureau examines all relevant price and non-price effects, including negative effects on allocative, productive and dynamic efficiency; redistributive effects; and effects on service, quality and product choice.

12.23 In addition to direct effects in the relevant market, the Bureau also considers price and non-price effects in interrelated markets. For example, mergers that are likely to

63 Consideration will only be given to alternative merger proposals that could reasonably be considered practical given the business realities faced by the merging firms.

64 The market realities of the industry in question will be considered in determining whether particular efficiencies could reasonably be expected to be achieved through non-merger alternatives. This includes growth prospects for the market in question, the extent of excess capacity in the market, and the extent to which the expansion can be carried out in increments.

65 Discounts from a supplier resulting from larger orders that would enable the supplier to achieve economies of scale, reduced transaction costs or other savings may qualify, to the extent that the savings by the supplier can be substantiated. Mere redistribution of income from the supplier to the merged firm in the form of volume or other discounts is not an efficiency.

66 A rationalization of the parties' facilities located outside of Canada where it could be established that these efficiencies would likely result in lower prices in Canada is an example of how such gains in efficiency from non-Canadian sources could accrue to the Canadian economy. The issue is whether the efficiency gains will benefit the Canadian economy rather than the nationality of ownership of the company.

result in increased prices and lower output can impair industries that use the merged firm's products as inputs.

12.24 Some examples of potential anti-competitive effects that can result from a merger are described below. This list is not intended to be exhaustive. While, in some cases, the negative impacts of a merger may be difficult to measure, all of the relevant anti-competitive effects of a merger are considered for the purposes of the trade-off. When anti-competitive effects (such as redistributive effects and non-price effects) cannot be quantified, they are considered from a qualitative perspective.

Price Effects: Loss of Allocative Efficiency (Deadweight Loss)

12.25 A merger that results in a price increase generally brings about a negative resource allocation effect (referred to as "deadweight loss"), which is a reduction in total consumer and producer surplus within Canada. This reflects a loss of allocative efficiency that is contrary to promoting the efficiency and adaptability of the Canadian economy.

12.26 In view of the difficulties associated with estimating the magnitude of a material price increase that is likely to be brought about by a merger and other variables, various estimates of the deadweight loss are usually prepared over a range of price increases and market demand elasticities.

12.27 The estimate of deadweight loss generally includes the following:

- losses to consumer surplus resulting from reductions in output owing to the merger;
- losses in producer surplus that arise when market power is being exercised in the relevant market prior to the merger[67]; and
- losses to consumer and producer surplus anticipated to result in interrelated markets.[68]

Price Effects: Redistributive Effects

12.28 Price increases resulting from an anti-competitive merger cause a redistributive effect ("wealth transfer") from buyers to sellers. Providing buyers with competitive prices and product choices is an objective of the Act.

Non-Price Effects: Reduction in Service, Quality, Choice

12.29 A substantial prevention or lessening of competition resulting from a merger can have a negative impact on service, quality, product choice and other dimensions of

67 When pre-merger conditions are not competitive, the deadweight loss arising from a merger may be significantly understated if this loss to producer surplus is not taken into account.

68 For example, when the products produced by the merged firm include intermediate goods that are used as inputs in other products, price increases in the intermediate goods can contribute to allocative inefficiency in interrelated markets.

competition that buyers value. Considering these effects is consistent with ensuring that buyers are provided with competitive prices and product choices.

Non-Price Effects: Loss of Productive Efficiency

12.30 Mergers that prevent or lessen competition substantially can also reduce productive efficiency, as resources are dissipated through x-inefficiency[69] and other distortions.[70] For instance, x-inefficiency may arise when firms, particularly in monopoly or near monopoly markets, are insulated from competitive market pressure to exert maximum efforts to be efficient.

Non-Price Effects: Loss of Dynamic Efficiency

12.31 Mergers that result in a highly concentrated market may reduce the rate of innovation, technological change and the dissemination of new technologies with a resulting opportunity loss of economic surplus.[71]

The Trade-Off

12.32 To satisfy the section 96 trade-off, the efficiency gains must both "be greater than and offset" the relevant anti-competitive effects.

12.33 The "greater than" aspect of the test requires that the efficiency gains be more extensive or of a larger magnitude than the anti-competitive effects. The "offset" aspect requires that efficiency gains compensate for the anti-competitive effects. The additional requirement to "offset" makes it clear that it is not sufficient for parties to show that efficiency gains merely, marginally or numerically exceed the anti-competitive effects to satisfy the section 96 trade-off. How significant this additional requirement may be has yet to be tested by the Tribunal and the courts.

12.34 Both the efficiency gains and the anti-competitive effects can have quantitative (measured) and qualitative aspects to them, and both the "greater than" and "offset" standards apply to all anti-competitive effects. To enable appropriate comparisons to be made, timing differences between measured future anticipated efficiency gains and measured anti-competitive effects are addressed by discounting to the present value.

12.35 Merging parties intending to invoke the efficiencies exception are encouraged to address how they propose that qualitative and quantitative gains and effects be evaluated for the purpose of performing the "greater than and offset" aspect of the

69 "X-inefficiency" typically refers to the difference between the maximum (or theoretical) productive efficiency achievable by a firm and actual productive efficiency attained.

70 For example, increased market power can lead to rent-seeking behaviour (such as lobbying) which can cause real economic resources to be consumed in activities directed towards redistributing income, rather than used in producing real output.

71 Losses in dynamic efficiency may be considered under anti-competitive effects or may be deducted from gains in efficiency at the outset, as indicated in paragraph 12.20.

trade-off; and to explain how and why the gains "compensate for" the anti-competitive effects.[72]

PART 13: FAILING FIRMS AND EXITING ASSETS

Business Failure and Exiting Assets

13.1 Among the factors that are relevant to an analysis of a merger and its effects on competition, section 93(*b*) lists "whether the business, or a part of the business, of a party to the merger or proposed merger has failed or is likely to fail." The opening clause of section 93 makes it clear that this information is to be considered "in determining, for the purpose of section 92, whether or not a merger or proposed merger prevents or lessens, or is likely to prevent or lessen, competition substantially." The impact that a firm's exit can have in terms of matters other than competition is generally beyond the scope of the assessment contemplated by section 93(*b*).

13.2 Probable business failure does not provide a defence for a merger that is likely to prevent or lessen competition substantially. Rather, the loss of the actual or future competitive influence of a failing firm is not attributed to the merger if imminent failure is probable and, in the absence of a merger, the assets of the firm are likely to exit the relevant market. Merging parties intending to invoke the failing firm rationale are encouraged to make their submissions in this regard as early as possible.

13.3 A firm is considered to be failing if:

- it is insolvent or is likely to become insolvent;[73]
- it has initiated or is likely to initiate voluntary bankruptcy proceedings; or
- it has been, or is likely to be, petitioned into bankruptcy or receivership.

13.4 In assessing the extent to which a firm is likely to fail, the Bureau typically seeks the following information:

- the most recent, audited, financial statements, including notes and qualifications in the auditor's report;
- projected cash flows;
- whether any of the firm's loans have been called, or further loans/line of credit advances at viable rates have been denied and are unobtainable elsewhere;
- whether suppliers have curtailed or eliminated trade credit;

72 The burden is ultimately on the parties to undertake the entire trade-off analysis and establish that the gains in efficiency are greater than and offset the anti-competitive effects.

73 Technical insolvency occurs when liabilities exceed the realizable value of assets, or when a firm is unable to pay its liabilities as they come due.

- whether there have been persistent operating losses or a serious decline in net worth or in the firm's assets;[74]
- whether such losses have been accompanied by an erosion of the firm's relative position in the market;
- the extent to which the firm engages in "off-balance-sheet" financing (such as leasing);
- whether the value of publicly-traded debt of the firm has significantly dropped;
- whether the firm is unlikely to be able to successfully reorganize pursuant to Canadian or foreign bankruptcy legislation, the Companies' Creditors Arrangement Act, or through a voluntary arrangement with its creditors.

13.5 These considerations are equally applicable to failure-related claims concerning a division or a wholly-owned subsidiary of a larger enterprise. However, in assessing submissions relating to the failure of a division or subsidiary, particular attention is paid to transfer pricing within the larger enterprise, intra-corporate cost allocations, management fees, royalty fees, and other matters that may be relevant in this context. The value of such payments or charges is generally assessed in relation to the value of equivalent arm's-length transactions.

13.6 Matters addressed in financial statements are ordinarily considered to be objectively verified when these statements have been audited or prepared by a person who is independent of the firm that is alleging failure. The Bureau's assessment of financial information includes a review of historic, current and projected income statements and balance sheets. The reasonableness of the assumptions underlying financial projections is also reviewed in light of historic results, current business conditions and the performance of other businesses in the industry.

Alternatives to the Merger

13.7 Before concluding that a merger involving a failing firm or division is not likely to result in a substantial lessening or prevention of competition, the Bureau assesses whether any of the following alternatives to the merger exist and are likely to result in a materially greater level of competition than if the proposed merger proceeds.

Acquisition by a Competitively Preferable Purchaser

13.8 The Bureau assesses whether there exists a third party whose purchase of the failing firm, division or productive assets is likely to result in a materially higher level of competition in the market.[75] In addition, such a third party ("competitively preferable purchaser") must be willing to pay a price which, net of the costs associated with

74 Persistent operating losses may not be indicative of failure, particularly in a "start-up" situation, in which such losses may be normal and indeed anticipated.

75 The Bureau considers whether the third party is capable of exercising a meaningful influence in the market. When an alternative buyer does not intend to keep the failing firm's assets in the relevant market, the Bureau assesses the extent to which the market power arising from the original merger proposal is likely to be less than if the alternative merger proceeds.

making the sale,[76] would be greater than the proceeds that would flow from liquidation, less the costs associated with such liquidation (referred to as the "net price above liquidation value").[77] Where it is determined that a competitively preferable purchaser exists, it can generally be expected that, if the proposed merger under review cannot be completed, the target will either seek to merge with that competitively preferable purchaser, or remain in the market. If the Bureau is not satisfied that a thorough search for a competitively preferable purchaser has been conducted, the Bureau will require the involvement of an independent third party (such as an investment dealer, trustee or broker who has no material interest in either of the merging parties or the proposal in question) to conduct such a search before the failing firm rationale is accepted.

Retrenchment/Restructuring

13.9 Where it appears that the firm is likely to remain in the market rather than sell to a competitively preferable purchaser or liquidate, it is necessary to determine whether this alternative to the proposed merger is likely to result in a materially greater level of competition than if the proposed merger proceeds. The retrenchment or restructuring of a failing firm may prevent failure and enable it to survive as a meaningful competitor by narrowing the scope of its operations, for instance, by downsizing or withdrawing from the sale of certain products or from certain geographic areas.

Liquidation

13.10 Where the Bureau is able to confirm that there are no competitively preferable purchasers for the failing firm and that there are no feasible and likely retrenchment scenarios, it assesses whether liquidation of the firm is likely to result in a materially higher level of competition in the market than if the merger in question proceeds. In some cases, liquidation can facilitate entry into a market by enabling actual or potential competitors to compete for the failing firm's customers or assets to a greater degree than if the failing firm merged with the proposed acquirer.

76 These costs include matters such as ongoing environmental liabilities, tax liabilities, commissions relating to the sale and severance and other labour-related costs.

77 Liquidation value is defined as the sale price of assets as a result of bankruptcy or foreclosure proceedings.

HOW TO CONTACT THE COMPETITION BUREAU

Anyone wishing to obtain additional information about the *Competition Act*, the *Consumer Packaging and Labelling Act* (except as it relates to food), the *Textile Labelling Act*, the *Precious Metals Marking Act* or the program of written opinions, or to file a complaint under any of these acts should contact the Competition Bureau's Information Centre:

Web site

www.competitionbureau.gc.ca

Address

Information Centre
Competition Bureau
50 Victoria Street
Gatineau, Quebec K1A 0C9

Telephone

Toll-free: 1-800-348-5358
National Capital Region: 819-997-4282
TTY (for hearing impaired) 1-800-642-3844

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MERGERS and the COMPETITION ACT

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À Rita, ma source
d'inspiration et d'appui

2. "THE TRIBUNAL SHALL NOT MAKE AN ORDER UNDER SECTION 92 IF IT FINDS"

Although the margin notes beside section 96 refer to this provision as an "exception", they have no legal force.[34] It is therefore pertinent to ask whether section 96 was intended to operate as an exception or, as is more commonly thought to be the case, as a defence.[35] In this regard, an examination of other sections of the Act provides little assistance. While the language of section 96 clearly more closely resembles the three defences of section 45 than the four exceptions of that section, the wording that is used elsewhere in the Act with respect to provisions that are described as "exceptions" and "defences", respectively, is not consistent. That is to say, some[36] provisions that are identified as "exceptions" employ the "shall not make an order/no order shall be made" language that is similar to the "shall not convict" wording of the section 45 "defences",[37] whereas at least two[38] provisions that are identified as "defences" employ the "subsection x does not apply" wording used in most of the provisions that are identified as "exceptions".[39] Similarly, while virtually all of the non-section 96 provisions that are identified as "exceptions" would facilitate the summary disposition of proceedings or a particular issue without requiring an examination of the substantive offence or reviewable matter in question,[40] the same is true of certain provisions that are identified as

Application, *supra*, Introduction, note 46, suggested otherwise, the Director explicitly stated at p. 39 of the Competitive Impact Statement that he filed that he did not believe that the requirements of section 96 had been met, "and therefore, the remedies provided for in the DCO are necessary."

34 *Interpretation Act*, R.S.C. 1985, c. I-21, s.14. Cf. Driedger, *supra*, note 32, at 133.

35 The persons responsible for the development of the 1986 amendments to the Act clearly took the position that this provision is a defence. See statements made to the Legislative Committee on *Bill C-91*, by Mr. Lawson Hunter, former Director of Investigation and Research, at *supra*, Chapter 5, note 145, at 7:27; Mr. Mel Cappe, Assistant Deputy Minister, Policy Coordination, Ministry of Consumer and Corporate Affairs, at *supra*, Chapter 5, note 145, at Issue No. 11 (May 21, 1986) p. 11:41; and Mr. Morris Rosenberg, General Counsel to the Ministry of Consumer and Corporate Affairs, at *supra*, Chapter 5, note 145, at Issue No. 11 (May 21, 1986), p. 11:46. Cf. note 43 *infra*.

36 Cf. ss.81(2), 81(3), 94, 95 and 96.

37 Cf. ss.45(3), (5) and (7).

38 Cf. ss.57(3) and 60.

39 Cf. ss.29(2), 45(4), 45(6), 45(7.1), 45(8), 49(2), 60(3), 61(2), and 61(5). See also ss. 124(3) and 128(3), which appear to operate more like these provisions than like a "shall not make an order" provision".

40 For example, a substantive or collateral matter in question can be disposed of upon a simple preliminary demonstration of "affiliation" with a particular person, [ss.45(8), 47(3) and 61(2)]; that a matter has already been made public [s.29(2)]; that a price has been affixed to a package, [cf. s.61(5)] or that the transaction in question involves a certain

defences.[41] Clearly, the way in which the notions "exception" and "defence" are employed throughout the Act is not consistent.

There are two aspects of section 96 which suggest that Parliament intended that it be employed as a defence: (i) the fact that an assessment of the anticompetitive effects of a merger must be made before the balancing process can begin; and (ii) the fact that the Tribunal must "find" that the efficiencies meet the test therein set forth.[42] With respect to the latter point, while it could be argued that the Director has a responsibility for placing evidence with respect to efficiencies before the Tribunal, he has on several occasions indicated that this burden lies with the parties.[43] Given that "the data are distributed unevenly to the strategic advantage of the (merging parties)"[44] and considering that the merging parties have "far better access to the relevant data and can use this advantage to disclose and argue the economies involved selectively,"[45] this position makes good sense. It is also widely shared.[46] In any event, it makes greater sense to

type of persons [s.60(3)] or subject matter [ss.45(4) and 49(2)]. Cf. ss.81(2), 81(3), 94(a), 94(b) and 95(1), 124(3) and 128(3).

41 See for example ss.45(3), (5) and (7).

42 As a practical matter, the fact that parties will typically wish to avoid the significant time and expense that is ordinarily associated with documenting and demonstrating the precise nature and extent of expected efficiency gains will also deter parties from invoking this provision unless they believe that there is a serious possibility that their transaction will be found to contravene s.92.

43 Consider for example the following passage from his speech to the Fordham Corporate Law Institute, *supra*, Chapter 6, note 14, at 18: "The efficiency provision is similar to a defence. Thus, the responsibility for establishing the existence of efficiency gains lies with the merging parties." Cf. Goldman, *supra*, Introduction, note 30, at p. 14.

44 Williamson II, *supra*, Chapter 2, note 220, at 703. Elsewhere, (Williamson I, *supra*, note 19, at 24) Williamson elaborates in the following terms:

> But if efficiencies are to be a defense at all, it is clear that the companies — which are, presumably, sensitive to the relevant economies in proposing the merger in the first place — must be prepared to make the case for them in court. They have the data and these must be supplied. Otherwise the mixed case which involves both scale economy and market power effects can only be handled arbitrarily — and this is satisfactory to no one.

45 Rogers, *supra*, note 11, at 518.

46 In addition to Rogers and Williamson, see Fisher & Lande, *supra*, note 13, at 1694; Warren-Boulton, "Merger Policy and Enforcement at the Antitrust Division: The Economist's View", (1985), 54 *Antit. L.J.* 109, at 113; and Fisher, *supra*, Chapter 4, note 60, at 36. It is significant to note that in no jurisdiction reviewed in this work do the enforcement authorities bear the burden of establishing efficiency gains or rebutting gains that are prima facie established. Merging parties everywhere bear the burden of establishing efficiency gains (or other offsetting benefits) from beginning to end. With respect to U.S. practice, see U.S. Department of Justice *Merger Guidelines*, *supra*, Chapter 2, note 277, at § 3.5; and FTC 1982 *Statement on Horizontal Mergers*, *supra*, Chapter 2, note

Horizontal Merger Guidelines

U.S. Department of Justice

and the

Federal Trade Commission

Issued: August 19, 2010

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1. Overview

These Guidelines outline the principal analytical techniques, practices, and the enforcement policy of the Department of Justice and the Federal Trade Commission (the "Agencies") with respect to mergers and acquisitions involving actual or potential competitors ("horizontal mergers") under the federal antitrust laws.[1] The relevant statutory provisions include Section 7 of the Clayton Act, 15 U.S.C. § 18, Sections 1 and 2 of the Sherman Act, 15 U.S.C. §§ 1, 2, and Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45. Most particularly, Section 7 of the Clayton Act prohibits mergers if "in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly."

The Agencies seek to identify and challenge competitively harmful mergers while avoiding unnecessary interference with mergers that are either competitively beneficial or neutral. Most merger analysis is necessarily predictive, requiring an assessment of what will likely happen if a merger proceeds as compared to what will likely happen if it does not. Given this inherent need for prediction, these Guidelines reflect the congressional intent that merger enforcement should interdict competitive problems in their incipiency and that certainty about anticompetitive effect is seldom possible and not required for a merger to be illegal.

These Guidelines describe the principal analytical techniques and the main types of evidence on which the Agencies usually rely to predict whether a horizontal merger may substantially lessen competition. They are not intended to describe how the Agencies analyze cases other than horizontal mergers. These Guidelines are intended to assist the business community and antitrust practitioners by increasing the transparency of the analytical process underlying the Agencies' enforcement decisions. They may also assist the courts in developing an appropriate framework for interpreting and applying the antitrust laws in the horizontal merger context.

These Guidelines should be read with the awareness that merger analysis does not consist of uniform application of a single methodology. Rather, it is a fact-specific process through which the Agencies, guided by their extensive experience, apply a range of analytical tools to the reasonably available and reliable evidence to evaluate competitive concerns in a limited period of time. Where these Guidelines provide examples, they are illustrative and do not exhaust the applications of the relevant principle.[2]

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1 These Guidelines replace the Horizontal Merger Guidelines issued in 1992, revised in 1997. They reflect the ongoing accumulation of experience at the Agencies. The Commentary on the Horizontal Merger Guidelines issued by the Agencies in 2006 remains a valuable supplement to these Guidelines. These Guidelines may be revised from time to time as necessary to reflect significant changes in enforcement policy, to clarify existing policy, or to reflect new learning. These Guidelines do not cover vertical or other types of non-horizontal acquisitions.

2 These Guidelines are not intended to describe how the Agencies will conduct the litigation of cases they decide to bring. Although relevant in that context, these Guidelines neither dictate nor exhaust the range of evidence the Agencies may introduce in litigation.

The unifying theme of these Guidelines is that mergers should not be permitted to create, enhance, or entrench market power or to facilitate its exercise. For simplicity of exposition, these Guidelines generally refer to all of these effects as enhancing market power. A merger enhances market power if it is likely to encourage one or more firms to raise price, reduce output, diminish innovation, or otherwise harm customers as a result of diminished competitive constraints or incentives. In evaluating how a merger will likely change a firm's behavior, the Agencies focus primarily on how the merger affects conduct that would be most profitable for the firm.

A merger can enhance market power simply by eliminating competition between the merging parties. This effect can arise even if the merger causes no changes in the way other firms behave. Adverse competitive effects arising in this manner are referred to as "unilateral effects." A merger also can enhance market power by increasing the risk of coordinated, accommodating, or interdependent behavior among rivals. Adverse competitive effects arising in this manner are referred to as "coordinated effects." In any given case, either or both types of effects may be present, and the distinction between them may be blurred.

These Guidelines principally describe how the Agencies analyze mergers between rival suppliers that may enhance their market power as sellers. Enhancement of market power by sellers often elevates the prices charged to customers. For simplicity of exposition, these Guidelines generally discuss the analysis in terms of such price effects. Enhanced market power can also be manifested in non-price terms and conditions that adversely affect customers, including reduced product quality, reduced product variety, reduced service, or diminished innovation. Such non-price effects may coexist with price effects, or can arise in their absence. When the Agencies investigate whether a merger may lead to a substantial lessening of non-price competition, they employ an approach analogous to that used to evaluate price competition. Enhanced market power may also make it more likely that the merged entity can profitably and effectively engage in exclusionary conduct. Regardless of how enhanced market power likely would be manifested, the Agencies normally evaluate mergers based on their impact on customers. The Agencies examine effects on either or both of the direct customers and the final consumers. The Agencies presume, absent convincing evidence to the contrary, that adverse effects on direct customers also cause adverse effects on final consumers.

Enhancement of market power by buyers, sometimes called "monopsony power," has adverse effects comparable to enhancement of market power by sellers. The Agencies employ an analogous framework to analyze mergers between rival purchasers that may enhance their market power as buyers. See Section 12.

2. Evidence of Adverse Competitive Effects

The Agencies consider any reasonably available and reliable evidence to address the central question of whether a merger may substantially lessen competition. This section discusses several categories and sources of evidence that the Agencies, in their experience, have found most informative in predicting the likely competitive effects of mergers. The list provided here is not exhaustive. In any given case, reliable evidence may be available in only some categories or from some sources. For each category of evidence, the Agencies consider evidence indicating that the merger may enhance competition as well as evidence indicating that it may lessen competition.

2.1 Types of Evidence

2.1.1 Actual Effects Observed in Consummated Mergers

When evaluating a consummated merger, the ultimate issue is not only whether adverse competitive effects have already resulted from the merger, but also whether such effects are likely to arise in the future. Evidence of observed post-merger price increases or other changes adverse to customers is given substantial weight. The Agencies evaluate whether such changes are anticompetitive effects resulting from the merger, in which case they can be dispositive. However, a consummated merger may be anticompetitive even if such effects have not yet been observed, perhaps because the merged firm may be aware of the possibility of post-merger antitrust review and moderating its conduct. Consequently, the Agencies also consider the same types of evidence they consider when evaluating unconsummated mergers.

2.1.2 Direct Comparisons Based on Experience

The Agencies look for historical events, or "natural experiments," that are informative regarding the competitive effects of the merger. For example, the Agencies may examine the impact of recent mergers, entry, expansion, or exit in the relevant market. Effects of analogous events in similar markets may also be informative.

The Agencies also look for reliable evidence based on variations among similar markets. For example, if the merging firms compete in some locales but not others, comparisons of prices charged in regions where they do and do not compete may be informative regarding post-merger prices. In some cases, however, prices are set on such a broad geographic basis that such comparisons are not informative. The Agencies also may examine how prices in similar markets vary with the number of significant competitors in those markets.

2.1.3 Market Shares and Concentration in a Relevant Market

The Agencies give weight to the merging parties' market shares in a relevant market, the level of concentration, and the change in concentration caused by the merger. See Sections 4 and 5. Mergers that cause a significant increase in concentration and result in highly concentrated markets are presumed to be likely to enhance market power, but this presumption can be rebutted by persuasive evidence showing that the merger is unlikely to enhance market power.

2.1.4 Substantial Head-to-Head Competition

The Agencies consider whether the merging firms have been, or likely will become absent the merger, substantial head-to-head competitors. Such evidence can be especially relevant for evaluating adverse unilateral effects, which result directly from the loss of that competition. See Section 6. This evidence can also inform market definition. See Section 4.

2.1.5 Disruptive Role of a Merging Party

The Agencies consider whether a merger may lessen competition by eliminating a "maverick" firm, i.e., a firm that plays a disruptive role in the market to the benefit of customers. For example, if one of the merging firms has a strong incumbency position and the other merging firm threatens to disrupt market conditions with a new technology or business model, their merger can involve the loss of actual or potential competition. Likewise, one of the merging firms may have the incentive to take the lead in price cutting or other competitive conduct or to resist increases in industry prices. A firm that may discipline prices based on its ability and incentive to expand production rapidly using available capacity also can be a maverick, as can a firm that has often resisted otherwise prevailing industry norms to cooperate on price setting or other terms of competition.

2.2 Sources of Evidence

The Agencies consider many sources of evidence in their merger analysis. The most common sources of reasonably available and reliable evidence are the merging parties, customers, other industry participants, and industry observers.

2.2.1 Merging Parties

The Agencies typically obtain substantial information from the merging parties. This information can take the form of documents, testimony, or data, and can consist of descriptions of competitively relevant conditions or reflect actual business conduct and decisions. Documents created in the normal course are more probative than documents created as advocacy materials in merger review. Documents describing industry conditions can be informative regarding the operation of the market and how a firm identifies and assesses its rivals, particularly when business decisions are made in reliance on the accuracy of those descriptions. The business decisions taken by the merging firms also can be informative about industry conditions. For example, if a firm sets price well above incremental cost, that normally indicates either that the firm believes its customers are not highly sensitive to price (not in itself of antitrust concern, see Section 4.1.3[3]) or that the firm and its rivals are engaged in coordinated interaction (see Section 7). Incremental cost depends on the relevant increment in output as well as on the time period involved, and in the case of large increments and sustained changes in output it may include some costs that would be fixed for smaller increments of output or shorter time periods.

Explicit or implicit evidence that the merging parties intend to raise prices, reduce output or capacity, reduce product quality or variety, withdraw products or delay their introduction, or curtail research and development efforts after the merger, or explicit or implicit evidence that the ability to engage in such conduct motivated the merger, can be highly informative in evaluating the likely effects of a merger. Likewise, the Agencies look for reliable evidence that the merger is likely to result in efficiencies. The Agencies give careful consideration to the views of individuals whose responsibilities, expertise, and experience relating to the issues in question provide particular indicia of reliability. The financial terms of the transaction may also be informative regarding competitive effects. For example, a purchase price in excess of the acquired firm’s stand-alone market value may indicate that the acquiring firm is paying a premium because it expects to be able to reduce competition or to achieve efficiencies.

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[3] High margins commonly arise for products that are significantly differentiated. Products involving substantial fixed costs typically will be developed only if suppliers expect there to be enough differentiation to support margins sufficient to cover those fixed costs. High margins can be consistent with incumbent firms earning competitive returns.

2.2.2 Customers

Customers can provide a variety of information to the Agencies, ranging from information about their own purchasing behavior and choices to their views about the effects of the merger itself.

Information from customers about how they would likely respond to a price increase, and the relative attractiveness of different products or suppliers, may be highly relevant, especially when corroborated by other evidence such as historical purchasing patterns and practices. Customers also can provide valuable information about the impact of historical events such as entry by a new supplier.

The conclusions of well-informed and sophisticated customers on the likely impact of the merger itself can also help the Agencies investigate competitive effects, because customers typically feel the consequences of both competitively beneficial and competitively harmful mergers. In evaluating such evidence, the Agencies are mindful that customers may oppose, or favor, a merger for reasons unrelated to the antitrust issues raised by that merger.

When some customers express concerns about the competitive effects of a merger while others view the merger as beneficial or neutral, the Agencies take account of this divergence in using the information provided by customers and consider the likely reasons for such divergence of views. For example, if for regulatory reasons some customers cannot buy imported products, while others can, a merger between domestic suppliers may harm the former customers even if it leaves the more flexible customers unharmed. See Section 3.

When direct customers of the merging firms compete against one another in a downstream market, their interests may not be aligned with the interests of final consumers, especially if the direct customers expect to pass on any anticompetitive price increase. A customer that is protected from adverse competitive effects by a long-term contract, or otherwise relatively immune from the merger's harmful effects, may even welcome an anticompetitive merger that provides that customer with a competitive advantage over its downstream rivals.

> *Example 1:* As a result of the merger, Customer C will experience a price increase for an input used in producing its final product, raising its costs. Customer C's rivals use this input more intensively than Customer C, and the same price increase applied to them will raise their costs more than it raises Customer C's costs. On balance, Customer C may benefit from the merger even though the merger involves a substantial lessening of competition.

2.2.3 Other Industry Participants and Observers

Suppliers, indirect customers, distributors, other industry participants, and industry analysts can also provide information helpful to a merger inquiry. The interests of firms selling products complementary to those offered by the merging firms often are well aligned with those of customers, making their informed views valuable.

Information from firms that are rivals to the merging parties can help illuminate how the market operates. The interests of rival firms often diverge from the interests of customers, since customers normally lose, but rival firms gain, if the merged entity raises its prices. For that reason, the Agencies do not routinely rely on the overall views of rival firms regarding the competitive effects of the merger. However, rival firms may provide relevant facts, and even their overall views may be instructive, especially in cases where the Agencies are concerned that the merged entity may engage in exclusionary conduct.

> *Example 2:* Merging Firms A and B operate in a market in which network effects are significant, implying that any firm's product is significantly more valuable if it commands a large market share or if it is interconnected with others that in aggregate command such a share. Prior to the merger, they and their rivals voluntarily interconnect with one another. The merger would create an entity with a large enough share that a strategy of ending voluntary interconnection would have a dangerous probability of creating monopoly power in this market. The interests of rivals and of consumers would be broadly aligned in preventing such a merger.

3. Targeted Customers and Price Discrimination

When examining possible adverse competitive effects from a merger, the Agencies consider whether those effects vary significantly for different customers purchasing the same or similar products. Such differential impacts are possible when sellers can discriminate, e.g., by profitably raising price to certain targeted customers but not to others. The possibility of price discrimination influences market definition (see Section 4), the measurement of market shares (see Section 5), and the evaluation of competitive effects (see Sections 6 and 7).

When price discrimination is feasible, adverse competitive effects on targeted customers can arise, even if such effects will not arise for other customers. A price increase for targeted customers may be profitable even if a price increase for all customers would not be profitable because too many other customers would substitute away. When discrimination is reasonably likely, the Agencies may evaluate competitive effects separately by type of customer. The Agencies may have access to information unavailable to customers that is relevant to evaluating whether discrimination is reasonably likely.

For price discrimination to be feasible, two conditions typically must be met: differential pricing and limited arbitrage.

First, the suppliers engaging in price discrimination must be able to price differently to targeted customers than to other customers. This may involve identification of individual customers to which different prices are offered or offering different prices to different types of customers based on observable characteristics.

> *Example 3:* Suppliers can distinguish large buyers from small buyers. Large buyers are more likely than small buyers to self-supply in response to a significant price increase. The merger may lead to price discrimination against small buyers, harming them, even if large buyers are not harmed. Such discrimination can occur even if there is no discrete gap in size between the classes of large and small buyers.

In other cases, suppliers may be unable to distinguish among different types of customers but can offer multiple products that sort customers based on their purchase decisions.

Second, the targeted customers must not be able to defeat the price increase of concern by arbitrage, e.g., by purchasing indirectly from or through other customers. Arbitrage may be difficult if it would void warranties or make service more difficult or costly for customers. Arbitrage is inherently impossible for many services. Arbitrage between customers at different geographic locations may be impractical due to transportation costs. Arbitrage on a modest scale may be possible but sufficiently costly or limited that it would not deter or defeat a discriminatory pricing strategy.

4. Market Definition

When the Agencies identify a potential competitive concern with a horizontal merger, market definition plays two roles. First, market definition helps specify the line of commerce and section of the country in which the competitive concern arises. In any merger enforcement action, the Agencies will normally identify one or more relevant markets in which the merger may substantially lessen competition. Second, market definition allows the Agencies to identify market participants and measure market shares and market concentration. See Section 5. The measurement of market shares and market concentration is not an end in itself, but is useful to the extent it illuminates the merger's likely competitive effects.

The Agencies' analysis need not start with market definition. Some of the analytical tools used by the Agencies to assess competitive effects do not rely on market definition, although evaluation of competitive alternatives available to customers is always necessary at some point in the analysis.

Evidence of competitive effects can inform market definition, just as market definition can be informative regarding competitive effects. For example, evidence that a reduction in the number of significant rivals offering a group of products causes prices for those products to rise significantly can itself establish that those products form a relevant market. Such evidence also may more directly predict the competitive effects of a merger, reducing the role of inferences from market definition and market shares.

Where analysis suggests alternative and reasonably plausible candidate markets, and where the resulting market shares lead to very different inferences regarding competitive effects, it is particularly valuable to examine more direct forms of evidence concerning those effects.

Market definition focuses solely on demand substitution factors, i.e., on customers' ability and willingness to substitute away from one product to another in response to a price increase or a corresponding non-price change such as a reduction in product quality or service. The responsive actions of suppliers are also important in competitive analysis. They are considered in these Guidelines in the sections addressing the identification of market participants, the measurement of market shares, the analysis of competitive effects, and entry.

Customers often confront a range of possible substitutes for the products of the merging firms. Some substitutes may be closer, and others more distant, either geographically or in terms of product attributes and perceptions. Additionally, customers may assess the proximity of different products differently. When products or suppliers in different geographic areas are substitutes for one another to varying degrees, defining a market to include some substitutes and exclude others is inevitably a simplification that cannot capture the full variation in the extent to which different products compete against each other. The principles of market definition outlined below seek to make this inevitable simplification as useful and informative as is practically possible. Relevant markets need not have precise metes and bounds.

Defining a market broadly to include relatively distant product or geographic substitutes can lead to misleading market shares. This is because the competitive significance of distant substitutes is unlikely to be commensurate with their shares in a broad market. Although excluding more distant substitutes from the market inevitably understates their competitive significance to some degree, doing so often provides a more accurate indicator of the competitive effects of the merger than would the alternative of including them and overstating their competitive significance as proportional to their shares in an expanded market.

> *Example 4:* Firms A and B, sellers of two leading brands of motorcycles, propose to merge. If Brand A motorcycle prices were to rise, some buyers would substitute to Brand B, and some others would substitute to cars. However, motorcycle buyers see Brand B motorcycles as much more similar to Brand A motorcycles than are cars. Far more cars are sold than motorcycles. Evaluating shares in a market that includes cars would greatly underestimate the competitive significance of Brand B motorcycles in constraining Brand A's prices and greatly overestimate the significance of cars.

Market shares of different products in narrowly defined markets are more likely to capture the relative competitive significance of these products, and often more accurately reflect competition between close substitutes. As a result, properly defined antitrust markets often exclude some substitutes to which some customers might turn in the face of a price increase even if such substitutes provide alternatives for those customers. However, a group of products is too narrow to constitute a relevant market if competition from products outside that group is so ample that even the complete elimination of competition within the group would not significantly harm either direct customers or downstream consumers. The hypothetical monopolist test (see Section 4.1.1) is designed to ensure that candidate markets are not overly narrow in this respect.

The Agencies implement these principles of market definition flexibly when evaluating different possible candidate markets. Relevant antitrust markets defined according to the hypothetical monopolist test are not always intuitive and may not align with how industry members use the term "market."

Section 4.1 describes the principles that apply to product market definition, and gives guidance on how the Agencies most often apply those principles. Section 4.2 describes how the same principles apply to geographic market definition. Although discussed separately for simplicity of exposition, the principles described in Sections 4.1 and 4.2 are combined to define a relevant market, which has both a product and a geographic dimension. In particular, the hypothetical monopolist test is applied to a group of products together with a geographic region to determine a relevant market.

4.1 Product Market Definition

When a product sold by one merging firm (Product A) competes against one or more products sold by the other merging firm, the Agencies define a relevant product market around Product A to evaluate the importance of that competition. Such a relevant product market consists of a group of substitute products including Product A. Multiple relevant product markets may thus be identified.

4.1.1 The Hypothetical Monopolist Test

The Agencies employ the hypothetical monopolist test to evaluate whether groups of products in candidate markets are sufficiently broad to constitute relevant antitrust markets. The Agencies use the hypothetical monopolist test to identify a set of products that are reasonably interchangeable with a product sold by one of the merging firms.

The hypothetical monopolist test requires that a product market contain enough substitute products so that it could be subject to post-merger exercise of market power significantly exceeding that existing absent the merger. Specifically, the test requires that a hypothetical profit-maximizing firm, not subject to price regulation, that was the only present and future seller of those products ("hypothetical monopolist") likely would impose at least a small but significant and non-transitory increase in price ("SSNIP") on at least one product in the market, including at least one product sold by one of the merging firms.[4] For the purpose of analyzing this issue, the terms of sale of products outside the candidate market are held constant. The SSNIP is employed solely as a methodological tool for performing the hypothetical monopolist test; it is not a tolerance level for price increases resulting from a merger.

Groups of products may satisfy the hypothetical monopolist test without including the full range of substitutes from which customers choose. The hypothetical monopolist test may identify a group of products as a relevant market even if customers would substitute significantly to products outside that group in response to a price increase.

> *Example 5:* Products A and B are being tested as a candidate market. Each sells for $100, has an incremental cost of $60, and sells 1200 units. For every dollar increase in the price of Product A, for any given price of Product B, Product A loses twenty units of sales to products outside the candidate market and ten units of sales to Product B, and likewise for Product B. Under these conditions, economic analysis shows that a hypothetical profit-maximizing monopolist controlling Products A and B would raise both of their prices by ten percent, to $110. Therefore, Products A and B satisfy the hypothetical monopolist test using a five percent SSNIP, and indeed for any SSNIP size up to ten percent. This is true even though two-thirds of the sales lost by one product when it raises its price are diverted to products outside the relevant market.

When applying the hypothetical monopolist test to define a market around a product offered by one of the merging firms, if the market includes a second product, the Agencies will normally also include a third product if that third product is a closer substitute for the first product than is the second product. The third product is a closer substitute if, in response to a SSNIP on the first product, greater revenues are diverted to the third product than to the second product.

> *Example 6:* In Example 5, suppose that half of the unit sales lost by Product A when it raises its price are diverted to Product C, which also has a price of $100, while one-third are diverted to Product B. Product C is a closer substitute for Product A than is Product B. Thus Product C will normally be included in the relevant market, even though Products A and B together satisfy the hypothetical monopolist test.

The hypothetical monopolist test ensures that markets are not defined too narrowly, but it does not lead to a single relevant market. The Agencies may evaluate a merger in any relevant market

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4 If the pricing incentives of the firms supplying the products in the candidate market differ substantially from those of the hypothetical monopolist, for reasons other than the latter's control over a larger group of substitutes, the Agencies may instead employ the concept of a hypothetical profit-maximizing cartel comprised of the firms (with all their products) that sell the products in the candidate market. This approach is most likely to be appropriate if the merging firms sell products outside the candidate market that significantly affect their pricing incentives for products in the candidate market. This could occur, for example, if the candidate market is one for durable equipment and the firms selling that equipment derive substantial net revenues from selling spare parts and service for that equipment.

satisfying the test, guided by the overarching principle that the purpose of defining the market and measuring market shares is to illuminate the evaluation of competitive effects. Because the relative competitive significance of more distant substitutes is apt to be overstated by their share of sales, when the Agencies rely on market shares and concentration, they usually do so in the smallest relevant market satisfying the hypothetical monopolist test.

> *Example 7:* In Example 4, including cars in the market will lead to misleadingly small market shares for motorcycle producers. Unless motorcycles fail the hypothetical monopolist test, the Agencies would not include cars in the market in analyzing this motorcycle merger.

4.1.2 Benchmark Prices and SSNIP Size

The Agencies apply the SSNIP starting from prices that would likely prevail absent the merger. If prices are not likely to change absent the merger, these benchmark prices can reasonably be taken to be the prices prevailing prior to the merger.[5] If prices are likely to change absent the merger, e.g., because of innovation or entry, the Agencies may use anticipated future prices as the benchmark for the test. If prices might fall absent the merger due to the breakdown of pre-merger coordination, the Agencies may use those lower prices as the benchmark for the test. In some cases, the techniques employed by the Agencies to implement the hypothetical monopolist test focus on the difference in incentives between pre-merger firms and the hypothetical monopolist and do not require specifying the benchmark prices.

The SSNIP is intended to represent a "small but significant" increase in the prices charged by firms in the candidate market for the value they contribute to the products or services used by customers. This properly directs attention to the effects of price changes commensurate with those that might result from a significant lessening of competition caused by the merger. This methodology is used because normally it is possible to quantify "small but significant" adverse price effects on customers and analyze their likely reactions, not because price effects are more important than non-price effects.

The Agencies most often use a SSNIP of five percent of the price paid by customers for the products or services to which the merging firms contribute value. However, what constitutes a "small but significant" increase in price, commensurate with a significant loss of competition caused by the merger, depends upon the nature of the industry and the merging firms' positions in it, and the Agencies may accordingly use a price increase that is larger or smaller than five percent. Where explicit or implicit prices for the firms' specific contribution to value can be identified with reasonable clarity, the Agencies may base the SSNIP on those prices.

> *Example 8:* In a merger between two oil pipelines, the SSNIP would be based on the price charged for transporting the oil, not on the price of the oil itself. If pipelines buy the oil at one end and sell it at the other, the price charged for transporting the oil is implicit, equal to the difference between the price paid for oil at the input end and the price charged for oil at the output end. The relevant product sold by the pipelines is better described as "pipeline transportation of oil from point A to point B" than as "oil at point B."

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[5] Market definition for the evaluation of non-merger antitrust concerns such as monopolization or facilitating practices will differ in this respect if the effects resulting from the conduct of concern are already occurring at the time of evaluation.

Example 9: In a merger between two firms that install computers purchased from third parties, the SSNIP would be based on their fees, not on the price of installed computers. If these firms purchase the computers and charge their customers one package price, the implicit installation fee is equal to the package charge to customers less the price of the computers.

Example 10: In Example 9, suppose that the prices paid by the merging firms to purchase computers are opaque, but account for at least ninety-five percent of the prices they charge for installed computers, with profits or implicit fees making up five percent of those prices at most. A five percent SSNIP on the total price paid by customers would at least double those fees or profits. Even if that would be unprofitable for a hypothetical monopolist, a significant increase in fees might well be profitable. If the SSNIP is based on the total price paid by customers, a lower percentage will be used.

4.1.3 Implementing the Hypothetical Monopolist Test

The hypothetical monopolist's incentive to raise prices depends both on the extent to which customers would likely substitute away from the products in the candidate market in response to such a price increase and on the profit margins earned on those products. The profit margin on incremental units is the difference between price and incremental cost on those units. The Agencies often estimate incremental costs, for example using merging parties' documents or data the merging parties use to make business decisions. Incremental cost is measured over the change in output that would be caused by the price increase under consideration.

In considering customers' likely responses to higher prices, the Agencies take into account any reasonably available and reliable evidence, including, but not limited to:

- how customers have shifted purchases in the past in response to relative changes in price or other terms and conditions;
- information from buyers, including surveys, concerning how they would respond to price changes;
- the conduct of industry participants, notably:
  - sellers' business decisions or business documents indicating sellers' informed beliefs concerning how customers would substitute among products in response to relative changes in price;
  - industry participants' behavior in tracking and responding to price changes by some or all rivals;
- objective information about product characteristics and the costs and delays of switching products, especially switching from products in the candidate market to products outside the candidate market;
- the percentage of sales lost by one product in the candidate market, when its price alone rises, that is recaptured by other products in the candidate market, with a higher recapture percentage making a price increase more profitable for the hypothetical monopolist;
- evidence from other industry participants, such as sellers of complementary products;

- legal or regulatory requirements; and
- the influence of downstream competition faced by customers in their output markets.

When the necessary data are available, the Agencies also may consider a "critical loss analysis" to assess the extent to which it corroborates inferences drawn from the evidence noted above. Critical loss analysis asks whether imposing at least a SSNIP on one or more products in a candidate market would raise or lower the hypothetical monopolist's profits. While this "breakeven" analysis differs from the profit-maximizing analysis called for by the hypothetical monopolist test in Section 4.1.1, merging parties sometimes present this type of analysis to the Agencies. A price increase raises profits on sales made at the higher price, but this will be offset to the extent customers substitute away from products in the candidate market. Critical loss analysis compares the magnitude of these two offsetting effects resulting from the price increase. The "critical loss" is defined as the number of lost unit sales that would leave profits unchanged. The "predicted loss" is defined as the number of unit sales that the hypothetical monopolist is predicted to lose due to the price increase. The price increase raises the hypothetical monopolist's profits if the predicted loss is less than the critical loss.

The Agencies consider all of the evidence of customer substitution noted above in assessing the predicted loss. The Agencies require that estimates of the predicted loss be consistent with that evidence, including the pre-merger margins of products in the candidate market used to calculate the critical loss. Unless the firms are engaging in coordinated interaction (see Section 7), high pre-merger margins normally indicate that each firm's product individually faces demand that is not highly sensitive to price.[6] Higher pre-merger margins thus indicate a smaller predicted loss as well as a smaller critical loss. The higher the pre-merger margin, the smaller the recapture percentage necessary for the candidate market to satisfy the hypothetical monopolist test.

Even when the evidence necessary to perform the hypothetical monopolist test quantitatively is not available, the conceptual framework of the test provides a useful methodological tool for gathering and analyzing evidence pertinent to customer substitution and to market definition. The Agencies follow the hypothetical monopolist test to the extent possible given the available evidence, bearing in mind that the ultimate goal of market definition is to help determine whether the merger may substantially lessen competition.

4.1.4 Product Market Definition with Targeted Customers

If a hypothetical monopolist could profitably target a subset of customers for price increases, the Agencies may identify relevant markets defined around those targeted customers, to whom a hypothetical monopolist would profitably and separately impose at least a SSNIP. Markets to serve targeted customers are also known as price discrimination markets. In practice, the Agencies identify price discrimination markets only where they believe there is a realistic prospect of an adverse competitive effect on a group of targeted customers.

> *Example 11:* Glass containers have many uses. In response to a price increase for glass containers, some users would substitute substantially to plastic or metal containers, but baby food manufacturers would not. If a

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[6] While margins are important for implementing the hypothetical monopolist test, high margins are not in themselves of antitrust concern.

hypothetical monopolist could price separately and limit arbitrage, baby food manufacturers would be vulnerable to a targeted increase in the price of glass containers. The Agencies could define a distinct market for glass containers used to package baby food.

The Agencies also often consider markets for targeted customers when prices are individually negotiated and suppliers have information about customers that would allow a hypothetical monopolist to identify customers that are likely to pay a higher price for the relevant product. If prices are negotiated individually with customers, the hypothetical monopolist test may suggest relevant markets that are as narrow as individual customers (see also Section 6.2 on bargaining and auctions). Nonetheless, the Agencies often define markets for groups of targeted customers, i.e., by type of customer, rather than by individual customer. By so doing, the Agencies are able to rely on aggregated market shares that can be more helpful in predicting the competitive effects of the merger.

4.2 Geographic Market Definition

The arena of competition affected by the merger may be geographically bounded if geography limits some customers' willingness or ability to substitute to some products, or some suppliers' willingness or ability to serve some customers. Both supplier and customer locations can affect this. The Agencies apply the principles of market definition described here and in Section 4.1 to define a relevant market with a geographic dimension as well as a product dimension.

The scope of geographic markets often depends on transportation costs. Other factors such as language, regulation, tariff and non-tariff trade barriers, custom and familiarity, reputation, and service availability may impede long-distance or international transactions. The competitive significance of foreign firms may be assessed at various exchange rates, especially if exchange rates have fluctuated in the recent past.

In the absence of price discrimination based on customer location, the Agencies normally define geographic markets based on the locations of suppliers, as explained in subsection 4.2.1. In other cases, notably if price discrimination based on customer location is feasible as is often the case when delivered pricing is commonly used in the industry, the Agencies may define geographic markets based on the locations of customers, as explained in subsection 4.2.2.

4.2.1 Geographic Markets Based on the Locations of Suppliers

Geographic markets based on the locations of suppliers encompass the region from which sales are made. Geographic markets of this type often apply when customers receive goods or services at suppliers' locations. Competitors in the market are firms with relevant production, sales, or service facilities in that region. Some customers who buy from these firms may be located outside the boundaries of the geographic market.

The hypothetical monopolist test requires that a hypothetical profit-maximizing firm that was the only present or future producer of the relevant product(s) located in the region would impose at least a SSNIP from at least one location, including at least one location of one of the merging firms. In this exercise the terms of sale for all products produced elsewhere are held constant. A single firm may operate in a number of different geographic markets, even for a single product.

Example 12: The merging parties both have manufacturing plants in City X. The relevant product is expensive to transport and suppliers price their products for pickup at their locations. Rival plants are some distance away in City Y. A hypothetical monopolist controlling all plants in City X could profitably impose a SSNIP at these plants. Competition from more distant plants would not defeat the price increase because supplies coming from more distant plants require expensive transportation. The relevant geographic market is defined around the plants in City X.

When the geographic market is defined based on supplier locations, sales made by suppliers located in the geographic market are counted, regardless of the location of the customer making the purchase.

In considering likely reactions of customers to price increases for the relevant product(s) imposed in a candidate geographic market, the Agencies consider any reasonably available and reliable evidence, including:

- how customers have shifted purchases in the past between different geographic locations in response to relative changes in price or other terms and conditions;
- the cost and difficulty of transporting the product (or the cost and difficulty of a customer traveling to a seller's location), in relation to its price;
- whether suppliers need a presence near customers to provide service or support;
- evidence on whether sellers base business decisions on the prospect of customers switching between geographic locations in response to relative changes in price or other competitive variables;
- the costs and delays of switching from suppliers in the candidate geographic market to suppliers outside the candidate geographic market; and
- the influence of downstream competition faced by customers in their output markets.

4.2.2 Geographic Markets Based on the Locations of Customers

When the hypothetical monopolist could discriminate based on customer location, the Agencies may define geographic markets based on the locations of targeted customers.[7] Geographic markets of this type often apply when suppliers deliver their products or services to customers' locations. Geographic markets of this type encompass the region into which sales are made. Competitors in the market are firms that sell to customers in the specified region. Some suppliers that sell into the relevant market may be located outside the boundaries of the geographic market.

The hypothetical monopolist test requires that a hypothetical profit-maximizing firm that was the only present or future seller of the relevant product(s) to customers in the region would impose at least a SSNIP on some customers in that region. A region forms a relevant geographic market if this price increase would not be defeated by substitution away from the relevant product or by arbitrage,

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[7] For customers operating in multiple locations, only those customer locations within the targeted zone are included in the market.

e.g., customers in the region travelling outside it to purchase the relevant product. In this exercise, the terms of sale for products sold to all customers outside the region are held constant.

> *Example 13:* Customers require local sales and support. Suppliers have sales and service operations in many geographic areas and can discriminate based on customer location. The geographic market can be defined around the locations of customers.

> *Example 14:* Each merging firm has a single manufacturing plant and delivers the relevant product to customers in City X and in City Y. The relevant product is expensive to transport. The merging firms' plants are by far the closest to City X, but no closer to City Y than are numerous rival plants. This fact pattern suggests that customers in City X may be harmed by the merger even if customers in City Y are not. For that reason, the Agencies consider a relevant geographic market defined around customers in City X. Such a market could be defined even if the region around the merging firms' plants would not be a relevant geographic market defined based on the location of sellers because a hypothetical monopolist controlling all plants in that region would find a SSNIP imposed on all of its customers unprofitable due to the loss of sales to customers in City Y.

When the geographic market is defined based on customer locations, sales made to those customers are counted, regardless of the location of the supplier making those sales.

> *Example 15:* Customers in the United States must use products approved by U.S. regulators. Foreign customers use products not approved by U.S. regulators. The relevant product market consists of products approved by U.S. regulators. The geographic market is defined around U.S. customers. Any sales made to U.S. customers by foreign suppliers are included in the market, and those foreign suppliers are participants in the U.S. market even though located outside it.

5. Market Participants, Market Shares, and Market Concentration

The Agencies normally consider measures of market shares and market concentration as part of their evaluation of competitive effects. The Agencies evaluate market shares and concentration in conjunction with other reasonably available and reliable evidence for the ultimate purpose of determining whether a merger may substantially lessen competition.

Market shares can directly influence firms' competitive incentives. For example, if a price reduction to gain new customers would also apply to a firm's existing customers, a firm with a large market share may be more reluctant to implement a price reduction than one with a small share. Likewise, a firm with a large market share may not feel pressure to reduce price even if a smaller rival does. Market shares also can reflect firms' capabilities. For example, a firm with a large market share may be able to expand output rapidly by a larger absolute amount than can a small firm. Similarly, a large market share tends to indicate low costs, an attractive product, or both.

5.1 Market Participants

All firms that currently earn revenues in the relevant market are considered market participants. Vertically integrated firms are also included to the extent that their inclusion accurately reflects their competitive significance. Firms not currently earning revenues in the relevant market, but that have committed to entering the market in the near future, are also considered market participants.

Firms that are not current producers in a relevant market, but that would very likely provide rapid supply responses with direct competitive impact in the event of a SSNIP, without incurring significant sunk costs, are also considered market participants. These firms are termed “rapid entrants.” Sunk costs are entry or exit costs that cannot be recovered outside the relevant market. Entry that would take place more slowly in response to adverse competitive effects, or that requires firms to incur significant sunk costs, is considered in Section 9.

Firms that produce the relevant product but do not sell it in the relevant geographic market may be rapid entrants. Other things equal, such firms are most likely to be rapid entrants if they are close to the geographic market.

> *Example 16:* Farm A grows tomatoes halfway between Cities X and Y. Currently, it ships its tomatoes to City X because prices there are two percent higher. Previously it has varied the destination of its shipments in response to small price variations. Farm A would likely be a rapid entrant participant in a market for tomatoes in City Y.

> *Example 17:* Firm B has bid multiple times to supply milk to School District S, and actually supplies milk to schools in some adjacent areas. It has never won a bid in School District S, but is well qualified to serve that district and has often nearly won. Firm B would be counted as a rapid entrant in a market for school milk in School District S.

More generally, if the relevant market is defined around targeted customers, firms that produce relevant products but do not sell them to those customers may be rapid entrants if they can easily and rapidly begin selling to the targeted customers.

Firms that clearly possess the necessary assets to supply into the relevant market rapidly may also be rapid entrants. In markets for relatively homogeneous goods where a supplier’s ability to compete depends predominantly on its costs and its capacity, and not on other factors such as experience or reputation in the relevant market, a supplier with efficient idle capacity, or readily available “swing” capacity currently used in adjacent markets that can easily and profitably be shifted to serve the relevant market, may be a rapid entrant.[8] However, idle capacity may be inefficient, and capacity used in adjacent markets may not be available, so a firm’s possession of idle or swing capacity alone does not make that firm a rapid entrant.

5.2 Market Shares

The Agencies normally calculate market shares for all firms that currently produce products in the relevant market, subject to the availability of data. The Agencies also calculate market shares for other market participants if this can be done to reliably reflect their competitive significance.

Market concentration and market share data are normally based on historical evidence. However, recent or ongoing changes in market conditions may indicate that the current market share of a particular firm either understates or overstates the firm’s future competitive significance. The Agencies consider reasonably predictable effects of recent or ongoing changes in market conditions when calculating and interpreting market share data. For example, if a new technology that is important to long-term competitive viability is available to other firms in the market, but is not available to a particular firm, the Agencies may conclude that that firm’s historical market share

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8 If this type of supply side substitution is nearly universal among the firms selling one or more of a group of products, the Agencies may use an aggregate description of markets for those products as a matter of convenience.

overstates its future competitive significance. The Agencies may project historical market shares into the foreseeable future when this can be done reliably.

The Agencies measure market shares based on the best available indicator of firms' future competitive significance in the relevant market. This may depend upon the type of competitive effect being considered, and on the availability of data. Typically, annual data are used, but where individual transactions are large and infrequent so annual data may be unrepresentative, the Agencies may measure market shares over a longer period of time.

In most contexts, the Agencies measure each firm's market share based on its actual or projected revenues in the relevant market. Revenues in the relevant market tend to be the best measure of attractiveness to customers, since they reflect the real-world ability of firms to surmount all of the obstacles necessary to offer products on terms and conditions that are attractive to customers. In cases where one unit of a low-priced product can substitute for one unit of a higher-priced product, unit sales may measure competitive significance better than revenues. For example, a new, much less expensive product may have great competitive significance if it substantially erodes the revenues earned by older, higher-priced products, even if it earns relatively few revenues. In cases where customers sign long-term contracts, face switching costs, or tend to re-evaluate their suppliers only occasionally, revenues earned from recently acquired customers may better reflect the competitive significance of suppliers than do total revenues.

In markets for homogeneous products, a firm's competitive significance may derive principally from its ability and incentive to rapidly expand production in the relevant market in response to a price increase or output reduction by others in that market. As a result, a firm's competitive significance may depend upon its level of readily available capacity to serve the relevant market if that capacity is efficient enough to make such expansion profitable. In such markets, capacities or reserves may better reflect the future competitive significance of suppliers than revenues, and the Agencies may calculate market shares using those measures. Market participants that are not current producers may then be assigned positive market shares, but only if a measure of their competitive significance properly comparable to that of current producers is available. When market shares are measured based on firms' readily available capacities, the Agencies do not include capacity that is committed or so profitably employed outside the relevant market, or so high-cost, that it would not likely be used to respond to a SSNIP in the relevant market.

> *Example 18:* The geographic market is defined around customers in the United States. Firm X produces the relevant product outside the United States, and most of its sales are made to customers outside the United States. In most contexts, Firm X's market share will be based on its sales to U.S. customers, not its total sales or total capacity. However, if the relevant product is homogeneous, and if Firm X would significantly expand sales to U.S. customers rapidly and without incurring significant sunk costs in response to a SSNIP, the Agencies may base Firm X's market share on its readily available capacity to serve U.S. customers.

When the Agencies define markets serving targeted customers, these same principles are used to measure market shares, as they apply to those customers. In most contexts, each firm's market share is based on its actual or projected revenues from the targeted customers. However, the Agencies may instead measure market shares based on revenues from a broader group of customers if doing so would more accurately reflect the competitive significance of different suppliers in the relevant market. Revenues earned from a broader group of customers may also be used when better data are thereby available.

5.3 Market Concentration

Market concentration is often one useful indicator of likely competitive effects of a merger. In evaluating market concentration, the Agencies consider both the post-merger level of market concentration and the change in concentration resulting from a merger. Market shares may not fully reflect the competitive significance of firms in the market or the impact of a merger. They are used in conjunction with other evidence of competitive effects. See Sections 6 and 7.

In analyzing mergers between an incumbent and a recent or potential entrant, to the extent the Agencies use the change in concentration to evaluate competitive effects, they will do so using projected market shares. A merger between an incumbent and a potential entrant can raise significant competitive concerns. The lessening of competition resulting from such a merger is more likely to be substantial, the larger is the market share of the incumbent, the greater is the competitive significance of the potential entrant, and the greater is the competitive threat posed by this potential entrant relative to others.

The Agencies give more weight to market concentration when market shares have been stable over time, especially in the face of historical changes in relative prices or costs. If a firm has retained its market share even after its price has increased relative to those of its rivals, that firm already faces limited competitive constraints, making it less likely that its remaining rivals will replace the competition lost if one of that firm's important rivals is eliminated due to a merger. By contrast, even a highly concentrated market can be very competitive if market shares fluctuate substantially over short periods of time in response to changes in competitive offerings. However, if competition by one of the merging firms has significantly contributed to these fluctuations, perhaps because it has acted as a maverick, the Agencies will consider whether the merger will enhance market power by combining that firm with one of its significant rivals.

The Agencies may measure market concentration using the number of significant competitors in the market. This measure is most useful when there is a gap in market share between significant competitors and smaller rivals or when it is difficult to measure revenues in the relevant market. The Agencies also may consider the combined market share of the merging firms as an indicator of the extent to which others in the market may not be able readily to replace competition between the merging firms that is lost through the merger.

The Agencies often calculate the Herfindahl-Hirschman Index ("HHI") of market concentration. The HHI is calculated by summing the squares of the individual firms' market shares,[9] and thus gives proportionately greater weight to the larger market shares. When using the HHI, the Agencies

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[9] For example, a market consisting of four firms with market shares of thirty percent, thirty percent, twenty percent, and twenty percent has an HHI of 2600 ($30^2 + 30^2 + 20^2 + 20^2 = 2600$). The HHI ranges from 10,000 (in the case of a pure monopoly) to a number approaching zero (in the case of an atomistic market). Although it is desirable to include all firms in the calculation, lack of information about firms with small shares is not critical because such firms do not affect the HHI significantly.

consider both the post-merger level of the HHI and the increase in the HHI resulting from the merger. The increase in the HHI is equal to twice the product of the market shares of the merging firms.[10]

Based on their experience, the Agencies generally classify markets into three types:

- Unconcentrated Markets: HHI below 1500
- Moderately Concentrated Markets: HHI between 1500 and 2500
- Highly Concentrated Markets: HHI above 2500

The Agencies employ the following general standards for the relevant markets they have defined:

- *Small Change in Concentration:* Mergers involving an increase in the HHI of less than 100 points are unlikely to have adverse competitive effects and ordinarily require no further analysis.
- *Unconcentrated Markets:* Mergers resulting in unconcentrated markets are unlikely to have adverse competitive effects and ordinarily require no further analysis.
- *Moderately Concentrated Markets:* Mergers resulting in moderately concentrated markets that involve an increase in the HHI of more than 100 points potentially raise significant competitive concerns and often warrant scrutiny.
- *Highly Concentrated Markets:* Mergers resulting in highly concentrated markets that involve an increase in the HHI of between 100 points and 200 points potentially raise significant competitive concerns and often warrant scrutiny. Mergers resulting in highly concentrated markets that involve an increase in the HHI of more than 200 points will be presumed to be likely to enhance market power. The presumption may be rebutted by persuasive evidence showing that the merger is unlikely to enhance market power.

The purpose of these thresholds is not to provide a rigid screen to separate competitively benign mergers from anticompetitive ones, although high levels of concentration do raise concerns. Rather, they provide one way to identify some mergers unlikely to raise competitive concerns and some others for which it is particularly important to examine whether other competitive factors confirm, reinforce, or counteract the potentially harmful effects of increased concentration. The higher the post-merger HHI and the increase in the HHI, the greater are the Agencies' potential competitive concerns and the greater is the likelihood that the Agencies will request additional information to conduct their analysis.

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10 For example, the merger of firms with shares of five percent and ten percent of the market would increase the HHI by 100 ($5 \times 10 \times 2 = 100$).

6. Unilateral Effects

The elimination of competition between two firms that results from their merger may alone constitute a substantial lessening of competition. Such unilateral effects are most apparent in a merger to monopoly in a relevant market, but are by no means limited to that case. Whether cognizable efficiencies resulting from the merger are likely to reduce or reverse adverse unilateral effects is addressed in Section 10.

Several common types of unilateral effects are discussed in this section. Section 6.1 discusses unilateral price effects in markets with differentiated products. Section 6.2 discusses unilateral effects in markets where sellers negotiate with buyers or prices are determined through auctions. Section 6.3 discusses unilateral effects relating to reductions in output or capacity in markets for relatively homogeneous products. Section 6.4 discusses unilateral effects arising from diminished innovation or reduced product variety. These effects do not exhaust the types of possible unilateral effects; for example, exclusionary unilateral effects also can arise.

A merger may result in different unilateral effects along different dimensions of competition. For example, a merger may increase prices in the short term but not raise longer-term concerns about innovation, either because rivals will provide sufficient innovation competition or because the merger will generate cognizable research and development efficiencies. See Section 10.

6.1 Pricing of Differentiated Products

In differentiated product industries, some products can be very close substitutes and compete strongly with each other, while other products are more distant substitutes and compete less strongly. For example, one high-end product may compete much more directly with another high-end product than with any low-end product.

A merger between firms selling differentiated products may diminish competition by enabling the merged firm to profit by unilaterally raising the price of one or both products above the pre-merger level. Some of the sales lost due to the price rise will merely be diverted to the product of the merger partner and, depending on relative margins, capturing such sales loss through merger may make the price increase profitable even though it would not have been profitable prior to the merger.

The extent of direct competition between the products sold by the merging parties is central to the evaluation of unilateral price effects. Unilateral price effects are greater, the more the buyers of products sold by one merging firm consider products sold by the other merging firm to be their next choice. The Agencies consider any reasonably available and reliable information to evaluate the extent of direct competition between the products sold by the merging firms. This includes documentary and testimonial evidence, win/loss reports and evidence from discount approval processes, customer switching patterns, and customer surveys. The types of evidence relied on often overlap substantially with the types of evidence of customer substitution relevant to the hypothetical monopolist test. See Section 4.1.1.

Substantial unilateral price elevation post-merger for a product formerly sold by one of the merging firms normally requires that a significant fraction of the customers purchasing that product view products formerly sold by the other merging firm as their next-best choice. However, unless pre-merger margins between price and incremental cost are low, that significant fraction need not approach a majority. For this purpose, incremental cost is measured over the change in output that would be caused by the price change considered. A merger may produce significant unilateral effects for a given product even though many more sales are diverted to products sold by non-merging firms than to products previously sold by the merger partner.

> *Example 19:* In Example 5, the merged entity controlling Products A and B would raise prices ten percent, given the product offerings and prices of other firms. In that example, one-third of the sales lost by Product A when its price alone is raised are diverted to Product B. Further analysis is required to account for repositioning, entry, and efficiencies.

In some cases, the Agencies may seek to quantify the extent of direct competition between a product sold by one merging firm and a second product sold by the other merging firm by estimating the diversion ratio from the first product to the second product. The diversion ratio is the fraction of unit sales lost by the first product due to an increase in its price that would be diverted to the second product. Diversion ratios between products sold by one merging firm and products sold by the other merging firm can be very informative for assessing unilateral price effects, with higher diversion ratios indicating a greater likelihood of such effects. Diversion ratios between products sold by merging firms and those sold by non-merging firms have at most secondary predictive value.

Adverse unilateral price effects can arise when the merger gives the merged entity an incentive to raise the price of a product previously sold by one merging firm and thereby divert sales to products previously sold by the other merging firm, boosting the profits on the latter products. Taking as given other prices and product offerings, that boost to profits is equal to the value to the merged firm of the sales diverted to those products. The value of sales diverted to a product is equal to the number of units diverted to that product multiplied by the margin between price and incremental cost on that product. In some cases, where sufficient information is available, the Agencies assess the value of diverted sales, which can serve as an indicator of the upward pricing pressure on the first product resulting from the merger. Diagnosing unilateral price effects based on the value of diverted sales need not rely on market definition or the calculation of market shares and concentration. The Agencies rely much more on the value of diverted sales than on the level of the HHI for diagnosing unilateral price effects in markets with differentiated products. If the value of diverted sales is proportionately small, significant unilateral price effects are unlikely.[11]

Where sufficient data are available, the Agencies may construct economic models designed to quantify the unilateral price effects resulting from the merger. These models often include independent price responses by non-merging firms. They also can incorporate merger-specific efficiencies. These merger simulation methods need not rely on market definition. The Agencies do not treat merger simulation evidence as conclusive in itself, and they place more weight on whether their merger simulations consistently predict substantial price increases than on the precise prediction of any single simulation.

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[11] For this purpose, the value of diverted sales is measured in proportion to the lost revenues attributable to the reduction in unit sales resulting from the price increase. Those lost revenues equal the reduction in the number of units sold of that product multiplied by that product’s price.

A merger is unlikely to generate substantial unilateral price increases if non-merging parties offer very close substitutes for the products offered by the merging firms. In some cases, non-merging firms may be able to reposition their products to offer close substitutes for the products offered by the merging firms. Repositioning is a supply-side response that is evaluated much like entry, with consideration given to timeliness, likelihood, and sufficiency. See Section 9. The Agencies consider whether repositioning would be sufficient to deter or counteract what otherwise would be significant anticompetitive unilateral effects from a differentiated products merger.

6.2 Bargaining and Auctions

In many industries, especially those involving intermediate goods and services, buyers and sellers negotiate to determine prices and other terms of trade. In that process, buyers commonly negotiate with more than one seller, and may play sellers off against one another. Some highly structured forms of such competition are known as auctions. Negotiations often combine aspects of an auction with aspects of one-on-one negotiation, although pure auctions are sometimes used in government procurement and elsewhere.

A merger between two competing sellers prevents buyers from playing those sellers off against each other in negotiations. This alone can significantly enhance the ability and incentive of the merged entity to obtain a result more favorable to it, and less favorable to the buyer, than the merging firms would have offered separately absent the merger. The Agencies analyze unilateral effects of this type using similar approaches to those described in Section 6.1.

Anticompetitive unilateral effects in these settings are likely in proportion to the frequency or probability with which, prior to the merger, one of the merging sellers had been the runner-up when the other won the business. These effects also are likely to be greater, the greater advantage the runner-up merging firm has over other suppliers in meeting customers' needs. These effects also tend to be greater, the more profitable were the pre-merger winning bids. All of these factors are likely to be small if there are many equally placed bidders.

The mechanisms of these anticompetitive unilateral effects, and the indicia of their likelihood, differ somewhat according to the bargaining practices used, the auction format, and the sellers' information about one another's costs and about buyers' preferences. For example, when the merging sellers are likely to know which buyers they are best and second best placed to serve, any anticompetitive unilateral effects are apt to be targeted at those buyers; when sellers are less well informed, such effects are more apt to be spread over a broader class of buyers.

6.3 Capacity and Output for Homogeneous Products

In markets involving relatively undifferentiated products, the Agencies may evaluate whether the merged firm will find it profitable unilaterally to suppress output and elevate the market price. A firm may leave capacity idle, refrain from building or obtaining capacity that would have been obtained absent the merger, or eliminate pre-existing production capabilities. A firm may also divert the use of capacity away from one relevant market and into another so as to raise the price in the former market. The competitive analyses of these alternative modes of output suppression may differ.

A unilateral output suppression strategy is more likely to be profitable when (1) the merged firm's market share is relatively high; (2) the share of the merged firm's output already committed for sale at prices unaffected by the output suppression is relatively low; (3) the margin on the suppressed output is relatively low; (4) the supply responses of rivals are relatively small; and (5) the market elasticity of demand is relatively low.

A merger may provide the merged firm a larger base of sales on which to benefit from the resulting price rise, or it may eliminate a competitor that otherwise could have expanded its output in response to the price rise.

> *Example 20:* Firms A and B both produce an industrial commodity and propose to merge. The demand for this commodity is insensitive to price. Firm A is the market leader. Firm B produces substantial output, but its operating margins are low because it operates high-cost plants. The other suppliers are operating very near capacity. The merged firm has an incentive to reduce output at the high-cost plants, perhaps shutting down some of that capacity, thus driving up the price it receives on the remainder of its output. The merger harms customers, notwithstanding that the merged firm shifts some output from high-cost plants to low-cost plants.

In some cases, a merger between a firm with a substantial share of the sales in the market and a firm with significant excess capacity to serve that market can make an output suppression strategy profitable.[12] This can occur even if the firm with the excess capacity has a relatively small share of sales, if that firm's ability to expand, and thus keep price from rising, has been making an output suppression strategy unprofitable for the firm with the larger market share.

6.4 Innovation and Product Variety

Competition often spurs firms to innovate. The Agencies may consider whether a merger is likely to diminish innovation competition by encouraging the merged firm to curtail its innovative efforts below the level that would prevail in the absence of the merger. That curtailment of innovation could take the form of reduced incentive to continue with an existing product-development effort or reduced incentive to initiate development of new products.

The first of these effects is most likely to occur if at least one of the merging firms is engaging in efforts to introduce new products that would capture substantial revenues from the other merging firm. The second, longer-run effect is most likely to occur if at least one of the merging firms has capabilities that are likely to lead it to develop new products in the future that would capture substantial revenues from the other merging firm. The Agencies therefore also consider whether a merger will diminish innovation competition by combining two of a very small number of firms with the strongest capabilities to successfully innovate in a specific direction.

The Agencies evaluate the extent to which successful innovation by one merging firm is likely to take sales from the other, and the extent to which post-merger incentives for future innovation will be lower than those that would prevail in the absence of the merger. The Agencies also consider whether the merger is likely to enable innovation that would not otherwise take place, by bringing together

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12 Such a merger also can cause adverse coordinated effects, especially if the acquired firm with excess capacity was disrupting effective coordination.

complementary capabilities that cannot be otherwise combined or for some other merger-specific reason. See Section 10.

The Agencies also consider whether a merger is likely to give the merged firm an incentive to cease offering one of the relevant products sold by the merging parties. Reductions in variety following a merger may or may not be anticompetitive. Mergers can lead to the efficient consolidation of products when variety offers little in value to customers. In other cases, a merger may increase variety by encouraging the merged firm to reposition its products to be more differentiated from one another.

If the merged firm would withdraw a product that a significant number of customers strongly prefer to those products that would remain available, this can constitute a harm to customers over and above any effects on the price or quality of any given product. If there is evidence of such an effect, the Agencies may inquire whether the reduction in variety is largely due to a loss of competitive incentives attributable to the merger. An anticompetitive incentive to eliminate a product as a result of the merger is greater and more likely, the larger is the share of profits from that product coming at the expense of profits from products sold by the merger partner. Where a merger substantially reduces competition by bringing two close substitute products under common ownership, and one of those products is eliminated, the merger will often also lead to a price increase on the remaining product, but that is not a necessary condition for anticompetitive effect.

> *Example 21:* Firm A sells a high-end product at a premium price. Firm B sells a mid-range product at a lower price, serving customers who are more price sensitive. Several other firms have low-end products. Firms A and B together have a large share of the relevant market. Firm A proposes to acquire Firm B and discontinue Firm B's product. Firm A expects to retain most of Firm B's customers. Firm A may not find it profitable to raise the price of its high-end product after the merger, because doing so would reduce its ability to retain Firm B's more price-sensitive customers. The Agencies may conclude that the withdrawal of Firm B's product results from a loss of competition and materially harms customers.

7. Coordinated Effects

A merger may diminish competition by enabling or encouraging post-merger coordinated interaction among firms in the relevant market that harms customers. Coordinated interaction involves conduct by multiple firms that is profitable for each of them only as a result of the accommodating reactions of the others. These reactions can blunt a firm's incentive to offer customers better deals by undercutting the extent to which such a move would win business away from rivals. They also can enhance a firm's incentive to raise prices, by assuaging the fear that such a move would lose customers to rivals.

Coordinated interaction includes a range of conduct. Coordinated interaction can involve the explicit negotiation of a common understanding of how firms will compete or refrain from competing. Such conduct typically would itself violate the antitrust laws. Coordinated interaction also can involve a similar common understanding that is not explicitly negotiated but would be enforced by the detection and punishment of deviations that would undermine the coordinated interaction. Coordinated interaction alternatively can involve parallel accommodating conduct not pursuant to a prior understanding. Parallel accommodating conduct includes situations in which each rival's response to competitive moves made by others is individually rational, and not motivated by retaliation or deterrence nor intended to sustain an agreed-upon market outcome, but nevertheless emboldens price increases and weakens competitive incentives to reduce prices or offer customers better terms. Coordinated interaction includes conduct not otherwise condemned by the antitrust laws.

The ability of rival firms to engage in coordinated conduct depends on the strength and predictability of rivals' responses to a price change or other competitive initiative. Under some circumstances, a merger can result in market concentration sufficient to strengthen such responses or enable multiple firms in the market to predict them more confidently, thereby affecting the competitive incentives of multiple firms in the market, not just the merged firm.

7.1 Impact of Merger on Coordinated Interaction

The Agencies examine whether a merger is likely to change the manner in which market participants interact, inducing substantially more coordinated interaction. The Agencies seek to identify how a merger might significantly weaken competitive incentives through an increase in the strength, extent, or likelihood of coordinated conduct. There are, however, numerous forms of coordination, and the risk that a merger will induce adverse coordinated effects may not be susceptible to quantification or detailed proof. Therefore, the Agencies evaluate the risk of coordinated effects using measures of market concentration (see Section 5) in conjunction with an assessment of whether a market is vulnerable to coordinated conduct. See Section 7.2. The analysis in Section 7.2 applies to moderately and highly concentrated markets, as unconcentrated markets are unlikely to be vulnerable to coordinated conduct.

Pursuant to the Clayton Act's incipiency standard, the Agencies may challenge mergers that in their judgment pose a real danger of harm through coordinated effects, even without specific evidence showing precisely how the coordination likely would take place. The Agencies are likely to challenge a merger if the following three conditions are all met: (1) the merger would significantly increase concentration and lead to a moderately or highly concentrated market; (2) that market shows signs of vulnerability to coordinated conduct (see Section 7.2); and (3) the Agencies have a credible basis on which to conclude that the merger may enhance that vulnerability. An acquisition eliminating a maverick firm (see Section 2.1.5) in a market vulnerable to coordinated conduct is likely to cause adverse coordinated effects.

7.2 Evidence a Market is Vulnerable to Coordinated Conduct

The Agencies presume that market conditions are conducive to coordinated interaction if firms representing a substantial share in the relevant market appear to have previously engaged in express collusion affecting the relevant market, unless competitive conditions in the market have since changed significantly. Previous express collusion in another geographic market will have the same weight if the salient characteristics of that other market at the time of the collusion are comparable to those in the relevant market. Failed previous attempts at collusion in the relevant market suggest that successful collusion was difficult pre-merger but not so difficult as to deter attempts, and a merger may tend to make success more likely. Previous collusion or attempted collusion in another product market may also be given substantial weight if the salient characteristics of that other market at the time of the collusion are closely comparable to those in the relevant market.

A market typically is more vulnerable to coordinated conduct if each competitively important firm's significant competitive initiatives can be promptly and confidently observed by that firm's rivals. This is more likely to be the case if the terms offered to customers are relatively transparent. Price transparency can be greater for relatively homogeneous products. Even if terms of dealing are not transparent, transparency regarding the identities of the firms serving particular customers can give rise to coordination, e.g., through customer or territorial allocation. Regular monitoring by suppliers of one another's prices or customers can indicate that the terms offered to customers are relatively transparent.

A market typically is more vulnerable to coordinated conduct if a firm's prospective competitive reward from attracting customers away from its rivals will be significantly diminished by likely responses of those rivals. This is more likely to be the case, the stronger and faster are the responses the firm anticipates from its rivals. The firm is more likely to anticipate strong responses if there are few significant competitors, if products in the relevant market are relatively homogeneous, if customers find it relatively easy to switch between suppliers, or if suppliers use meeting-competition clauses.

A firm is more likely to be deterred from making competitive initiatives by whatever responses occur if sales are small and frequent rather than via occasional large and long-term contracts or if relatively few customers will switch to it before rivals are able to respond. A firm is less likely to be deterred by whatever responses occur if the firm has little stake in the status quo. For example, a firm with a small market share that can quickly and dramatically expand, constrained neither by limits on production nor by customer reluctance to switch providers or to entrust business to a historically small provider, is unlikely to be deterred. Firms are also less likely to be deterred by whatever responses occur if competition in the relevant market is marked by leapfrogging technological innovation, so that responses by competitors leave the gains from successful innovation largely intact.

A market is more apt to be vulnerable to coordinated conduct if the firm initiating a price increase will lose relatively few customers after rivals respond to the increase. Similarly, a market is more apt to be vulnerable to coordinated conduct if a firm that first offers a lower price or improved product to customers will retain relatively few customers thus attracted away from its rivals after those rivals respond.

The Agencies regard coordinated interaction as more likely, the more the participants stand to gain from successful coordination. Coordination generally is more profitable, the lower is the market elasticity of demand.

Coordinated conduct can harm customers even if not all firms in the relevant market engage in the coordination, but significant harm normally is likely only if a substantial part of the market is subject to such conduct. The prospect of harm depends on the collective market power, in the relevant market, of firms whose incentives to compete are substantially weakened by coordinated conduct. This collective market power is greater, the lower is the market elasticity of demand. This collective market power is diminished by the presence of other market participants with small market shares and little stake in the outcome resulting from the coordinated conduct, if these firms can rapidly expand their sales in the relevant market.

Buyer characteristics and the nature of the procurement process can affect coordination. For example, sellers may have the incentive to bid aggressively for a large contract even if they expect strong responses by rivals. This is especially the case for sellers with small market shares, if they can realistically win such large contracts. In some cases, a large buyer may be able to strategically undermine coordinated conduct, at least as it pertains to that buyer's needs, by choosing to put up for bid a few large contracts rather than many smaller ones, and by making its procurement decisions opaque to suppliers.

8. Powerful Buyers

Powerful buyers are often able to negotiate favorable terms with their suppliers. Such terms may reflect the lower costs of serving these buyers, but they also can reflect price discrimination in their favor.

The Agencies consider the possibility that powerful buyers may constrain the ability of the merging parties to raise prices. This can occur, for example, if powerful buyers have the ability and incentive to vertically integrate upstream or sponsor entry, or if the conduct or presence of large buyers undermines coordinated effects. However, the Agencies do not presume that the presence of powerful buyers alone forestalls adverse competitive effects flowing from the merger. Even buyers that can negotiate favorable terms may be harmed by an increase in market power. The Agencies examine the choices available to powerful buyers and how those choices likely would change due to the merger. Normally, a merger that eliminates a supplier whose presence contributed significantly to a buyer's negotiating leverage will harm that buyer.

> *Example 22:* Customer C has been able to negotiate lower pre-merger prices than other customers by threatening to shift its large volume of purchases from one merging firm to the other. No other suppliers are as well placed to meet Customer C's needs for volume and reliability. The merger is likely to harm Customer C. In this situation, the Agencies could identify a price discrimination market consisting of Customer C and similarly placed customers. The merger threatens to end previous price discrimination in their favor.

Furthermore, even if some powerful buyers could protect themselves, the Agencies also consider whether market power can be exercised against other buyers.

> *Example 23:* In Example 22, if Customer C instead obtained the lower pre-merger prices based on a credible threat to supply its own needs, or to sponsor new entry, Customer C might not be harmed. However, even in this case, other customers may still be harmed.

9. Entry

The analysis of competitive effects in Sections 6 and 7 focuses on current participants in the relevant market. That analysis may also include some forms of entry. Firms that would rapidly and easily enter the market in response to a SSNIP are market participants and may be assigned market shares. See Sections 5.1 and 5.2. Firms that have, prior to the merger, committed to entering the market also will normally be treated as market participants. See Section 5.1. This section concerns entry or adjustments to pre-existing entry plans that are induced by the merger.

As part of their full assessment of competitive effects, the Agencies consider entry into the relevant market. The prospect of entry into the relevant market will alleviate concerns about adverse competitive effects only if such entry will deter or counteract any competitive effects of concern so the merger will not substantially harm customers.

The Agencies consider the actual history of entry into the relevant market and give substantial weight to this evidence. Lack of successful and effective entry in the face of non-transitory increases in the margins earned on products in the relevant market tends to suggest that successful entry is slow or difficult. Market values of incumbent firms greatly exceeding the replacement costs of their tangible assets may indicate that these firms have valuable intangible assets, which may be difficult or time consuming for an entrant to replicate.

A merger is not likely to enhance market power if entry into the market is so easy that the merged firm and its remaining rivals in the market, either unilaterally or collectively, could not profitably raise price or otherwise reduce competition compared to the level that would prevail in the absence of the merger. Entry is that easy if entry would be timely, likely, and sufficient in its magnitude, character, and scope to deter or counteract the competitive effects of concern.

The Agencies examine the timeliness, likelihood, and sufficiency of the entry efforts an entrant might practically employ. An entry effort is defined by the actions the firm must undertake to produce and sell in the market. Various elements of the entry effort will be considered. These elements can include: planning, design, and management; permitting, licensing, or other approvals; construction, debugging, and operation of production facilities; and promotion (including necessary introductory discounts), marketing, distribution, and satisfaction of customer testing and qualification requirements. Recent examples of entry, whether successful or unsuccessful, generally provide the starting point for identifying the elements of practical entry efforts. They also can be informative regarding the scale necessary for an entrant to be successful, the presence or absence of entry barriers, the factors that influence the timing of entry, the costs and risk associated with entry, and the sales opportunities realistically available to entrants.

If the assets necessary for an effective and profitable entry effort are widely available, the Agencies will not necessarily attempt to identify which firms might enter. Where an identifiable set of firms appears to have necessary assets that others lack, or to have particularly strong incentives to enter, the Agencies focus their entry analysis on those firms. Firms operating in adjacent or complementary markets, or large customers themselves, may be best placed to enter. However, the Agencies will not presume that a powerful firm in an adjacent market or a large customer will enter the relevant market unless there is reliable evidence supporting that conclusion.

In assessing whether entry will be timely, likely, and sufficient, the Agencies recognize that precise and detailed information may be difficult or impossible to obtain. The Agencies consider reasonably available and reliable evidence bearing on whether entry will satisfy the conditions of timeliness, likelihood, and sufficiency.

9.1 Timeliness

In order to deter the competitive effects of concern, entry must be rapid enough to make unprofitable overall the actions causing those effects and thus leading to entry, even though those actions would be profitable until entry takes effect.

Even if the prospect of entry does not deter the competitive effects of concern, post-merger entry may counteract them. This requires that the impact of entrants in the relevant market be rapid enough that customers are not significantly harmed by the merger, despite any anticompetitive harm that occurs prior to the entry.

The Agencies will not presume that an entrant can have a significant impact on prices before that entrant is ready to provide the relevant product to customers unless there is reliable evidence that anticipated future entry would have such an effect on prices.

9.2 Likelihood

Entry is likely if it would be profitable, accounting for the assets, capabilities, and capital needed and the risks involved, including the need for the entrant to incur costs that would not be recovered if the entrant later exits. Profitability depends upon (a) the output level the entrant is likely to obtain, accounting for the obstacles facing new entrants; (b) the price the entrant would likely obtain in the post-merger market, accounting for the impact of that entry itself on prices; and (c) the cost per unit the entrant would likely incur, which may depend upon the scale at which the entrant would operate.

9.3 Sufficiency

Even where timely and likely, entry may not be sufficient to deter or counteract the competitive effects of concern. For example, in a differentiated product industry, entry may be insufficient because the products offered by entrants are not close enough substitutes to the products offered by the merged firm to render a price increase by the merged firm unprofitable. Entry may also be insufficient due to constraints that limit entrants' competitive effectiveness, such as limitations on the capabilities of the firms best placed to enter or reputational barriers to rapid expansion by new entrants. Entry by a single firm that will replicate at least the scale and strength of one of the merging firms is sufficient. Entry by one or more firms operating at a smaller scale may be sufficient if such firms are not at a significant competitive disadvantage.

10. Efficiencies

Competition usually spurs firms to achieve efficiencies internally. Nevertheless, a primary benefit of mergers to the economy is their potential to generate significant efficiencies and thus enhance the merged firm's ability and incentive to compete, which may result in lower prices, improved quality, enhanced service, or new products. For example, merger-generated efficiencies may enhance competition by permitting two ineffective competitors to form a more effective competitor, e.g., by combining complementary assets. In a unilateral effects context, incremental cost reductions may reduce or reverse any increases in the merged firm's incentive to elevate price. Efficiencies also may lead to new or improved products, even if they do not immediately and directly affect price. In a coordinated effects context, incremental cost reductions may make coordination less likely or effective by enhancing the incentive of a maverick to lower price or by creating a new maverick firm. Even when efficiencies generated through a merger enhance a firm's ability to compete, however, a merger may have other effects that may lessen competition and make the merger anticompetitive.

The Agencies credit only those efficiencies likely to be accomplished with the proposed merger and unlikely to be accomplished in the absence of either the proposed merger or another means having comparable anticompetitive effects. These are termed merger-specific efficiencies.[13] Only alternatives that are practical in the business situation faced by the merging firms are considered in making this determination. The Agencies do not insist upon a less restrictive alternative that is merely theoretical.

Efficiencies are difficult to verify and quantify, in part because much of the information relating to efficiencies is uniquely in the possession of the merging firms. Moreover, efficiencies projected reasonably and in good faith by the merging firms may not be realized. Therefore, it is incumbent upon the merging firms to substantiate efficiency claims so that the Agencies can verify by reasonable means the likelihood and magnitude of each asserted efficiency, how and when each would be achieved (and any costs of doing so), how each would enhance the merged firm's ability and incentive to compete, and why each would be merger-specific.

Efficiency claims will not be considered if they are vague, speculative, or otherwise cannot be verified by reasonable means. Projections of efficiencies may be viewed with skepticism, particularly when generated outside of the usual business planning process. By contrast, efficiency claims substantiated by analogous past experience are those most likely to be credited.

Cognizable efficiencies are merger-specific efficiencies that have been verified and do not arise from anticompetitive reductions in output or service. Cognizable efficiencies are assessed net of costs produced by the merger or incurred in achieving those efficiencies.

The Agencies will not challenge a merger if cognizable efficiencies are of a character and magnitude such that the merger is not likely to be anticompetitive in any relevant market.[14] To make the requisite determination, the Agencies consider whether cognizable efficiencies likely would be sufficient to reverse the merger's potential to harm customers in the relevant market, e.g., by preventing price

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13 The Agencies will not deem efficiencies to be merger-specific if they could be attained by practical alternatives that mitigate competitive concerns, such as divestiture or licensing. If a merger affects not whether but only when an efficiency would be achieved, only the timing advantage is a merger-specific efficiency.

14 The Agencies normally assess competition in each relevant market affected by a merger independently and normally will challenge the merger if it is likely to be anticompetitive in any relevant market. In some cases, however, the Agencies in their prosecutorial discretion will consider efficiencies not strictly in the relevant market, but so inextricably linked with it that a partial divestiture or other remedy could not feasibly eliminate the anticompetitive effect in the relevant market without sacrificing the efficiencies in the other market(s). Inextricably linked efficiencies are most likely to make a difference when they are great and the likely anticompetitive effect in the relevant market(s) is small so the merger is likely to benefit customers overall.

increases in that market.[15] In conducting this analysis, the Agencies will not simply compare the magnitude of the cognizable efficiencies with the magnitude of the likely harm to competition absent the efficiencies. The greater the potential adverse competitive effect of a merger, the greater must be the cognizable efficiencies, and the more they must be passed through to customers, for the Agencies to conclude that the merger will not have an anticompetitive effect in the relevant market. When the potential adverse competitive effect of a merger is likely to be particularly substantial, extraordinarily great cognizable efficiencies would be necessary to prevent the merger from being anticompetitive. In adhering to this approach, the Agencies are mindful that the antitrust laws give competition, not internal operational efficiency, primacy in protecting customers.

In the Agencies' experience, efficiencies are most likely to make a difference in merger analysis when the likely adverse competitive effects, absent the efficiencies, are not great. Efficiencies almost never justify a merger to monopoly or near-monopoly. Just as adverse competitive effects can arise along multiple dimensions of conduct, such as pricing and new product development, so too can efficiencies operate along multiple dimensions. Similarly, purported efficiency claims based on lower prices can be undermined if they rest on reductions in product quality or variety that customers value.

The Agencies have found that certain types of efficiencies are more likely to be cognizable and substantial than others. For example, efficiencies resulting from shifting production among facilities formerly owned separately, which enable the merging firms to reduce the incremental cost of production, are more likely to be susceptible to verification and are less likely to result from anticompetitive reductions in output. Other efficiencies, such as those relating to research and development, are potentially substantial but are generally less susceptible to verification and may be the result of anticompetitive output reductions. Yet others, such as those relating to procurement, management, or capital cost, are less likely to be merger-specific or substantial, or may not be cognizable for other reasons.

When evaluating the effects of a merger on innovation, the Agencies consider the ability of the merged firm to conduct research or development more effectively. Such efficiencies may spur innovation but not affect short-term pricing. The Agencies also consider the ability of the merged firm to appropriate a greater fraction of the benefits resulting from its innovations. Licensing and intellectual property conditions may be important to this enquiry, as they affect the ability of a firm to appropriate the benefits of its innovation. Research and development cost savings may be substantial and yet not be cognizable efficiencies because they are difficult to verify or result from anticompetitive reductions in innovative activities.

[15] The Agencies normally give the most weight to the results of this analysis over the short term. The Agencies also may consider the effects of cognizable efficiencies with no short-term, direct effect on prices in the relevant market. Delayed benefits from efficiencies (due to delay in the achievement of, or the realization of customer benefits from, the efficiencies) will be given less weight because they are less proximate and more difficult to predict. Efficiencies relating to costs that are fixed in the short term are unlikely to benefit customers in the short term, but can benefit customers in the longer run, e.g., if they make new product introduction less expensive.

11. Failure and Exiting Assets

Notwithstanding the analysis above, a merger is not likely to enhance market power if imminent failure, as defined below, of one of the merging firms would cause the assets of that firm to exit the relevant market. This is an extreme instance of the more general circumstance in which the competitive significance of one of the merging firms is declining: the projected market share and significance of the exiting firm is zero. If the relevant assets would otherwise exit the market, customers are not worse off after the merger than they would have been had the merger been enjoined.

The Agencies do not normally credit claims that the assets of the failing firm would exit the relevant market unless all of the following circumstances are met: (1) the allegedly failing firm would be unable to meet its financial obligations in the near future; (2) it would not be able to reorganize successfully under Chapter 11 of the Bankruptcy Act; and (3) it has made unsuccessful good-faith efforts to elicit reasonable alternative offers that would keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition than does the proposed merger.[16]

Similarly, a merger is unlikely to cause competitive harm if the risks to competition arise from the acquisition of a failing division. The Agencies do not normally credit claims that the assets of a division would exit the relevant market in the near future unless both of the following conditions are met: (1) applying cost allocation rules that reflect true economic costs, the division has a persistently negative cash flow on an operating basis, and such negative cash flow is not economically justified for the firm by benefits such as added sales in complementary markets or enhanced customer goodwill;[17] and (2) the owner of the failing division has made unsuccessful good-faith efforts to elicit reasonable alternative offers that would keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition than does the proposed acquisition.

12. Mergers of Competing Buyers

Mergers of competing buyers can enhance market power on the buying side of the market, just as mergers of competing sellers can enhance market power on the selling side of the market. Buyer market power is sometimes called "monopsony power."

To evaluate whether a merger is likely to enhance market power on the buying side of the market, the Agencies employ essentially the framework described above for evaluating whether a merger is likely to enhance market power on the selling side of the market. In defining relevant markets, the Agencies

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16 Any offer to purchase the assets of the failing firm for a price above the liquidation value of those assets will be regarded as a reasonable alternative offer. Liquidation value is the highest value the assets could command for use outside the relevant market.

17 Because the parent firm can allocate costs, revenues, and intra-company transactions among itself and its subsidiaries and divisions, the Agencies require evidence on these two points that is not solely based on management plans that could have been prepared for the purpose of demonstrating negative cash flow or the prospect of exit from the relevant market.

focus on the alternatives available to sellers in the face of a decrease in the price paid by a hypothetical monopsonist.

Market power on the buying side of the market is not a significant concern if suppliers have numerous attractive outlets for their goods or services. However, when that is not the case, the Agencies may conclude that the merger of competing buyers is likely to lessen competition in a manner harmful to sellers.

The Agencies distinguish between effects on sellers arising from a lessening of competition and effects arising in other ways. A merger that does not enhance market power on the buying side of the market can nevertheless lead to a reduction in prices paid by the merged firm, for example, by reducing transactions costs or allowing the merged firm to take advantage of volume-based discounts. Reduction in prices paid by the merging firms not arising from the enhancement of market power can be significant in the evaluation of efficiencies from a merger, as discussed in Section 10.

The Agencies do not view a short-run reduction in the quantity purchased as the only, or best, indicator of whether a merger enhances buyer market power. Nor do the Agencies evaluate the competitive effects of mergers between competing buyers strictly, or even primarily, on the basis of effects in the downstream markets in which the merging firms sell.

> *Example 24:* Merging Firms A and B are the only two buyers in the relevant geographic market for an agricultural product. Their merger will enhance buyer power and depress the price paid to farmers for this product, causing a transfer of wealth from farmers to the merged firm and inefficiently reducing supply. These effects can arise even if the merger will not lead to any increase in the price charged by the merged firm for its output.

13. Partial Acquisitions

In most horizontal mergers, two competitors come under common ownership and control, completely and permanently eliminating competition between them. This elimination of competition is a basic element of merger analysis. However, the statutory provisions referenced in Section 1 also apply to one firm's partial acquisition of a competitor. The Agencies therefore also review acquisitions of minority positions involving competing firms, even if such minority positions do not necessarily or completely eliminate competition between the parties to the transaction.

When the Agencies determine that a partial acquisition results in effective control of the target firm, or involves substantially all of the relevant assets of the target firm, they analyze the transaction much as they do a merger. Partial acquisitions that do not result in effective control may nevertheless present significant competitive concerns and may require a somewhat distinct analysis from that applied to full mergers or to acquisitions involving effective control. The details of the post-acquisition relationship between the parties, and how those details are likely to affect competition, can be important. While the Agencies will consider any way in which a partial acquisition may affect competition, they generally focus on three principal effects.

First, a partial acquisition can lessen competition by giving the acquiring firm the ability to influence the competitive conduct of the target firm. A voting interest in the target firm or specific governance rights, such as the right to appoint members to the board of directors, can permit such influence. Such influence can lessen competition because the acquiring firm can use its influence to induce the target firm to compete less aggressively or to coordinate its conduct with that of the acquiring firm.

Second, a partial acquisition can lessen competition by reducing the incentive of the acquiring firm to compete. Acquiring a minority position in a rival might significantly blunt the incentive of the acquiring firm to compete aggressively because it shares in the losses thereby inflicted on that rival. This reduction in the incentive of the acquiring firm to compete arises even if cannot influence the conduct of the target firm. As compared with the unilateral competitive effect of a full merger, this effect is likely attenuated by the fact that the ownership is only partial.

Third, a partial acquisition can lessen competition by giving the acquiring firm access to non-public, competitively sensitive information from the target firm. Even absent any ability to influence the conduct of the target firm, access to competitively sensitive information can lead to adverse unilateral or coordinated effects. For example, it can enhance the ability of the two firms to coordinate their behavior, and make other accommodating responses faster and more targeted. The risk of coordinated effects is greater if the transaction also facilitates the flow of competitively sensitive information from the acquiring firm to the target firm.

Partial acquisitions, like mergers, vary greatly in their potential for anticompetitive effects. Accordingly, the specific facts of each case must be examined to assess the likelihood of harm to competition. While partial acquisitions usually do not enable many of the types of efficiencies associated with mergers, the Agencies consider whether a partial acquisition is likely to create cognizable efficiencies.

II

(Information)

INFORMATION FROM EUROPEAN UNION INSTITUTIONS AND BODIES

COMMISSION

Commission notice on remedies acceptable under Council Regulation (EC) No 139/2004 and under Commission Regulation (EC) No 802/2004

(Text with EEA relevance)

(2008/C 267/01)

I. INTRODUCTION

1. Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings ([1]) (hereinafter referred to as 'the Merger Regulation') in Articles 6(2) and 8(2) expressly provides that the Commission may decide to declare a concentration compatible with the common market following modification by the parties ([2]), both before and after the initiation of proceedings. To that end, the Commission may attach to its decision conditions and obligations intended to ensure that the undertakings concerned comply with the commitments they have entered into *vis-à-vis* the Commission with a view to rendering the concentration compatible with the common market ([3]).

2. The purpose of this Notice is to provide guidance on modifications to concentrations, in particular commitments by the undertakings concerned to modify a concentration. Such modifications are more commonly described as 'remedies' since their object is to eliminate the competition concerns ([4]) identified by the Commission. The guidance set out in this Notice reflects the Commission's evolving experience with the assessment, acceptance and implementation of remedies under the Merger Regulation since its entry into force on 21 September 1990. The revision of the Commission's 2001 Notice on remedies ([5]) is entailed by the entry into force of the recast Merger Regulation (EC) No 139/2004 ([6])

([1]) OJ L 24, 29.1.2004, p. 1-22.
([2]) The references to 'parties' and 'merging parties' also cover situations with one notifying party.
([3]) Articles 6(2) and 8(2), second subparagraphs respectively. See also Recital 30 of the Merger Regulation which states that 'where the undertakings concerned modify a notified concentration, in particular by offering commitments with a view to rendering the concentration compatible with the common market, the Commission should be able to declare the concentration, as modified, compatible with the common market. Such commitments should be proportionate to the competition problem and entirely eliminate it'. Recital 30 further explains that 'it is also appropriate to accept commitments before the initiation of proceedings where the competition problem is readily identifiable and can easily be remedied'.
([4]) Save where the contrary is indicated, in the following, the term 'competition concerns' corresponds, according to the stage of the procedure, to serious doubts or preliminary findings that the concentration is likely to significantly impede effective competition in the common market or in a substantial part of it, in particular as a result of the creation or strengthening of a dominant position.
([5]) Commission Notice on remedies acceptable under Council Regulation (EEC) No 4064/89 and under Commission Regulation (EC) No 447/98 (OJ C 68, 2.3.2001, p. 3).
([6]) Regulation replacing Council Regulation (EEC) No 4064/89 (OJ L 395, 30.12.1989, corrected version in OJ L 257, 21.9.1990, p. 13.

and of Commission Regulation (EC) No 802/2004 (the 'Implementing Regulation') (1) on 1 May 2004, case-law of the Court of Justice and the Court of First Instance, the conclusions drawn from the systematic *ex post* review of the Commission of past remedies case (2), and decisional practice of the Commission in cases involving remedies in recent years. The principles contained herein will be applied and further developed and refined by the Commission in individual cases. The guidance provided in this Notice is without prejudice to the interpretation which may be given by the Court of Justice or by the Court of First Instance of the European Communities.

3. This Notice sets out the general principles applicable to remedies acceptable to the Commission, the main types of commitments that may be accepted by the Commission in cases under the Merger Regulation, the specific requirements which proposals of commitments need to fulfil in both phases of the procedure, and the main requirements for the implementation of commitments. In any case, the Commission will take due account of the particular circumstances of the individual case.

II. **GENERAL PRINCIPLES**

4. Under the Merger Regulation, the Commission assesses the compatibility of a notified concentration with the common market on the basis of its effect on the structure of competition in the Community (3). The test for compatibility under Article 2(2) and (3) of the Merger Regulation is whether or not a concentration would significantly impede effective competition in the common market or a substantial part of it, in particular as a result of the creation or strengthening of a dominant position. A concentration that significantly impedes effective competition as described above is incompatible with the common market and the Commission is required to prohibit it. For the creation of a joint venture, the Commission will also examine the concentration under Article 2(4) of the Merger Regulation. The principles set out in this Notice will generally also apply to remedies submitted to eliminate competition concerns identified under Article 2(4).

5. Where a concentration raises competition concerns in that it could significantly impede effective competition, in particular as a result of the creation or strengthening of a dominant position, the parties may seek to modify the concentration in order to resolve the competition concerns and thereby gain clearance of their merger. Such modifications may be fully implemented in advance of a clearance decision. However, it is more common that the parties submit commitments with a view to rendering the concentration compatible with the common market and that those commitments are implemented following clearance.

6. Under the structure of the Merger Regulation, it is the responsibility of the Commission to show that a concentration would significantly impede competition (4). The Commission communicates its competition concerns to the parties to allow them to formulate appropriate and corresponding remedies proposals (5). It is then for the parties to the concentration to put forward commitments; the Commission is not in a position to impose unilaterally any conditions to an authorisation decision, but only on the basis of the parties' commitments (6). The Commission will inform the parties about

(1) Commission Regulation (EC) No 802/2004 of 7 April 2004 implementing Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings (OJ L 133, 30.4.2004, p. 1). This Regulation replaces Commission Regulation (EC) No 447/98 implementing Council Regulation (EEC) No 4064/89 on the control of concentrations between undertakings (OJ L 61, 2.3.1998, p. 1).

(2) DG COMP, Merger Remedies Study, October 2005.

(3) Recital 6 of the Merger Regulation.

(4) In phase I and before the issuance of a Statement of Objections, this corresponds to *serious doubts* as to the significant impediment to effective competition.

(5) The Merger Regulation provides for formal steps where the parties are informed of the competition concerns identified by the Commission (Article 6(1)(c) decision, Statement of Objections). In addition, the DG COMPETITION Best Practices on the conduct of EC merger control proceedings foresee that 'state of play' meetings will normally be offered at key stages of the procedure where the Commission will explain its concerns to the parties in order to allow them to respond with remedies proposals.

(6) Judgment of the CFI in Case T-210/01 *General Electric v Commission* [2005] ECR II-5575, paragraph 52; see judgment of the CFI in Case T-87/05 *EDP v Commission* [2005] ECR II-3745, paragraph 105.

its preliminary assessment of remedies proposals. If, however, the parties do not validly propose remedies adequate to eliminate the competition concerns, the only option for the Commission will be to adopt a prohibition decision [1].

7. The Commission has to assess whether the proposed remedies, once implemented, would eliminate the competition concerns identified. Only the parties have all the relevant information necessary for such an assessment, in particular as to the feasibility of the commitments proposed and the viability and competitiveness of the assets proposed for divestiture. It is therefore the responsibility of the parties to provide all such information available that is necessary for the Commission's assessment of the remedies proposal. To this end, the Implementing Regulation obliges the notifying parties to provide, with the commitments, detailed information on the content of the commitments offered, the conditions for their implementation and showing their suitability to remove any significant impediment of effective competition, as set out in the annex to the Implementing Regulation ('Form RM'). For commitments consisting in the divestiture of a business, parties have to describe in detail in particular how the business to be divested is currently operated. This information will enable the Commission to assess the viability, competitiveness and marketability of the business by comparing its current operation to its proposed scope under the commitments. The Commission can adapt the precise requirements to the information necessary in the individual case at hand and will be available to discuss the scope of the information required with the parties in advance of submission of Form RM.

8. Whereas the parties have to propose commitments sufficient to remove the competition concerns and submit the necessary information to assess them, it is for the Commission to establish whether or not a concentration, as modified by commitments validly submitted, must be declared incompatible with the common market because it leads, despite the commitments, to a significant impediment of effective competition. The burden of proof for a prohibition or authorisation of a concentration modified by commitments is therefore subject to the same criteria as an unmodified concentration [2].

Basic conditions for acceptable commitments

9. Under the Merger Regulation, the Commission only has power to accept commitments that are deemed capable of rendering the concentration compatible with the common market so that they will prevent a significant impediment of effective competition. The commitments have to eliminate the competition concerns entirely [3] and have to be comprehensive and effective from all points of view [4]. Furthermore, commitments must be capable of being implemented effectively within a short period of time as the conditions of competition on the market will not be maintained until the commitments have been fulfilled.

10. Structural commitments, in particular divestitures, proposed by the parties will meet these conditions only in so far as the Commission is able to conclude with the requisite degree of certainty that it will be possible to implement them and that it will be likely that the new commercial structures resulting from them will be sufficiently workable and lasting to ensure that the significant impediment to effective competition will not materialise [5].

11. The requisite degree of certainty concerning the implementation of the proposed commitments may in particular be affected by risks in relation to the transfer of a business to be divested, such as conditions attached by the parties to the divestiture, third party rights in relation to the business or the

(1) See Case COMP/M.2220 — GE/Honeywell of 3 July 2001, confirmed by judgment of the CFI in Case T-210/01 *General Electric v Commission* [2005] ECR II-5575, paragraph 555 *et seq.*, 612 *et seq.*; Case COMP/M.3440 — EDP/ENI/GDP of 9 December 2004, confirmed by judgment of the CFI in Case T-87/05 *EDP v Commission* [2005] ECR II-3745, paragraphs 63 *et seq.*, 75 *et seq.*; Case IV/M.469 — MSG Media Service of 9 November 1994; Case IV/M.490 — Nordic Satellite Distribution of 19 July 1995; Case IV/M.553 — RTL/Veronica/Endemol of 20 September 1995; Case IV/M.993 — Bertelsmann/Kirch/Prèmiere of 27 May 1998; Case IV/M.1027 — Deutsche Telekom BetaResearch of 27 May 1998; Case IV/M.774 — St Gobain/Wacker Chemie of 4 December 1996; Case IV/M.53 — Aerospatiale/Alenia/De Havilland of 2 October 1991; Case IV/M.619 — Gencor/Lonrho of 24 April 1996, confirmed by judgment of the CFI in Case T-102/96 *Gencor v Commission* [1999] ECR II-753.

(2) See judgment of the CFI in Case T-87/05 *EDP v Commission* [2005] ECR II-3745, paragraphs 62 ff.

(3) See recital 30 of the Merger Regulation and judgment of the CFI in Case T-282/02 *Cementbouw v Commission* [2006] ECR II-319, paragraph 307.

(4) CFI, Case T-210/01 *General Electrics v Commission* [2005] ECR II-5575, paragraph 52; Case T-87/05 *EDP v Commission* [2005] ECR II-3745, paragraph 105.

(5) CFI, Case T-210/01 *General Electric v Commission* [2005] ECR II-5575, paragraphs 555, 612.

risks of finding a suitable purchaser, as well as risks in relation to the degradation of the assets until the divestiture has taken place. It is incumbent on the parties to remove such uncertainties as to the implementation of the remedy when submitting it to the Commission (1).

12. In assessing the second condition, whether the proposed commitment will likely eliminate the competition concerns identified, the Commission will consider all relevant factors relating to the proposed remedy itself, including, *inter alia*, the type, scale and scope of the remedy proposed, judged by reference to the structure and particular characteristics of the market in which the competition concerns arise, including the position of the parties and other players on the market.

13. In order for the commitments to comply with these principles, there has to be an effective implementation and ability to monitor the commitments (2). Whereas divestitures, once implemented, do not require any further monitoring measures, other types of commitments require effective monitoring mechanisms in order to ensure that their effect is not reduced or even eliminated by the parties. Otherwise, such commitments would have to be considered as mere declarations of intention by the parties and would not amount to binding obligations, as, due to the lack of effective monitoring mechanisms, any breach of them could not result in the revocation of the decision according to the provisions of the Merger Regulation (3).

14. Where, however, the parties submit remedies proposals that are so extensive and complex that it is not possible for the Commission to determine with the requisite degree of certainty, at the time of its decision, that they will be fully implemented and that they are likely to maintain effective competition in the market, an authorisation decision cannot be granted (4). The Commission may reject such remedies in particular on the grounds that the implementation of the remedies cannot be effectively monitored and that the lack of effective monitoring diminishes, or even eliminates, the effect of the commitments proposed.

Appropriateness of different types of remedies

15. According to the case law of the Court, the basic aim of commitments is to ensure competitive market structures (5). Accordingly, commitments which are structural in nature, such as the commitment to sell a business unit, are, as a rule, preferable from the point of view of the Merger Regulation's objective, inasmuch as such commitments prevent, durably, the competition concerns which would be raised by the merger as notified, and do not, moreover, require medium or long-term monitoring measures. Nevertheless, the possibility cannot automatically be ruled out that other types of commitments may also be capable of preventing the significant impediment of effective competition (6).

16. The Commission stresses that the question of whether a remedy and, more specifically, which type of remedy is suitable to eliminate the competition concerns identified, has to be examined on a case-by-case basis.

17. Nevertheless, a general distinction can be made between divestitures, other structural remedies, such as granting access to key infrastructure or inputs on non-discriminatory terms, and commitments relating to the future behaviour of the merged entity. Divestiture commitments are the best way to eliminate competition concerns resulting from horizontal overlaps, and may also be the best means of resolving

(1) Depending on the nature of the risks, specific safeguards may aim at compensating for them. For example, the risk arising from third party rights in relation to the assets to be divested may be compensated by the proposal of an alternative divestiture. Such safeguards will be discussed in more detail below.

(2) CFI, Case T-177/04 *easyJet v Commission* [2006] ECR II-1931, paragraph 188.

(3) CFI, Case T-177/04 *easyJet v Commission* [2006] ECR II-1931, paragraph 186 *et seq.*; CFI, judgment in Case T-87/05 *EDP v Commission* [2005] ECR II-3745, paragraph 72.

(4) See, as an example for such a complex and inappropriate remedy, Case COMP/M.3440 — ENI/EDP/GDP of 9 December 2004; confirmed by CFI, judgment in Case T-87/05 *EDP v Commission* [2005] ECR II-3745, paragraph 102; Case COMP/M.1672 — Volvo/Scania of 15 March 2000.

(5) See recital 8 of the Merger Regulation; judgment of CFI in Case T-102/96 *Gencor v Commission* [1999] ECR II-753, at paragraph 316; ECJ in Case C-12/03 P *Commission v Tetra Laval* [2005] ECR I-987, paragraph 86; judgment of CFI in Case T-158/00 *ARD v Commission* [2003] ECR II-3825, at paragraphs 192 *et seq*.

(6) ECJ, judgment in Case C-12/03 P *Commission v Tetra Laval* [2005] ECR I-987, paragraph 86; CFI, judgment of 25 March 1999 in Case T-102/96 *Gencor v Commission* [1999] ECR II-753, paragraphs 319 *et seq.*; CFI, judgment of 30 September 2003 in Case T-158/00 *ARD v Commission* [2003] ECR II-3825, paragraph 193; CFI in Case T-177/04 *easyJet v Commission* [2006] ECR II-1931, paragraph 182; CFI, judgment in Case T-87/05 *EDP v Commission* [2005] ECR II-3745, paragraph 101.

problems resulting from vertical or conglomerate concerns ([1]). Other structural commitments may be suitable to resolve all types of concerns if those remedies are equivalent to divestitures in their effects, as explained in more detail below in paragraphs 61 *et seq*. Commitments relating to the future behaviour of the merged entity may be acceptable only exceptionally in very specific circumstances ([2]). In particular, commitments in the form of undertakings not to raise prices, to reduce product ranges or to remove brands, etc., will generally not eliminate competition concerns resulting from horizontal overlaps. In any case, those types of remedies can only exceptionally be accepted if their workability is fully ensured by effective implementation and monitoring in line with the considerations set out in paragraphs 13-14, 66, 69, and if they do not risk leading to distorting effects on competition ([3]).

Procedure

18. The Commission may accept commitments in either phase of the procedure ([4]). However, given the fact that an in-depth market investigation is only carried out in phase II, commitments submitted to the Commission in phase I must be sufficient to clearly rule out 'serious doubts' within the meaning of Article 6(1)(c) of the Merger Regulation ([5]). Pursuant to Article 10(2) of the Merger Regulation, the Commission has to take a clearance decision as soon as the serious doubts referred to in Article 6(1)(c) of the Merger Regulation are removed as a result of commitments submitted by the parties. This rule applies to commitments proposed in phase II-proceedings before the Commission issues a Statement of Objections ([6]). If the Commission reaches the preliminary view that the merger leads to a significant impediment to effective competition and issues a Statement of Objections, the commitments must be sufficient to eliminate such a significant impediment to effective competition.

19. Whilst commitments have to be offered by the parties, the Commission will ensure the enforceability of commitments by making the authorisation of the merger subject to compliance with the commitments. A distinction must be made between conditions and obligations. The requirement for achievement of the structural change of the market is a condition — for example, that a business is to be divested. The implementing steps which are necessary to achieve this result are generally obligations on the parties, e.g. such as the appointment of a trustee with an irrevocable mandate to sell the business.

20. Where the undertakings concerned commit a breach of an obligation, the Commission may revoke clearance decisions issued either under Article 6(2) or Article 8(2) of the Merger Regulation, acting pursuant to Article 6(3) or Article 8(6), respectively. In case of a breach of an obligation, the parties may also be subject to fines and periodic penalty payments as provided in Article 14(2)(d) and 15(1)(c) respectively of the Merger Regulation. Where, however, a condition is breached, e.g. a business is not divested in the time-frame foreseen in the commitments or afterwards re-acquired, the compatibility decision is no longer applicable. In such circumstances, the Commission may, first, take interim measures appropriate to maintain conditions of effective competition pursuant to Article 8(5)(b) of the Merger Regulation. Second, it may, if the conditions of Article 8(4)(b) are met, order any appropriate measure to ensure that the undertakings concerned dissolve the concentration or take other restorative measures or, according to Article 8(7), take a decision pursuant to Article 8(1)-(3). In addition, the parties may also be subject to fines as provided in Article 14(2)(d).

([1]) See divestiture of storage facilities in Case COMP/M.3868 — DONG/Elsam/Energi E2 of 14 March 2006, paragraphs 170 *et seq*.; Case COMP/M.3696 — E.ON/MOL of 21 December 2005, paragraphs 735 *et seq*., for an example of 'ownership unbundling' to eliminate structural links between the parties in the gas storage sector; further Case COMP/M.4314 — Johnson&Johnson/Pfizer of 11 December 2006, Case COMP/M.4494 — Evraz/Highveld of 20 February 2007.

([2]) See, in relation to conglomerate effects of a concentration, ECJ, judgment of 15 February 2005 in Case C-12/03 P *Commission v Tetra Laval* [2005] ECR I-987, paragraphs 85, 89.

([3]) For example, commitments regarding a certain pricing behaviour such as price caps which contain the risk to lead to an anticompetitive alignment of prices among competitors.

([4]) As foreseen in recital 30 of the Merger Regulation, the Commission will ensure transparency and effective consultation of Member States in both phases of the procedure.

([5]) Commitments in phase I can only be accepted in certain types of situations; see below in paragraph 81.

([6]) See, *inter alia*, Case COMP/M.2972 — DSM/Roche Vitamins of 23 July 2003; Case COMP/M.2861 — Siemens/Drägerwerk/JV of 30 April 2003; Case IV/JV.15 — BT/AT & T of 30 March 1999; Case IV/M.1532 — BP Amoco/Arco of 29 September 1999.

Model Texts for divestiture commitments

21. The Commission services have issued Best Practice Guidelines for divestiture commitments, consisting of a Model Text for Divestiture Commitments and a Model Text for Trustee Mandates [1]. These model texts are neither intended to provide an exhaustive coverage of all issues that may become relevant in all cases, nor are they legally binding upon parties in a merger procedure. They complement the present Notice as they outline the typical arrangements for divestiture commitments in a format which can be used by the parties. At the same time, the model texts leave the flexibility to adapt them to the requirements of the specific case.

III. DIFFERENT TYPES OF REMEDIES

1. Divestiture of a business to a suitable purchaser

22. Where a proposed concentration threatens to significantly impede effective competition the most effective way to maintain effective competition, apart from prohibition, is to create the conditions for the emergence of a new competitive entity or for the strengthening of existing competitors via divestiture by the merging parties.

1.1. *Divestiture of a viable and competitive business*

23. The divested activities must consist of a viable business that, if operated by a suitable purchaser, can compete effectively with the merged entity on a lasting basis and that is divested as a going concern [2]. For the business to be viable, it may also be necessary to include activities which are related to markets where the Commission did not identify competition concerns if this is required to create an effective competitor in the affected markets [3].

24. In proposing a viable business for divestiture, it is necessary to take into account the uncertainties and risks related to the transfer of a business to a new owner. These risks may limit the competitive impact of the divested business, and, therefore, may lead to a market situation where the competition concerns at stake will not necessarily be eliminated.

Scope of the business to be divested

25. The business has to include all the assets which contribute to its current operation or which are necessary to ensure its viability and competitiveness and all personnel which is currently employed or which is necessary to ensure the business' viability and competitiveness [4].

26. Personnel and assets which are currently shared between the business to be divested and other businesses of the parties, but which contribute to the operation of the business or which are necessary to ensure its viability and competitiveness, also have to be included. Otherwise, the viability and competitiveness of the business to be divested would be endangered. Therefore, the divested business has to contain the personnel providing essential functions for the business such as, for instance, group R & D and information technology staff even where such personnel is currently employed by another business unit of the parties — at least in a sufficient proportion to meet the on-going needs of the divested business. In the same way shared assets have to be included even if those assets are owned by or allocated to another business unit.

(1) See website of DG COMP, released in May 2003, available at: http://ec.europa.eu/comm/competition/mergers/legislation/legislation.html. The model texts may be continuously up-dated and, if there should be a need, further best practice guidelines in the field of remedies may be issued.
(2) This includes, under certain conditions, businesses that have to be carved out from a party's business or individual assets; see below paragraphs 35 ff.
(3) Case IV/M.913 — Siemens/Elektrowatt of 18 November 1997; Case IV/M.1578 — Sanitec/Sphinx of 1 December 1999, at paragraph 255; Case COMP/M.1802 — Unilever/Amora-Maille of 8 March 2000; Case COMP/M.1990 — Unilever/Bestfoods of 28 September 2000.
(4) Notifying parties will have to undertake in the commitments that the business to be divested includes all those assets and personnel. Where the detailed description of the business, to be provided by the parties as set out in paragraph 27, will at a later point in time appear to be incomplete in that respect and the parties do not complement the business with the necessary additional assets or personnel, the Commission may consider revoking the conditional clearance decision.

27. In order for the Commission to be able to identify the scope of the business to be divested, the parties have to include a precise definition of the scope of the divested business in the commitments (the 'description of the business'). The description of the business has to be adapted to the individual case at hand and should contain all the elements that are part of the business to be divested: tangible (e.g. R & D, production, distribution, sales and marketing activities) and intangible assets (such as intellectual property rights, know-how and goodwill); licences, permits and authorisations by governmental organisations granted to the business; contracts, leases and commitments (e.g. arrangements with suppliers and customers) for the benefit of the business to be divested; and customer, credit and other records. In the description of the business, the parties have to include the personnel to be transferred in general terms, including staff seconded and temporary employees, and to insert a list of the key personnel, i.e. the personnel essential for the viability and competitiveness of the business. The transfer of those employees is without prejudice to the application of the Council Directives on collective redundancies ([1]); on safeguarding employees' rights in the event of transfers of undertakings ([2]); and on informing and consulting employees ([3]) as well as national provisions implementing those Directives and other national laws. The remedy has to include a non-solicitation commitment by the parties with regard to the key personnel.

28. In the description of the business, the parties also have to set out the arrangements for the supply of products and services by them to the divested business or by the divested business to them. Such on-going relationships of the divested business may be necessary to maintain the full economic viability and competitiveness of the divested business for a transitional basis. The Commission will only accept such arrangements if they do not affect the independence of the divested business from the parties.

29. In order to avoid any misunderstanding about the business to be divested, assets or personnel that are used within or employed by the business but that should not, according to the parties, be transferred with the divestiture, have to be expressly excluded by the parties in the commitments text. The Commission will only be able to accept such exclusion of assets or personnel if the parties can clearly show that this does not affect the viability and competitiveness of the business.

30. The business to be divested has to be viable as such. Therefore, the resources of a possible or even presumed future purchaser are not taken into account by the Commission at the stage of assessing the remedy. The situation is different if already during the procedure a sale and purchase agreement with a specific purchaser is concluded whose resources can be taken into account at the time of the assessment of the commitment. This situation will be dealt with in more detail below in paragraphs 56 ff.

31. Once a purchaser is identified after adoption of an authorisation decision, some of the assets or personnel included in the divested business may not be needed by the proposed purchaser. In the purchaser approval process, the Commission may, upon request by the parties, approve the divestiture of the business to the proposed purchaser without one or more assets or parts of the personnel if this does not affect the viability and competitiveness of the business to be divested after the sale, taking account of the resources of the proposed purchaser.

1.2. *Stand-alone business and conditions for acceptability of alternatives*

32. Normally, a viable business is a business that can operate on a stand-alone-basis, which means independently of the merging parties as regards the supply of input materials or other forms of cooperation other than during a transitory period.

(1) Council Directive 98/59/EC of 20 July 1998 on the approximation of the laws of the Member States relating to collective redundancies (OJ L 225, 12.8.1998, p. 16).
(2) Council Directive 2001/23/EC of 12 March 2001 on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses (OJ L 82, 22.3.2001, p. 16).
(3) Council Directive 94/45/EC of 22 September 1994 on the establishment of a European Works Council or a procedure in Community-scale undertakings and Community-scale groups of undertakings for the purposes of informing and consulting employees (OJ L 254, 30.9.1994, p. 64); Directive 2002/14/EC of the European Parliament and of the Council of 11 March 2002 establishing a general framework for informing and consulting employees in the European Community (OJ L 80, 23.3.2002, p. 29).

33. The Commission has a clear preference for an existing stand-alone business. This may take the form of a pre-existing company or group of companies, or of a business division which was not previously legally incorporated as such.

34. Where the competition concern results from a horizontal overlap, the parties may be able to choose between two businesses. In cases involving a hostile bid, a commitment to divest activities of the target company may, in such circumstances of limited information available to the notifying parties about the business to be divested, increase the risk that this business might not, after a divestiture, result in a viable competitor which could effectively compete in the market on a lasting basis. It may therefore be more appropriate for the parties to propose to divest activities of the acquiring company in such scenarios.

Carve-outs

35. Even though normally the divestiture of an existing viable stand-alone business is required, the Commission, taking into account the principle of proportionality, may also consider the divestiture of businesses which have existing strong links or are partially integrated with businesses retained by the parties and therefore need to be 'carved out' in those respects. In order to reduce the risks for the viability and competitiveness to a minimum in such circumstances, an option for the parties is to submit commitments proposing to carve out those parts of an existing business which do not necessarily have to be divested. In effect, an existing, stand-alone business is being divested in those circumstances although, by way of a 'reverse carve-out', the parties may carve-out the limited parts which they may keep.

36. In any case, the Commission will only be able to accept commitments which require the carve-out of a business if it can be certain that, at least at the time when the business is transferred to the purchaser, a viable business on a stand-alone basis will be divested and the risks for the viability and competitiveness caused by the carve-out will thereby be reduced to a minimum. The parties therefore have to ensure, as set out in detail below in paragraph 113, that the carve-out is started in the interim period, i.e. the period between the adoption of the Commission decision up to the completion of the divestiture (meaning the legal and factual transfer of the business to the purchaser). Consequently, at the end of this period, a viable business on a stand-alone basis will be divested. If this should not be possible or if the carve-out should be particularly difficult, parties may provide the requisite degree of certainty for the Commission by proposing an up-front buyer solution, as further detailed below in paragraph 55.

Divestiture of assets, in particular of brands and licences

37. A divestiture consisting of a combination of certain assets which did not form a uniform and viable business in the past creates risks as to the viability and competitiveness of the resulting business. This is in particular the case if assets from more than one party are involved. Such an approach may be accepted by the Commission only if the viability of the business is ensured notwithstanding the fact that the assets did not form a uniform business in the past. This may be the case if the individual assets can already be considered a viable and competitive business ([1]). Similarly, only in exceptional cases a divestiture package including only brands and supporting production and/or distribution assets may be sufficient to create the conditions for effective competition ([2]). In such circumstances, the package consisting of brands and assets must be sufficient to allow the Commission to conclude that the resulting business will be immediately viable in the hands of a suitable purchaser.

38. Divestitures of a business generally appear preferable to the granting of licenses to IP rights, as the granting of a license involve more uncertainties, will not enable the licensee to compete immediately in the market, requires an on-going relationship with the parties which may allow the licensor to influence the licensee in its competitive behaviour and may give rise to disputes between the licensor

([1]) Case COMP/M.1806 — AstraZeneca/Novartis of 26 July 2000; COMP/M.1628 — TotalFina/Elf of 9 February 2000; Case IV/M.603 — Crown Cork & Seal/CarnaudMetalbox of 14 November 1995.

([2]) Case COMP/M.2544 — Masterfoods/Royal Canin of 15 February 2002; Case COMP/M.2337 — Nestlé/Ralston Purina of 27 July 2001; Case IV/M.623 — Kimberly-Clark/Scott Paper of 16 January 1996; Case COMP/M.3779 — Pernod Ricard/Allied Domecq of 24 June 2005.

and the licensee over the scope and the terms and conditions of the license. The granting of a license will therefore generally not be considered appropriate where a divestiture of a business seems feasible. Where the competition concerns arise from the market position held for such a technology or such IP rights, a divestiture of the technology or the IP rights is the preferable remedy as it eliminates a lasting relationship between the merged entity and its competitors ([1]). However, the Commission may accept licensing arrangements as an alternative to divestiture where, for instance, a divestiture would impede efficient, on-going research or where a divestiture would be impossible due to the nature of the business ([2]). Such licences will have to enable the licensee to compete effectively with the parties in a similar way as if a divestiture had taken place. They will normally be exclusive licences and have to be without any field-of-use and any geographical restrictions on the licensee. Where there might be any uncertainty as regards the scope of the licence or its terms and conditions, the parties will have to divest the underlying IP right, but may obtain a licence back. If there is uncertainty that the license will actually be granted to a suitable licensee, the parties may consider to propose an up-front licensee or a fix-it-first solution according to the considerations set out below in paragraphs 56, in order to enable the Commission to conclude with the requisite degree of certainty that the remedy will be implemented ([3]).

Re-branding

39. In exceptional cases, the Commission has accepted commitments to grant an exclusive, time-limited licence for a brand with the purpose of allowing the licensee to re-brand the product in the period foreseen. After the first licence phase of these so-called re-branding commitments, the parties commit in a second phase to abstain from any use of the brand (blackout phase). The goal of such commitments is to allow the licensee to transfer the customers from the licensed brand to its own brand in order to create a viable competitor, without the licensed brand being permanently divested.

40. A re-branding remedy carries substantially higher risks for restoring effective competition than a divestiture, including the divestiture of a brand as there is considerable uncertainty whether the licensee will succeed in establishing itself as an active competitor in the market on the basis of the re-branded product. A re-branding remedy may be acceptable in circumstances where the brand at stake is widely used and a high proportion of its turnover is generated in markets outside those in which competition concerns have been identified ([4]). In those circumstances, a re-branding remedy has to be defined in such a way as to ensure that the granting of the licence will effectively maintain competition in the market on a lasting basis and that the licensee will be an effective competitor after re-branding the products.

41. As the success of re-branding commitments is substantially linked to the viability of the licensed brand a number of preconditions have to be met for the design of such commitments. Firstly, the brand to be transferred must be well-known and one of considerable strength to guarantee both immediate viability of the licensed brand and its economic survival in the re-branding period. Secondly, part of the assets related to the production or the distribution of the products marketed under the licensed brand or the transfer of know-how may be necessary to ensure the viability of the remedy ([5]). Thirdly, the licence has to be exclusive and normally comprehensive, i.e. not limited to a

([1]) See Case COMP/M.2972 — DSM/Roche Vitamins of 23 July 2003; Case IV/M.1378 — Hoechst/Rhône-Poulenc of 9 August 1999; Case COMP/M.1601 — Allied Signal/Honeywell of 1 December 1999; Case COMP/M.1671 — Dow/UCC of 3 May 2000.

([2]) Case COMP/M.2949 — Finmeccanica/Alenia Telespazio of 30 October 2002; Case COMP/M.3593 — Apollo/Bakelite of 11 April 2005, commitment on carbon bond refractory licence; for cases from the pharmaceutical industry see Case COMP/M.2972 — DSM/Roche Vitamins of 23 July 2003; Case IV/M.555 — Glaxo/Wellcome of 28 February 1995.

([3]) Case COMP/M.2972 — DSM/Roche Vitamins of 23 July 2003.

([4]) However, even in these conditions a divestiture of the brand may be more appropriate, especially if the resulting split in the ownership of the brand corresponds to common practice in the industry, see for the pharmaceutical industry Case COMP/M.3544 — Bayer Healthcare/Roche (OTC) of 19 November 2004, paragraph 59 concerning the divestiture of the Desenex brand.

([5]) COMP/M.3149 — Procter&Gamble/Wella paragraph 60; IV/M.623 — Kimberly-Clark/Scott Paper of 16 January 1996, paragraph 236(i). This is particularly important during the licence phase in which the licensee has to prepare for the launch of a new competitive brand. Such a launch of a new brand appears to not be feasible if the purchaser had to spend considerable resources on the production process, marketing and distribution of the licensed brand; COMP/M.2337 — Nestlé/Ralston Purina of 27 July 2001, paragraphs 67 *et seq.*; COMP/M.2621 — SEB/Moulinex of 8 January 2002, paragraph 140.

certain range of products within a specific market, and has to include the intellectual property rights to ensure that customers will acknowledge the familiarity of the re-branded product. The parties will not be allowed to use similar words or signs as this could undermine the effect of the re-branding exercise ([1]). Fourthly, both the licence and the black-out period have to be sufficiently long, account being taken of the particularities of the case, so that the re-branding remedy is in its effects similar to a divestiture ([2]).

42. The identity of the potential licensee will be a key factor for the success of the commitment. If there is uncertainty that a number of suitable licensees are available, being able and having strong incentives to carry out the re-branding exercise, the parties may consider proposing an up-front or fix-it-first solution, in line with the considerations set out in paragraph 53 below.

1.3. *Non-reacquisition clause*

43. In order to maintain the structural effect of a remedy, the commitments have to foresee that the merged entity cannot subsequently acquire influence ([3]) over the whole or parts of the divested business. The commitments will normally have to foresee that no re-acquisition of material influence is possible for a significant period, generally of 10 years. However, the commitments can also provide for a waiver allowing the Commission to relieve the parties from this obligation if it subsequently finds that the structure of the market has changed to such an extent that the absence of influence over the divested business is no longer necessary to render the concentration compatible with the common market. Even in the absence of an explicit clause, a re-acquisition of the business would violate an implicit obligation on the parties under the commitments as this would affect the effectiveness of the remedies.

1.4. *Alternative divestiture commitments: Crown Jewels*

44. In certain cases, the implementation of the parties' preferred divestiture option (of a viable business solving the competition concerns) might be uncertain in view, for example, of third parties' pre-emption rights or uncertainty as to the transferability of key contracts, intellectual property rights, or the uncertainty of finding a suitable purchaser. Nevertheless, the parties may consider that they would be able to divest this business to a suitable purchaser within a very short time period.

45. In such circumstances, the Commission cannot take the risk that, in the end, effective competition will not be maintained. Accordingly, the Commission will only accept such divestiture commitments under the following conditions: (a) absent the uncertainty, the first divestiture proposed in the commitments would consist of a viable business, and (b) the parties will have to propose a second alternative divestiture which the parties will be obliged to implement if they are not able to implement the first commitment within the given time frame for the first divestiture ([4]). Such an alternative commitment normally has to be a 'crown jewel' ([5]), i.e. it should be as least as good as the first proposed divestiture in terms of creating a viable competitor once implemented, it should not involve any uncertainties as to its implementation and it should be capable of being implemented quickly in order to avoid that the overall implementation period exceeds what would normally be regarded as acceptable in the conditions of the market in question. In order to limit the risks in the interim period, it is indispensable that interim preservation and holding separate measures apply to all assets included in both divestiture alternatives. Furthermore, the commitment has to establish clear criteria and a strict timetable as to how and when the alternative divestiture obligation will become effective and the Commission will require shorter periods for its implementation.

([1]) COMP/M.3149 — Procter&Gamble/Wella of 30 July 2003, paragraph 61; COMP/M.2337 — Nestlé/Ralstone Purina of 27 July 2001, paragraph 68; COMP/M.2621 — SEB/Moulinex of 8 January 2002, paragraph 141; IV/M.623 — Kimberly-Clark/Scott Paper of 16 January 1996, paragraph 236(ii).

([2]) For example taking into account the life cycle of products, c.f. COMP/M.2621 — SEB/Moulinex of 8 January 2002, paragraph 141, where effectively the duration of the commitments covered a period equal to about three product life cycles; confirmed by judgment of CFI in Case T-119/02 *Royal Philips Electronics NV v Commission* [2003] ECR II-1433, paragraphs 112 *et seq*.

([3]) An influence by the previous owner of the business in the competitive behaviour of the divested business risking to frustrate the objective of the remedy.

([4]) See judgment of the CFI in Case T-210/01 *General Electric v Commission* [2005] ECR II-5575, paragraph 617; COMP/M.1453 — AXA/GRE of 8 April 1999.

([5]) The alternative may consist of an entirely different business or, in case of uncertainty as to finding a suitable buyer, of additional businesses and assets that are added to the initial package.

46. If there is uncertainty as to the implementation of the divestiture due to third party rights or as to finding a suitable purchaser crown jewel commitments and up-front buyers as discussed below in paragraphs 54 address the same concerns, and the parties may therefore choose between both structures.

1.5. *Transfer to a suitable purchaser*

47. The intended effect of the divestiture will only be achieved if and once the business is transferred to a suitable purchaser in whose hands it will become an active competitive force in the market. The potential of a business to attract a suitable purchaser is an important element already of the Commission's assessment of the appropriateness of the proposed commitment ([1]). In order to ensure that the business is divested to a suitable purchaser, the commitments have to include criteria to define its suitability which will allow the Commission to conclude that the divestiture of the business to such a purchaser will likely remove the competition concerns identified.

(a) Suitability of a purchaser

48. The standard purchaser requirements are the following:

— the purchaser is required to be independent of and unconnected to the parties,

— the purchaser must possess the financial resources, proven relevant expertise and have the incentive and ability to maintain and develop the divested business as a viable and active competitive force in competition with the parties and other competitors, and

— the acquisition of the business by a proposed purchaser must neither be likely to create new competition problems nor give rise to a risk that the implementation of the commitments will be delayed. Therefore, the proposed purchaser must reasonably be expected to obtain all necessary approvals from the relevant regulatory authorities for the acquisition of the business to be divested.

49. The standard purchaser requirements may have to be supplemented on a case-by-case basis. An example is the requirement, where appropriate, that the purchaser should be an industrial, rather than a financial purchaser ([2]). The commitments will normally contain such a clause where, due to the specific circumstances of the case, a financial buyer might not be able or might not have the incentives to develop the business as a viable and competitive force in the market even considering that it could obtain the necessary management expertise (e.g. by recruiting managers experienced in the sector at stake) and therefore the acquisition by a financial buyer would not remove the competition concerns with sufficient certainty.

(b) Identification of a suitable purchaser

50. In general, there are three ways to ensure that the business is transferred to a suitable purchaser. First, the business is transferred within a fixed time-limit after adoption of the decision to a purchaser which is approved by the Commission on the basis of the purchaser requirements. Second, in addition to the conditions set out for the first category, the commitments foresee that the parties may not complete the notified operation before having entered into a binding agreement with a purchaser for the business, approved by the Commission (so-called 'up-front-buyer'). Third, the parties identify a purchaser for the business and enter into a binding agreement already during the Commission's procedure ([3]) (so-called 'fix-it-first' ([4]) remedy). The main difference between the two latter options is that in the case of an up-front buyer, the identity of the purchaser is not known to the Commission prior to the authorisation decision.

51. The choice of the category depends on the risks involved in the case and therefore on the measures which enable the Commission to conclude with the requisite degree of certainty that the commitment will be implemented. This will depend on the nature and the scope of the business to be divested, the risks of degradation of the business in the interim period up to divestiture and any uncertainties inherent in the transfer and implementation, in particular the risks of finding a suitable purchaser.

(1) Case IV/M.913 — Siemens/Elektrowatt of 18 November 1997.
(2) See commitments in Case COMP/M.2621 — SEB/Moulinex of 8 January 2002, which foresee that the licensee needs to have its own trademark used in the sector concerned. Certain markets may require a sufficient degree of recognition by customers for a purchaser to be able to translate the business to be divested into a competitive force on the market.
(3) The transfer of the business may be implemented after the Commission decision.
(4) This terminology might be used differently in other jurisdictions.

1. Sale of the divested business within a fixed time-limit after the decision

52. In the first category, the parties may proceed with the sale of the divested business on the basis of the purchaser requirements within a fixed time-limit after the adoption of the decision. This procedure is likely to be appropriate in the majority of cases, provided that a number of purchasers can be envisaged for a viable business and that no specific issues complicate or stand in the way of the divestiture. Where the purchaser needs to have special qualifications, this procedure may be appropriate if there are sufficient interested potential purchasers available which fulfil the specific purchaser requirements to be included in the commitments in such cases. In these circumstances the Commission may be able to conclude that the divestiture will be implemented and that there are no reasons for the implementation of the notified concentration to be suspended after the Commission decision.

2. Up-front buyer

53. There are cases where only the proposal of an up-front buyer will allow the Commission to conclude with the requisite degree of certainty that the business will be effectively divested to a suitable purchaser. The parties therefore have to undertake in the commitments that they are not going to complete the notified operation before having entered into a binding agreement with a purchaser for the divested business, approved by the Commission ([1]).

54. First, this concerns cases where there are considerable obstacles for a divestiture, such as third party rights, or uncertainties as to finding a suitable purchaser ([2]). In such cases, an up-front buyer will allow the Commission to conclude with the requisite degree of certainty that the commitments will be implemented, as such a commitment creates greater incentives for the parties to close the divestiture in order to be able to complete their own concentration. In these circumstances, parties may choose between proposing an up-front buyer and an alternative divestiture commitment, as set out above in paragraph 46.

55. Second, an up-front buyer may be necessary in cases which cause considerable risks of preserving the competitiveness and saleability of the divestment business in the interim period until divestiture. This category comprises cases where the risks of a degradation of the divestment business appear to be high, in particular due to a risk of losing employees being key for the business, or where the interim risks are increased as the parties are not able to undertake the carve-out process in the interim period, but the carve-out process can only take place once a sales and purchase agreement with a purchaser is entered into. The up-front buyer provision may accelerate the transfer of the business to be divested — given the increased incentives for the parties to close the divestiture in order to be able to complete their own concentration — to such an extent that the commitments may allow the Commission to conclude with the requisite degree of certainty that those risks are limited and the divestiture will be effectively implemented ([3]).

3. Fix-it-first remedies

56. The third category involves cases where the parties identify and enter into a legally binding agreement with a buyer outlining the essentials of the purchase during the Commission procedure ([4]). The Commission will be able to decide in the final decision whether the transfer of the divested business to the identified purchaser will remove the competition concerns. If the Commission authorises the notified concentration, no additional Commission decision for the purchaser approval will be needed and the closing of the sale of the divested business may take place shortly afterwards.

57. The Commission welcomes fix-it-first remedies in particular in cases where the identity of the purchaser is crucial for the effectiveness of the proposed remedy. This concerns cases where, given the circumstances, only very few potential purchasers can be considered suitable, in particular as the divested business is not a viable business in itself, but its viability will only be ensured by specific

([1]) Case COMP/M.3796 — Omya/Huber PCC of 19 July 2006; Case COMP/M.2972 — DSM/Roche Vitamins of 23 July 2003; Case COMP/M.2060 — Bosch/Rexroth of 13 December 2000; Case COMP/M.2337 — Nestlé/Ralston Purina of 27 July 2001; Case COMP/M.2544 — Masterfoods/Royal Canin of 15 February 2002; Case COMP/M.2947 — Verbund/Energie Allianz of 11 June 2003.

([2]) See Case COMP/M.2060 — Bosch/Rexroth of 13 December 2000, paragraph 92.

([3]) See Case COMP/M.2060 — Bosch/Rexroth of 13 December 2000, paragraph 95.

([4]) Such agreements are normally conditional to the final Commission decision accepting the remedy in question.

assets of the purchaser, or where the purchaser needs to have specific characteristics in order for the remedy to solve the competition concerns ([1]). If the parties choose to enter into a binding agreement with a suitable purchaser during the procedure by way of a fix-it-first solution, the Commission can in those circumstances conclude with the requisite degree of certainty that the commitments will be implemented with a sale to a suitable purchaser. In these situations, an 'upfront buyer' solution containing specific requirements as to the suitability of a buyer will generally be considered equivalent and acceptable.

2. **Removal of links with competitors**

58. Divestiture commitments may also be used for removing links between the parties and competitors in cases where these links contribute to the competition concerns raised by the merger. The divestiture of a minority shareholding in a joint venture may be necessary in order to sever a structural link with a major competitor ([2]), or, similarly, the divestiture of a minority shareholding in a competitor ([3]).

59. Although the divestiture of such stakes is the preferable solution, the Commission may exceptionally accept the waiving of rights linked to minority stakes in a competitor where it can be excluded, given the specific circumstances of the case, that the financial gains derived from a minority shareholding in a competitor would in themselves raise competition concerns ([4]). In such circumstances, the parties have to waive all the rights linked to such a shareholding which were relevant for behaviour in terms of competition, such as representations on the board, veto rights and also information rights ([5]). The Commission may only be able to accept such a severing of the link with a competitor if those rights are waived comprehensively and in a permanent way ([6]).

60. Where competition concerns result from agreements with companies supplying the same products or providing the same services, a suitable remedy may be the termination of the respective agreement, such as distribution agreements with competitors ([7]) or agreements resulting in the coordination of certain commercial behaviour ([8]). However, the termination of a distribution agreement alone will only remove the competition concerns if it is ensured that the product of a competitor will also be distributed in the future and exercise effective competitive pressure on the parties.

3. **Other remedies**

61. Whilst being the preferred remedy, divestitures or the removal of links with competitors are not the only remedy possible to eliminate certain competition concerns. However, divestitures are the benchmark for other remedies in terms of effectiveness and efficiency. The Commission therefore may accept other types of commitments, but only in circumstances where the other remedy proposed is at least equivalent in its effects to a divestiture ([9]).

([1]) See Case COMP/M.3916 — T-Mobile Austria/tele.ring of April 2006, the divestiture of certain mobile telephony sites and frequencies, not constituting a viable business, could only take place to a competitor which was likely to play a similar role in the market as tele.ring; Case COMP/M.4000 — Inco/Falconbridge of 4 July 2006, the divestiture of a nickel processing business could only take place to a competitor vertically integrated into the supply of nickel; Case COMP/M.4187 — Metso/Aker Kvaerner of 12 December 2006, only one purchaser was suitable for acquiring the businesses to be divested as it was the only one with the necessary know-how and the necessary presence in neighbouring markets; Case COMP/M.3436 — Continental/Phoenix of 26 October 2004, only the partner in the distribution joint venture was able to render the divested business viable; Case COMP/M.3136 — GE/Agfa of 5 December 2003.

([2]) Case IV/M.942 — VEBA/Degussa of 3 December 1997.

([3]) Case COMP/M.3653 — Siemens/VA Tech of 13 July 2005, paragraphs 491, 493 ff.

([4]) See Case COMP/M.3653 — Siemens/VA Tech of 13 July 2005, paragraphs 327 ff., where effects from the minority stake in financial respect could be excluded as a put option for the sale of this stake had already been exercised.

([5]) Case COMP/M.4153 — Toshiba/Westinghouse of 19 September 2006.

([6]) See Case COMP/M.3440 — ENI/EDP/GDP of 9 December 2004, paragraphs 648 f., 672.

([7]) See for the termination of distribution agreements Case COMP/M.3779 — Pernod Ricard/Allied Domecq of 24 June 2005; Case COMP/M.3658 — Orkla/Chips of 3 March 2005.

([8]) See particularly the sea transport sector, Case COMP/M.3829 — Maersk/PONL of 29 July 2005 and Case COMP/M.3863 — TUI/CP Ships of 12 October 2005. In those cases, the parties committed to withdraw from certain liner conferences and consortia.

([9]) Case COMP/M.3680 — Alcatel/Finmeccanica/Alcatel Alenia Space & Telespazio of 28 April 2005, where a divestiture was impossible.

Access remedies

62. In a number of cases, the Commission has accepted remedies foreseeing the granting of access to key infrastructure, networks, key technology, including patents, know-how or other intellectual property rights, and essential inputs. Normally, the parties grant such access to third parties on a non-discriminatory and transparent basis.

63. Commitments granting access to infrastructure and networks may be submitted in order to facilitate market entry by competitors. They may be acceptable to the Commission in circumstances where it is sufficiently clear that there will be actual entry of new competitors that would eliminate any significant impediment to effective competition ([1]). Other examples of access commitments are commitments granting access to pay-TV platforms ([2]) and to energy via gas release programs ([3]). Often, a sufficient reduction of entry barriers is not achieved by individual measures, but by a package comprising a combination of divestiture remedies and access commitments or a commitments package aimed at overall facilitating entry of competitors by a whole range of different measures. If those commitments actually make the entry of sufficient new competitors timely and likely, they can be considered to have a similar effect on competition in the market as a divestiture. If it cannot be concluded that the lowering of the entry barriers by the proposed commitments will likely lead to the entry of new competitors in the market, the Commission will reject such a remedies package ([4]).

64. Commitments granting non-discriminatory access to infrastructure or networks of the merging parties may also be submitted in order to ensure that competition is not significantly impeded as a result of foreclosure. In past Commission decisions, commitments have foreseen the granting of access to pipelines ([5]) and to telecom or similar networks ([6]). The Commission will only accept such commitments if it can be concluded that these commitments will be effective and competitors will likely use them so that foreclosure concerns will be eliminated. In specific cases, it may be appropriate to link such a commitment with an up-front or fix-it-first provision in order to allow the Commission to conclude with the requisite degree of certainty that the commitment will be implemented ([7]).

65. Similarly, the control of key technology or IP rights may lead to concerns of foreclosure of competitors which depend on the technology or IP rights as essential input for the activities in a downstream market. This, for example, concerns cases where competition problems arise as the parties may withhold information necessary for the interoperability of different equipment. In such circumstances, commitments to grant competitors access to the necessary information may eliminate the competition concerns ([8]). Similarly, in sectors where players commonly have to cooperate by licensing patents to each other, concerns that the merged entity would no longer have the incentive to provide licences to the same extent and under the same conditions as before may be eliminated by commitments to grant

([1]) See judgment of the CFI in Case T-177/04 *easyJet v Commission* [2006] ECR II-1931, at paragraphs 197 *et seq*.
([2]) See Case COMP/M.2876 — Newscorp/Telepiù of 2 April 2003, paragraphs 225 *et seq*., where the commitments package included access of competitors to all essential elements of a pay-TV network, such as 1. access to the necessary content; 2. access to the technical platform as well as 3. access to the necessary technical services. Similarly, in Case COMP/JV.37 — BskyB/Kirch Pay TV of 21 March 2000, confirmed by judgment of CFI in Case T-158/00 *ARD v Commission* [2003] ECR II-3825, the Commission accepted a commitments package which allowed other operators comprehensive access to the pay-TV market.
([3]) See Case COMP/M.3696 — E.ON/MOL of 21 December 2005; Case COMP/M.3868 — DONG/Elsam/Energi E2 of 14 March 2006.
([4]) In air transport mergers, a mere reduction of barriers to entry by a commitment of the parties to offer slots on specific airports may not always be sufficient to ensure the entry of new competitors on those routes where competition problems arise and to render the remedy equivalent in its effects to a divestiture.
([5]) Case COMP/M.2533 — BP/E.ON of 20 December 2001, access to pipelines in addition to divestiture of shares in a pipeline company; Case COMP/M.2389 — Shell/DEA of 20 December 2001, access to an ethylene import terminal.
([6]) For access to telecom networks, see Case COMP/M.2803 — Telia/Sonera of 10 July 2002; Case IV/M.1439 — Telia/Telenor of 13 October 1999; Case COMP/M.1795 — Vodafone/Mannesmann of 12 April 2000. See also Case COMP/M.2903 — DaimlerChrysler/Deutsche Telekom/JV of 30 April 2003, where the Commission accepted a commitments package to grant third parties access to a telematics network and to reduce the entry barriers by allowing them to use parts of a telematics device, designed for toll collection, provided by the parties.
([7]) See the 'qualitative moratorium' in Case COMP/M.2903 — DaimlerChrysler/Deutsche Telekom/JV of 30 April 2003, paragraph 76.
([8]) Case COMP/M.3083 — GE/Instrumentarium of 2 September 2003; Case COMP/M.2861 — Siemens/Draegerwerk of 30 April 2003.

licenses on the same basis also in the future (1). In those cases, commitments should foresee non-exclusive licences or the disclosure of information on a non-exclusive basis to all third parties which depend on the IP rights or information for their activities. It has to be further ensured that the terms and conditions under which the licenses are granted do not impede the effective implementation of such a license remedy. If no clearly determined terms and conditions for the granting of licenses exist in the market at stake, the terms and conditions, including the pricing, should be clearly apparent from the commitments (e.g. by way of pricing formulas). An alternative solution may be to rely on royalty-free licences. Furthermore, depending on the case, the granting of licenses may also transmit sensitive information to the licensor on the competitive behaviour of the licensees which are active as competitors in the downstream market, e.g. by transmitting the number of licenses used in the down-stream market. In such cases, in order for the remedy to be suitable, the commitments will have to exclude such confidentiality problems. Generally, as set out in the preceding paragraph, the Commission will only accept such commitments if it can be concluded that they will be effective and competitors will likely use them.

66. Access commitments are often complex in nature and necessarily include general terms for determining the terms and conditions under which access is granted. In order to render them effective, those commitments have to contain the procedural requirements necessary for monitoring them, such as the requirement of separate accounts for the infrastructure in order to allow a review of the costs involved (2), and suitable monitoring devices. Normally, such monitoring has to be done by the market participants themselves, e.g. by those undertakings wishing to benefit from the commitments. Measures allowing third parties themselves to enforce the commitments are in particular access to a fast dispute resolution mechanism via arbitration proceedings (together with trustees) (3) or via arbitration proceedings involving national regulatory authorities if existing for the markets concerned (4). If the Commission can conclude that the mechanisms foreseen in the commitments will allow the market participants themselves to effectively enforce them in a timely manner, no permanent monitoring of the commitments by the Commission is required. In those cases, an intervention by the Commission would only be necessary in cases where the parties do not comply with the solutions found by those dispute resolution mechanisms (5). However, the Commission will only be able to accept such commitments where the complexity does not lead to a risk of their effectiveness from the outset and where the monitoring devices proposed ensure that those commitments will be effectively implemented and the enforcement mechanism will lead to timely results (6).

Change of long-term exclusive contracts

67. The change in the market structure resulting from a proposed concentration can cause existing contractual arrangements to be inimical to effective competition. This is in particular true for exclusive long-term supply agreements if such agreements foreclose either, up-stream, the input for competitors or, down-stream, their access to customers. Where the merged entity will have the ability and the incentives to foreclose competitors in this way, the foreclosure effects resulting from existing exclusive agreements may contribute to significantly impeding effective competition (7).

68. In such circumstances, the termination or change of existing exclusive agreements may be considered appropriate to eliminate the competition concerns (8). However, the available evidence must allow the

(1) See Case COMP/M.3998 — Axalto/Gemplus of 19 May 2006.
(2) See e.g. Case COMP/M.2803 — Telia/Sonera of 10 July 2002; Case COMP/M.2903 — DaimlerChrysler/Deutsche Telekom/JV of 30 April 2003.
(3) As to the effects of arbitration clauses, see judgment of CFI in Case T-158/00 *ARD v Commission* [2003] ECR II-3825, paragraphs 212, 295, 352; CFI judgment in Case T-177/04 *easyJet v Commission* [2006] ECR II-1931, paragraph 186.
(4) See Case COMP/M.2876 — Newscorp/Telepiù; Case COMP/M.3916 — T-Mobile Austria/tele.ring.
(5) CFI, judgment in Case T-158/00 *ARD v Commission* [2003] ECR II-3825, paragraphs 212, 295, 352.
(6) See judgments of the CFI in Case T-87/05 *EDP v Commission* [2005] ECR II-3745, at paragraphs 102 *et seq.*; and Case T-177/04 *easyJet v Commission* [2006] ECR II-1931, at paragraph 188.
(7) See Commission Notice on non-horizontal mergers […]; Case IV/M.986 — AGFA Gevaert/DuPont of 11 February 1998.
(8) Case COMP/M.2876 — Newscorp/Telepiù of 2 April 2003, paragraphs 225 *et seq.*, granting unilateral termination rights to suppliers of TV content, limiting the scope of the exclusivity clauses and limiting the duration of future exclusive agreements relating to supply of content; Case COMP/M.2822 — ENI/EnBW/GVS of 17 December 2002, granting of early termination rights to all local gas distributors concerning long-term gas supply agreements; Case IV/M.1571 — New Holland of 28 October 1999; Case IV/M.1467 — Rohm and Haas/Morton of 19 April 1999.

Commission to clearly determine that no *de facto* exclusivity will be maintained. Furthermore, such change of long-term agreements will normally only be sufficient as part of a remedies package to remove the competition concerns identified.

Other non-divestiture remedies

69. As indicated above in paragraph 17, non-structural types of remedies, such as promises by the parties to abstain from certain commercial behaviour (e.g. bundling products), will generally not eliminate the competition concerns resulting from horizontal overlaps. In any case, it may be difficult to achieve the required degree of effectiveness of such a remedy due to the absence of effective monitoring of its implementation, as already set out above in paragraph 13(f) ([1]). Indeed, it may be impossible for the Commission to verify whether or not the commitment is complied with and even other market participants, such as competitors, may not be able to establish at all or with the requisite degree of certainty whether the parties meet the conditions of the commitment in practice. In addition, competitors may also not have an incentive to alert the Commission as they do not directly benefit from the commitments. Therefore, the Commission may examine other types of non-divestiture remedies, such as behavioural promises, only exceptionally in specific circumstances, such as in respect of competition concerns arising in conglomerate structures ([2]).

Time limit for non-divestiture remedies

70. The Commission may accept that non-divestiture remedies are limited in their duration. The acceptability of a time limit and the duration will depend on the individual circumstances of the case and cannot be pre-defined in a general manner in the present Notice.

4. **Review Clause**

71. Irrespective of the type of remedy, commitments will usually include a review clause ([3]). This may allow the Commission, upon request by the parties showing good cause, to grant an extension of deadlines or, in exceptional circumstances, to waive, modify or substitute the commitments.

72. Modifying commitments by extending the deadlines is in particular relevant for divestiture commitments. Parties have to submit a request for an extension within the deadline. Where parties apply for an extension for the first divestiture period, the Commission will only accept that they have shown good cause if the parties were not able to meet the deadline for reasons outside their responsibility and if it can be expected that the parties subsequently will succeed in divesting the business within a short time-frame. Otherwise, the divestiture trustee may be better placed to undertake the divestiture and to fulfil the commitments for the parties.

73. The Commission may grant waivers or accept modifications or substitutions of the commitments only in exceptional circumstances. This will very rarely be relevant for divestiture commitments. As divestiture commitments have to be implemented within a short time-frame after the decision, it is very unlikely that changes of market circumstances will have occurred in such a short time-frame and the Commission will normally not accept any modifications under the general review clause. For specific situations the commitments normally foresee more targeted review clauses ([4]).

([1]) See, as an example for such remedies, Case COMP/M.3440 — ENI/EDP/GDP of 9 December 2004, paragraphs 663, 719.

([2]) See, in relation to conglomerate effects of a concentration, ECJ, judgment of 15 February 2005 in Case C-12/03 P *Commission v Tetra Laval* [2005] ECR I-987, paragraphs 85, 89.

([3]) However, the review clause is of particular relevance for access remedies, which systematically should include such a clause; see below paragraph 74.

([4]) As mentioned in paragraph 30, the Commission may approve a purchaser without some of the assets or personnel foreseen if this does not affect the competitiveness and viability of the divested business. Similarly, the non-requisition clause, as explained in paragraph 43, prohibits the re-acquisition of control over the assets divested only if the Commission has not previously found that that the market structure has changed to such an extent that the divestiture is no longer necessary.

74. A waiver, modification or substitution of commitments may be more relevant for non-divestiture commitments, such as access commitments, which may be on-going for a number of years and for which not all contingencies can be predicted at the time of the adoption of the Commission decision. Exceptional circumstances justifying a waiver, modification or substitution may, first, be accepted for such commitments if parties show that market circumstances have changed significantly and on a permanent basis. For showing this, a sufficient long time-span, normally at least several years, between the Commission decision and a request by the parties is required. Second, exceptional circumstances may also be present if the parties can show that the experience gained in the application of the remedy demonstrates that the objective pursued with the remedy will be better achieved if modalities of the commitment are changed. For any waiver, modification or substitution of commitments, the Commission will also take into account the view of third parties and the impact a modification may have on the position of third parties and thereby on the overall effectiveness of the remedy. In this regard, the Commission will also consider whether modifications affect the right already acquired by third parties after implementation of the remedy ([1]).

75. If at the time of the adoption of the decision the Commission for particular reasons cannot anticipate all contingencies in relation to the implementation of such commitments, it may also be appropriate for the parties to include a clause in the commitments, allowing the Commission to trigger a limited modification to the commitments. Such modifications may be necessary if the original commitments do not achieve the envisaged results set out in those commitments, and therefore do not effectively remove the competition concerns. Procedurally, the parties may be obliged in such cases to propose a change to the commitments in order to achieve the result defined in those commitments, or the Commission may itself, after hearing the parties, modify the conditions and obligations to this end. This type of clause will typically be limited to cases where specific modalities risk to jeopardise effective implementation of the commitments. Such clauses have been used, for example, in relation to the modalities of gas release programs ([2]).

76. The Commission may, upon request, adopt a formal decision for any waiver, modification or substitution of commitments or simply take note of satisfactory amendments of the remedy by the parties, where such amendments improve the effectiveness of the remedy and result in legally binding obligations of the parties, e.g. by contractual arrangements. A change of the commitments will normally only be effective *ex nunc*. Consequently, a modification of the commitments will not heal retroactively any breach of the commitments which has been committed before the time of the modification. The Commission may therefore, where appropriate, further pursue a breach under Articles 14, 15 of the Merger Regulation.

IV. **ASPECTS OF PROCEDURE FOR SUBMISSION OF COMMITMENTS**

1. **Phase I**

77. Pursuant to Article 6(2) of the Merger Regulation the Commission may declare a concentration compatible with the common market also before the initiation of proceedings, where it is confident that following modification a notified concentration no longer raises serious doubts within the meaning of paragraph 1(c).

78. Parties can submit proposals for commitments to the Commission on an informal basis, even before notification. Parties have to submit commitments within not more than 20 working days from the date of the receipt of the notification ([3]). The Commission informs the parties about its serious doubts in due time before that deadline ([4]). Where the parties submit commitments, the deadline for the Commission's decision pursuant to Article 6(1) of the Merger Regulation is extended from 25 to 35 working days ([5]).

([1]) See examples in judgment of CFI in Case T-119/02 *Royal Philips Electronics NV v Commission* [2003] ECR II-1433, paragraph 184.
([2]) See Case COMP/M.3868 — DONG/Elsam/Energi E2 of 14 March 2006, paragraph 24 of the Annex.
([3]) Article 19(1) of the Implementing Regulation.
([4]) The notifying parties will normally be offered the opportunity of attending a state of play meeting in such circumstances, see point 33 of the DG COMPETITION Best Practices on the conduct of EC merger control proceedings.
([5]) Article 10(1), subparagraph 2 of the Merger Regulation.

79. In order to form the basis of a decision pursuant to Article 6(2), proposals for commitments must meet the following requirements:

(a) they shall fully specify the substantive and implementing commitments entered into by the parties;

(b) they shall be signed by a person duly authorised to do so;

(c) they shall be accompanied by the information on the commitments offered as provided for in the Implementing Regulation (as explained above in paragraph 7); and

(d) they shall be accompanied by a non-confidential version of the commitments ([1]) for the purposes of market testing them with third parties. The non-confidential version of the commitments must allow third parties to fully assess the workability and the effectiveness of the proposed remedies to remove the competition concerns.

80. Proposals submitted by the parties in accordance with these requirements will be assessed by the Commission. The Commission will consult the authorities of the Member States on the proposed commitments and, when considered appropriate, also third parties in the form of a market test, including in particular those third parties and the recognised representatives ([2]) of those employees whose positions are directly affected by the proposed remedies. In markets with national regulatory authorities the Commission may also, if appropriate, consult the competent national regulatory authorities ([3]). In addition, in cases involving a geographic market that is wider than the European Economic Area ('EEA') or where, for reasons related to the viability of the business, the scope of the business to be divested is wider than the EEA territory, the non-confidential version of the proposed remedies may also be discussed with non-EEA competition authorities in the framework of the Community's bilateral cooperation agreements with these countries.

81. Commitments in phase I can only be accepted where the competition problem is readily identifiable and can easily be remedied ([4]). The competition problem therefore needs to be so straightforward and the remedies so clear-cut that it is not necessary to enter into an in-depth investigation and that the commitments are sufficient to clearly rule out 'serious doubts' within the meaning of Article 6(1)(c) of the Merger Regulation ([5]). Where the assessment confirms that the proposed commitments remove the grounds for serious doubts on this basis, the Commission clears the merger in phase I.

82. Due to the time-constraints in phase I, it is particularly important for the parties to submit in a timely manner to the Commission the information required in the Implementing Regulation to properly assess the content and workability of the commitments and their suitability to maintain conditions of effective competition in the common market on a permanent basis. If the parties do not comply with the obligation in the Implementing Regulation, the Commission may not be able to conclude that the proposed commitments will remove the grounds for serious doubts.

83. Where the assessment shows that the commitments offered are not sufficient to remove the competition concerns raised by the concentration, the parties will be informed accordingly. Given that phase I remedies are designed to provide a clear-cut answer to a readily identifiable competition concern, only limited modifications can be accepted to the proposed commitments. Such modifications, presented as an immediate response to the result of the consultations, may include clarifications, refinements and/or other improvements designed to ensure that the commitments are workable and effective. However, such modifications may only be accepted in circumstances where it is ensured that the Commission can carry out a proper assessment of those commitments ([6]).

([1]) Article 20(2) of the Implementing Regulation.

([2]) Cf. Article 2(1)(c) of Council Directive 2001/23/EC of 12 March 2001 on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses (OJ L 82, 22.3.2001, p. 16). See also Article 2(1)(g) of Council Directive 94/45/EC of 22 September 1994 on the establishment of a European Works Council or a procedure in Community-scale undertakings and Community-scale groups of undertakings for the purposes of informing and consulting employees (OJ L 254, 30.9.1994, p. 64).

([3]) For the role of national regulatory authorities in a dispute resolution mechanism, see paragraph 66.

([4]) See recital 30 of the Merger Regulation.

([5]) See judgment of CFI in Case T-119/02 *Royal Philips Electronics NV v Commission* [2003] ECR II-1433, paragraphs 79 *et seq.*

([6]) See recital 17 of the Implementing Regulation and judgment of the CFI, Case T-119/02 *Royal Philips Electronics NV v Commission* [2003] ECR II-1433, paragraphs 237 *et seq.*

84. If the Commission's final assessment of a case shows that there are no competition concerns in one or more markets, the parties will be informed accordingly and may withdraw the unnecessary commitments for such markets. If the parties do not withdraw them, the Commission will normally ignore them in the decision. In any event, such commitment proposals do not constitute a condition for clearance.

85. Where the parties are informed that the Commission intends to maintain in its final decision that the transaction raises competition concerns for a specific market, it is for the parties to propose commitments. The Commission is not in a position to impose unilaterally any conditions to an authorisation decision, but only on the basis of the parties' commitments ([1]). However, the Commission will review whether the commitments submitted by the parties are proportionate to the competition problem when assessing whether to attach them as conditions or obligations to its final decision ([2]). Nevertheless, it has to be stressed that, in a commitments proposal, all those elements which are required to fulfil the basic conditions for acceptable commitments as set out above in paragraphs 9 *et seq*. will be considered necessary. This paragraph as well as the previous one also applies to commitments in phase II.

86. If the Commission concludes that the commitments offered by the parties do not remove the serious doubts, it will issue an Article 6(1)(c) decision and open proceedings.

2. **Phase II**

87. Pursuant to Article 8(2) of the Merger Regulation, the Commission must declare a concentration compatible with the common market, where following modification a notified concentration does no longer significantly impede effective competition within the meaning of Article 2(3) of the Merger Regulation.

88. Commitments proposed to the Commission pursuant to Article 8(2) must be submitted to the Commission within not more than 65 working days from the day on which proceedings were initiated. Where the deadlines for the final decision have been extended according to Article 10(3) of the Merger Regulation, also the deadline for remedies is automatically extended by the same number of days ([3]). Only in exceptional circumstances, the Commission may accept that commitments are submitted for the first time after the expiry of this period. The request by the parties for an extension of the deadline must be received within the period and has to set forth the exceptional circumstances which, according to the parties, justify it. In addition to the existence of exceptional circumstances, an extension is only possible where there is sufficient time to make a proper assessment of the proposal by the Commission and to allow adequate consultation with Member States and third parties ([4]).

89. The question whether or not submitting remedies will extend the deadline for the Commission to take a final decision depends on the time in the procedure when the commitments are submitted. Where the parties submit commitments within less than 55 working days after the initiation of proceedings, the Commission has to take a final decision within not more than 90 working days of the date of initiation of proceedings ([5]). Where the parties submit commitments on working day 55 or afterwards (even after working day 65, if those commitments should be acceptable due to exceptional circumstances as described above in paragraph 88), the period for the Commission to take a final decision is increased to 105 working days according to Article 10(3), subparagraph 2. Where the parties submit commitments within less than 55 working days, but submit a modified version on day 55 or thereafter, the period to take a final decision will also be extended to 105 working days.

([1]) See above paragraph 6.
([2]) See judgment of ECJ of 18 December 2007 in Case C-202/06 P *Cementbouw v Commission* [2007], paragraph 54.
([3]) Article 19(2), subparagraph 2 of the Implementing Regulation.
([4]) Article 19(2), subparagraph 3 of the Implementing Regulation. See Case COMP/M.1439 — Telia/Telenor of 13 October 1999; Case IV/M.754 — Anglo American Corporation/Lonrho of 23 April 1997.
([5]) Where the deadlines for the final decision have been extended according to Article 10(3) subparagraph 2 of the Merger Regulation before working day 55, this period is also extended.

90. The Commission is available to discuss suitable commitments well in advance of the end of the 65 working day period. The parties are encouraged to submit draft proposals dealing with both substantive and implementation aspects which are necessary to ensure that the commitments are fully workable. If the parties are of the opinion that more time is needed for the investigation of the competition concerns and for the corresponding design of appropriate commitments, they may also suggest to the Commission to extend the final deadline under Article 10(3), subparagraph 1. Such a request will have to be made before the end of the 65 working day period. Indeed, the Commission will normally not extend the period for adopting a final decision according to Article 10(3), subparagraph 1 where the request for extension is presented after the deadline for submitting remedies foreseen in the Implementing Regulation, i.e. after working day 65 (1).

91. In order to meet the requirements for a decision pursuant to Article 8(2), commitments must meet the following requirements:

(a) they shall address all competition concerns raised by the concentration and shall fully specify the substantive and implementing commitments entered into by the parties;

(b) they shall be signed by a person duly authorised to do so;

(c) they shall by accompanied by the information on the commitments offered as provided for in the Implementing Regulation (as explained above in paragraph 7); and

(d) they shall be accompanied by a non-confidential version of the commitments (2) for the purposes of market testing them with third parties, fulfilling the requirements set out above in paragraph 79.

92. Proposals submitted by the parties in accordance with these requirements will be assessed by the Commission. If the assessment confirms that the proposed commitments remove the serious doubts (if no Statement of Objection has been issued yet by the Commission) or the competition concerns raised in the Statement of Objections, following the consultations as set out in paragraph 80 above, the Commission will adopt a conditional clearance decision.

93. Conversely, where the assessment leads to the conclusion that the proposed commitments appear not to be sufficient to resolve the competition concerns raised by the concentration, the parties will be informed accordingly (3).

94. The Merger Regulation does not impose any obligation on the Commission to accept commitments after the legal deadline for remedies, unless the Commission voluntarily undertakes to assess commitments in specific circumstances (4). In view of this, where parties subsequently modify the proposed commitments after the deadline of 65 working days, the Commission will only accept these modified commitments where it can clearly determine — on the basis of its assessment of information already received in the course of the investigation, including the results of prior market testing, and without the need for any other market test — that such commitments, once implemented, fully and unambiguously resolve the competition concerns identified and where there is sufficient time to allow for an adequate assessment by the Commission and for proper consultation with Member States (5) (6). The Commission will normally reject modified commitments which do not fulfil those conditions (7).

(1) The Court of First Instance confirmed that the Merger Regulation and the Implementing Regulation do not impose any obligations on the Commission to accept commitments which are submitted after the legal deadline, as set out below in paragraph 94, see Case T-87/05 *EDP v Commission* [2005] ECR II-3745, at paragraph 161. Therefore, the Commission is not bound to consider any remedies which are submitted by the parties after the deadline for remedies, even if the parties were to agree to extend the final deadline. Moreover, this would not correspond to the purpose, as explained in recital 35 of the Merger Regulation, of the extensions foreseen in Article 10(3). The extension foreseen in Article 10(3), subparagraph 1 is to allow for sufficient time for the investigation of the competitive concerns, whereas it is the purpose of the extension laid down in Article 10(3), subparagraph 2 to allow for sufficient time for the analysis and market testing of commitments.

(2) Article 20(2) of the Implementing Regulation.

(3) See paragraphs 30 ff. of the DG Competition Best Practices on the conduct of EC merger proceedings which provide for several state of play meetings between the Commission and the parties throughout the procedure.

(4) See judgment of CFI in Case T-87/05 *EDP v Commission* [2005] ECR II-3745, at paragraphs 161 *et seq*. See also judgement of CFI in case T-290/94 *Kaysersberg SA v Commission* [1997] ECR II-2137.

(5) Case COMP/M.3440 — ENI/EDP/GDP of 9 December 2004, paragraphs 855 *et seq*.; confirmed by Judgment of CFI in Case T-87/05 *EDP v Commission* [2005] ECR II-3745, at paragraphs 162 *et seq*.; Case COMP/M.1628 — TotalFina/Elf of 9 March 2000, at paragraph 345.

(6) This consultation normally requires that the Commission has to be able to send a draft of the final decision, including an assessment of the modified commitments, to the Member States not less than 10 working days before the Advisory Committee with Member States. This period may only be shortened in exceptional circumstances (Article 19(5) of the Merger Regulation).

(7) See Case COMP/M.3440 — ENI/EDP/GDP of 9 December 2004, paragraph 913.

V. REQUIREMENTS FOR IMPLEMENTATION OF COMMITMENTS

95. Commitments are offered as a means of securing a clearance, with the implementation normally taking place after the decision. Commitments therefore require safeguards to ensure their effective and timely implementation. These implementing provisions will normally form part of the commitments entered into by the parties *vis-à-vis* the Commission.

96. In the following, detailed guidance is given on the implementation of divestiture commitments, as the most typical commitment. Afterwards, some aspects of the implementation of other types of commitments are discussed.

1. Divestiture process

97. The divestiture has to be completed within a fixed time period agreed between the parties and the Commission. In the Commission's practice, the total time period is divided into a period for entering into a final agreement and a further period for the closing, the transfer of legal title, of the transaction. The period for entering into a binding agreement is further normally divided into a first period in which the parties can look for a suitable purchaser (the 'first divestiture period') and, if the parties do not succeed to divest the business, a second period in which a divestiture trustee obtains the mandate to divest the business at no minimum price (the 'trustee divestiture period').

98. The Commission's experience has shown that short divestiture periods contribute largely to the success of the divestiture as, otherwise, the business to be divested will be exposed to an extended period of uncertainty. The time periods should therefore be as short as feasible. The Commission will normally consider a period of around six months for the first divestiture period and an additional period of three months for the trustee divestiture period as appropriate. A period of further three months is normally foreseen for closing the transaction. These periods may be modified on a case-by-case basis. In particular, they may have to be shortened if there is a high risk of degradation of the business' viability in the interim period.

99. The deadline for the divestiture shall normally start on the day of the adoption of the Commission decision. An exception might be justified for a transaction via public bid where the parties commit to divest a business belonging to the target. Where in such circumstances the parties cannot prepare for the divestiture of the target's business before closing of the notified concentration, the Commission might accept that the periods for such a divestiture only start with the date of closing the notified transaction. Similarly, such a solution may be considered if the date of closing of the concentration is not under the control of the parties as it, e.g. requires state approval ([1]). In return, it may be appropriate to shorten the deadlines in order to reduce the time of uncertainty for the business to be divested.

100. Whereas for up-front buyer solutions the above-described procedure applies, the procedure will be different for fix-it-first solutions. In general, a binding agreement with a purchaser will already be entered into during the procedure so that after the decision only a further period for the closing of the transaction has to be foreseen. If before the decision only a framework agreement has been concluded with the purchaser, the periods to be foreseen for entering into a full agreement and the closing afterwards will have to be decided on a case-by-case basis ([2]).

2. Approval of the purchaser and of the sale and purchase agreement

101. In order to ensure the effectiveness of the commitment, the sale to a proposed purchaser is subject to prior approval by the Commission. When the parties (or the divestiture trustee) have reached a final agreement with a purchaser, they have to submit a reasoned and documented proposal to the Commission. The parties or the divestiture trustee, as the case may be, will be required to demonstrate to the satisfaction of the Commission that the proposed purchaser meets the purchaser requirements, and that the business is divested in a manner consistent with the Commission's decision and the commitments. Where the commitments allow that different purchasers are being proposed for different parts of the package, the Commission will assess whether each individual proposed purchaser is acceptable and that the total package solves the competition concern.

([1]) However, also in those circumstances, other provisions in the commitments, in particular the provisions establishing the safeguards in the interim period, should start running on the date of the adoption of the decision.

([2]) See Case COMP/M.3916 — T-Mobile Austria/tele.ring of 20 April 2006.

102. In assessing any proposed purchaser, the Commission will interpret the purchaser requirements in the light of the purpose of the commitments, to immediately maintain effective competition in the market where competition concerns had been found, and of the market circumstances as set out in the decision [1]. Generally, the basis for the Commission's assessment of the purchaser requirements will be the submission of the parties, the assessment of the monitoring trustee and, in particular, discussions with the proposed purchaser and its business plan. The Commission will further analyse whether the underlying assumptions of the purchaser appear plausible according to the market circumstances.

103. The requirement that the purchaser has to have the necessary financial resources extends in particular to the way the acquisition is financed by the proposed purchaser. The Commission will normally not accept any financing of the divestiture by the seller, and, in particular, any seller financing if this were to give the seller a share in the profits of the divested business in the future.

104. In assessing whether the proposed purchaser threatens to create competition problems, the Commission will undertake a prima facie assessment in the light of the information available to the Commission in the purchaser approval process. Where the purchase results in a concentration that has a Community dimension, this new operation will have to be notified under the Merger Regulation and cleared under normal procedures [2]. Where this is not the case, the Commission's approval of a proposed purchaser is without prejudice to the merger control jurisdiction of national authorities. In addition, the proposed purchaser must be expected to obtain all other necessary approvals from the relevant regulatory authorities. Where it can be foreseen, in the light of the information available to the Commission, that difficulties in obtaining merger control clearance or other approvals may unduly delay the timely implementation of the commitment, it will be considered that the proposed purchaser does not meet the purchaser requirements. Otherwise, the competition concerns identified by the Commission would not be removed in the appropriate time-frame.

105. The requirement for an approval by the Commission does usually not only extend to the identity of the purchaser, but also to the sale and purchase agreement and any other agreement entered into between the parties and the proposed purchaser, including transitory agreements. The Commission will verify whether the divestiture according to the agreements is in line with the commitments [3].

106. The Commission will communicate its view as to the suitability of the proposed purchaser to the parties. If the Commission concludes that the proposed purchaser does not meet the purchaser requirements, it will adopt a decision that the proposed purchaser is not a purchaser under the commitments [4]. If the Commission concludes that the sale and purchase agreement (or any ancillary agreements) does not foresee a divestiture in line with the commitments, the Commission will communicate this to the parties without necessarily rejecting the purchaser as such. If the Commission concludes that the purchaser is suitable under the commitments and that the contracts agree a divestiture in line with the commitments, the Commission will approve the divestiture to the proposed purchaser [5]. The Commission will issue the necessary approvals as expeditiously as possible.

3. **Obligations of the parties in the interim period**

107. Parties have to fulfil certain obligations in the interim period (as defined above in paragraph 36). The following should normally be included in the commitments in this respect: (i) safeguards for the interim preservation of the viability to the business; (ii) the necessary steps for a carve-out process, if relevant; and (iii) the necessary steps to prepare the divestiture of the business.

(1) See judgment of the CFI in Case T-342/00 *Petrolessence v Commission* [2003] ECR II-1161.

(2) Case IV/M.1383 — Exxon/Mobil of 29 September 1999 and the follow-up Cases COMP/M.1820 — BP/JV Dissolution of 2 February 2000 and COMP/M.1822 — Mobil/JV Dissolution of 2 February 2000.

(3) As discussed above, the parties may apply to the Commission to approve the divestiture of the business to the proposed purchaser without one or more assets or parts of the personnel if this does not affect the viability and competitiveness of the Divestment Business after the sale, taking account of the resources of the proposed purchaser.

(4) COMP/M.1628 — TotalFina/Elf of 9 February 2000, motorway service stations; confirmed by judgment of the CFI in Case T-342/00 *Petrolessence v Commission* [2003] ECR II-1161.

(5) Depending on the circumstances of the divestiture, the parties may also have to ensure, for example through appropriate provisions in the purchase agreement, that the purchaser will maintain the divested business as a competitive force in the market and will not sell on the business within a short time-span.

Interim preservation of the divested business

108. It is the parties' responsibility to reduce to the minimum any possible risk of loss of competitive potential of the business to be divested resulting from the uncertainties inherent in the transfer of a business. Up to the transfer of the business to the purchaser, the Commission will require the parties to offer commitments to maintain the independence, economic viability, marketability and competitiveness of the business. Only such commitments will allow the Commission to conclude with the requisite degree of certainty that the divestiture of the business will be implemented in the way as proposed by the parties in the commitments.

109. Generally, these commitments should be designed to keep the business separate from the business retained by the parties, and to ensure that it is managed as a distinct and saleable business in its best interest, with a view to ensuring its continued economic viability, marketability and competitiveness and its independence from the businesses retained by the parties.

110. The parties will be required to ensure that all assets of the business are maintained, pursuant to good business practice and in the ordinary course of business, and that no acts which might have a significant adverse impact on the business are carried out. This relates in particular to the maintenance of fixed assets, know-how or commercial information of a confidential or proprietary nature, the customer base and the technical and commercial competence of the employees. Furthermore, the parties must maintain the business in the same conditions as before the concentration, in particular provide sufficient resources, such as capital or a line of credit, on the basis and continuation of existing business plans, the same administrative and management functions, or other factors relevant for maintaining competition in the specific sector. The commitments also have to foresee that the parties should take all reasonable steps, including appropriate incentive schemes, to encourage all key personnel to remain with the business, and that the parties may not solicit or move any personnel to their remaining businesses.

111. The parties should further hold the business separate from its retained business and ensure that the key personnel of the business to be divested do not have any involvement into the retained businesses and *vice versa*. If the business to be divested is in corporate form and a strict separation of the corporate structure appears necessary, the parties' rights as shareholders, in particular the voting rights, should be exercised by the monitoring trustee which should also have the power to replace the board members appointed on behalf of the parties. In relation to information, the parties must ring-fence the business to be divested and take all necessary measures to ensure that the parties do not obtain any business secrets or other confidential information. Any documents or information confidential to the business obtained by the parties before adoption of the decision have to be returned to the business or destroyed.

112. The parties are further generally required to appoint a hold-separate manager with the necessary expertise, who will be responsible for the management of the business and the implementation of the hold-separate and ring-fencing obligations. The hold-separate manager should act under the supervision of the monitoring trustee who may issue instructions to the hold-separate manager. The commitments have to provide that the appointment should take place immediately after the adoption of the decision and even before the parties may close the notified concentration. Whereas the parties can appoint the hold-separate manager on their own, the commitments have to foresee that the monitoring trustee is able to remove the hold-separate manager if s/he does not act in line with the commitments or endangers their timely and proper implementation. A new appointment of a hold-separate manager afterwards will be subject to the approval of the monitoring trustee.

Steps for a carve-out

113. As outlined above in paragraph 35, the Commission may accept in appropriate circumstances that the divestiture of a business which needs to be carved out from the remaining businesses of the parties can be considered a suitable remedy. Nevertheless, also in such circumstances only the transfer of a viable business to a purchaser which can maintain and develop this business as an active competitive force in the market will remove the Commission's competition concerns. Therefore, the parties have

to commit to a result-oriented obligation to carry out, in the interim period, a carve-out of the assets that contribute to the divested business. The result has to be that a viable and competitive business, which is stand-alone and separate from the other businesses of the parties, can be transferred to a suitable purchaser at the end of the interim period. The parties will have to bear the costs and risks of such a carve-out in the interim period.

114. The carve-out will need to be carried out by the parties under the supervision of the trustee and in cooperation with the hold-separate manager. First, those assets and parts of the personnel which are shared between the business to be divested and remaining businesses of the parties have to be allocated to the business to the extent that this is not excluded in the commitments [1]. The allocation of the assets and the personnel will be monitored and has to be approved by the monitoring trustee. Second, the carve-out process may also require a replication for the business of assets held or functions performed by other parts of the parties' businesses if this is necessary to ensure the viability and competitiveness of the business to be divested. An example is the termination of the business' participation in a central information technology network and an installation of a separate IT system for the business. In general, the major steps of such a carve-out process and the functions to be replicated should be decided on a case-by-case basis and described in the commitments.

115. At the same time, it has to be ensured that the viability of the business to be divested is not affected by such measures. In the interim period, the parties therefore have to maintain the use of shared assets by and to continue to provide services to the business to the same extent as in the past as long as the business is not yet viable on a stand-alone basis.

Specific obligations of the parties concerning the divestiture process

116. For the divestiture process, the commitments should foresee that potential purchasers can carry out a due diligence exercise and obtain, dependent on the stage of the procedure, sufficient information concerning the divested business to allow the purchaser to fully asses the value, scope and commercial potential of the business, and have direct access to its personnel. The parties further have to submit periodic reports on potential purchasers and developments in the negotiations. The divestiture will only be implemented once the transaction is closed, that is the legal title has passed to the approved purchaser, and the assets have been actually transferred. At the end of the process, the parties will have to send a final report, confirming the closing and the transfer of the assets.

4. **The monitoring and the divestiture trustee**

Role of the monitoring trustee

117. As the Commission cannot, on a daily basis, be directly involved in overseeing the implementation of the commitments, the parties have to propose the appointment of a trustee to oversee the parties' compliance with the commitments, in particular with their obligations in the interim period and the divestiture process (the so-called 'monitoring trustee'). Thereby, the parties guarantee the effectiveness of the commitments submitted by them and allow the Commission to ensure that the modification of the notified concentration, as proposed by the parties, will be carried out with the requisite degree of certainty.

118. The monitoring trustee will carry out its tasks under the supervision of the Commission and is to be considered the Commission's 'eyes and ears'. It shall be the guardian that the business is managed and kept properly on a stand-alone basis in the interim period. The Commission may therefore give any orders and instructions to the monitoring trustee in order to ensure compliance with the commitments, and the trustee may propose to the parties any measures it considers necessary for carrying out its tasks. The parties, however, may not issue any instructions to the trustee without approval by the Commission.

[1] See paragraph 26 above for the question how shared assets have to be dealt with in commitments.

119. The Commitments will generally set out the tasks of the monitoring trustee. Its duties and obligations will be specified in detail in the trustee mandate, to be concluded between the parties and the trustee, and its tasks shall be further detailed in a work-plan. The tasks of the monitoring trustee will normally start immediately after the adoption of the Commission decision and last until the legal and actual transfer of the business to the approved purchaser. Five main, non-exhaustive tasks can be distinguished which the monitoring trustee should carry out under the supervision of the Commission:

— first, the monitoring trustee will be called upon to oversee the safeguards for the business to be divested in the interim period,

— second, in carve-out cases, the monitoring trustee has to monitor the splitting of assets and the allocation of the personnel between the divested business and retained businesses by the parties as well as the replication of assets and functions in the business previously provided by the parties,

— third, the monitoring trustee shall be responsible for overseeing the parties' efforts to find a potential purchaser and to transfer the business. In general, it shall review the progress of the divestiture process and the potential purchasers included in the process. It shall verify that potential purchasers receive sufficient information relating to the business — in particular by reviewing the information memorandum (if available), the data room or the due diligence process. Once a purchaser is proposed, the monitoring trustee shall submit to the Commission a reasoned opinion as to whether the proposed purchaser fulfils the purchaser requirements in the commitments and whether the business is sold in a manner consistent with the commitments. At the end of the process, the monitoring trustee has to oversee the legal and actual transfer of the business to the purchaser and make a final report, confirming the transfer,

— fourth, the monitoring trustee shall act as a contact point for any requests by third parties, in particular potential purchasers, in relation to the commitments. The parties shall inform interested third parties of the identity and the tasks of the monitoring trustee, including any potential purchasers. In case of disagreement between the parties and third parties in relation to matters dealt with by the commitments, the monitoring trustee shall discuss those matters with both sides and report to the Commission. In order to be able to carry out its role, the monitoring trustee will keep confidential any business secrets of the parties and third parties,

— fifth, the monitoring trustee shall report on these issues to the Commission in periodic compliance reports and shall also submit additional reports upon request by the Commission.

120. The commitments will also comprehensively set out the monitoring trustee's needs for support by and cooperation with the parties; the Commission will supervise the relationship between the parties and the trustee also in this respect. In order to fulfil its tasks, the trustee shall have access to books and records of the parties and of the divested business, insofar and as long as this is relevant for the implementation of the commitments, may ask for managerial and administrative support by the parties, shall be informed of potential purchasers and all developments in the divestiture process, and shall be provided with the information submitted to potential purchasers. In addition, the parties shall indemnify the trustee and allow the trustee to appoint advisors, if appropriate for the fulfilment of its tasks under the commitments. The commitments will also enable the Commission to share the parties' information with the monitoring trustee in order to allow the monitoring trustee to fulfil its tasks. The monitoring trustee will be bound to keep this information confidential.

Role of the divestiture trustee

121. As for the monitoring trustee, the parties have to propose to appoint a divestiture trustee in order to make the commitments submitted by them effective and allow the Commission to ensure that the modification of the notified concentration, as proposed by them, will be carried out. If the parties do not succeed in finding a suitable purchaser within the first divestiture period, then in the trustee divestiture period, the divestiture trustee will be given an irrevocable and exclusive mandate to dispose of the business, under the supervision of the Commission, within a specific deadline at no minimum price to a suitable purchaser. The commitments shall allow the divestiture trustee to include in the sale and purchase agreement such terms and conditions as it considers appropriate for an expedient sale, in particular customary representations, warranties and indemnities. The sale of the business by the divestiture trustee is in the same way subject to the prior approval of the Commission as the sale by the parties.

122. The commitments will set out that the parties shall support and inform the divestiture trustee and cooperate with the trustee in the same way as this is foreseen for the monitoring trustee. For the divestiture, the parties have to grant to the divestiture trustee comprehensive powers of attorney, covering all stages of the divestiture.

Approval of the trustee and the trustee mandate

123. Depending on the commitment, the monitoring trustee may or may not be the same person or institution as the divestiture trustee. The parties shall propose one or several potential trustees to the Commission, including the full terms of the mandate and an outline of a work-plan. It is of the essence that the monitoring trustee is in place immediately after the Commission decision. Therefore, the parties should propose a suitable trustee immediately after the Commission decision ([1]) and the commitments normally have to foresee that the notified concentration can only be implemented once the monitoring trustee is appointed, after being approved by the Commission ([2]). The situation is different for the divestiture trustee who should be appointed well ahead of the end of the first divestiture period ([3]) so that its mandate can take effect with the beginning of the trustee divestiture period.

124. Both types of trustees will be appointed by the parties on the basis of a trustee mandate, entered into by the parties and the trustee. The appointment and the mandate will be subject to the approval by the Commission which will have discretion in the selection of the trustee and will assess whether the proposed candidate is suitable for the tasks in the specific case. The trustee shall be independent of the parties, possess the necessary qualifications to carry out its mandate and shall not be, or become, exposed to a conflict of interests.

125. The Commission will assess the necessary qualifications in the light of the requirements of the specific case, including the geographic area and the sector concerned. According to the Commission's experience, auditing firms and other consulting firms may be particularly well placed to fulfil the tasks of a monitoring trustee. Individuals who have worked in the specific industry may also be suitable candidates for performing such a role if they have the necessary resources available to deal with the tasks at stake. Investment banks seem to be particularly suitable for the role of a divestiture trustee. The independence of the trustee is crucial in order to enable the trustee to properly fulfil its role of monitoring the parties' compliance for the Commission and to ensure its credibility *vis-à-vis* third parties. In particular, the Commission will not accept persons or institutions as trustees which are at the same time the parties' auditors or their investment advisors in the divestiture. However, no conflicts of interests will arise by relations of the trustee with the parties if those relations will not impair the Trustee's objectivity and independence in discharging its tasks. It is the parties' responsibility to supply the Commission with adequate information for it to verify that the trustee fulfils the requirements. The appointment of the trustee after approval by the parties is irrevocable unless the trustee is replaced with the approval of or upon request by the Commission.

126. The trustee mandate shall define the tasks as specified in the commitments further and shall include all provisions necessary to enable the trustee to fulfil its tasks under the commitments accepted by the Commission. The parties are responsible for remuneration of the trustee under the mandate, and the remuneration structure must be such as to not impede the trustee's independence and effectiveness in fulfilling the mandate. The Commission will approve a trustee only together with a suitable mandate. In appropriate cases, it may publish the identity of the trustee and a summary of its tasks.

127. When the specific commitments with which the trustee has been entrusted have been implemented — that is to say, when legal title for the business to be divested has passed, the assets have been actually transferred to the purchaser and specific arrangements which may continue post-divestiture have been fulfilled — the mandate will provide for the trustee to request the Commission for a discharge from further responsibilities. Even after the discharge has been given, it may be necessary for the Commission to require the reappointment of the trustee on the basis of the commitments, if it appears subsequently to the Commission that the relevant commitments might not have been fully and properly implemented.

([1]) Normally, the commitments should foresee that a monitoring trustee is proposed within two weeks of the date of the decision.

([2]) See Case COMP/M.4180 — GdF/Suez of 14 November 2006; Case COMP/M.4187 — Metso/Aker Kvaerner of 12 December 2006; Case COMP/M.3916 — T-Mobile/tele.ring of 20 April 2006.

([3]) The Commission will normally require an appointment at least one month ahead of the end of the first divestiture period.

5. **Obligations of the parties following implementation of the divestiture**

128. The Commitments also have to foresee that for a period of 10 years after the adoption of the decision accepting the commitments the Commission may request information from the parties. This will allow the Commission to monitor the effective implementation of the remedy.

6. **Implementation of other commitments**

129. Many of the principles discussed above for the implementation of divestiture commitments can equally be applied to other types of commitments if those commitments need to be implemented subsequent to the Commission decision. For example, if it is foreseen that the beneficiary of a licence needs to be approved by the Commission, the considerations regarding the purchaser approval can be applied. Given the wide range of non-divestiture commitments, no general and comprehensive requirements for the implementation of non-divestiture commitments can be set out.

130. However, given the long duration of non-divestiture commitments and their frequent complexity, they often require a very high monitoring effort and specific monitoring tools in order to allow the Commission to conclude that they will effectively be implemented. Therefore, the Commission will often require the involvement of a trustee to oversee the implementation of such commitments and the establishment of a fast-track arbitration procedure in order to provide for a dispute resolution mechanism and to render the commitments enforceable by the market participants themselves. In past cases, the Commission has often required both the appointment of a trustee and an arbitration clause [1]. In those circumstances, the trustee will oversee the implementation of the commitments, but will also be able to assist in arbitral proceedings to the effect that they may be finalised in a short period of time.

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[1] Such an approach of combined monitoring by arbitration and a monitoring trustee was, e.g. used in Case COMP/M.2803 — Telia/Sonera of 10 July 2002; Case COMP/M.3083 — GE/Instrumentarium of 2 September 2003; and Case COMP/M.3225 — Alcan/Pechiney II of 29 September 2003.

Merger Guidelines

November 2008*

*November 2017 – amended to include Harper reforms to the *Competition and Consumer Act 2010*

Important notice

This publication has been updated to refer to the *Competition and Consumer Act 2010* which replaces the *Trade Practices Act 1974* on 1 January 2011 and to reflect the 2017 amendments to the *Competition and Consumer Act 2010*.

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Foreword

The Australian Competition and Consumer Commission's (ACCC's) approach to merger assessment has evolved significantly since the ACCC last published analytical guidelines in the area of mergers in 1999. The changes in the ACCC's approach have been developed in line with international best practice, contemporary views on anti-trust analysis and the ACCC's experience since 1999. These revised guidelines have benefited from valuable input from the business and trade practices advisory community on an earlier draft, which was released for consultation in February 2008.

These revised guidelines outline the general principles underpinning the ACCC's merger analysis under s. 50 of the *Competition and Consumer Act 2010* (the Act), formerly the *Trade Practices Act 1974*. It is important to note that the approach taken in the revised guidelines is not radically different from the approach contained in the 1999 guidelines — the competition test is the same and analysis of the market and merger factors remains a vital element in merger assessment.

However, the approach to merger assessment has been developed with an increased emphasis on the competitive theories of harm and the effect of constraints, which facilitates a more integrated analysis. The changes to the guidelines do not represent a new approach by the ACCC but are rather a better reflection of the approach being undertaken by the ACCC to merger reviews.

The ACCC will continue to assess each merger on its merits according to the specific nature of the transaction, the industry and the particular competitive impact likely to result in each case. The general principles set out in these guidelines provide a framework within which mergers will be reviewed. Importantly, the application of those principles to different facts and situations may give rise to different results.

It is not possible for these guidelines to cover every issue or circumstance that may arise in a merger review. In practice, individual mergers involve a great variety of facts and situations, and the analysis of particular issues may need to be tailored to the specific circumstances of a merger or deal with competition issues not specifically considered in these guidelines. Therefore the ACCC proposes to apply the revised guidelines flexibly.

The ACCC's case-by-case approach to merger analysis is reflected in both the public competition assessments issued for mergers considered to be of major public interest and in the shorter summaries of reasons for merger decisions, which are available on the ACCC website for all public merger reviews. These guidelines, supplemented with the growing body of public competition assessments and reasons for decisions, should provide an enhanced level of predictability and certainty to merger parties, their advisers, the business community and the public.

1. Introduction

1.1. Mergers and acquisitions are important for the efficient functioning of the economy. They allow firms to achieve efficiencies, such as economies of scale or scope, and diversify risk across a range of activities. They also provide a mechanism to replace the managers of underperforming firms.

1.2. In the vast majority of mergers, sufficient competitive tension remains after the merger to ensure that consumers and suppliers are no worse off. Indeed, in many cases consumers or suppliers benefit from mergers. In some cases, however, mergers have anti-competitive effects. By altering the structure of markets and the incentives for firms to behave in a competitive manner, some mergers can result in significant consumer detriment.

Section 50 of the Act

1.3. Section 50 of the Act prohibits mergers that would have the effect, or be likely to have the effect, of substantially lessening competition in a market.

1.4. Section 50(3) requires the following non-exhaustive list of matters (or 'merger factors') to be taken into account when assessing whether a merger would be likely to substantially lessen competition:

(a) the actual and potential level of import competition in the market

(b) the height of barriers to entry to the market

(c) the level of concentration in the market

(d) the degree of countervailing power in the market

(e) the likelihood that the acquisition would result in the acquirer being able to significantly and sustainably increase prices or profit margins

(f) the extent to which substitutes are available in the market or are likely to be available in the market

(g) the dynamic characteristics of the market, including growth, innovation and product differentiation

(h) the likelihood that the acquisition would result in the removal from the market of a vigorous and effective competitor

(i) the nature and extent of vertical integration in the market.

1.5. These matters or 'merger factors' illuminate the policy intent underlying s. 50.[1] In particular, they highlight key potential constraints on a merged firm (for example, new entry and imports) and identify market characteristics that could potentially affect the impact of a merger on competition (for example, growth in demand, innovation or the level of vertical integration). Other factors not listed in s. 50 may also be relevant to a merger assessment.

Types of s. 50 merger assessments

1.6. Merger parties have two avenues available to have a merger considered and assessed:[2]

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[1] Australia, House of Representatives 1992, *Debates*, vol. HR186, p. 2406.

[2] A reference to a 'merger' in these guidelines includes a proposed merger, unless the context otherwise specifies.

- the ACCC assesses the merger on an informal basis applying a substantial lessening of competition test or
- applicants apply to the ACCC for merger authorisation for a proposed acquisition which will be assessed under test outlined in paragraph 1.10.

1.7. As merger parties are not legally required to notify the ACCC of a merger, they also have the option of proceeding with the merger without seeking any regulatory consideration.[3] However, this will not prevent the ACCC from subsequently investigating the merger, including making public inquiries to assist its investigation and, if necessary, taking legal action. Proceeding without regulatory approval may put merger parties at risk of the ACCC or other interested parties taking legal action on the basis that the merger would have the effect, or be likely to have the effect, of substantially lessening competition in one or more substantial markets in contravention of s. 50.

Informal review

1.8. The informal review process enables merger parties to seek the ACCC's view on whether it will seek an injunction under s. 50 to stop a merger from proceeding. Information on the procedural aspects of informal clearances can be found in the ACCC's *Informal Merger Review Process Guidelines*.

1.9. If the ACCC forms the view that a merger proposal is likely to contravene s. 50, the merger parties may decide:

- not to proceed with the merger
- to provide a court enforceable undertaking to address ACCC concerns
- to apply to the ACCC for merger authorisation, or
- to proceed and defend court action under s. 50.

If the merger parties seek to proceed with the proposal, the ACCC can apply to the Federal Court of Australia for an injunction to prevent the merger from proceeding, as well as divestiture or penalties.[4]

Merger authorisation

1.10. Merger parties may also seek legal protection from court action under s. 50 by applying to the ACCC for merger authorisation. Pursuant to s. 90(7), the ACCC can grant merger authorisation if it is satisfied that either:

- the proposed acquisition would not be likely to substantially lessen competition or
- the likely public benefit from the proposed acquisition outweighs the likely public detriment.

1.11. Information on the procedural and analytical aspects of applications for merger authorisation are set out in the *Merger Authorisation Guidelines*.

[3] Parties may also seek a declaration from the Federal Court that the acquisition will not contravene s. 50.

[4] Other parties (such as customers, competitors or other interested parties) may also apply to the Federal Court for a declaration (that the acquisition will not contravene s. 50) and/or divestiture, and any person suffering loss or damage as a result of a merger that breaches s. 50 can apply for damages.

Types of mergers

1.12. As outlined in appendix 2, s. 50 applies to a wide variety of mergers and acquisitions. A ‘merger’ involves the shareholders of two companies becoming the shareholders of a new merged company. An ‘acquisition’ occurs when one company acquires a shareholding in, or the assets of, another company. Generally, when assessing its impact on competition, little turns on whether a transaction is, strictly speaking, a ‘merger’ or an ‘acquisition’. For convenience, these guidelines refer to ‘mergers’ and ‘merger parties’.

1.13. These guidelines discuss three types of merger — in each, the merger may involve firms that are either actual or potential competitors:

- horizontal mergers — involving actual or potential suppliers of substitutable goods or services
- vertical mergers — involving firms operating or potentially operating at different functional levels of the same vertical supply chain
- conglomerate mergers — involving firms that interact or potentially interact across several separate markets and supply goods or services that are in some way related to each other, for example, products that are complementary in either demand or supply.

1.14. Each type of merger has the potential to affect competition in a different way and will therefore be analysed differently. While some competition issues and theories of competitive harm are presented separately in these guidelines, the ACCC will adopt an approach tailored to the particular nature of the merger.

Acquisition markets

1.15. These guidelines focus on potential competition concerns in supply markets into which the merged firm supplies goods and services. However, there could also be competition concerns in acquisition markets in which the merged firm acquires goods and services. In particular, the merged firm may be able to depress the price paid for the inputs below their competitive price by restricting its purchase of those inputs. The ACCC will apply an approach to acquisition markets that is analogous to that set out in these guidelines for supply markets.

Purpose of these guidelines

1.16. These guidelines provide an outline of the broad analytical framework applied by the ACCC when assessing whether a merger is likely to substantially lessen competition under s. 50. These guidelines have been developed by the ACCC in relation to its functions under s. 50.

1.17. These guidelines are designed to provide reliable, comprehensive and detailed information that merger parties, the business community, their advisers and the public can draw on to:

- assess the likely level of scrutiny a merger will receive from the ACCC — in particular, guidance is provided on when merger parties should notify the ACCC of a merger (the threshold for notification is outlined in chapter 2)
- increase understanding of the application of s. 50
- assist in structuring (or restructuring) mergers to avoid raising competition concerns

- identify the types of information that will assist the ACCC to reach a view on how a merger is likely to affect competition — to make informed and timely decisions, the ACCC relies on the cooperation of the merger parties, customers, competitors, suppliers and any other persons or bodies holding relevant information
- identify the ACCC's broad approach to remedying possible anti-competitive mergers through undertakings (see appendix 3).

1.18. These guidelines do not have any legal force in determining whether a merger is likely to contravene the Act — final determination of the issues is a matter for the courts.

1.19. It is not possible for these guidelines to cover every issue or circumstance that may arise in a merger review. In practice, individual mergers involve a great variety of facts and situations, and the analysis of particular issues may need to be tailored to the specific circumstances of a merger or deal with competition issues not specifically considered in these guidelines. Therefore the ACCC will apply these guidelines flexibly and may adapt the framework to specific issues where appropriate.

1.20. These guidelines are supplemented by public competition assessments published by the ACCC. These competition assessments outline how the principles contained in the guidelines have been applied to specific mergers.

1.21. These guidelines replace the 1999 *Merger Guidelines*. They reflect the ACCC's analytical approach at the time of publication and may be revised periodically, as necessary, on the basis of new legal precedent, evolving insight and best practice. The latest version of the guidelines will be the version published on the ACCC website. In developing these guidelines, the ACCC has considered guidelines issued by overseas competition authorities and the work done by the International Competition Network.

Contact with the ACCC

1.22. Any inquiries about the ACCC's administration and analysis of merger reviews should be directed to:

Executive General Manager
Merger and Authorisation Review Division
Australian Competition and Consumer Commission
GPO Box 3131
Canberra ACT 2601

Email: mergers@accc.gov.au
Tel: (02) 6243 1368
Fax: (02) 6243 1212

2. Notification threshold

2.1. While there is no compulsory pre-notification requirement for mergers in Australia, it is recommended that certain mergers that may be subject to the Act (see appendix 2) be voluntarily notified to the ACCC for review, well in advance of completion.

2.2. To assist merger parties and their advisers to determine whether they should notify the ACCC, the ACCC has developed a notification threshold, outlined below. This threshold has been established by the ACCC to filter and thereby limit the merger reviews it conducts to those mergers which, in its view, may potentially raise competition concerns. The notification threshold is set at a level that reflects the ACCC's experience in determining which mergers are more likely to raise competition concerns and therefore require further investigation.[5]

2.3. If merger parties believe their merger proposal will meet the notification threshold, they are encouraged to approach the ACCC on a confidential and informal basis as soon as there is a real likelihood that the merger may proceed to discuss possible competition issues and options for having the matter considered.

2.4. Merger parties are also encouraged to approach the ACCC where the ACCC has indicated to a firm or industry that notification of mergers by that firm or in that industry would be advisable.

2.5. Parties may choose to seek informal review or merger authorisation from the ACCC. The informal review process provides flexibility in terms of timeframes, information requirements and confidentiality, while the merger authorisation process has mandated timeframes and transparency requirements.

2.6. If mergers that raise competition concerns are not notified to the ACCC in adequate time for it to conduct a review, the ACCC may seek to use its formal information-gathering powers and/or injunctive relief, to enable it to properly consider such mergers to ensure no anti-competitive harm arises.

2.7. Mergers that fall outside the notification threshold will rarely require investigation by the ACCC. However, the notification threshold is indicative only. It is intended to provide a starting point for identifying those mergers that may raise competition concerns and therefore require investigation in accordance with these guidelines. Importantly, the notification threshold should not be confused with the concentration threshold (set out in chapter 7) which the ACCC has regard to as part of an overall assessment of whether a merger is likely to substantially lessen competition under s. 50.

2.8. As market shares are an imprecise indicator of likely competition effects, a merger that does not meet the notification threshold may still raise competition concerns. The ACCC may therefore investigate such mergers, even if they have not been notified to it.

2.9. For simplicity, the notification threshold is based on market shares. The calculation of market shares depends critically on market definition. If there is uncertainty as to the relevant market, it is preferable that market shares be calculated on the basis of the market definition most likely to raise competition concerns. This will usually mean

[5] The ACCC determined the level of the notification threshold based on an analysis of all previous merger reviews where the ACCC released a statement of issues. A statement of issues is released by the ACCC where, after an initial assessment, it believes the merger requires further detailed assessment. The notification threshold is based on the market shares of the merged firm in matters that proceeded to this stage.

adopting a conservative rather than broad definition of the market, unless doing so would reduce or eliminate the overlap between the merger parties.

Notification threshold

Merger parties are encouraged to notify the ACCC well in advance of completing a merger where both of the following apply:

- the products of the merger parties are either substitutes or complements
- the merged firm will have a post-merger market share of greater than 20 per cent in the relevant market/s.

3. The competition test

3.1. Competition is a state of ongoing rivalry between firms — rivalry in terms of price, service, technology and quality. Market participants are mutually constrained in their pricing, output and related commercial decisions to some extent by the activity of other market participants (or potential market participants). In other words, the greater the degree of competition in a market, the less market power each market participant will possess.

3.2. Mergers can alter the level of competition in a market. Some mergers enable the merged firm to meet customer demand in a way that facilitates more intense competition. Many mergers do not affect the level of competition at all because there are sufficient substitution possibilities to effectively constrain the merged firm.

3.3. Other mergers, however, lessen competition by reducing or weakening the competitive constraints or reducing the incentives for competitive rivalry.[6] Mergers that increase the market power of one or more market participants may be detrimental to consumers because they may lead to an increase in price, or deterioration in some other aspect of the service offering (see the text box below) — the level of market power will be dependent on whether alternative actual or potential supply options are available post-merger to effectively constrain the merged firm. If market structure and circumstances mean that there is limited potential for alternative supply options or substitution possibilities to constrain the merged firm, then it will be profitable for the merged firm to raise prices despite the potential for lost sales to alternative suppliers.

3.4. Further, mergers that increase market power may decrease economic efficiency (because transactions at the margin are deterred) thereby reducing gains from trade and total welfare.

Market power and increases in price

The most obvious and direct manifestation of an increase in market power is the ability of one or more firms to profitably raise prices post-merger for a sustained period. Market power can, however, be exercised in other ways. For example, a firm with market power may:

- lower the quality of its products without a compensating reduction in price
- reduce the range or variety of its products
- lower customer service standards, and/or
- change any other parameter relevant to how it competes in the market.

While the exact nature of competitive detriment caused by a merged firm's increased market power will vary depending on the particular circumstances of the matter, the ACCC often characterises an increase in market power as the ability to raise prices. References to 'raising prices' in these guidelines should therefore be read as implicitly incorporating the exercise of market power in other non-price ways.

[6] For convenience the guidelines refer to any increase in market power as accruing to sellers in a relevant market. A merger can also lead to a substantial lessening of competition among buyers in a market. In such a situation, the increased market power of a buyer may enable it to profitably reduce prices or otherwise engage in behaviour that is detrimental to suppliers.

Substantial lessening of competition

3.5. Not all mergers that lessen competition are prohibited by s. 50 of the Act; only those that lessen competition **substantially** are prohibited.[7] The term 'substantial' has been variously interpreted as meaning real or of substance,[8] not merely discernible but material in a relative sense[9] and meaningful.[10] The precise threshold between a lessening of competition and a substantial lessening of competition is a matter of judgement and will always depend on the particular facts of the merger under investigation. Generally, the ACCC takes the view that a lessening of competition is substantial if it confers an increase in market power on the merged firm that is significant and sustainable. For example, a merger will substantially lessen competition if it results in the merged firm being able to significantly and sustainably increase prices.

3.6. The level at which an increase in market power is likely to become significant and sustainable will vary from merger to merger. For example, an increase in price that is very small in magnitude might also be significant. The ACCC considers that firms would generally be deterred from instituting a price increase, or only be able to institute it for a transitory period, where effective competitive constraints exist or where constraints are likely to become effective within a period of one to two years.

3.7. In some markets, particular characteristics, such as the prevalence of certain types of long-term contracts between buyers and sellers, may prevent a merged firm from exercising any market power it gains through the merger until some point in the future — for example, at contract renewal. If the exercise of market power is likely to be delayed in this way, the ACCC will focus on the period commencing at the point where market power would be exercised (for example, at contract negotiations).

3.8. As outlined in chapter 4, a substantial lessening of competition must arise in a market to contravene s. 50. However, this does not imply that a lessening of competition must apply to the entire market or to all aspects of competition in the relevant market.[11]

Competitive constraints and the 'merger factors'

3.9. In assessing whether a merger is likely to result in a significant and sustainable increase in market power, the ACCC must consider each of the 'merger factors' set out in s. 50(3) as well as any other relevant factors (see paragraph 1.4). These merger factors provide insight as to the likely competitive pressure the merged firm will face following the merger and the possible competitive effects of the merger. The assessment of the competitive effects is based on the theories of competitive harm — namely, unilateral and coordinated effects. Mergers result in unilateral and/or coordinated effects when they weaken or remove the competitive pressure on firms in a market. In cases where unilateral and/or coordinated effects amount to a significant and sustainable increase in the market power of the merged firm and/or other firms in a market, the merger is likely to substantially lessen competition in contravention of the Act.

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[7] Under s. 4G, a lessening of competition includes, but is not limited to, preventing or hindering competition. Mergers likely to have the effect of substantially preventing or hindering competition are therefore also prohibited by s. 50.

[8] Trade Practices Legislation Amendment Bill 1992, explanatory memorandum, paragraph 12.

[9] Australia, Senate 1992, Debates, vol. S157, p. 4776.

[10] *Rural Press Limited v Australian Competition and Consumer Commission* [2003] HCA 75 at 41.

[11] *Dandy Power Equipment Pty Ltd v Mercury Marine Pty Ltd* (1982) ATPR 40–315 at 43,888.

3.10. The merger factors cover a broad range of possible actual and potential competitive constraints[12] faced by the merged firm — some assist in identifying the presence of direct constraints[13] while others provide insight into less direct forms of constraint relating to either the structure and characteristics of the market[14] or the behaviour of actual and potential participants in a market.[15]

3.11. The ACCC recognises that competitive constraints are not static and strategic behaviour by market participants can affect competition. The significance of the merger factors, and the weight that is placed on them, will depend on the actual matter under investigation.

3.12. The likely presence of effective competitive constraints post-merger is a key indicator that a merger is unlikely to result in a substantial lessening of competition. While all the merger factors must be taken into consideration, it may not be necessary for all factors to indicate that the merged firm would face effective competitive constraints. In some cases a single effective constraint can be sufficient to prevent a significant and sustained increase in the market power of the merged firm, while in other cases the collective effect of several constraints may be required. Conversely, the absence of a single particular constraint is unlikely to be indicative of an increase in market power as a result of a merger.

3.13. Unilateral and coordinated effects are discussed in chapters 5 and 6 of these guidelines, while chapter 7 sets out in more detail the relevance of each merger factor in deciding whether a merger is likely to result in a substantial lessening of competition in a market.

The forward-looking nature of the competition test

3.14. Section 50 requires a forward-looking analysis into the effects or likely effects of a merger, since analysis is generally conducted before the impact of a merger on competition can be observed. The ACCC therefore focuses on the foreseeable future (generally within one to two years) when considering market definition and each of the merger factors to determine whether a substantial lessening of competition is likely to occur. This raises a number of issues.

Likely effect

3.15. Mergers are prohibited under s. 50 if they would have the effect, or be **likely** to have the effect, of substantially lessening competition. Clearly a substantial lessening of competition must be more than speculation or a mere possibility for it to be likely, but it does not need to be a certainty. Importantly, a substantial lessening of competition need not be 'more probable than not', for the merger to contravene s. 50. Mergers are prohibited when there is a 'real chance' that a substantial lessening of competition will occur. However, a 'mere possibility' would be insufficient.[16] Ultimately, the determination of whether a substantial lessening of competition is likely will depend on the facts of the particular matter.

[12] In these guidelines, the term 'competitive constraints' refers to both actual and potential competitive constraints.

[13] For example, the level of actual and potential imports, the height of barriers to entry, the degree of countervailing power and the availability of substitutes.

[14] For example, the dynamic characteristics of the market, the level of concentration in the market, and the nature and extent of vertical integration.

[15] For example, the likelihood that the acquirer would be able to significantly and sustainably increase prices or profit margins, whether the acquisition will result in the removal of a vigorous and effective competitor and other relevant factors.

[16] *Australian Gas Light Company (ACN 052 167 405) v Australian Competition and Consumer Commission (No 3)* [2003] FCA 1525, at [348].

With and without test

3.16. Merger analysis requires comparing likely future states — the future **with** the merger and the future **without** the merger. This comparison isolates the merger's impact on competition. For this reason, the competition test in s. 50 is sometimes referred to as a future 'with and without' test.[17]

3.17. The likely future state of competition without the merger (the counterfactual) will generally be similar to the state of competition prevailing at the time of the merger. However, in some cases taking the state of competition prevailing at the time of the merger as the benchmark for analysis could risk attributing a change in the level of competition to a merger, when the real cause is some other development that is unrelated to the merger and likely to occur regardless of the merger. Focusing on the state of competition prevailing at the time of the merger might also disguise a substantial lessening of competition in situations where a merger hinders or prevents competition that would otherwise have emerged.

3.18. The ACCC therefore uses information about the state of competition prevailing at the time of the merger to inform its assessment of the likely future state of competition without the merger. This applies to market definition and all the merger factors outlined in chapter 7. It also applies to likely developments involving the merger parties — in particular, mergers involving firms that are likely to be more effective competitors in the future and those involving failing firms.

3.19. However, the ACCC will not take into account counterfactuals it considers have been manipulated for the purposes of making clearance more likely. Signs that a counterfactual may have been manipulated include:

- a change of policy or intention by the merger parties that occurs after the merger is proposed
- any course of action by the merger parties which cannot be demonstrated to be profit maximising and/or in the interests of shareholders (for example, refusing to sell the business to a strong competitor if the proposed merger does not proceed).

Expected competition

3.20. The state of competition prevailing at the time of a merger will **understate** the future state of competition without the merger in situations where the merger parties are not presently constraining one another but would be likely to constrain one another in the foreseeable future. For example, the target firm may be on the verge of entering the relevant market or may already operate in the relevant market but be likely within the next one to two years to benefit from new technology or intellectual property that would enhance its competitiveness with the acquiring firm. Alternatively, if it can be established with strong and credible evidence that, in the absence of the merger, a particular alternative firm would acquire the target, the relevant counterfactual may involve a competitive outcome that differs from the status quo. The ACCC notes that such circumstances are likely to be rare.

3.21. As specified in s. 4G of the Act, a lessening of competition includes preventing or hindering competition. Mergers likely to eliminate the prospect of more aggressive competition in the future may therefore result in a substantial lessening of competition.

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[17] See, for example, *Australian Gas Light Company (ACN 052 167 405) v Australian Competition and Consumer Commission (No 3)* [2003] FCA 1525, at [352].

The following are examples of the types of information the ACCC may require to assess whether the merger parties are likely to be effective competitors in the relevant market in the future:

- board papers and internal plans demonstrating that the target firm has the capability and intention to vigorously compete in the future
- evidence of vigorous entry in the past that may be replicated on a broader scale
- evidence of similar successful entry in other markets either in Australia or overseas.

The range and extent of information and documents required by the ACCC will be assessed on a case-by-case basis and will depend on the complexity of the matter and the potential competition concerns raised.

Failing firms

3.22. The state of competition prevailing at the time of a merger will overstate the future state of competition without the merger in situations where one of the merger parties is likely to exit the market in the foreseeable future (generally within one to two years). In such situations, the merger party that is likely to exit is referred to as a 'failing firm'. Although the likely state of competition with the merger may be substantially less than the state of competition prevailing at the time of the merger, the relevant test is whether the future state of competition with the merger would be substantially less than the future state of competition without the merger (where the firm fails).

3.23. Mere speculation that the target firm will exit in the near future or evidence of a recent decline in profitability is insufficient to establish that an absence of competition between the merger parties is the counterfactual. In general, to demonstrate that a merger will not substantially lessen competition due to the prospective failure of one of the merger parties, it is necessary to show that:

- the relevant firm is in imminent danger of failure and is unlikely to be successfully restructured without the merger
- in the absence of the merger, the assets associated with the relevant firm, including its brands, will leave the industry
- the likely state of competition with the merger would not be substantially less than the likely state of competition after the target has exited and the target's customers have moved their business to alternative sources of supply.

4. Market definition

4.1. Section 50 of the Act requires that a substantial lessening of competition occur in a substantial market for goods and services in Australia, or a state, territory or region of Australia.[18] Accordingly, in assessing whether a merger substantially lessens competition, the ACCC will examine the competitive impact of the transaction in the context of the markets relevant to the merger.

4.2. Market definition establishes the relevant 'field of inquiry' for merger analysis, identifying those sellers and buyers that may potentially constrain the commercial decisions of the merger parties and the merged firm, and those participants, particularly customers, that may be affected if the merger lessens competition.

4.3. While market definition is a useful tool for merger analysis, by itself it cannot determine or establish a merger's impact on competition. Accordingly, market definition should not obscure factors relevant to competition that fall outside the relevant markets. Similarly, there is no presumption that other firms within a relevant market necessarily provide an effective competitive constraint on the merged firm. Other factors also relevant to merger analysis are outlined in chapters 5, 6 and 7.

4.4. It is rarely possible to draw a clear line around fields of rivalry. Indeed, it is often possible to determine a merger's likely impact on competition without precisely defining the boundaries of the relevant market. For example, if the consolidation of the merger parties' activities is unlikely to substantially lessen competition in a narrow product and geographic area, then it is also unlikely to do so in a more broadly defined product and geographic area and, therefore, a conclusive view on the relevant market may not be necessary. Similarly, when a merger is likely to substantially lessen competition in any number of potential markets, it may be unnecessary to define the precise market boundaries.

4.5. This chapter explains the concept of a market and the ACCC's approach to identifying and defining the scope of markets that are relevant to assessing a merger under s. 50 of the Act.

The concept of a market

4.6. A market is the product and geographic space in which rivalry and competition take place.

4.7. Section 4E of the Act provides that a market includes goods or services that are substitutable for, or otherwise competitive with, the goods or services under analysis. Accordingly, substitution is key to market definition.

4.8. The ACCC focuses on two key dimensions of substitution in characterising markets: the product dimension[19] and the geographic dimension. In some cases, market definition requires close attention to the functional levels of the supply chain that are relevant to a merger or the particular timeframe over which substitution possibilities should be assessed. Generally, however, these functional and temporal considerations form part of the product and geographic dimension analysis. Consistent with the forward-looking nature of merger analysis, the ACCC focuses on the foreseeable future when considering the likely product and geographic dimensions of a market.

[18] Section 50(6).

[19] The term 'product' encompasses both goods and service for the purpose of discussion in these guidelines.

4.9. Market definition is purposive, which means that the definition of a relevant market cannot be separated from the particular merger under investigation. Market definition always depends on the specific facts and circumstances of a merger, and current evidence from market participants will often be critical. Decisions relating to market definition in previous, albeit similar, merger inquiries will provide only limited guidance.

The ACCC approach to defining a market

4.10. The ACCC's starting point for delineating relevant markets to assess a merger under s. 50 of the Act is identifying the products and geographic regions actually or potentially supplied by the merger parties.[20] The ACCC then focuses on defining markets in areas of activity where competitive harm could occur. This must be assessed on a case-by-case basis. Generally, the ACCC focuses on overlaps between the products or geographic regions supplied by the merger parties, or some other meaningful economic relationship — such as an actual or potential vertical relationship or where the products supplied by the merger parties are complementary in nature. It is not uncommon for more than one market to be identified in any particular merger review.

4.11. The ACCC then considers what other products and geographic regions, if any, constitute relevant close substitutes in defining the market.[21] Importantly, the ACCC defines markets by reference to products and regions not by reference to the firms actually supplying those products or regions at the time of the merger.

Substitution

4.12. As outlined above, identifying relevant substitutes is key to defining a market. Substitution involves switching from one product to another in response to a change in the relative price, service or quality of two products (holding unchanged all other relevant factors, such as income, advertising or prices of third products). Market definition begins by selecting a product supplied by one or both of the merger parties in a particular geographic area and incrementally broadening the market to include the next closest substitute until all close substitutes for the initial product are included.

4.13. There are two types of substitution: demand-side substitution, which involves customer-switching; and supply-side substitution, which involves supplier-switching.

Demand-side substitution

4.14. Whether or not a product or region is a close substitute for a product supplied by one or more of the merger parties, depends on likely switching behaviour in response to an increase in the price, or decrease in the service or quality of that product. The likelihood that a product (or group of products) will be a **demand-side** substitute for a product of one of the merger parties will be assessed according to:

- the characteristics or functions of the product (the **product** dimension of a market). Comparable product characteristics and functionality will often be indicative but are not sufficient to determine whether products are demand-side substitutes. Demand-side substitution depends on the willingness of customers to switch from one product to another in response to a price increase

[20] There need not be trade in a product for a separate market to exist — the potential for exchange can be sufficient. See, for example, *Queensland Wire Industries Pty. Ltd v The Broken Hill Proprietary Company Limited & Anor* [1989] HCA 6; (1989) 167 CLR 177 F.C. 89/004; ATPR 40–925, Deane J at p. 50,013 (ATPR).

[21] Note: there are some circumstances where the approach to market definition does not depend solely on the analysis of substitution possibilities. Some of these circumstances are discussed in paragraphs 4.41 to 4.44.

- the availability of the product for purchase, and use, at the present location of the merger party's customers, or within a wider geographic area (the **geographic** dimension of a market). Demand-side substitution depends on the willingness of customers to switch from a product supplied in one location to the same product supplied in another location in response to a price increase.

4.15. It will often be possible on the demand-side, in some degree, to substitute a wide variety of products in various geographic regions for the products of the merger parties. Not all of these substitutes will be included in the relevant market. For instance, some customers might view seemingly remote products as substitutes under some circumstances. This simply illustrates that an economy is essentially 'a network of substitution possibilities'.[22]

4.16. On the other hand, substitution does not have to be complete or instantaneous, and products do not have to be 'perfect' substitutes to form part of the same market. To be included in the relevant market, the ACCC's view is that a product in a particular geographic region (or a group of products or regions) must be a close substitute in demand.

4.17. A product in a particular geographic region (or a group of products or regions) is a close demand-side substitute if a significant proportion of sales would be likely to switch in response to a small but significant increase in the price of the merger party's product, quickly and without significant switching costs. In cases where only a small proportion of sales is likely to switch, the ACCC's view is that the alternative product or geographic region (or group of alternative products or regions) is not part of the relevant market.

4.18. Qualitative and quantitative information may be requested from the merger parties and market participants to examine substitution possibilities. The ACCC draws on the conceptual framework provided by the hypothetical monopolist test (HMT) to define the relevant markets, particularly in relation to demand-side substitution.

The hypothetical monopolist test

4.19. The HMT determines the smallest area in product and geographic space within which a hypothetical current and future profit-maximising monopolist could effectively exercise market power. In general, the exercise of market power by the hypothetical monopolist is characterised by the imposition of a small but significant and non-transitory increase in price (SSNIP) above the price level that would prevail without the merger, assuming the terms of sale of all other products are held constant.

4.20. The process of applying the HMT starts with one of the products and geographic areas supplied by one or both of the merger parties. If a hypothetical monopolist supplier of this product cannot profitably institute a SSNIP because of customers switching to alternative products, the next closest demand substitute is added. If a hypothetical monopolist supplier of this extended group of products cannot profitably institute such a price increase because of customers switching to alternative products, the next best substitute is added. The collection of products is expanded until a hypothetical monopoly supplier of all those products could profitably institute a SSNIP.

4.21. A SSNIP in the context of the HMT usually consists of a price rise for the foreseeable future of at least 5 per cent above the price level that would prevail without the merger.

[22] *Re Tooth & Co. Ltd* (1978) ATPR 40-065, in *Re Tooheys Ltd* (1979), ATPR 40–113, at pp. 18,196–18,197.

4.22. While the HMT is a useful tool for analysis, it is rarely strictly applied to factual circumstances in a merger review because of its onerous data requirement. Consequently, the ACCC will generally take a qualitative approach to market definition, using the HMT as an 'intellectual aid to focus the exercise'.[23]

Supply-side substitution

4.23. In defining the product and geographic dimensions of the market the ACCC will also consider supply-side substitutes. A product (or group of products) may be a **supply-side** substitute for a product of one of the merger parties if in response to an increase in the price of the product:

- the production facilities and marketing efforts used for that product can be switched quickly and without significant investment to supply a demand-side substitute for the product of the merger party (the product dimension of the market)
- the distribution network used by the product can be modified quickly and without significant investment to supply the merger party's customers at their present location or within a distance they would likely travel (the geographic dimension of a market)
- it would be profitable for the current suppliers of the product to make these changes — that is, the profits earned on the assets in their current use would be less than if they were switched to supply a demand-side substitute for the product of the merger party.

4.24. The ACCC will treat one product as a supply-side substitute for another in cases where all (or virtually all) of the capacity for producing that product could profitably be switched to supply an effective substitute to the other product quickly and without significant investment in response to a price increase.

4.25. For some products, only a proportion of total supply capacity could feasibly be switched quickly and at minimal cost (for example, because firms producing this product use different technologies). In these cases, the capacity that could be switched will be considered as potential new entry when conducting the competition analysis rather than included in the market definition.

4.26. While a distinction is made between supply-side substitution and new entry for market definition purposes, the relevant consideration in establishing a substantial lessening of competition is the degree of competitive constraint imposed on the merged firm by either firms in the market or new entrants.

Useful information in identifying demand-side and supply-side substitutes

4.27. The ACCC relies on information from the merger parties and third parties to identify and assess the strength of substitution possibilities.

Identifying products that may be close substitutes

The following are examples of the types of information the ACCC may require to identify close substitutes of the relevant product:

- the function or end use of the product
- physical and technical characteristics of the product

[23] *Seven Network Limited v News Limited* [2007] FCA 1062, at [1786].

- costs of switching purchases between the product and potential substitutes
- views and past behaviour of buyers regarding the likelihood of substitution between products
- evidence of buyers switching to other products in response to price increases in the recent past
- evidence of producers redeploying their production capacity in response to price increases in the recent past
- costs of switching production and distribution systems from another product line to a product that is closely substitutable with the relevant product
- views, business records and past behaviour of suppliers of the relevant products regarding the impact of price and marketing decisions by suppliers of potential substitute products on their own pricing and marketing decisions
- relative price levels and price movements of the product compared to potential substitutes.

In an informal merger review, providing a base level of information to the ACCC will, in non-controversial cases, usually be sufficient to satisfy the ACCC of whether or not a substantial lessening of competition is likely. Whether a wider range of information will be required by the ACCC will be assessed on a case-by-case basis and will depend on the complexity of the matter and the potential competition concerns raised.

Identifying geographic regions that may be close substitutes

The following are examples of the types of information the ACCC may require to identify close substitutes of the relevant geographic region:

- the portability of the relevant product as determined by its perishability, weight, etc.
- transportation costs to move the relevant product between regions (particularly the transportation costs as a proportion of total value of the product)
- the costs to customers of obtaining supply from alternative regions
- any limitations on the ability of customers to access alternative sources of supply in alternative regions
- the costs of extending or switching production and distribution systems to supply the customers in alternative regions
- any regulatory or other practical constraints on suppliers selling to alternative regions
- records relating to trade flows and the actual movement of customers and/or suppliers between geographic regions, especially related to changes in relative prices across regions in the recent past
- views and business records of buyers and suppliers regarding the likelihood of switching between geographic sources of supply
- the relative price levels and price movements of different geographic sources of supply.

In an informal merger review, providing a base level of information will, in non-controversial cases, usually be sufficient to satisfy the ACCC of whether or not a substantial lessening of competition is likely. Whether a wider range of information will be required by the ACCC will be assessed on a case-by-case basis and will depend on the complexity of the matter and the potential competition concerns raised.

Substantial market in Australia, a state, territory or region of Australia

4.28. Section 50(6) of the Act states that 'market' means a substantial market in Australia, or in a state, a territory or a region of Australia.

4.29. The ACCC's view is that the substantiality criteria could be satisfied in many ways including by reference to the size of the market in terms of number of customers, total sales or geographic size. A market that is 'small' in some sense may still be substantial.

4.30. In particular, substantiality of a market is not necessarily related to geographic size. A market may be small geographically (for example, a local market) but may also be substantial within the region in which it is located. Alternatively, a market for the supply of a product that is an essential but small ingredient in the production of one or more other products sold in large markets may be considered substantial.

4.31. Section 50(6) also states that 'market' means a market for goods or services in Australia, or in a state, a territory or region of Australia. In addition, s. 4E specifies that 'market' is a market in Australia. The ACCC's view is that this does not preclude it from analysing a merger proposal in the context of a geographically broader market — for example, a trans-Tasman market or even a global market — provided that at least some part of it is located in Australia.[24] In most cases the ACCC will define the relevant market to be Australia or a part of Australia, and take full account of any competitive constraint provided by suppliers located outside Australia when considering import competition (as required by the merger factors — see paragraphs 7.33 to 7.37).

Issues that may arise in market definition

Asymmetric substitution

4.32. Substitution possibilities are not necessarily symmetric. Asymmetric demand-side substitution occurs when substitution between two products only occurs in one direction. For example, buyers of luxury cars may substitute to more 'standard' cars in response to an increase in the price of luxury cars, but the opposite may not be the case. Asymmetric supply-side substitution may occur when one group of suppliers has the same production facilities as another group of suppliers, but also has additional facilities for supplying a slightly different good or service. For example, suppliers of scheduled travel services might be able to redeploy their facilities to provide charter travel services, but suppliers of charter travel services might face significant investment or obstacles to supply scheduled travel services (such as building terminal facilities).

Product differentiation

4.33. Market definition establishes the boundaries for competitive analysis but within those boundaries the degree of substitution can vary. Indeed it is extremely rare for a uniform level of substitution to exist across all products, services or regions within a relevant market. For example, products that serve similar functions may be differentiated rather than homogenous. Product differentiation often limits substitution at the margins because certain customers do not view differentiated products as comparable. For example, brand loyalty may limit the extent of both demand- and

[24] See, for example, *Riverstone Computer Services Pty Limited v IBM Global Financing Australia Limited* [2002] FCA 1608, at [21].

supply-side substitution. However, it is important to note that differentiated products may still be part of the same market.

4.34. The extent to which product differentiation affects the constraint provided by actual or potential competitors in the market is taken into account when assessing the competitive effects of a merger (often by reference to different 'segments' of the market). While a substantial lessening of competition must arise in a market to contravene s. 50, this does not imply that the lessening of competition must apply to the entire market or to all aspects of competition in the relevant market.[25]

Discrimination and captive customers

4.35. In certain cases where substitution possibilities are not uniform across consumer groups, it may be appropriate to define separate markets for different consumer groups. For example, some consumers may view two products to be highly substitutable while other consumers may consider the products to be, at best, weak substitutes. In such situations, the relative number and importance of each customer class and the ability of suppliers (including the merger parties) to discriminate between the customer classes will be important when determining the appropriate product and/or geographic dimension of the market.

4.36. The ability of suppliers to discriminate between customer classes will depend on their ability to:

- distinguish between those customers that have the option of substitution and those who lack that option
- prevent resale or arbitrage between the customer classes.

4.37. If suppliers can discriminate, a customer that has limited substitution possibilities receives different terms and conditions from suppliers to a customer that has strong substitution possibilities. In this situation it may be appropriate to consider two separate markets for merger analysis. One market would include the relevant product and the alternative product, and would focus on those consumers who have the option of substitution. The second market would not include the alternative product and would focus on those consumers who are 'captive' or do not have the option of substitution.

4.38. If suppliers are unable to discriminate between customer classes, they will provide similar, if not identical, prices and levels of service to each customer, regardless of their substitution possibilities. In this situation, there are unlikely to be multiple markets based on different customer classes. Customers that are unable to substitute to the alternative product would be protected to the extent that suppliers cannot distinguish them from customers that are able to switch.

Indirect substitution

4.39. In some limited circumstances, a relevant market may include products that are only indirect substitutes for a product of one of the merger parties (that is, a substitute for a substitute of the relevant product). Indirect substitution occurs when there is a 'chain' of products in the product dimension or a 'chain' of regions in the geographic dimension. There are at least three significant limitations on the extent to which an indirect substitute can provide an alternative to the product or region under investigation and thereby be included in the relevant market:

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[25] *Dandy Power Equipment Pty Ltd v Mercury Marine Pty Ltd* (1982) ATPR 40–315, at 43,888.

- chains of substitution often have a break such that products on one side of the break are not close substitutes for those on the other side of the break (for example, breaks caused by obstacles to travel)
- as a chain of substitution expands, the proportion of customers that can switch to neighbouring links in the chain (marginal customers) will tend to decrease and at some point a hypothetical monopolist controlling the chain would find a SSNIP profitable regardless of those switching customers
- where price discrimination is possible, a market may be limited to the captive customers at the centre of a chain or circle of substitution.

4.40. While analysis depends on the particular circumstances under examination, in general, the further removed from the product or region under investigation, the less likely it is that an indirect substitute will be included in the relevant market. The ACCC draws on whatever quantitative and qualitative information is available to determine the boundary of a market where chains of substitution exist.

Integration and aggregation[26]

4.41. The purposive nature of market definition can require the product or geographic dimension of a market to be extended beyond what can be substituted for products of the merger parties to include other **functional** levels in the vertical supply chain or other products that are typically purchased or supplied together with those of the merger parties.

4.42. Where merger parties are vertically integrated or compete against vertically integrated firms, the ACCC must determine whether competition analysis is best conducted in the context of one relevant market encompassing the whole vertical supply chain or a series of separate markets each comprising one or more stages of the chain. This delineation depends on the economics of integration. Importantly, there need not be trade between the relevant stages of the vertical supply chain for there to be separate markets — the potential for exchange can be sufficient.[27] However, where there are overwhelming efficiencies of vertical integration between two or more stages in the vertical supply chain, the ACCC will define one market encompassing all those stages.

4.43. To define the relevant markets where vertical integration exists, the ACCC considers, among other things:

- the actual patterns of exchange between firms at different vertical levels
- the split between internal transfers of each relevant product and third party transactions
- the costs involved in trading the product between firms at different vertical levels
- any obstacles to trade between firms at different vertical levels
- any assets or specialisation required to supply each product within the vertical chain.

4.44. In some cases, a product that the merger parties supply is part of a package of several distinct products that are generally purchased or supplied together. Such

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[26] This includes considerations that have hitherto been categorised as the ‘functional dimension’ of the market. In practice, issues relating to integration and aggregation tend to inform the appropriate product and geographic characterisation of the market.

[27] *Queensland Wire Industries Pty Ltd v The Broken Hill Proprietary Company Limited & Anor* [1989] HCA 6; (1989) 167 CLR 177 F.C 89/004; ATPR 40-925, Deane J at p. 50,013(ATPR).

products may belong to several separate disaggregated markets and/or one aggregated market consisting of a suite of goods and services generally supplied together (sometimes referred to as a ‘cluster market’). To define the relevant markets in these cases, the ACCC considers, among other things:

- the split between products purchased or supplied separately, and products purchased or supplied together
- the costs involved in purchasing or supplying the product separately
- any obstacles to purchasing or supplying the product separately
- any assets or specialisation required to supply each product.

5. Unilateral effects

5.1. One of the main ways in which mergers can lessen competition is through unilateral effects. Mergers have unilateral effects when they remove or weaken competitive constraints in such a way that the merged firm's unilateral market power is increased. That is, as a result of the merger the merged firm finds it profitable to raise prices, reduce output or otherwise exercise market power it has gained, and can do so, even given the expected response of other market participants to the resulting change in market conditions.[28]

5.2. Where unilateral effects occur, other market participants' responses may vary. In some situations other market participants may respond in a pro-competitive way and (at least partially) attempt to offset the merged firm's behaviour. Alternatively, it may be more profitable for other market participants to simply support the merged firm's conduct — for example, if a merged firm exercises unilateral market power by raising the price of its products, other firms supplying substitutes may respond by also raising their prices, thereby exacerbating the competitive impact of the unilateral exercise of market power. As this example illustrates, a unilateral exercise of market power may make it profitable for both the merged firm and its competitors to raise prices.

5.3. In determining whether unilateral effects arise and whether they are likely to result in a substantial lessening of competition, the ACCC considers all of the merger factors contained in s. 50(3) of the Act and any other relevant factors. In particular, it considers whether the broader actual and potential competitive constraints — such as new entrants, imports or countervailing power — will limit any increase in the unilateral market power of each remaining market participant. These factors are discussed in more detail in chapter 7.

5.4. Although horizontal, vertical and conglomerate mergers can all potentially give rise to unilateral effects, it is recognised that vertical and conglomerate mergers are generally less likely than horizontal mergers to raise competition concerns. Since much of the general guidance on horizontal mergers is also relevant to vertical and conglomerate mergers, this section also identifies those competition issues that are specific to non-horizontal mergers that the ACCC will take into account. Mergers that involve both horizontal and non-horizontal effects will be assessed based on the combined horizontal and non-horizontal impact on competition.

Horizontal mergers

5.5. Horizontal mergers involve firms that operate in the same relevant market or markets. Horizontal mergers may give rise to unilateral effects by eliminating the actual or potential competitive constraint that the merger parties exerted on each other pre-merger. Two competing firms may constrain each other, including via the (actual or potential) transfer of sales from one to the other as customers switch, or threaten to switch, between them. If these two firms merge, the merger 'internalises' any such transfers within the merged firm, thereby removing this constraining effect. Where there are limited effective constraints from other sources, this unilateral effect can amount to a substantial lessening of competition.

5.6. Unilateral effects may arise in different ways depending on the characteristics of the market — some, but not all are outlined below. The most obvious way is when no

[28] This may be contrasted to coordinated effects arising from a merger where it may be profitable for the merged firm to raise prices, reduce output or otherwise exercise market power because it considers that the responses of its rivals will be directly influenced by its own actions. This may manifest as either tacit or explicit collusion (see chapter 6).

rivals[29] remain post-merger (i.e. merger to monopoly). In the absence of effective competitive constraints from other sources, such as future entrants, imports or countervailing power, a merger that leaves no rivals to the merged firm will likely result in unilateral effects amounting to a substantial lessening of competition.

5.7. Unilateral effects may also arise where a merger results in markets characterised by a single firm with market power and numerous other smaller competitors that can supply only a small portion of the total market demand because of factors limiting their ability to significantly expand output. In these circumstances, consideration will be given to whether the merged firm would have the ability and incentive to raise prices for the segment of the market that the smaller competitors are unable to supply — taking into account, amongst other factors, the ability and incentives of these smaller competitors to expand capacity.

5.8. In markets involving homogeneous products with no dominant firm, competition analysis will focus on the strategic interaction between rivals competing on output or capacity. Unilateral effects may arise where the merged firm sets its post-merger output level significantly below the level of output that would have prevailed absent the merger and, despite the response of competitors, brings about a higher price than would have prevailed absent the merger.

5.9. In contrast, in markets where competition between firms selling differentiated products is based on price, unilateral effects may arise where a merger between firms previously supplying close substitutes is able to increase the price of either or both of the close substitutes. In this case, consideration will be given to the proportion of substitution that would occur.

5.10. Outlined below are some of the relevant factors that the ACCC will take into account, in addition to those specified in s. 50(3) of the Act, to determine whether unilateral effects are likely to arise from a merger.

Significance of the merger parties to the competitive process

5.11. While some firms may be relatively small in terms of size and market share, they may nevertheless have a significant influence on the competitiveness of the market. Mergers involving such firms may result in unilateral effects by impeding or removing significant aspects of competition, such as innovation or product development.

Closeness of merger parties

5.12. The ACCC will take into consideration the extent of competitive constraint that the merger parties exert on each other pre-merger. Merger parties are more likely to be close competitors — and therefore provide each other with an effective constraint that may be lost post-merger — if they differ from rivals in respect of characteristics such as:

- product features and function
- customer loyalty
- production capacity
- breadth of product line and level of specialisation
- distribution channel coverage
- geographic presence

[29] In these guidelines, the term 'rival' includes both actual and potential rivals, unless the context otherwise specifies.

- cost structures
- level of vertical integration.

5.13. The degree of rivalry between the merger parties pre-merger can be an important factor in the analysis of mergers in differentiated product markets. Mergers between firms supplying competing differentiated products may result in unilateral effects when the merger parties are considered close competitors by a sufficient number of customers, which thereby alters the incentives of the merger parties. Merger parties are likely to have an incentive to increase the price of one or both products if the sales lost due to the price increase would be recaptured by an increase in sales of the other product. That is, the greater the number of customers that regard the merger parties as particularly close competitors (for example, their first and second choices), the greater the potential for the merger parties to impose a unilateral increase in price post-merger. Unilateral effects may arise even where the merger parties are not one another's 'closest' competitor pre-merger or would not be the dominant firm post-merger based on market shares.

5.14. Competitors supplying the relevant market with products that are less likely to be substituted for, or repositioned to compete with, the merger parties' products may only be able to offer a competitive alternative to marginal customers; the loss of such marginal customers would not prevent the merged firm's actions being profitable. Such competitors may also decide to simply follow the merged firm's price increase to profit from the less competitive environment.

Rivals' responses

5.15. Unilateral effects are unlikely if rivals have the incentive and ability to respond to a price increase by the merged firm such that they are able to capture sales and replace competition lost by the merger.

5.16. In some cases, rivals in differentiated product markets that are less direct competitors at the time of a merger may potentially overcome differences between themselves and the merged firm to become closer competitors. This may occur where rivals have the ability and incentive to reposition or extend their product range relatively easily and without significant cost in response to the merged firm increasing its prices. If the competition lost through the merger would likely be replaced by other rivals in the market or new entrants within a one- to two-year period, a merger is less likely to result in an increase in unilateral market power.

5.17. In non-differentiated product markets, other factors that may influence the abilities and incentives of rivals to constrain the merged firm from unilaterally increasing prices post-merger include whether:

- rival firms have sufficient capacity or are able to profitably expand capacity
- the merged firm is able to hinder entry or expansion by rivals through various means (for example, by controlling inputs, distribution channels and patents/other IP and access to, or pricing of, different platforms)
- the relevant products are sold under terms and conditions likely to limit or curtail the ability of rivals to compete effectively for the customers of the merged firm post-merger
- customers are constrained in their ability to switch to rival suppliers of the merged firm post-merger.

Non-horizontal mergers

5.18. Non-horizontal mergers include vertical mergers and conglomerate mergers.

5.19. Vertical mergers involve combining firms that operate at different stages of a single vertical supply chain — that is, a merger between an 'upstream' firm and a 'downstream' firm (for example, an upstream manufacturer and a downstream distributor) where the upstream firm is an actual or potential supplier of an input into the production process of the downstream firm. It is often the case that vertical mergers will promote efficiency by combining complementary assets/services which may benefit consumers.

5.20. Conglomerate mergers involve firms that interact across several separate markets and supply products that are typically in some way related to each other — for example, products that are in neighbouring markets or products that are complementary in either demand or supply, such as staples and staplers.[30] Often, conglomerate mergers will allow firms to achieve efficiencies and result in better integration, increased convenience and reduced transaction costs.

5.21. In the majority of cases, non-horizontal mergers will raise no competition concerns. However, where insufficient competitive constraints remain in the relevant market post-merger, some non-horizontal mergers will raise competition concerns when the merged firm is able to increase its unilateral market power. One way in which this can occur is through the merged firm 'foreclosing' rivals, but non-horizontal mergers can also increase unilateral market power in other ways. In some cases, a non-horizontal transaction, either alone or in conjunction with a horizontal transaction, may amount to a substantial lessening of competition in a market.

Foreclosure

5.22. Recognising that not all forms of foreclosure are anti-competitive, the ACCC is only concerned with non-horizontal mergers where the merged firm has the ability and incentive to use its position in one market to anti-competitively foreclose rivals in another market in a way that lessens competition.

5.23. In determining whether foreclosure is likely to increase the unilateral market power of the merged firm, the ACCC will consider the following three issues:

- the merged firm's ability to foreclose
- any incentive the merged firm may have to foreclose
- the likely effect of any such foreclosure.

Vertical mergers

5.24. The particular anti-competitive foreclosure strategies that a vertically integrated merged firm might adopt will depend on the circumstances of each case, but some examples include:

- charging a higher price for an important input into the production processes of downstream (non-integrated) rivals

[30] Conglomerate mergers may also arise in markets that are unrelated or independent of one another.

- limiting,[31] or denying access by, downstream (non-integrated) rivals to important inputs (thereby forcing them, for example, to use more expensive or inferior quality alternatives)
- limiting, or denying access by, upstream (non-integrated) rivals to a sufficient customer base
- raising the cost of access by upstream (non-integrated) rivals to a sufficient customer base.

Conglomerate mergers

5.25. Conglomerate mergers provide a merged firm with the opportunity to bundle or tie products in related or independent markets. The practice of bundling or tying product offerings is common and is undertaken by firms for a variety reasons, often with no anti-competitive consequences under s. 50.[32]

5.26. However, in some cases conglomerate mergers can raise competition concerns where they enable the merged firm to alter its operations or product offerings in a way that forecloses the merged firm's rivals and ultimately reduces the competitive constraint they provide. For example, the merged firm's rivals may be foreclosed if the merged firm chooses to bundle or tie complementary products, such that:

- no product can be purchased or used separately
- at least one product cannot be purchased or used separately, or
- customers receive additional benefits when they purchase or use the merged firm's products together (for example, due to discounts, rebates or design features).

5.27. The adoption of such strategies can limit or raise the cost of rival firms' access to a sufficient customer base and in some circumstances deny rival firms access to customers altogether.

Ability to foreclose

5.28. An integrated or conglomerate firm will generally only be able to engage in foreclosure if it has sufficient market power at one or more functional levels within the vertical supply chain, or in one or more of the related markets post-acquisition.

5.29. The ACCC will determine whether an integrated or conglomerate firm has market power in the relevant markets by assessing whether there are effective competitive constraints, such as those discussed in chapter 7.

Vertical mergers

5.30. An integrated merged firm would only be able to engage in foreclosure strategies against rival downstream firms if it had sufficient market power in the upstream market — that is, where its downstream rivals faced insufficient viable supply alternatives. This might occur for a variety of reasons including capacity constraints faced by rival upstream suppliers, barriers to entry or product differentiation between the products and/or services offered by the integrated firm and its rivals.

[31] Limiting access may involve reducing the quality of the good or service supplied.

[32] Tying or bundling may however raise competition concerns under other provisions of the Act.

5.31. Similarly, an integrated merged firm would only be able to engage in foreclosure strategies against rival upstream firms if it had sufficient market power in the downstream market — that is, where its upstream rivals lacked sufficient actual or potential economic alternatives in the downstream market to sell their output. The ability of upstream rivals to sell their output is especially likely to be prevented or impeded where the downstream division of the merged firm is an important customer in that market and where there are significant economies of scale or scope in the input market.

Conglomerate mergers

5.32. In the context of conglomerate mergers, market power may arise where products are considered by customers to be especially important or a 'must have' because of factors such as superior functionality (product differentiation) or brand loyalty. Where the merged firm supplies customers that on-sell its products to end customers, the market power of the merged firm may be reflected in its ability to influence the product-stocking decisions of its customers. This will depend on the specifics of the industry, but can include supplier involvement in category management and the supply of in-store distribution assets to retailers on condition of certain stocking requirements.

Incentive to foreclose

5.33. While possession of market power by the merged firm in one or more of the relevant markets is a necessary consideration, it is not determinative in itself. Even if a vertically integrated or conglomerate firm has the ability, it may not have the economic incentive to foreclose rivals. A firm is unlikely to exercise its ability to foreclose unless it is profitable to do so, which will depend on the nature of competition in each of the relevant markets and the particular means available to the firm to foreclose rivals.[33]

5.34. An integrated or conglomerate firm will only have an incentive to engage in foreclosure strategies with rivals if the benefit it receives from doing so outweighs potential lost sales resulting from the foreclosure. In assessing whether the merged firm has the incentive to engage in foreclosure, the ACCC will weigh likely short-term costs against likely gains and the relative size and importance of each market to the merged firm.

5.35. For example, in vertical mergers foreclosing independent downstream rivals may simply close off a good source of upstream revenue without providing any significant boost to the integrated merged firm's own downstream sales or other benefits. Similarly, an integrated firm will only have an incentive to limit the downstream sales of its non-integrated upstream rivals if it receives sufficient benefits to offset any increased costs or decreased custom associated with the foreclosure.

5.36. In conglomerate mergers, the merged firm may be able to take advantage of economies of scale in a market by increasing sales in that market and, where there is commonality in operations (such as in manufacturing, distribution and/or marketing), may also be able to gain economies in a related market.

5.37. In assessing the merged firm's likely incentives, the ACCC will take into account a range of quantitative and qualitative information.

[33] For example, a conglomerate firm implementing a tie may involve risking the loss of customers that are not interested in purchasing the bundle, depending on the closeness of the products in question. In addition, the profitability of discounting a bundle may depend on the relative value of the products being united and the value of the markets in which they are supplied.

Likely effect of foreclosure

5.38. The ability and incentive of the merged firm to foreclose rivals may not of itself increase the merged firm's unilateral market power to the extent that there is a substantial lessening of competition. Consideration must also be given to the effect of foreclosure on competition in the relevant market/s.

5.39. Foreclosure need not result in rivals being forced to exit the market to have a detrimental effect on competition. Actual rivals may simply be forced to use more expensive alternatives to those offered by the merged firm or may be discouraged from expanding their operations. Potential rivals may be discouraged from entering the market. Foreclosure lessens competition when the merged firm — and, in some cases, certain of its rivals — finds it profitable to increase the price charged to intermediate and end consumers or decrease the price paid to upstream suppliers below competitive levels.

5.40. In determining whether a merger is likely to result in a substantial lessening of competition, the ACCC considers all the merger factors contained in s. 50(3) of the Act and other relevant factors. In particular, the following factors inform the ACCC's assessment as to whether the merged firm's unilateral market power is likely to increase to the extent that there is a substantial lessening of competition:

- the proportion and significance of the firms that are foreclosed as a result of the merger
- the proportion and significance of other firms still able to provide a constraint over the merged firm
- the potential for the merger to raise barriers to entry by foreclosure or the threat of foreclosure to rivals in related markets.

5.41. Two further factors that may be relevant in the context of vertical mergers are:

- the significance of the input to the production process of downstream rivals
- the presence of countervailing power, particularly the ability of firms to integrate to avoid foreclosure.

5.42. An additional factor that may be relevant in the context of conglomerate mergers is the proportion of customers likely to purchase the relevant products from the merged firm. This must be sufficiently large to cause independent rivals to face a significant decline in sales, resulting in increased costs. The level of competitive constraint imposed by rivals may be detrimentally affected where economies of scale or network effects[34] are important features of the relevant markets, since foreclosure may prevent the merged firm's rivals from achieving minimum efficient scale.

5.43. However, where a significant proportion of customers continue to purchase products from independent rivals, a conglomerate firm is likely to continue to be constrained post-merger. For example, where rivals are able to replicate the merged firm's offering through assembly of their own competing bundle, and therefore reap similar cost savings and/or retain economies of scale or scope, they may be able to avoid or minimise foreclosure and thereby continue to constrain the merged firm. This may be through organic growth, counter-merger or joint supply arrangements with suppliers of the related product. Depending on the nature of the merged firm's market power, however, it may be difficult or impossible for rivals to replicate the merged firm's

[34] Network effects arise when a product becomes more valuable as the number of customers consuming it increases, thus providing an advantage to firms that have an existing customer base over rivals and prospective entrants that do not.

bundle. If rivals are able to avoid foreclosure by supplying a competitive bundle, a conglomerate merger is unlikely to substantially lessen competition.

Other unilateral effects

5.44. Other unilateral effects that may arise from vertical mergers and conglomerate mergers include raising structural and/or strategic barriers to entry and access to commercially sensitive information.

Barriers to entry

5.45. A vertical merger may raise barriers to entry if, as a result of the merger, new entrants would have to enter at multiple stages of the vertical supply chain instead of just one. In some cases, the increase in unilateral market power accruing to the merged firm as a result of increased barriers to entry constitutes a substantial lessening of competition.

5.46. By creating strategic links between related products, a conglomerate merger may result in formerly separate markets becoming part of one integrated market in which suppliers must offer the full range of complementary products to compete. Future entry may therefore require an offering of the full range of products, potentially increasing the sunk costs associated with entry or exit.

Access to commercially sensitive information

5.47. A vertical merger may also result in unilateral effects if the integrated merged firm would, through its supply of an input or distribution services to firms that are otherwise rivals, obtain competitively sensitive information such as costs or planned product launches. This may distort the dynamics of competition.

6. Coordinated effects

6.1. In addition to unilateral effects, mergers can lessen competition through coordinated effects. Mergers have coordinated effects when they assist firms in the market in implicitly or explicitly coordinating their pricing, output or related commercial decisions. A merger may do so simply by reducing the number of firms among which to coordinate, by removing or weakening competitive constraints or by altering certain market conditions that make coordination more likely. Coordinated effects may occur in addition to unilateral effects so that the merged firm is able to achieve even higher prices than it would on its own. In some cases, coordinated effects, either alone or in conjunction with unilateral effects, may amount to a substantial lessening of competition.

6.2. Horizontal, vertical and conglomerate mergers may give rise to coordinated effects in a number of different ways. Some of these are discussed below, but coordinated effects may also arise in ways that are not discussed here. Competitive constraints and other factors relevant to coordinated effects are discussed in chapter 7. Rather than presenting horizontal, vertical and conglomerate mergers separately, this section discusses the issues that the ACCC considers relevant across all three types of merger.

Coordinated conduct

6.3. Mergers have coordinated effects when they alter the nature of interdependence between rivals such that coordinated conduct is more likely, more complete or more sustainable. Interdependence arises when a market is characterised by a small number of firms (an oligopoly or a duopoly), with each firm anticipating the response of the other firms and devising their commercial strategies accordingly. If the oligopolistic structure of a market persists over time — for instance, because barriers to entry and expansion shield incumbents from new competitors — the repeated nature of the competitive interaction can result in a range of coordinated conduct, from muted competition through to tacit or explicit agreement between firms not to compete. Although firms may have the ability to engage in effective competition, they may not have the incentive if they recognise that any short-term benefits from competing will likely be eroded by lost sales once other firms respond. Coordinated conduct can in some cases involve contravention of other provisions of the Act.

6.4. In some cases, a change in the nature of the interdependence among competitors may lead to an implicit agreement among them to refrain from competing. This behaviour is sometimes referred to as tacit collusion, since it involves active coordination but no explicit agreement between firms. Firms may signal to each other that they will not compete on price, output, customer allocation or indeed any other parameter of competition. Where the products are relatively homogenous, coordinated terms are more likely to be based on price or output in markets, whereas differentiated products may be more conducive to division of a market by customer type or region. In certain circumstances, interdependence may result in explicit collusion between firms, whereby firms explicitly agree to refrain from competing.

Conditions facilitating coordinated conduct

6.5. When assessing whether a merger is likely to give rise to coordinated effects, the ACCC first assesses whether conditions in the relevant market are likely to be conducive to coordinated conduct. Generally, the potential for sustainable coordination is greatest where:

- firms have the ability and incentive to settle on terms[35] that are profitable for all
- firms can detect deviations from the consensus
- the threat of retaliation from other firms involved is sufficiently costly to act as a deterrent to deviation
- the consensus is not undermined by competitive constraints in the market (discussed further in chapter 7).

6.6. It is impossible to be prescriptive about the conditions in which coordinated conduct is likely to arise or the types of mergers that would increase the likelihood of coordinated conduct. However, settling on and maintaining a profitable consensus will often be easier where certain conditions exist post-merger. Some of these conditions are discussed below. The non-existence of one or more of these conditions may not necessarily make coordinated effects less likely and there may be other factors not discussed here which are relevant.

6.7. Importantly, a merger will only result in coordinated effects if it increases the likelihood of coordinated conduct, or it results in more complete or sustainable coordination post-merger. As noted above, a merger may do this by reducing the number of firms among which to coordinate (thereby reducing the likelihood of deviation from the consensus), by removing or weakening competitive constraints or by altering certain market conditions that make coordination more likely.

Observing other firms

6.8. Each firm must be aware of the behaviour of other firms for coordinated conduct to arise. This is easiest when the number of firms in the market is small (that is, concentration is high) and firms can quickly and readily observe other firms' activities and general market conditions. Information may be readily available if, for example, firms actively publish their prices to consumers, firms hold cross-shareholdings in each other, or trade associations collate and publish recent market information. Markets need not be fully transparent for coordinated conduct to arise, but firms must have some mechanism for detecting the behaviour of their competitors.

6.9. In addition, where product innovation or fluctuations in costs or demand are common, it may be difficult for firms to know whether a change in their rivals' pricing arises from such a fluctuation or constitutes a deviation from the settled terms. Market stability therefore facilitates coordination.

Retaliation and incentives

6.10. Coordinated effects are more likely when firms are likely to interact regularly post-merger, either in the relevant market where coordination could occur or in other separate markets, and for a considerable period. The sustainability of coordination rests upon repeated interaction, since the prospect of future retaliation discourages firms from pursuing more competitive strategies.

6.11. Firms in a market will have an incentive to deviate from the consensus unless they fear punishment that would outweigh the potential short-term gains from cheating on the terms of coordination. Punishment may simply involve a return to competitive conditions or, for example, a 'price war'. The incentive to cheat is increased if the imposition of punishment is likely to be significantly delayed (for example, because

[35] In these guidelines, 'settle on terms' and 'consensus' do not necessarily involve communication or active coordination but are intended to reflect muted competition, tacit collusion and explicit collusion.

market transactions are infrequent). The credible threat of effective punishment alone may be sufficient to deter cheating.

6.12. The ability of coordinating firms to punish deviations is often increased where:

- firms have similar cost structures — low-cost firms may not fear retaliation by higher cost firms
- firms compete against each other in more than one market — this provides additional markets in which to punish deviating firms
- some firms have excess capacity, which enables them to increase output and reduce prices in response to a deviation from the terms of coordination.

6.13. Interdependence and coordination may therefore be facilitated by a merger that creates firms with similar market shares, cost structures, production capacities and levels of vertical integration. Where there is firm asymmetry, smaller firms or firms with lower cost structures may have more to gain from competing rather than refraining from competition. In this regard, a vigorous and effective competitor may be instrumental in disrupting interdependence and ensuring effective competition (see paragraph 7.56).

Competitive constraints

6.14. Coordination is unlikely to be sustained if it induces new entry or expansion by firms in the relevant market that are not engaging in coordination. Such competitive constraints are discussed further in chapter 7.

6.15. Generally, assessing whether a merger is likely to give rise to coordinated effects requires a close examination of the conditions prevailing in the relevant market and the likely effect of the merger on these conditions. This generally requires a detailed qualitative assessment of a range of factors (including those noted above), some of which may suggest conflicting conclusions. For example, a merger may decrease the number of firms in a market, while increasing the level of asymmetry between firms (or it might increase the level of symmetry). Given the potential complexity of the assessment required, evidence of prior coordinated conduct between firms in the relevant market may be highly relevant, particularly if the merger is likely to reduce the number of participants without undermining the conditions that facilitate coordinated conduct.

7. Merger factors

7.1. Mergers result in unilateral and/or coordinated effects when they weaken or remove the competitive pressure on firms in a market. Where unilateral and/or coordinated effects amount to a significant and sustainable increase in the market power of the merged firm and/or other firms in a market, the merger is likely to substantially lessen competition in contravention of the Act.

7.2. In assessing whether a merger is likely to result in a significant and sustainable increase in market power, the ACCC must consider each of the merger factors set out in s. 50(3) as well as any other relevant factors (see paragraph 1.4). These merger factors provide insight about the likely competitive constraints that the merged firm will face post-merger. The merger factors cover a broad range of possible competitive constraints faced by the merged firm — some assist in identifying the presence of direct constraints,[36] while others provide insight into less direct forms of constraint relating to either the structure and characteristics of the market[37] or the behaviour of actual and potential participants in the market.[38]

7.3. The ACCC recognises that competitive constraints are not static and strategic behaviour by market participants can affect competition. The significance of the merger factors and the weight placed on them will depend on the actual matter under investigation.

7.4. The likely presence of effective competitive constraints post-merger is a key indicator that a merger is unlikely to result in a substantial lessening of competition. While all the merger factors must be taken into consideration, it may not be necessary for all factors to indicate that the merged firm would face effective competitive constraints. In some cases a single constraint can be sufficient to prevent a significant and sustainable increase in the market power of the merged firm while in other cases the collective effect of several constraints may be required. Conversely, the absence of a single particular constraint is unlikely to be indicative of an increase in market power as a result of the merger.

7.5. The order in which the merger factors and other sources of constraint are considered below reflects the order in which the ACCC generally undertakes its analysis and does not reflect the priority or weight given to any particular factor. Indeed, many of the factors are interrelated and the ACCC adopts an integrated approach, taking into account all potential competitive constraints.

Concentration and market shares[39]

7.6. Market concentration refers to the number and size of participants in the market. It provides a snapshot of market structure as well as an approximation of the size of the merger parties, which can assist when considering the other merger factors. Changes in market concentration over time can also reveal the frequency of new entry and provide insight into the ability of new entrants and smaller competitors to attract custom and expand.

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[36] For example, the level of actual and potential imports, height of barriers to entry, degree of countervailing power and the availability of substitutes.

[37] For example, the dynamic characteristics of the market, level of concentration in the market and nature and extent of vertical integration.

[38] For example, the likelihood that the acquirer would be able to significantly and sustainably increase prices or profit margins, whether the acquisition will result in the removal of a vigorous and effective competitor and other relevant factors.

[39] Refers to the merger factor contained in s. 50(3)(c).

7.7. However, market concentration is not determinative in itself. For example, firms can gain a high market share by adopting more efficient technology, lowering costs and reducing prices. In such cases, high levels of market concentration are not necessarily reflective of a non-competitive market. Measures of concentration in markets characterised by product differentiation may also obscure the closeness of competitors.

7.8. Notwithstanding these limitations, market concentration can help to determine whether a merger is likely to result in unilateral and/or coordinated effects. It is the link between concentration and the strength of competition that is important for merger analysis and this ultimately requires consideration of all relevant factors before a final conclusion can be reached.

Measuring market concentration

7.9. The ACCC typically measures concentration with reference to market shares, concentration ratios and the Herfindahl-Hirschman Index (HHI).

Market shares

7.10. Market shares are a key input when determining concentration. The ACCC will generally calculate market shares according to sales, volume and capacity using information from a variety of sources, such as:

- the merger parties
- competitors
- customers
- suppliers
- trade associations
- market research reports.

7.11. Consistent with the forward-looking nature of the competition test, the ACCC considers the extent to which current market shares are likely to accurately reflect future market share patterns. For example, there may be evidence that substantial new capacity is due to come on- stream in a manufactured product market, new licences are about to be issued in a broadcasting market or some firms are running out of reserves in a primary product market. Where such evidence exists, the ACCC adapts current market shares accordingly.

Concentration and market shares

The ACCC will generally require information from the merger parties to calculate market shares based on the most appropriate measure from one of the following:

- sales by volume (for each competitor) in at least three recent annual periods
- sales by value (for each competitor) in those periods
- capacity (for each competitor) over the previous three years.

In some cases the ACCC may request additional information to calculate market shares based on an alternative measure to that provided by the merger parties. Whether a wider range of information will be required by the ACCC will be assessed on a case-by-case basis.

Market share information should be supported by details of how the data was compiled, the source of the estimates and any assumptions used. Where actual figures are not available, best estimates will be considered — for example, where there are a number of smaller firms in the market, an approximation may be appropriate.

In markets where actual or potential imports are relevant, these should be clearly identified (indicating whether these imports are independent of the merger parties) and included in the market share and concentration metric calculations. Similarly, supply-side substitutes should be included in these calculations.

Measures of concentration

7.12. In assessing market concentration, the ACCC takes into account the pre- and post-merger market shares of the merged firm and its rivals and the actual increase in concentration, as well as the level of symmetry between rival firms' market shares. Concentration metrics such as the HHI and the x-firm concentration ratio (CRx) may provide useful summary statistics by combining some or all of the market share data for individual firms. Different concentration metrics may highlight different aspects of the market share data.

7.13. The HHI is calculated by adding the sum of the squares of the post-merger market share of the merged firm and each rival firm in the relevant market, thereby giving greater weight to the market shares of the larger firms. The HHI therefore requires the market shares, or estimates of them, for all the participants in the relevant market. The HHI indicates the level of market concentration while the change in the HHI (or 'delta') reflects the change in market concentration as a result of the merger.

HHI threshold

7.14. As part of its overall assessment of a merger, the ACCC will take into account the HHI, as a preliminary indicator of the likelihood that the merger will raise competition concerns requiring more extensive analysis. The ACCC will generally be less likely to identify horizontal competition concerns when the post-merger HHI is:

- less than 2000, or
- greater than 2000 with a delta less than 100.

7.15. These HHI levels should not be taken to imply a presumption as to whether or not a merger will be likely to result in a substantial lessening of competition. Only by considering the merger factors can this assessment be made. To illustrate this point, a merger that falls below the HHI threshold may still raise competition concerns if any of the following are relevant:

- a substantial number of customers consider the products of the merger parties to be particularly close substitutes — for example, the merger parties represent their first and second choices
- the target firm has shown a recent rapid increase in market share, has driven innovation or has tended to charge lower prices than its competitors in one or more markets (properly defined) in which the merged firm would operate.

7.16. The HHI threshold is not interchangeable with, or a substitute for, the notification threshold (see chapter 2). Mergers that meet the notification threshold should be notified to the ACCC regardless of the specific HHI and delta.

Height of barriers to entry[40]

7.17. The entry of new firms into a market can provide an important source of competitive constraint on incumbents. If new entrants are able to offer customers an appropriate alternative source of supply at the right time, any attempt by incumbents to exercise market power will be unsustainable since their customers will simply switch to the new entrants. A credible threat of new entry alone may prevent any attempt to exercise market power in the first place.

7.18. If there is a high likelihood of timely and sufficient entry in all relevant markets post-merger, the merged firm is unlikely to have market power either pre- or post-merger and therefore the merger is unlikely to result in a substantial lessening of competition. In some markets, however, there are barriers to entry that either prevent firms from entering the market altogether or delay and impede entry to such a degree that the merged firm is sheltered from competitive constraint for a significant period.[41] A barrier to entry is any factor that prevents or hinders effective new entry that would otherwise be capable of defeating a price increase caused by a merger.[42]

7.19. The ACCC takes the view that new entry must be timely, likely and sufficient in scope and nature to be effective. This test will be based on an assessment of the height of barriers to entry taking into account whether actual or threatened entry post-merger is both possible and likely in response to an attempted exercise of market power by the merged firm — this will generally depend on the profitability of entering the market.

7.20. It is not necessary for a merger to increase barriers to entry for it to be anti-competitive — only that significant barriers exist and provide the merged firm with discretion over its pricing and other conduct. If the merger also increases barriers to entry, the effect on competition is likely to be more severe because new entry that may have been possible before the merger is likely to be prevented or impeded post-merger — that is, the gap between the future states with and without the merger will be widened.

Timeliness of entry

7.21. When considering the degree of competitive constraint provided by new entry, it is necessary to assess the time it would take a new firm to enter the relevant market and offer customers a competitive alternative to the merged firm. The evaluation of whether entry will be timely necessarily varies with each specific merger and the dynamics of the market.

7.22. Entry will generally provide an effective competitive constraint post-merger if actual or threatened entry would occur in an appropriate time to deter or defeat any non-transitory exercise of increased market power by the merged firm. While the ACCC's starting point for timely entry is entry within one to two years, the appropriate timeframe will depend on the particular market under consideration.

7.23. When determining whether potential entry is likely to be timely the ACCC considers the barriers outlined in paragraphs 7.30 to 7.32, as well as factors such as the frequency of transactions, the nature and duration of contracts between buyers and

[40] Refers to the merger factor contained in s. 50(3)(b).

[41] The analysis would apply in matters involving unilateral effects and also matters involving coordinated effects (in particular the possibility of new entry constraining the ability and incentive of a small group of firms to engage in coordinated conduct).

[42] Note that some barriers to entry may technically be barriers to **exit**. Nevertheless, the effect is the same if such barriers to exit increase the risk to prospective entrants and ultimately discourage entry.

sellers, lead times for production and the time required to achieve the necessary scale.

Likelihood of entry

7.24. The ACCC needs to be satisfied that actual or threatened entry post-merger is not just possible but likely in response to an attempted exercise of market power by the merged firm. The likelihood of entry generally depends on the profitability of entering the market. The ACCC will assess whether a new entrant could expect to make a commercial return on its investment taking into account the price effects the additional output may have on the market and the likely responses of the incumbent firms and other costs/risks associated with entry.

7.25. Factors likely to affect the profitability of entry include the examples of barriers outlined in paragraphs 7.30 to 7.32. Evidence of the past success or failure of new entrants in establishing themselves as effective competitors in the relevant market may also provide insight into the profitability of entry into particular markets but will not necessarily indicate ease of entry. To test the likelihood of entry where it is not possible to identify potential new entrants, the ACCC requires identification of the likely categories of entrants that could potentially enter.

Sufficiency of entry

7.26. Entry must be of sufficient scale with a sufficient range of products to provide an effective competitive constraint. In differentiated product markets, the sufficiency of entry will critically depend on the ability and incentive[43] of entrants to supply a sufficiently close substitute to that of the merged firm. Entry at the fringe of the market is unlikely to constrain any attempted exercise of market power by incumbents if incumbents are unlikely to lose significant sales to those fringe entrants. Therefore individual entry that is small-scale, localised or targeted at niche segments is unlikely to be an effective constraint post-merger.

7.27. Sufficiency does not require in all circumstances that one new entrant alone duplicates the scale and all the relevant activities of the merged firm. Timely entry by multiple firms may be sufficient if the combined effect of their entry would defeat or deter the exercise of increased market power by the merged firm.

7.28. The ACCC's assessment of the timeliness, likelihood and sufficiency of entry will depend on the circumstances of each particular merger under consideration. However, the underlying test is always whether the potential for entry provides an effective competitive constraint that would prevent a significant and sustainable increase in the market power of market participants post-merger.

Types of barriers to entry

7.29. In assessing the potential for entry to act as a competitive constraint, the ACCC considers the costs of entry and incumbency advantages under the following categories:

7.30. **Legal or regulatory barriers**, including but not limited to:

- licensing conditions, tariffs, explicit restrictions on the number of market participants and other government regulations

[43] The ACCC will take into account a range of factors including whether new entry that targets the products of the merged firm would be profitable.

- legally enforceable intellectual property rights
- environmental regulations that raise the costs of entry or limit the ability for customers to switch suppliers.

7.31. **Structural or technological barriers**, including but not limited to:

- the existence of sunk costs, which increase the risks of, and costs associated with, failed entry and include factors such as product development, advertising or promotion to establish a sufficient reputation in the market and construction of specialised facilities — the high risk and costs associated with failed entry may deter new entry
- substantial economies of scale, which may limit the viability of entry below a certain minimum efficient scale
- high customer switching costs, such as search costs, transaction costs and market specific behaviour (including customer inertia to switching suppliers)
- mature markets or markets with declining levels of demand growth
- access to key production or supply assets, important technologies or distribution channels
- the existence of significant network effects.

7.32. **Strategic barriers** that arise because of actions or threatened actions by incumbents to deter new entry, including but not limited to:

- risk of retaliatory action by incumbents against new entry, such as price wars or temporarily pricing below cost
- creation and maintenance of excess capacity by incumbents that can be deployed against new entry
- creation of strategic customer switching costs through contracting, such as exclusive long-term contracts and termination fees
- brand proliferation by incumbents, which may crowd out the product space leaving insufficient opportunities for new firms to recover any sunk entry costs.

Height of barriers to entry

The following are examples of the types of information the ACCC may require to assess the height of any barriers to entry:

- the ability of producers that are not current competitors to switch production to competing products or services
- the market conditions that may affect the ability of existing firms to expand
- the size and extent of any investment, particularly sunk investment, that producers would need to make to either enter the relevant market/s or to expand production significantly in these market/s
- the extent of brand loyalty in the relevant market/s
- the existence and nature of any long-term supply contracts in the relevant market/s
- any relevant ‘switching costs’ (such as product compatibility issues, product bundling, contract termination charges) that may prevent buyers in the relevant market/s from changing suppliers or sellers in the relevant market/s from changing buyers, in the short to medium term

- evidence of any growth or decline in the relevant market/s.

In an informal merger review, providing a base level of information to the ACCC will, in non-controversial cases, usually be sufficient to satisfy the ACCC of whether or not a substantial lessening of competition is likely. Whether a wider range of information will be required by the ACCC will be assessed on a case-by-case basis and will depend on the complexity of the matter and the potential competition concerns raised.

Actual and potential import competition[44]

7.33. Actual or potential direct competition from imported goods or services can provide an important competitive discipline on domestic firms. Where the ACCC can be satisfied that import competition — or the potential for import competition — provides an effective constraint on domestic suppliers, it is unlikely that a merger would result in a substantial lessening of competition.

7.34. While the current or historic levels of imports may indicate the competitive role of imports in the relevant market, the ACCC will consider the potential for imports to expand if the merged firm[45] attempted to exercise increased market power post-merger.

7.35. Imports are most likely to provide an effective and direct competitive constraint in circumstances where all of the following conditions are met:

- independent imports (that is, imports distributed by parties that are independent of the merger parties) represent at least 10 per cent of total sales in each of the previous three years
- there are no barriers to the quantity of independent imports rapidly increasing that would prevent suppliers of the imported product from competing effectively against the merged firm within a period of one to two years (for example, government regulations, the likelihood and impact of anti-dumping applications on imports, customer-switching costs or the need to establish or expand distribution networks)
- the (actual or potential) imported product is a strong substitute in all respects (that is, quality, range, price, etc.) for the relevant product of the merged firm, taking into account factors including the need to meet any relevant Australian or industry standards, any increase in the complexity of customers' logistical arrangements, increased transport times and costs, and the risk of adverse currency exchange rate fluctuations
- the price of actual or potential landed imports, including any tariffs or other import-specific taxes and charges, (that is, the import parity price) is close to the domestic price of the relevant product that would prevail in the absence of the merger
- importers are able to readily increase the supply volume of the product they import with minimal or no increase in the price paid
- the merged firm and other major domestic suppliers do not have a direct interest in, are not controlled by, and do not otherwise interact with, actual or potential import suppliers.

[44] Refers to the merger factor contained in s. 50(3)(a).

[45] The analysis would apply in matters involving unilateral effects and also matters involving coordinated effects (in particular the possibility of import competition constraining the ability and incentive of a small number of firms to engage in coordinated conduct).

Barriers to import expansion

7.36. The ability of imports to expand (import supply elasticity) will be a key consideration in the ACCC's competition analysis. If the supply of imports is either unable to respond, or only able to respond slowly, to an increase in demand by Australian consumers, imports are unlikely to effectively counteract any increased market power of the merged firm. For example, where there are production capacity or supply constraints, or where imports targeted to niche segments would not be profitable on a wider scale given their cost structures, import competition is unlikely to be sufficient to prevent a substantial lessening of competition.

7.37. The barriers to import expansion that the ACCC considers when assessing the supply elasticity of imports include:

- the existence of capacity constraints overseas and the resulting impact on the potential for expansion of imports into Australia
- the level and impact of transport costs and logistics (particularly the impact of transport costs as a percentage of the value of the good or service being imported)
- the cost and delay associated with the need to establish or expand effective distribution networks
- the cost and delay associated with any specialised facilities required by importers to supply domestic customers
- the level and effect of tariffs, quotas and other government regulations (both in Australia and the country of origin)
- the likelihood and impact of anti-dumping applications on imports
- the presence of exclusive licensing arrangements on imports
- the existence of impediments to customers choosing imports rather than the domestic product post-merger, such as switching costs, lock-in contracts, compatibility problems, importance of an Australian agent and local service and supply, or consistency and timeliness of supply.

Actual and potential import competition

The following are examples of the types of information the ACCC may require to determine the competitive constraint provided by imports:

- which products are imported into the relevant market/s
- who undertakes the importation and their relative share of the market/s
- estimates of the actual and potential level of import competition in the market/s
- historical importation figures
- details of any barriers to entry to importing, including access to distribution facilities, transport costs and customs restrictions
- details of the price of imports as opposed to domestic production in the relevant market/s and an explanation of any divergence in these prices
- the extent to which imports provide a constraint on domestic suppliers, including the merger parties, in the relevant market/s post-merger.

In an informal merger review, providing a base level of information to the ACCC will, in non-controversial cases, usually be sufficient to satisfy the ACCC of whether or not a substantial lessening of competition is likely. Whether a wider range of information will be required by the ACCC will be assessed on a case-by-case basis and will depend on the complexity of the matter and the potential competition concerns raised.

Availability of substitutes[46]

7.38. In assessing the competitive implications of a merger, the ACCC considers both the range of available or potentially available substitutes in each relevant market and the relative intensity of rivalry between different products within those markets. The existence of comparable alternatives to the merged firm that are available in plentiful supply to the entire market can, in the absence of coordinated effects, indicate that a merger is unlikely to substantially lessen competition.

7.39. The analysis of the likely competitive constraints provided by alternatives focuses on two issues:

- rivalry within the market, given the likely closeness of rivalry between the merger parties and
- between the merged firm and its rivals
- barriers to expansion (elasticity of supply).

Rivalry within the market

7.40. When analysing the competitive effects of a merger, the ACCC assesses the closeness of rivalry between the merger parties and between the merger parties and other market participants. This analysis goes beyond the process of defining the market based on whether products are close substitutes — it also considers the relative degree of substitution or rivalry between alternative suppliers of products in the relevant market and the merged firm.

7.41. As discussed in chapter 5, unilateral effects in differentiated product markets are more likely if the merger parties are relatively close competitors pre-merger and other market participants, while providing alternatives to consumers, are relatively more distant competitors for the products of the merged firm. The ACCC therefore considers the extent of product differentiation by assessing whether the merger parties differ from rivals in terms of:

- product features and function
- customer loyalty
- brand loyalty
- whether a substantial number of customers consider the products of the merger parties to be particularly close substitutes — for example, the merger parties represent their first and second choices
- production capacity
- breadth of product line and level of specialization
- distribution channel coverage
- geographic presence

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[46] Refers to the merger factor contained in s. 50(3)(f).

- cost structures
- the level of vertical integration.

7.42. If, for a significant number of customers, the merger parties are each other's closest competitor and there would be no close competitors to the merged firm in one or more relevant markets, the ACCC then explores the ability and incentives of rivals in the relevant market/s to move into the merged firm's product or geographic space post-merger. This analysis involves considering any barriers to mobility across the product or geographic space within a market and taking into account relevant factors such as those listed below in the context of barriers to expansion. Impediments may include the costs of altering the mix of products, the costs of introducing a new type of product, brand loyalty to the relevant products, the profitability of entry targeting the products of the merged firm or the costs of establishing or expanding distribution channels for the relevant types of product.

7.43. Conversely, if the merger parties are relatively distant competitors in the relevant market pre-merger, and several of the merged firm's remaining rivals would be close competitors to the merged firm, the merger is less likely to result in a substantial lessening of competition in that market.

Barriers to expansion

7.44. The degree of competitive constraint provided by rivals to the merged firm also depends on their ability to profitably increase production in the event that the merged firm attempts to exercise market power (the elasticity of supply).[47] The ability of rivals to expand depends on the existence of any features of the market that either prevent firms from expanding altogether or delay or impede expansion to such a degree that rivals are unable to expand in an appropriate time to defer or defeat any non-transitory exercise of increased market power by the merged firm. While the ACCC's starting point for timely expansion is within one to two years, the appropriate timeframe will depend on the particular matter under consideration. For example, the appropriate timeframe may be longer than one to two years in industries where supply arrangements are subject to long-term contracts.

7.45. The abilities and incentives of the merged firm's rivals to increase output and sales if the merged firm attempts to exercise increased market power post-merger depend on, among other things:

- the level of excess capacity that non-merger parties could deploy to take sales away from the merged firm
- the cost to non-merger parties of expanding their output
- the ability of non-merger parties to source increased inputs and their ability to distribute increased output to customers
- the level of excess capacity held by the merged firm that could be deployed to prevent non-merger parties from capturing sales.

7.46. The ACCC will consider similar factors to those set out in paragraphs 7.30 to 7.32 in relation to new entry. For example, if non-merger parties face difficulties in distributing increased output because of logistical bottlenecks, the availability of substitutes may be limited post-merger. However, the costs of expansion can sometimes differ significantly from the costs of new entry.

[47] The analysis would apply in matters involving unilateral effects and also matters involving coordinated effects (in particular the possibility of smaller rivals expanding production in response to coordinated conduct).

7.47. If non-merger parties are capacity constrained post-merger, they will have a reduced ability to steal customers from the merged firm if it attempts to exercise market power. As a result, if non- merger parties in the relevant market are capacity constrained, the merger is more likely to result in a substantial lessening of competition.

The availability of substitutes

The following are examples of the types of information the ACCC may require to assess the relative degree of rivalry both between the merger parties themselves and between the merger parties and other market participants:

- internal company strategy, marketing and sales documents
- information about advertising campaigns and other information that highlights how firms in the market perceive the competitive constraint created by other market participants
- past history of customers switching between suppliers
- whether market features exist that prevent or hinder customers changing suppliers — for example, switching costs resulting from the use of exclusive long-term contracts and termination fees
- studies and information regarding consumer preferences
- estimates of cross elasticities of supply and demand[i]
- the diversion ratios between the merger parties[ii]
- estimates of the own-price elasticity of supply of non-merger parties[iii]
- the production capacity of firms in the market, including any capacity constraints or excess capacity
- the costs to rival firms of expanding their output
- impediments to firms altering or expanding their product mix to compete more closely with the products of the merged firm
- whether the merged firm controls inputs/distribution channels, patents/other IP and access to, or pricing of, different platforms
- the degree of homogeneity of products.

In an informal merger review, providing a base level of information to the ACCC will, in non-controversial cases, usually be sufficient to satisfy the ACCC of whether or not a substantial lessening of competition is likely. Whether a wider range of information will be required by the ACCC will be assessed on a case-by-case basis and will depend on the complexity of the matter and the potential competition concerns raised.

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i The cross-elasticity of supply (demand) is the percentage change in the supply (demand) for one firm's output in response to a 1 per cent change in the price of the product sold by a second firm.

ii A diversion ratio measures the proportion of consumers that switch to another firm's product if a particular firm increases the price of its product.

iii The own-price elasticity of supply of a firm is the percentage change in the firm's output in response to a 1 per cent change in the price the firm sells its product for.

Countervailing power[48]

7.48. In addition to considering supply-side sources of competitive constraint, the ACCC also considers whether one or more buyers would have sufficient countervailing power to constrain any attempted increase in market power by a supplier.[49] Countervailing power exists when buyers have special characteristics that enable them to credibly threaten to bypass the merged firm,[50] such as by vertically integrating into the upstream market, establishing importing operations or sponsoring new entry.

7.49. Countervailing power is more than the ability of buyers to switch to alternative domestic or imported products. As discussed above, the availability of substitutes and import competition are important considerations in assessing whether a merger is likely to result in a substantial lessening of competition. The availability of effective alternatives to the merged firm provides all buyers with a means of bypassing the merged firm. Countervailing power, however, exists when the specific characteristics of a buyer — such as its size, its commercial significance to suppliers or the manner in which it purchases from suppliers — provide the buyer with additional negotiating leverage. In some cases, a buyer may have countervailing power because they have market power.[51]

7.50. Importantly, the size and commercial significance of customers (sometimes referred to as 'buyer power') is not sufficient to constitute countervailing power. A large buyer that accounts for a significant proportion of the merged firm's sales may be able to negotiate favourable terms and price relative to other buyers in the market. However, buyers need more than size to constrain the exercise of market power by a supplier. For example, if the supplier's product is an essential input for the buyer, the only way the buyer can defeat any attempted increase in market power is if it can credibly threaten to bypass the supplier.

7.51. In assessing whether countervailing power is likely to prevent a substantial lessening of competition by constraining any attempt by the merged firm to increase market power, the ACCC considers the following factors, among others:

- **Whether the threat to bypass is credible on commercial grounds** Evidence of this will often include the size of the buyer's purchases and the efficient scale of production of the product. For sponsored entry to be commercially viable, the entrant will have to operate at an efficient scale of production. If the purchases of the sponsoring firm are insufficient to underpin such a production scale, the ACCC needs to be convinced that the entrant could readily find other sales in the relevant market.

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[48] Refers to the merger factor contained in s. 50(3)(d).

[49] In a merger between buyers, countervailing power may also be exerted by one or more suppliers if they are able to bypass the merged firm and establish alternative supply channels. In line with the approach adopted throughout these guidelines, consideration is directed towards the case where the merged firm is a seller in the relevant market under analysis. As previously noted, all guidance provided here needs to be appropriately adjusted when merger analysis involves a merger of competing purchasers.

[50] The analysis would apply in matters involving unilateral effects and also matters involving coordinated effects (in particular the possibility of countervailing power constraining the ability and incentive of a small number of firms to engage in coordinated conduct).

[51] The existence of buyer market power may offset the merged firm's market power on the supply side (see the Trade Practices Legislation Amendment Bill 1992, explanatory memorandum, paragraph 23). However, the ACCC notes that the outcomes of mergers that 'pit' market power against market power are difficult to determine. When firms in both markets have market power, a broad range of prices and price structures are possible and there is a risk that the merger will result in monopoly prices being charged for both the input (in the upstream market) and the final output (in the downstream market). Such a 'double-monopoly' can be particularly damaging to consumers.

- **Whether the buyer is likely to bypass the supplier** Evidence of this could include plans or other documents suggesting such a strategy is commercial, as well as instances and circumstances when the buyer or other buyers of the relevant input have previously sponsored entry or vertically integrated. The ACCC places greater weight on evidence that such strategies form part of the firm's business model. Also, if the relevant input does not account for a significant proportion of the buyer's total input costs, sponsored entry or backward integration may be less likely.
- **The proportion of the downstream market able to wield a credible threat** For the countervailing power to offset or limit any market power arising from a merger, it will usually not be sufficient if only one buyer or category of customers is able to bypass the merged firm post-merger. For example, the merged firm may be able to increase prices charged to smaller buyers that are unable to bypass the supplier while larger buyers with countervailing power are able to avoid the increase. A significant proportion of customers must be shielded from the effects of market power if countervailing power is to prevent a substantial lessening of competition in the relevant market/s.

Countervailing power

The following are examples of the types of information the ACCC may require to ascertain the degree of countervailing power in the relevant market/s:

- the relative strength of bargaining power possessed by customers of the products in the relevant market/s
- the extent to which it is possible for customers to bypass the merger parties by importing or producing the product themselves, vertically integrating, or using an alternative supplier.

In an informal merger review, providing a base level of information to the ACCC will, in non-controversial cases, usually be sufficient to satisfy the ACCC of whether or not a substantial lessening of competition is likely. Whether a wider range of information will be required by the ACCC will be assessed on a case-by-case basis and will depend on the complexity of the matter and the potential competition concerns raised.

Dynamic characteristics of the market[52]

7.52. The forward-looking nature of merger analysis means that the ACCC, when analysing the competitive effect of a merger, must take into account the changing nature of the market in the future. Dynamic changes may result from a range of factors including market growth, innovation, product differentiation and technological changes. The analysis of the effects of dynamic changes in the market is closely linked with analysis of the other merger factors discussed in this chapter. The changes in the market will be considered from two perspectives:

- the extent to which the dynamic features of the market affect the likely competitive impact of the merger
- whether the merger itself impacts on the dynamic features of the market.

7.53. Whether a market is growing or declining can have significant implications for the competitiveness of the market in the future. Markets that are growing rapidly may offer both greater scope for new entry and the erosion of market shares over time.

[52] Refers to the merger factor contained in s. 50(3)(g).

Similarly, markets that are characterised by rapid product innovation may be unstable so that any increased market power gained through a merger is transitory.

7.54. In general, a merger is less likely to substantially lessen competition in a market that is rapidly evolving.

7.55. When considering how a merger will influence future competition in a dynamic market, the ACCC places more weight on robust evidence about likely future developments in the relevant market. The ACCC will give significantly less weight to predictions about the future state of competition that are speculative or have little chance of developing for some considerable time in the future.

Dynamic characteristics of the market

The ACCC may require information on dynamic characteristics such as growth, innovation and product and/or service differentiation. In an informal merger review, providing a base level of information to the ACCC will, in non-controversial cases, usually be sufficient to satisfy the ACCC of whether or not a substantial lessening of competition is likely. Whether a wider range of information will be required by the ACCC will be assessed on a case-by-case basis and will depend on the complexity of the matter and the potential competition concerns raised.

Removal of a vigorous and effective competitor[53]

7.56. Mergers involving a vigorous and effective competitor (sometimes referred to as a maverick firm) are more likely to result in a significant and sustainable increase in the unilateral market power of the merged firm or increase the ability and incentive of a small number of firms to engage in coordinated conduct. Vigorous and effective competitors may drive significant aspects of competition, such as pricing, innovation or product development, even though their own market share may be modest. These firms tend to be less predictable in their behaviour and deliver benefits to consumers beyond their own immediate supply, by forcing other market participants to deliver better and cheaper products. They also tend to undermine attempts to coordinate the exercise of market power.

7.57. A merger that removes a vigorous and effective competitor may therefore remove one of the most effective competitive constraints on market participants and thereby result in a substantial lessening of competition.

Removal of a vigorous and effective competitor

The following are examples of the types of information the ACCC may require to ascertain the extent to which each party to the transaction would separately be considered as a vigorous and effective competitor in the relevant market/s:

- evidence of past competitive pricing behaviour, for example discounting and promotions
- levels of point-of-sale service (for example opening hours and store format) and after-sales service
- past and expected innovation, for example in design or production technology
- past evidence of leadership in non-price competition, for example product quality and loyalty programs.

[53] Refers to the merger factor contained in s. 50(3)(h).

In an informal merger review, providing a base level of information to the ACCC will, in non-controversial cases, usually be sufficient to satisfy the ACCC of whether or not a substantial lessening of competition is likely. Whether a wider range of information will be required by the ACCC will be assessed on a case-by-case basis and will depend on the complexity of the matter and the potential competition concerns raised.

Vertical integration[54]

7.58. It is recognised that some horizontal mergers can be affected by vertical integration or vertical relationships in the market — for example, horizontal competition issues may be exacerbated by vertical aspects of a merger and vice versa. Where a merger involves both horizontal and vertical competition issues, the ACCC will assess the merger based on the combined horizontal and vertical impact on competition.

7.59. The nature and extent of vertical relationships between firms in separate areas of activity along a vertical supply chain can affect the competitive implications of consolidation in any one of those areas. For example, a horizontal merger can increase the likelihood of coordination in cases where downstream integration increases the visibility of pricing. Generally, horizontal mergers involving a vertically integrated firm are unlikely to lessen competition provided effective competition remains at all levels of the vertical supply chain post-merger.

Vertical integration

The following are examples of the types of information the ACCC may require to ascertain whether vertical integration is likely to be relevant to the competition assessment:

- whether the merger will result in vertical integration between firms involved at different functional levels of the relevant market/s
- whether the merger is likely to increase the risk of limiting the supply of inputs or access to distribution, such that downstream or upstream rivals face higher costs post-merger or risks of full or partial foreclosure of key inputs or distribution channels
- the extent of existing vertical integration, noting in particular where either merger party currently operates as a customer or supplier to competitors in the relevant market/s.

In an informal merger review, providing a base level of information to the ACCC will, in non-controversial cases, usually be sufficient to satisfy the ACCC of whether or not a substantial lessening of competition is likely. Whether a wider range of information will be required by the ACCC will be assessed on a case-by-case basis and will depend on the complexity of the matter and the potential competition concerns raised.

Ability to increase prices or profit margins[55]

7.60. As discussed in paragraph 3.5, a merger that results in the merged firm[56] being able to significantly and sustainably increase prices (or exercise market power in other non-price ways) will substantially lessen competition. In general, an increase in price will result in a corresponding increase in profit margins. In some cases, the merged firm's ability to significantly and sustainably increase profit margins may also indicate a substantial lessening of competition. For example, following a vertical merger that achieves control over essential inputs, the merged firm may be able to raise the

[54] Refers to the merger factor contained in s. 50(3)(i).

[55] Refers to the merger factor contained in s. 50(3)(e).

[56] The analysis would apply in matters involving unilateral effects and also matters involving coordinated effects (in particular whether a small number of firms could significantly and sustainably increase prices post-merger.

prices at which it sells to competitors in intermediate markets, thereby increasing its revenue and accordingly its profit margins, while raising the input costs of its competitors above its own.[57] However, several factors influence profit margins and the ACCC recognises that increased profitability may not be a conclusive indicator of a substantial lessening of competition. Assessing the likelihood of a significant and sustainable increase in prices or profit margins requires an analysis of all sources of competitive constraint.

7.61. The ACCC considers both qualitative and quantitative evidence relating to the likelihood that the merger will lead to a significant and sustainable increase in prices or profit margins. Qualitative evidence may include relevant internal firm documents, industry studies and other information provided by market participants, including the merging parties.

Ability to increase prices or profit margins

The following are examples of the types of information the ACCC may require to determine the extent to which merger parties may be able to increase prices or profit margins:

- details of recent and current levels of pricing in the relevant market/s, including the use of rebates and discounts
- details of supply costs of goods and services supplied by the merger parties including manufacturing, marketing and distribution costs in the relevant market/s
- a description of any competitive constraints likely to prevent the merger parties from significantly and sustainably increasing the prices paid by their customers, or lowering the prices paid to their suppliers post-merger in the relevant market/s
- a description of the likely effect of the merger on the profit margins of the merger parties post-merger and the expected cause of any change.

In an informal merger review, providing a base level of information to the ACCC will, in non-controversial cases, usually be sufficient to satisfy the ACCC of whether or not a substantial lessening of competition is likely. Whether a wider range of information will be required by the ACCC will be assessed on a case-by-case basis and will depend on the complexity of the matter and the potential competition concerns raised.

Other factors

7.62. The list of merger factors contained in s. 50(3) is not exhaustive. Particular mergers may involve other factors that affect the likely competitive outcome of the merger. It is not possible in these guidelines to foresee every possible factor that may be relevant in a particular merger assessment, but other factors such as merger-related efficiencies, effect of export markets and government regulation may be relevant.

Efficiencies

7.63. The potential for improved efficiency is a common motivation for firms to merge. Merger-related efficiencies include greater economies of scale and scope from combining production, distribution and marketing activities, greater innovation yields from combining investment in research and development and reduced transaction

[57] Trade Practices Legislation Amendment Bill 1992, explanatory memorandum, paragraph 26.

costs.[58] The ACCC recognises that a reduction in marginal costs post-merger may increase competitive tension. However, the ACCC's focus in s. 50 merger analyses is the effect of the merger on competition, competitive constraints and the efficiency of markets, rather than the efficiency of individual firms. A merger that removes or weakens competitive constraints to the extent that a substantial lessening of competition results, will (unless authorised) contravene s. 50 — even if the merger results in a more efficient firm with a lower cost structure.

7.64. While competitive constraints are generally external to a firm, the likely internal cost structure of a firm (which, for a merged firm, is in part determined by the efficiencies it has gained through merging) is often relevant to competition. For instance, the cost structure of firms in a duopoly or oligopoly market is one of many factors relevant to the likelihood of coordinated conduct. Symmetry between firms may be conducive to coordinated conduct and strategic interdependence, whereas the presence of a firm with a lower cost structure than that of its rivals might cause coordination to break down. Similarly, changes in the level of excess capacity in a market may alter the intensity of competition. The competitive impact of a merged firm's likely cost structure depends on the circumstances of the merger.

7.65. If efficiencies are likely to result in lower (or not significantly higher) prices, increased output and/or higher quality goods or services, the merger may not substantially lessen competition. The ACCC generally only considers merger-related efficiencies to be relevant to s. 50 merger analyses when it involves a significant reduction in the marginal production cost of the merged firm and there is clear and compelling evidence that the resulting efficiencies directly affect the level of competition in a market and these efficiencies will not be dissipated post-merger.

7.66. In cases where a merger is likely to achieve significant efficiencies, but the efficiencies do not prevent a substantial lessening of competition, the merger may only proceed if the acquirer applies for, and the ACCC grants, authorisation for the proposed merger. As part of the statutory test, the ACCC may consider whether gains in efficiency constitute a public benefit that outweighs the public detriment from the substantial lessening of competition.

Potential effect of exports on domestic markets

7.67. While competition in overseas markets may prevent the merged firm from raising its export prices, the ACCC generally focuses on whether the merged firm[59] is able to significantly and sustainably raise prices in a market in Australia post-merger.[60] Generally, the merged firm's export operations do not limit its ability to exercise market power in a market in Australia. In some limited circumstances, however, exports can play a similar role in constraining the market power of domestic suppliers to the role played by imports in constraining the market power of domestic suppliers.

7.68. The merged firm may be constrained in its domestic activities by competition in export markets if:

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[58] Larger firms also typically achieve lower input prices because of enhanced bargaining power and bulk discounts. Such cost reductions are pecuniary benefits, not efficiency gains. In some cases a merger of two significant acquirers of an input can substantially lessen competition for the acquisition of that input. The ACCC will explore such issues separately from the impact of efficiencies on competitive constraints in the relevant supply market.

[59] Either unilaterally or in conjunction with other suppliers.

[60] Exports may provide a competitive constraint when a merger involves firms that are buyers in the relevant market. In line with the approach adopted throughout these guidelines, consideration is directed towards the case where the merged firm is a seller in the relevant market under analysis. As previously noted, all guidance provided here needs to be appropriately adjusted when merger analysis involves a merger of competing purchasers.

- the merged firm's foreign sales (exports) represent a significant proportion of the merged firm's total sales and
- the merged firm is unable to discriminate in price (or other characteristics) between foreign and domestic sales.

7.69. Under these circumstances, the merged firm may be limited in its ability to exercise market power in the relevant market in Australia without losing export sales. Any increased profit from the domestic market may be offset by the fall in profits from export sales.

Government regulation

7.70. The ACCC considers the effect of any state or federal government regulation that affects competition. For example, firms may be restricted in the range or features of products they can supply, or a price cap might prevent increases in price. However, the ACCC does not regard speculation about future alterations to the regulatory environment, or the mere ability of government to regulate, as an effective competitive constraint.

Appendix 1: Relevant provisions of the Act

1. The merger and acquisition provisions are part of the competition provisions of Part IV of the Act. Some of the relevant provisions of the Act are summarised below for ease of reading. However, the Act is complex legislation and, while the ACCC believes such summaries are accurate, the nature of the Act requires the actual provisions to be consulted in specific cases.

The substantive mergers test (s. 50)

2. Section 50 of the Act prohibits acquisitions that would have the effect, or be likely to have the effect, of substantially lessening competition in a substantial market in Australia or a state, territory or region of Australia.
3. Section 50 of the Act provides that:

    1) A corporation must not directly or indirectly:

        (a) acquire shares in the capital of a body corporate, or

        (b) acquire assets of a person

    if the acquisition would have the effect, or be likely to have the effect, of substantially lessening competition in a market.

    2) A person must not directly or indirectly:

        (a) acquire shares in the capital of a corporation, or

        (b) acquire any assets of a corporation

    if the acquisition would have the effect, or be likely to have the effect, of substantially lessening competition in a market.

    3) Without limiting the matters that may be taken into account for the purposes of subsections (1) and (2) in determining whether the acquisition would have the effect, or be likely to have the effect, of substantially lessening competition in a market, the following matters must be taken into account:

        (a) the actual and potential level of import competition in the market

        (b) the height of barriers to entry to the market

        (c) the level of concentration in the market

        (d) the degree of countervailing power in the market

        (e) the likelihood that the acquisition would result in the acquirer being able to significantly and sustainably increase prices or profit margins

        (f) the extent to which substitutes are available in the market or are likely to be available in the market

        (g) the dynamic characteristics of the market, including growth, innovation and product differentiation

        (h) the likelihood that the acquisition would result in the removal from the market of a vigorous and effective competitor

        (i) the nature and extent of vertical integration in the market.

4. Foreign acquisitions for which an acquirer is not considered to be carrying on a business within Australia may fall under s. 50A of the Act for consideration.

5. Section 4G provides:

> For the purposes of this Act, references to the lessening of competition shall be read as including references to preventing or hindering competition.

6. Section 4E of the Act provides:

> For the purposes of this Act, unless the contrary intention appears, market' means a market in Australia and, when used in relation to any goods or services, includes a market for those goods or services and other goods or services that are substitutable for, or otherwise competitive with, the first mentioned goods or services.

7. Sections 50 and 50A relate only to substantial markets for goods and services in Australia, a state, a territory or a region (ss. 50(6) and 50A(9)).
8. The terms 'substantial lessening of competition', 'market' and 'substantial market' are discussed in paragraphs 3.5, 4.6 and 4.28 respectively.

Clearance processes and authorisations provisions

9. The ACCC investigates and reviews those mergers it becomes aware of that have the potential to raise concerns under s. 50 of the Act. The ACCC's approach to informal merger reviews is contained in its *Informal Merger Review Process Guidelines* (available at www.accc.gov.au).
10. Alternatively, parties may seek legal protection from court action under s. 50 by applying to the ACCC for authorisation of a proposed merger. Sections 88 to 90 of the Act provide for the ACCC, upon application by the acquirer, to grant authorisation for a proposed merger if it is satisfied that:
    - the proposed acquisition would not be likely to substantially lessen competition or
    - the likely public benefit from the proposed acquisition outweighs the likely public detriment.

    Further detail about the merger authorisation process may be found in the ACCC's *Merger Authorisation Guidelines* (available at www.accc.gov.au).

Enforcement and undertakings provisions

11. Under s. 87B of the Act, the ACCC may accept a written undertaking in connection with a matter in relation to which it has a power or function under the Act, except Part X. If the undertaking is breached, the ACCC may seek orders from the court directing compliance with the undertaking, the giving up of any financial benefit gained from the breach, compensation for any other loss or damage as a result of the breach, or any other appropriate orders. Section 87B provides:

    1) The ACCC may accept a written undertaking given by a person for the purposes of this section in connection with a matter in relation to which the ACCC has a power or function under this Act (other than Part X).
    2) The person may withdraw or vary the undertaking at any time, but only with the consent of the ACCC.
    3) If the ACCC considers that the person who gave the undertaking has breached any of its terms, the ACCC may apply to the court for an order under subsection (4).
    4) If the court is satisfied that the person has breached a term of the undertaking, the court may make all or any of the following orders:

(a) an order directing the person to comply with that term of the undertaking;

(b) an order directing the person to pay to the Commonwealth an amount up to the amount of any financial benefit that the person has obtained directly or indirectly and that is reasonably attributable to the breach;

(c) any order that the court considers appropriate directing the person to compensate any other person who has suffered loss or damage as a result of the breach;

(d) any other order that the court considers appropriate.

12. Under s. 80 of the Act, only the ACCC may seek injunctive relief from the Federal Court to prevent a merger from proceeding (s. 80(1A)). Other persons may institute declaration proceedings in respect of an acquisition (s. 163A) but may not seek an injunction.

13. Under s. 81(1) of the Act, the court may, on the application of the ACCC or any other person, if it finds or has in another proceeding under the Act found that a person has contravened s. 50, give directions to secure disposal of all or any of the shares or assets acquired in contravention of s. 50. Under s. 81(1A) the court may declare such an acquisition void where it finds that the vendor was involved in the contravention. Section 81(1C) provides for the court to accept as an alternative an undertaking from the person to dispose of other shares or assets owned by the person. An application under s. 81(1) or 81(1A) may be made at any time within three years after the date on which the contravention occurred.

14. In certain circumstances, as provided for in ss. 76(1A) and 76(1B) of the Act, the court may impose a penalty for a contravention of s. 50 of up to $500,000 for an individual and, for a corporation, up to the greatest of:

- $10 million
- three times the value of the benefit to the corporation that is reasonably attributable to the contravention
- 10 per cent of the corporation’s annual turnover.

15. In summary, the provisions of the Act relevant to mergers include:

- mergers and acquisitions — s. 50
- extraterritorial operation — s. 5(1)
- overseas share acquisitions — s. 50A
- anti-competitive agreements — s. 45
- definition of acquisition of shares or assets — s. 4(4)
- market definition — s. 4E
- lessening of competition includes preventing or hindering — s. 4G
- injunctions — s. 80
- divestiture and setting aside acquisitions — s. 81
- pecuniary penalty — s. 76
- enforceable undertakings — s. 87B
- ability to grant authorisation – s. 88(1)
- ability to grant authorisation subject to conditions – s. 88(3)
- procedure for applications and the keeping of a register – s. 89
- determination of an application for authorisation – s. 90.

Appendix 2: Acquisitions subject to the Act

1. The following provides guidance about the types of transactions that are subject to the Act. Nevertheless, the Act is complex legislation, and parties should consult the actual provisions of the Act to determine whether a particular transaction falls within the scope of the Act.

Territorial jurisdiction

2. The Act applies to the following acquisitions:

    (a) acquisitions of property within Australia are covered by virtue of s. 50, including (but not limited to):

    - shares in Australian companies, wherever the transaction is entered into, as the shares are domestically situated
    - domestic businesses
    - local intellectual property such as trademarks
    - local plant and equipment.

    (b) acquisitions of property wherever situated are covered by virtue of ss. 50 and 5(1) if the acquirer is:

    - incorporated in Australia
    - carries on business in Australia
    - an Australian citizen, or
    - ordinarily resident in Australia.

    (c) if (a) and (b) above do not apply, acquisitions of a controlling interest (presumably shares in almost all cases) in a body corporate where that body corporate has a controlling interest in a corporation are covered by virtue of s. 50A.

Acquirers subject to the Act

3. Section 50 of the Act applies to corporations (s. 50(1)) and persons (s. 50(2)).
4. Acquisitions involving both incorporated and non-incorporated entities are subject to the Act through Part XIA (the Competition Code). Each Australian state and territory government has, under clause 5 of the Conduct Code Agreement between the Australian Government and state and territory governments, passed legislation implementing the Competition Code.
5. The merger provisions of the Act also apply to the Commonwealth and to the state and territory governments insofar as they are carrying on business (ss. 2A and 2B respectively). Pecuniary penalties do not, however, apply to activities of the Crown.

Types of acquisitions

6. The Act applies to both direct and indirect acquisitions. Section 4(1) of the Act makes it clear that ‘acquire’ is not limited to acquisition by way of purchase but also includes exchange, lease, hire or hire purchase.

7. Section 4(4) of the Act provides that joint acquisitions and acquisitions of equitable as well as legal interests are acquisitions subject to s. 50,[61] but that in the case of assets, an acquisition by way of a charge and an acquisition in the ordinary course of business are not acquisitions to which s. 50 applies.

Exceptions

8. Section 51(1) of the Act provides for exceptions from s. 50 and s. 50A for conduct that is specified in and specifically authorised by Commonwealth legislation. As with all exceptions under s. 51, the relevant Commonwealth law must specify the excepted acquisition and specifically authorize it (s. 51(1)(a)(i)). Acquisitions cannot be exempted from s. 50 and s. 50A by state or territory laws (s. 51(1C)(b)).

Partial shareholdings and minority interests

9. Mergers often involve one or more firms being completely subsumed by another firm. However, mergers and acquisitions may also involve parties acquiring a partial shareholding in another firm. There is no threshold shareholding for the purposes of s. 50 and all acquisitions are therefore subject to the Act.

10. For the purposes of competition analysis, acquisition by one company of a controlling interest in another company will be treated in the same way as an acquisition of all the shares of the target company. While a majority shareholding would in many cases ensure control, much lower shareholdings with or without other non-shareholding interests might also be sufficient. Factors that the ACCC takes into account when considering whether a shareholding and/or other interest is sufficient to deliver control of a company include, among other things:
    - the ownership distribution of the remaining shares and securities, including ordinary and preference shares and any special shares
    - the distribution of voting rights, including any special voting rights
    - whether other shareholders are active or passive participants at company meetings
    - any restrictive covenants or special benefits attaching to shares
    - any pre-emption rights in relation to the sale of shares or assets
    - any other contracts or arrangements between the parties
    - the rights and influence of any significant debt holders
    - the composition of the board of directors
    - the company's constitution.

11. In any event, a level of ownership less than a controlling interest that nevertheless alters the incentives of all parties may give rise to a contravention of s. 50 of the Act. The Act does not refer to control but rather to the effect on competition. The following are some of the potential anti-competitive effects of shareholdings below a level delivering control:
    - horizontal acquisitions may increase interdependence between rivals and lead to muted competition or coordinated conduct (see chapter 6)
    - joint acquisitions of assets by rivals may have coordinated effects

[61] In *Trade Practices Commission v Arnotts Ltd & Ors* (1990) ATPR 41–002, at 51,044, creation of an option over shares was found to create an equitable interest in those shares and therefore constituted an acquisition subject to s. 50.

- vertical or conglomerate acquisitions may increase the acquirer's incentive to foreclose rival suppliers
- acquisitions may provide access to commercially sensitive information in relation to competitors
- acquisitions may block potentially pro-competitive mergers and rationalisation.

Horizontal minority acquisitions

12. If a firm has a significant shareholding in a rival firm, it may be less inclined to compete head-to-head with that firm, since to do so would result in a transfer of revenue between commonly held assets and would likely reduce overall profitability. Refraining from competition to maximise joint profits becomes more attractive. Where the incentives lie in particular circumstances depends on the relative value of the assets as well as the percentage shareholding. Partial shareholdings and directorships may result in coordinated effects by reducing the incentives for 'cheating', making departures from the consensus harder to conceal and facilitating the exchange of information between firms.

Third party minority acquisitions

13. Two parties that compete in one market may acquire shares in a company or participate in a joint venture in another market. This may result in coordinated effects in the first market.
14. Minority interests may raise competition concerns when the same party has an interest in a number of otherwise independent competitors. For example, if a party acquires a minority interest in two competitors, that acquisition may substantially lessen competition if it results in coordinated effects. Such coordination need not be explicit but may simply reflect the mutual benefits to be gained by the relevant firms in limiting competition, together with the requirement for each competitor's directors to act in the interests of the company as a whole. In such circumstances, the ACCC may also consider whether overlapping directorships create opportunities to limit competition between rivals.

Vertical minority acquisitions

15. Minority interests may also raise competition concerns when the same party has an interest in vertically related firms or firms supplying complementary products. If an acquisition creates a relationship between a firm with significant market power in one market and another firm operating in a market upstream or downstream, the acquisition may create an incentive for the firm with market power to discriminate in favour of the related firm.
16. In addition to analysing the effect that the acquisition of the minority interest will have on the incentives of the relevant firms, the ACCC will take into consideration the legal responsibilities of company directors under the *Corporations Act 2001* and at common law.

Minority acquisitions and information flows

17. Firms could gain access to commercially sensitive information about their rivals through either horizontal or vertical acquisitions. Debt holders may also have access to significant information. Information such as costs, revenues, bids, contracts, forward supply estimates, marketing campaigns and new product plans may be available. The level of available information depends on the nature and level of the shareholding. If the shareholding is sufficient to secure a position on the board of directors, more information is likely to be available.

Blocking stakes

18. A shareholding of over 10 per cent in a company is sufficient to block the compulsory acquisition of all the shares by another party. This in turn may allow the minority shareholder to prevent rationalisation of two weak rivals and the creation of a more competitive firm, thereby hindering or preventing competition.

ACCC's assessment

19. The framework for competition analysis set out in these guidelines is relevant for all share acquisitions, whether or not they deliver control of the target firm. Where share acquisitions do not deliver control, the ACCC will take into consideration inter-company relationships, director's duties, and a range of other factors including:

    - the actual ownership share of the minority interest
    - the existence of any contractual or other arrangements that may enhance the influence of the minority interest
    - the size, concentration, dispersion and rights of the remaining ownership shares
    - the board representation and voting rights of the minority interests.

Appendix 3: Undertakings

1. During the course of its competition assessment, the ACCC may identify competition concerns that support the view that an acquisition is likely to substantially lessen competition in contravention of the Act. If these competition concerns cannot be resolved and the merger parties continue to pursue the acquisition, the ACCC will, along with other orders, seek an injunction in the Federal Court to stop the merger proceeding.
2. In some cases, however, merger parties can provide the ACCC with a court enforceable undertaking under s. 87B of the Act to implement structural, behavioural or other measures that assuage the competition concerns identified by the ACCC.[62] Undertakings of this type are also referred to as 'remedies.' If the ACCC is satisfied that the proposed measures will address the competition concerns identified, it may accept the undertaking and allow the merger to proceed. Merger parties therefore have strong incentives for proposing effective and enforceable remedies in the form of s. 87B undertakings to remedy identified competition concerns.
3. Undertakings that remedy a likely contravention of the Act prevent the detriment that would otherwise result from the transaction, while at the same time allowing any benefits arising from the transaction to be realised. In the merger context, undertakings can address the competition concerns while at the same time permitting the realisation of merger benefits, such as efficiencies or improvements in management. In this context, s. 87B undertakings are a flexible alternative to simply opposing an acquisition when the ACCC believes that a merger or acquisition is likely to substantially lessen competition.
4. The provision of undertakings is at the discretion of the party giving the undertaking. The structure and content of undertakings offered to the ACCC will therefore be a matter for the party offering the undertaking to determine. However, the ACCC will not accept undertakings if it is not satisfied they address its competition concerns. The ACCC encourages merger parties to carefully consider ACCC feedback on the form and content of proposed undertakings.

General principles

5. The ACCC's approach to the substance of s. 87B undertakings will depend on the merits and circumstances of each matter. However, it is possible to identify certain general principles that underpin effective undertakings.
6. In accepting an undertaking the ACCC does not seek to improve competition beyond the pre-merger level of competition, but the remedy needs to adequately address the potential harm identified. There will be instances when only an outright rejection of the merger can address the ACCC's competition concerns.
7. To determine whether the undertaking is acceptable, the ACCC will consider a range of factors — in particular the effectiveness of the remedy to address the ACCC's competition concerns, how difficult the proposal will be to administer, the ability of the merged firm to deliver the required outcomes, monitoring and compliance costs and any risk to competition associated with the implementation of the undertaking (or failure to do so).
8. Before accepting an undertaking, the ACCC will need to be satisfied that:
   - the proposed undertaking is customised to the particular nature of the relevant merger, the competition concerns raised, and the industry or industries involved

[62] In some circumstances, the ACCC may seek an undertaking from merger parties not to proceed until the ACCC has completed an informal merger review. This is distinct from the enforceable undertakings under discussion in this appendix 3.

- the core obligations in the proposed undertaking (for example, a divesture) specifically, comprehensively and effectively address the ACCC's competition concerns
- the proposed undertaking would impose clear and unambiguous obligations on the party giving the undertaking, including clear delineation of assets and businesses covered by the remedy, the terms under which the remedy is to be carried out, timeframes for actions to be completed, and the consequences of non-performance within those timeframes
- the party offering the undertaking is capable of meeting its obligations as set out in the undertaking, and the remedy cannot be frustrated by the actions (or inaction) of third parties (for example, there may be matters where minority shareholders remain following the acquisition of a firm, who may be able to prevent the acquirer from meeting its obligations under a proposed undertaking)
- for international mergers involving firms operating in jurisdictions other than Australia, any remedies provided to the ACCC are capable of being enforced by the ACCC and coordinated with any of the other relevant jurisdictions involved.

9. Importantly, the ACCC will be unlikely to accept an undertaking when, in its view:
    - there are risks that the undertaking will not be effective in preventing a substantial lessening of competition as a result of the merger, and/or
    - there are risks that the undertaking cannot be implemented in practice and (where necessary) properly monitored and/or enforced.

Types of undertakings

10. Undertaking remedies are conventionally classified as either structural or behavioural. Structural remedies generally change the structure of the merged firm and/or the market, typically through divestiture of part or all of a business, and, in satisfying the ACCC's competition concerns, are generally aimed at restoring or maintaining the level of competition prevailing before the acquisition. Behavioural remedies are normally ongoing remedies designed to modify or constrain the behaviour of the merged firms, by mandating the price, quality or output of the merged firm's goods or services, or otherwise modifying their dealings with other firms.
11. The ACCC has a strong preference for structural undertakings — that is, undertakings to divest part of the merged firm to address competition concerns. Structural undertakings provide an enduring remedy with relatively low monitoring and compliance costs.
12. On occasion, behavioural undertakings — that is, undertakings by the merged firm to do, or not do, certain acts (for example, meet specified service levels) — may be appropriate as an adjunct to a structural remedy. Behavioural remedies are rarely appropriate on their own to address competition concerns.

Structural undertakings — divestitures

13. Divestiture is generally the most common form of structural remedy accepted by the ACCC. In essence, a divestiture seeks to remedy the competitive detriments of a merger by either:
    - creating a new source of competition through the disposal of shares, interests, a business or a set of assets to a new, competitive market participant, or
    - strengthening an existing source of competition through disposal to an existing market participant independent of the merging parties.

14. As a general rule, divestiture undertakings aim to ensure that the ultimate purchaser of the divestiture assets will be a viable, long-term, independent and effective competitor to the merged firm, in a way that addresses the ACCC's competition concerns with the merger.

15. Key elements of a divestiture are the scope of the divestiture package, the purchaser selection and the disposal process. While merger parties will generally seek to offer divestiture remedies that satisfy the ACCC's requirements so that the merger is not opposed, they may have a conflicting incentive to undermine the future competitive effect of any divested assets and businesses where those divested assets or business will compete against the merged firm post-merger. Each of the key aspects of the divestiture may be susceptible to a number of risks such as:

    - composition risks — the scope of the divestiture package may not be appropriately configured (or sufficiently wide, say, in product range) to attract a suitable purchaser or allow a suitable purchaser to operate effectively
    - purchaser risks — a suitable purchaser may not be available or the merging firms may attempt to dispose of assets to a weak or otherwise inappropriate purchaser
    - asset risks — the competitive capability of a divestiture package may deteriorate significantly before completion of a divestment, for example through loss of customers or key members of staff, or there may be some impediment to sale such as third party approvals, or minority shareholder actions.

16. The ACCC closely examines the nature and extent of the undertakings offered against such risks in any individual case.

17. Generally, for a structural undertaking to be acceptable to the ACCC, all of the following requirements should be satisfied:

    - the divestiture remedy should be proportionate to the competition concerns or detriments and be effective in restoring or maintaining competition
    - the assets must be sold to a viable, effective and long-term competitor. That is, the part of the merged firm to be divested (for example, a subsidiary or a suite of assets) must facilitate the maintenance or creation of an independent and effective long-term competitor in the market. There should be no need for continuing supply or other arrangements between the merged firm and the purchaser of the divested business
    - there must be procedures for the purchaser to be approved by the ACCC. Generally, purchasers should be independent of the merged firm and possess the necessary expertise, experience and resources to be an effective long-term competitor in the market. The purchaser's acquisition of the divestiture business must not itself raise competition concerns in any market
    - the value and integrity of the divestiture package must be preserved and independently maintained and operated as a going concern, pending divestiture. Wherever practicable, divestiture should occur on or before the completion date of the merger, particularly in cases where there are risks in identifying a (suitable) purchaser or asset-deterioration risks. There will be some specific circumstances where, if the remedy cannot be implemented on or before completion of the main transaction to address the identified competition concerns, no remedy will be acceptable to the ACCC
    - appropriate provisions will apply, should firms fail in their core obligations. For example, an undertaking should provide for the merged firm to appoint an ACCC-approved sales agent to divest the business to an ACCC-approved purchaser if the firm fails to sell the divestiture business itself within the requisite period

- appropriate provisions will apply to enable the ACCC to monitor and investigate compliance with the undertakings and enforce the provisions if necessary. For example, an undertaking may require the appointment of an ACCC-approved independent auditor or other independent expert to monitor certain aspects of the undertakings, contain provisions that require periodic reporting by the undertaking parties or an auditor, and contain provisions to enable the ACCC to obtain information about compliance with the undertakings
- remedies will also be required to be implemented in a timely manner.

18. In each case the specific measures and provisions needed to achieve these requirements (and further requirements if appropriate) may differ, in accordance with the circumstances of each case. Examples of specific provisions found to be acceptable to the ACCC in previous matters and that may assist merger party/parties in developing undertakings proposals can be found on the ACCC website (www.accc.gov.au).

Behavioural undertakings

19. The nature of effective behavioural undertakings will depend on the particular competition concerns they seek to address and the likely future state of competition in the relevant markets. It is therefore difficult to provide clear guidance as to whether behavioural undertakings will be appropriate to remedy the competition issues in any given matter.
20. Generally, behavioural undertakings are only likely to address the ACCC's competition concerns if they foster the development or maintenance of enduring and effective competitive constraints within a short and pre-specified period of time. It is particularly rare for the ACCC to accept behavioural remedies that apply on a permanent basis due to the inherent risk to competition combined with the monitoring and enforcement burden such remedies create.
21. An effective behavioural undertaking must contain an effective mechanism for the on-going monitoring and compliance and investigation of suspected breaches of the undertaking by the merged firm. Commonly, behavioural undertakings provide for the appointment of an ACCC-approved auditor to monitor compliance and report back to the ACCC.

Process

22. The *Informal Merger Review Process Guidelines* and *Merger Authorisation Guidelines* explain the ACCC's processes when considering a proposed undertaking.
23. To the greatest extent possible, subject to the legitimate confidentiality concerns of the parties, the ACCC will seek to ensure that the reasons for accepting an undertaking are publicly available and that undertakings accepted for one merger are broadly consistent with the undertakings accepted in other merger cases.
24. A party to an undertaking may withdraw or vary their undertaking at any time but only with the consent of the ACCC.

Enforcement

25. The ACCC considers that s. 87B undertakings play a critical role in administering and enforcing s. 50 of the Act. Accordingly, the ACCC carefully monitors compliance with all undertakings it accepts and will investigate if it identifies any potential non-compliance. The ACCC will not hesitate to take enforcement action if it considers that an undertaking has been breached, and that court action is the appropriate response in the circumstances.

26. In the event of non-compliance with an undertaking the ACCC may make an application to the Federal Court for an order under s. 87B(4), and the court may, if it is satisfied that the party to the undertaking has contravened a term of the undertaking, make all or any of the following orders:

- an order directing the person to comply with that term of the undertaking
- an order directing the person to pay to the Commonwealth an amount up to the amount of any financial benefit that the person has obtained directly or indirectly and that is reasonably attributable to the breach
- any order that the court considers appropriate directing the person to compensate any other person who has suffered loss or damage as a result of the breach any other order that the court considers appropriate.

27. Further, the ACCC will generally not cede the legal right to take action in an undertaking. An undertaking accepted by the ACCC does not preclude the ACCC from taking legal action under s. 50, particularly if the undertaking is not properly implemented or the decision to accept the undertaking was based on inaccurate information.

Glossary and shortened forms

Note: in these guidelines, the term ‘product’ encompasses both goods and services.

ACCC	Australian Competition and Consumer Commission
Act (the)	*Competition and Consumer Act 2010* (Cth) formerly the *Trade Practices Act 1974*
behavioural undertakings	An undertaking that prescribes conduct to be carried out, directed or avoided by the merged firm on an ongoing basis to minimise its ability to exercise anti-competitive market power.
complementary products	Products are complementary in either demand or supply where a change in the demand for one generates demand for the other. If the price of one product rises, demand for both products may fall. Similarly, if the price of one product falls, demand for both products may increase.
conglomerate mergers	Mergers involving firms that interact or potentially interact across several separate markets and supply products that are in some way related to each other — for example, products that are complementary in either demand or supply.
court (the)	Federal Court of Australia
CRx	The x firm concentration ratio. This ratio is the fraction of market shares possessed by the ‘x’ largest firms in a given market. The higher the concentration ratio, the greater the level of concentration in that market.
differentiation	Differences in the features of a range of products that all serve the same function.
economies of scale	The economic principle whereby a firm’s long-run average total cost of production is decreased as the quantity of that firm’s output is increased.
economies of scope	The economic principle whereby a firm’s long-run average total cost of production is decreased as the quantity of different goods produced by that firm is increased.
failing firm	A firm that is likely to exit a particular market in the foreseeable future (generally within one to two years) with its productive capacity leaving the market — that is, not simply a change in ownership.
foreclosure	Refers to when a firm prevents or impedes a rival firm from competing.
guidelines (the)	*ACCC Merger Guidelines 2008*
HHI	Herfindahl-Hirschman Index — a metric used to estimate the post-merger level of concentration of markets, as well as changes in the concentration of markets as a result of a merger. The HHI is calculated by adding the sum of the squares of the market share of each firm in a particular market.
HMT	Hypothetical monopolist test — the HMT identifies the smallest area in product and geographic space within which a hypothetical current and future profit-maximising monopolist could effectively exercise market power.
horizontal mergers	The merging of firms operating in the same market or markets.
ICN	International Competition Network
market participant	A firm that operates in a particular market or markets, such as a supplier or customer.
maverick firm	A firm with a relatively small market share in a particular industry that is considered a vigorous and effective competitor and which generally drive

	significant aspects of competition, such as pricing, innovation and/or product development.
merger factors	The non-exhaustive list of factors set out in s. 50(3) of the Act that must be taken into account when assessing whether a merger will contravene the Act, as well as any other factors relevant to the effect of a merger on competition.
minimum efficient scale	The minimum size (typically in terms of output, capacity or customer base) that a firm requires to compete effectively with incumbent suppliers in a market.
niche segment	Refers to a portion of a differentiated market serviced by small, specialised suppliers and often involving products that are in some way distinct from the products of larger suppliers.
notification threshold	The threshold established by the ACCC to identify mergers that should be notified to it (see chapter 2 of these guidelines)
public competition assessment	This outlines the basis for the ACCC reaching its final conclusion on a merger when: the merger is rejected; the merger is subject to enforceable undertakings; the merger parties seek such disclosure; or the merger is approved but raises important issues that the ACCC considers should be made public (published at www.accc.gov.au).
section 87B undertaking	A court enforceable undertaking under s. 87B of the Act that may be accepted by the ACCC to assuage any competition concerns identified.
SSNIP	A small but significant and non-transitory increase in price.
statement of issues	This provides the ACCC's preliminary views on a merger which raises competition concerns requiring further investigation.
structural undertakings	An undertaking that provides for one-off actions that alter the entry conditions, or the vertical or the horizontal relationships in a particular industry. Structural undertakings will typically involve the divestment of part of a merged firm.
sunk costs	Costs that have already been committed by a firm to its business and cannot be recovered on exiting the market.
supply elasticity	This is a measure of how much the quantity of product supplied by a firm responds to specific changes in its particular market (for example, a change in the price of the product, a fall in input prices, or an improvement in production technology).
switching cost	Refers to the cost for customers to switch suppliers (for example, including search costs, transaction costs and market specific behaviour).
Tribunal (the)	Australian Competition Tribunal
undertaking	See section 87B undertaking.
vertical mergers	A merger involving firms operating or potentially operating at different functional levels of the same vertical supply chain.

Joint statement on merger control enforcement

Competition and Markets Authority (CMA), Australian Competition and Consumer Commission (ACCC) and Bundeskartellamt

Purpose of this statement

1. The CMA, ACCC and Bundeskartellamt release this joint statement to highlight to businesses, advisers, courts and governments that there is a common understanding across competition agencies on the need for rigorous and effective merger enforcement. This statement is made in the face of high levels of concentration across various markets in the UK, Australia and Germany and a marked increase in the number of merger reviews involving dynamic and fast-paced markets. The need for effective merger control remains important where our economies are weakened, including as a result of the Coronavirus (Covid-19) pandemic.

2. The combination of the uncertainty inherent in the forward-looking nature of merger control and changes in the nature and complexity of the mergers under review presents challenges to preventing further concentration from anticompetitive mergers over the longer term. It is important that the decisions by competition agencies, the courts and tribunals give due credence to the importance of competition and the economic principles underlying merger control, so as to ensure good outcomes for consumers and the economy.

Purpose of merger control

3. The purpose of merger control is to ensure that relevant transactions are assessed, and anticompetitive mergers are prevented so that consumers benefit from the lower prices, higher quality products and services, greater choice and innovation that effective competition brings. Competition increases consumer trust in markets and drives the functioning of market economies and economic prosperity.

4. Without strong merger control regimes, there is a risk that mergers will proceed that lessen the level of competition by weakening competitive constraints and in some cases strengthening dominant positions. An effective regime therefore seeks to prevent companies from gaining market power

through acquisitions. Firms are typically motivated to use gains in market power to increase shareholder returns at the expense of consumers.

5. Given the long-term structural effects of mergers, ineffective merger control that does not properly scrutinise mergers can cause long-term negative consequences for businesses and end consumers. It can be very difficult, and in some cases impossible, to reverse the loss of competition by taking enforcement action after a merger has taken place. Equally, it can take considerable time for markets to adjust to recover the competition lost through a merger.

The impact of the Coronavirus (Covid-19) pandemic

6. Companies are facing difficult times as a result of the pandemic, which may result in more takeovers and acquisitions. However, these weakened economic conditions and the greater struggles companies may face does not mean that consumers should bear the costs of the loss of competition that can arise from anticompetitive mergers.

7. The pandemic should not be used to bring about a relaxation of the standards against which mergers are ultimately assessed. It is important that merger assessments remain focused on the long-term consequences of a merger and do not unduly focus on short-term market features. For instance, while it is conceivable that the pandemic could lead to an increase in valid failing firm claims, the pandemic is not a reason to lower the standard for accepting such claims. While in some circumstances it may be necessary to factor the short-term impact of the pandemic into merger assessments, this will need to consider the impact on all firms in the market and competition agencies' assessments must remain rigorous and evidence-based. In particular, competition agencies cannot base assessments on speculation or unfounded claims as to the impact of the pandemic.

Challenges for merger control

8. Competition agencies face a difficult challenge when taking a view on future market positions and company actions, and the forward-looking nature of merger control review will always mean competition agencies face some uncertainty when making such decisions. However, uncertainty as to the future should not necessarily mean that potentially anticompetitive mergers are cleared because of that uncertainty: a seemingly small transaction can cause a competitive market to tip in an anticompetitive direction. For example, an acquisition of a small start-up could in reality be the acquisition of what would have been a major competitive threat to the purchaser in the longer term.

9. When faced with uncertainty, it is therefore important that competition agencies are willing to challenge the presumption often promoted by merging firms and their advisers that mergers are generally efficiency-enhancing and should only be restrained where there is certainty that serious detriment will result.

10. Competition agencies are increasingly reviewing mergers in dynamic and fast-paced markets. These mergers can involve hundreds of products or services in related markets, as well as products and services in earlier research and development stages. In addition, the last decade has seen the rise of acquisitive tech giants with activities across multiple current or future markets. Anticompetitive mergers in these markets can cause significant harm given the increased importance of these products and services and the aggregation of data over time across various services. Technology markets can also be examples of highly concentrated markets with features such as high barriers to entry due to network effects. This can result in high market concentration, such that market power is easily created or entrenched, and is likely long-lived.

11. Harm to consumers may arise where incumbents seek to protect their market position by acquiring potential competitors in the form of smaller firms or potential entrants in adjacent markets. This is relevant where, absent the merger, entry or expansion by either or both merger firms may have resulted in new or increased competition between them. Even if the likelihood of entry is not high, the threat of entry can still constrain incumbent firms. This is particularly the case if entry, in the event it occurred, would likely have a substantial impact on the profits of incumbent firms.

12. Merging firms and their advisers often assert that their merger will increase competition. This is generally based on claims that the merger will generate synergies or other efficiencies. Our experience suggests that merging firms often overstate the apparent efficiency benefits of mergers and how these will translate into more competitive outcomes for markets. Given the long-term structural change and clear loss of rivalry that can result from a merger, protecting competition may require the prevention of problematic mergers rather than the acceptance of submissions relating to purportedly procompetitive benefits that are difficult to verify and predict.

13. Companies are often advised and represented by law firms and economists that strongly advocate for their views of the market. Competition agencies (and courts and tribunals where appropriate) are tasked with reviewing and testing that advocacy to examine the evidence, particularly documents and data, and decide whether these claims are supported.

14. The merger review process relies on competitors and customers (who are often unrepresented or not heavily engaged in the review) to make available any evidence that could support or counter the claims of the merging companies. However, it is not uncommon for some firms (whether suppliers, competitors or customers) to be reluctant to provide information that may jeopardise their commercial relationship with the merged firm, particularly if the merged firm is a key customer or supplier. It is also relevant that individual consumers are a disparate and disaggregated group that are often not well placed to coordinate to represent their interests. Because of this, competition agencies, courts and tribunals need to be aware of the risk of accepting the merger firm's views over those of competitors, customers and consumers simply because the merger firms are more engaged in the merger review process.

Remedies

15. In view of the challenges to ensuring effective merger control, competition agencies have an opportunity to reassess their approach so that a degree of uncertainty about future developments in the relevant markets does not lead, by default, to a clearance decision. In practice, this may mean intervening in a merger to seek remedies to maintain competition or, where that is not possible, prohibiting the merger.

16. The increasing complexity of dynamic markets and the need to undertake forward-looking assessments require competition agencies to favour structural over behavioural remedies. It is widely acknowledged that complex behavioural remedies that create continuing economic links and dependencies are unlikely to recreate the pre-merger competitive intensity of the market, can raise significant circumvention risks, and can quickly become outdated as market conditions change. In some circumstances they can also distort the natural development of the market.[1] Behavioural remedies also place a burden on competition agencies and businesses by necessitating extensive post-merger monitoring of companies and their conduct.

17. Structural remedies – whether prohibition or divestment of a standalone business – are more likely to preserve competition and lead to an optimal solution for stakeholders and are therefore in the best interests of consumers. Importantly, the threshold of proof required to prohibit a merger is not higher when no divestment would be effective in restoring the lost competition;

1 CMA109 (18 June 2019), Merger remedy evaluations: Report on case study research.

indeed, protecting competition and consumer welfare can sometimes only be achieved by blocking a merger outright.

The way forward

18. Effective merger control is vital to ensuring competitive markets exist in a free market economy. Competition drives prices down; quality, choice and service up; and pushes companies to innovate. Competition can only be maintained by ensuring anticompetitive mergers do not happen. This is even more so in a fast-developing digital world impacted by the Coronavirus (Covid-19) pandemic. We believe that in the world today there is a real need for strong merger enforcement from competition agencies globally to ensure that high concentration levels do not become the accepted norm, and to maintain and promote competition for the benefit of consumers. To achieve this, competition agencies, courts and tribunals are strongly encouraged to protect competition also when there is uncertainty raised by contentious mergers and ensure the interests of consumers are promoted over the profits of the merging firms.

ECONOMIC COUNCIL OF CANADA

Interim Report on Competition Policy

July 1969

ECONOMIC COUNCIL OF CANADA

INTERIM REPORT ON COMPETITION POLICY

July 1969

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GLOSSARY OF TERMS

BASING-POINT PRICING. A system of product pricing adopted by an industry under which buyers are under compulsion to accept identical prices in a given market regardless of the location of the production facilities of the various suppliers.

> The delivered price to the buyer is made up of the price at a given place, known as the "basing point", plus freight to the point of delivery.... [These freight] ... charges are obtained from freight books prepared by leading companies or trade associations.... A buyer is not allowed to take delivery of the goods F.O.B. plant and transport them by any means he desires.... Under the single basing-point system, one producing center is taken as the base from which all F.O.B. prices are quoted, the delivered price of the product being this F.O.B. price plus freight from the base point to destination. Producers not located at the basing point quote the same delivered price as the firm at that place.... The multiple basing-point system is simply an extension of the single basing-point idea. A number of producing centers become basing points which quote F.O.B. prices, and the delivered price at any given destination will be the lowest combination of base price plus transportation to point of delivery....
>
> Dudley F. Pegrum, *Public Regulation of Business*, rev. ed., Homewood, Ill., Richard D. Irwin, 1965, p. 215.

CARTELS. Arrangements whereby independent business enterprises enter into agreements that have the purpose of restricting competition among them. Most cartels involve an agreement on the prices to be charged and/or a division of a market or markets. International cartels are those cartels which include the enterprises of more than one country.

CONCENTRATION. The proportion of an industry's output accounted for by a specified number of the largest firms.

CONGLOMERATE MERGER. A merger that is neither horizontal (no competitive market relationship) nor vertical (no customer-supplier relationship).

Conglomerate firm -- a firm that has diversified operations.

CONSIGNMENT SELLING. A distributor acts as an agent in selling the products of a manufacturer, with the title to the goods remaining with the manufacturer.

DIRECTED BUYING. See Exclusive Arrangements.

EXCLUSIVE ARRANGEMENTS. These undertakings serve to foreclose the part of the market covered by the agreement from the supplier's competitors. However, it should be noted that the contracts or other arrangements may serve legitimate business needs and need not involve any detriment to the public. Exclusive arrangements include:

a) *Directed Buying*. A form of exclusive dealing under which a supplier may require a distributor of his product to buy other products from a stipulated firm or firms. Directed buying will ordinarily imply a *market-access arrangement* (see below).

b) *Exclusive Dealing*. A contractual undertaking between a supplier and a purchaser under which the purchaser agrees not to handle a product or products sold by competitors of the supplier. (The contract may also obligate the supplier not to make the product available to other purchasers in the relevant market, in which case there is said to be a "bilateral exclusive agreement".) *Franchise agreements* are a form of exclusive dealing.

c) *Full-Line Forcing*. An obligation imposed on a firm wishing to distribute a particular product to handle the entire line of the supplier of that product.

d) *Market-Access Arrangement*. An agreement between a firm that controls access to a group of outlets and one or more suppliers, which gives exclusive or preferred access to the outlets in return for a commission to the firm on sales to such outlets.

e) *Reciprocal Buying*. A practice that may occur when two multiproduct firms, A and B, are in a customer-supplier relationship for some products and a supplier-customer relationship for others. Firm A may agree to obtain all or most of its requirements of product X from firm B on condition that firm B obtain all or most of its requirements of product Y from firm A. Other competitors are thus wholly or partly excluded from the markets for products X and Y.

f) *Requirements Contract*. An obligation that requires the purchaser to obtain his total requirements of a product or service from a single supplier over a given period.

g) *Tying Arrangement (Contract)*. An obligation between a supplier and a buyer that obligates the latter to buy from the supplier a product or service (tied good/tied service) in addition to the one the distributor wants to obtain (tying good/tying service).

EXCLUSIVE DEALING. See Exclusive Arrangements.

FRANCHISE AGREEMENTS. See Exclusive Arrangements -- Exclusive Dealing.

FULL-LINE FORCING. See Exclusive Arrangements.

GEOGRAPHIC MARKET EXTENSION. A term used to describe the extension by a firm (via internal expansion or merger) into geographical markets where it was not previously represented either in the production and/or distribution of its products or services.

HORIZONTAL MARKET RELATIONSHIP. A market relationship in which two firms are in direct competition with each other, such as two suppliers of a similar product or service. (This definition has been further refined in Appendix III of this Report to distinguish between "ordinary" horizontal relationships, in which two firms sell the same product in the same market, and "other" horizontal in which the area of common activity is too small for the firms to be considered as direct competitors.)

INTERLOCKING DIRECTORATES. A situation under which two or more companies have overlapping Boards of Directors.

MARKET-ACCESS arrangements. See Exclusive Arrangements.

MARKET POWER. The ability to earn profits, over a long period of time, higher than those which would have to be earned by efficient firms in order to attract and maintain sufficient capital to stay in business.

MERGER. A union of two previously separate firms through the acquisition by one of the whole or part of the assets or voting stock of the other; or the union of two or more firms through share exchange. Mergers may be described as vertical, horizontal or conglomerate.

MONOPOLY. Strictly speaking, under "monopoly", there is a sole supplier of a good or service to a market. In reality there is more likely to be a firm with virtually complete, but not wholly complete, control over the supply of the good or service to that market.

MONOPSONY. The converse to monopoly. Under monopsony, there is in theory a sole buyer of a good or service from a market. However in reality there is more likely to be a firm with virtually complete but not wholly complete control over the demand for the good or service from that market.

OLIGOPOLY. A condition under which the supply of a good or service to a market is controlled by a relatively small number of firms.

OLIGOPSONY. The converse to oligopoly. A condition under which the demand for a good or service is controlled by a relatively small number of firms.

PER SE OFFENCE. An offence subject to an unconditional ban.

PREDATORY PRACTICE. The activities of a firm or firms directed to the object of eliminating a competitor. These activities are such that they would not normally be expected to be profitable unless they had the prospect of disciplining or eliminating a competitor.

PRICE DISCRIMINATION. A pricing policy whereby products or services are offered by a manufacturer or distributor to customers at different prices not justified by cost differences; or at the same prices where there are different costs.

PRODUCT EXTENSION. A term used here to designate the entry (by internal expansion or merger) by a manufacturer into a product line that is complementary to the line he is already producing.

RECIPROCAL BUYING. See Exclusive Arrangements.

REFUSAL TO DEAL. The practice by a seller of refusing to deal with particular buyers or with a particular class of buyers.

REQUIREMENTS CONTRACT. See Exclusive Arrangements.

RESALE PRICE MAINTENANCE. An obligation imposed on a distributor to sell a product at the price (or minimum price) specified by the supplier. The practice may often result from pressure applied by the distributors on the supplier.

RESTRICTIVE AGREEMENT. See Cartels.

TYING ARRANGEMENT (CONTRACT). See Exclusive Arrangements.

VERTICAL MARKET RELATIONSHIP. *Vertical forward* integration brings a firm (via internal expansion or merger) a step closer to the final consumer -- such as a manufacturer moving into wholesaling. *Vertical backward* integration brings a firm (via internal expansion or merger) closer to its source of supply.

CHAPTER 1

INTRODUCTION

This is the Council's second Report in response to a special Reference from the federal government, dated July 22, 1966, requesting the Council,

> "In the light of the Government's long-term economic objectives, to study and advise regarding:
>
> (a) the interests of the consumer particularly as they relate to the functions of the Department of the Registrar General [now the Department of Consumer and Corporate Affairs];
>
> (b) combines, mergers, monopolies and restraint of trade;
>
> (c) patents, trade marks, copyrights and registered industrial designs."

The first part of the Reference was treated in the Council's *Interim Report on Consumer Affairs*, published in 1967. The present Report deals with the second part -- that is, with "combines, mergers, monopolies and restraint of trade" or, as we prefer to call it, competition policy. It is designated an *interim* document to indicate: (a) that further reports are to be issued, and (b) that these reports are likely to include further discussion of combines, mergers, monopolies and restraint of trade. The Council's next report will discuss patents, copyrights, trademarks and registered industrial designs. A fourth and final report will then be issued containing further observations and recommendations, notably on the subject of consumer affairs, and a general summing-up of the interrelations between the three main elements of the Reference and their place in the broader spectrum of government economic policies.

The last substantial revisions to Canadian anticombines law took place in 1960. Even more time has elapsed since the law as a whole was last subjected to thoroughgoing study -- by the MacQuarrie Committee in 1951-52. Over the intervening period, much has happened to the Canadian economy, both in terms of particular events and in terms of less dramatic but sometimes more fundamental underlying trends. Among the events may be mentioned the following:

-- the resources boom of the mid-1950's;

-- the North American economic slowdown of the late 1950's and early 1960's;

-- the devaluation of the Canadian dollar in 1960-62 and the return to a fixed exchange rate in April 1962;

-- the defence-sharing and automobile-production arrangements with the United States;

-- a series of tariff reductions culminating in the Kennedy Round;

-- the "Great Expansion" of the economy in the 1960's.

Among the trends have been the continuing industrialization and urbanization of Canada, the persisting decline in agricultural employment, the relative rise in employment in service industries to a point where they now account for more than half of total employment, and the sharp increase (though from a low starting point) in the share of manufactured goods in total exports.

Meanwhile, the external economic environment has been altering in important ways. Of the various changes that were by no means readily foreseeable in 1951-52, three in particular may be mentioned as having major long-term significance for Canadian industrial organization and structure: the successful postwar recovery and subsequent rapid growth of the economies of Western Europe as a whole and of Japan, the strong absolute and relative increase in world trade in manufactured products, and the rise of the international corporation.

The above lists are far from exhaustive; their purpose is merely to recall how different, in certain respects other than sheer size, is the Canadian economy of 1969 from the entity with which the MacQuarrie Committee was concerned. There are of course many similarities also, and not all of the changes that have occurred since 1952 have been such as to affect greatly the appropriateness or inappropriateness of anticombines policies. Perhaps the most significant change has been less a measurable, physical one than a shift in attitudes regarding the likely future course of Canada's economic development. In the early 1950's, such a forward look would typically have laid much emphasis on the growth of primary resource-based industries and their supporting infrastructure. A similar look today would still devote a good deal of attention to these industries, but would allot a larger proportionate place than before to secondary and tertiary industry, and to certain particular matters such as the desirability of developing greater scale, specialization and export-orientation in Canadian manufacturing, with all that this would imply in the way of manpower training, technological change, and policies to smooth and promote industrial adjustment.

Enough has therefore happened, both to the Canadian economy and to attitudes regarding its future, to make timely a general reappraisal of anticombines legislation. This timeliness is reinforced by the persistence since 1952 of discussion and argument regarding various features of the legislation. No policy in this field will ever be uncontroversial, and certain basic dilemmas are bound to persist and be a continuing subject of discussion. But it is our impression that too much of the debate in Canada has settled into a stock pattern -- has involved opposing positions that have existed so long as to become almost a national tradition. Anything that could be done towards resolving some of these set-piece controversies would liberate mental energies for much-needed consideration of newer problems.

Finally, it may be noted that a reappraisal of this branch of economic policy is also rendered timely by the administrative transfer of the Combines Branch from the Department of Justice to what has since become the Department of Consumer and Corporate Affairs. Even apart from other considerations, this transfer would have made it desirable to examine the functions of the Branch and how they might best be integrated with the new Department's other responsibilities.

In its Reference to the Council, the Government made clear that the review of combines, mergers, monopolies and restraint of trade should be fundamental in character:

> Mr. Favreau further stated that the importance of this study cannot be over-estimated as a first and necessary step in the determination of a cohesive economic policy in relation to these important matters considered as a whole and in relation to each other with a view to bringing the policy in these matters into harmony with the overall economic policy of Canada and the needs of the consumer and other important segments of the economy.[1]

The sequential treatment of the three main sections of the Government's Reference of 1966 has been adopted as the best means of taking account, on the one hand, of the inherent complexity of the subject matter and, on the other, of the Government's desire to proceed to legislative proposals in certain areas without undue delay. While, therefore, some work has gone forward from the beginning on all three sections of the Reference, research resources have deliberately been concentrated on each section in turn. This research will ultimately give rise not only to reports such as the present one, but also to staff and other studies designed for a more specialized audience.

Shortly after receiving the Reference, the Economic Council advertised across Canada its readiness to receive written submissions from individuals and organizations regarding any of the areas to be studied. Nearly 40 such submissions have been received. They have proved of value in identifying problems and issues and in pointing to appropriate fields of inquiry for the Council's research program. We are grateful to those who expended time and effort on the preparation of submissions.

Notes and References

[1] Press Release of July 22, 1966, issued by the President of the Privy Council, Ottawa. See Appendix I.

CHAPTER 2

PHILOSOPHY AND PROBLEMS OF COMPETITION POLICY

This Chapter will set forth what we believe should be the basic objective of Canadian government policy relating to combines, mergers, monopolies and restraint of trade. It will place this objective in a broader context of economic goals and policies for the achievement of such goals, and indicate some of the more important problems that arise in the practical implementation of competition policy.

The Council's view, in brief, is that the objective of legislation such as the Combines Investigation Act should be the promotion of dynamic efficiency, flexibility and good all-round performance in the Canadian economy. Competition is regarded as only a means, though an important means, to this end. Conceived in this fashion, "competition policy" can be readily related to the goals for the Canadian economy elaborated by this Council in successive Annual Reviews. It can also be related to policies such as tariff policy, manpower policy, and patent policy which strongly condition how favourable or otherwise the economic environment is likely to be for the strengthening of effective competition and the achievement of high levels of efficiency.

But while the establishment of these linkages makes possible a clearer and more consistent view of the place of competition policy in the total spectrum of economic policies, there must also be discussed certain special difficulties of policy administration and enforcement. In some areas of competition policy, reliance can be placed on relatively broad prohibitions of anticompetitive behaviour, but in other areas more discretion must be exercised and more analysis of probable economic effects brought to bear on individual cases.

It is useful for some purposes to think of competition as one form (the most impersonal form) of social control of industry. Where competition is such as to promote the efficient use of manpower, capital and natural resources, it obviates or lessens the need for other forms of control such as more or less detailed public regulation or public ownership of industry.

Competition Policy

There are of course sectors of the economy, such as the post office, telephones, and other natural monopolies, in which other forms of control are needed. This does not mean, however, that competition policy should never apply to such sectors. On the contrary, a comprehensive and broadly conceived competition policy should concern itself with promoting efficiency in *all* parts of the economy, by whatever means are most appropriate in each particular case. It should include periodic assessments of publicly owned and publicly regulated sectors to see whether the arrangements there are truly furthering the public interest in efficient economic performance. In some cases, it may be found, as it was recently in the case of the railways, that conditions are ripe for more market competition and less direct regulation.

Objectives of Competition Policy

In the past, the major objective of Canadian competition policy has usually been expressed in such terms as "the protection of the public interest in free competition". But it is necessary to go behind this and ask what the preservation of competition was intended to accomplish. One would be unwise to assume that what the legislators aimed at was a single, simple end such as economic efficiency. At least some role was likely played by considerations such as the desire to diffuse economic power (and thus, by implication, political power), sympathy for the plight of the small enterprise and entrepreneur, suspicion of big business, and concern for the fairness of competitive behaviour.

On the whole, however, competition policy in Canada appears to have been directed towards more strictly economic ends. Two such ends may be distinguished, one being concerned with the distribution of income, the other with the allocation of real resources in the economy.

Popular thinking about competition policy has tended to stress the first, or income, objective. Opposition to noncompetitive situations such as outright monopoly (to take the extreme example, although less extreme cases of imperfect competition would serve the turn as well) has traditionally centred on the transfer of income from the buyer to the monopoly seller. The abnormal monopoly profit may be regarded as an unnecessary exaction -- as a privately imposed tax. This point was no doubt uppermost in the minds of the farm interests who were among the stronger supporters of early anticombines and antitrust legislation in Canada and the United States before the turn of the century. They, like others, wanted to recover some of the income which they believed had been transferred from themselves to the tariff-protected and in some cases quite highly concentrated manufacturing industries from which they bought. (They also had grievances against the railroads, which then dominated land transport to a far greater extent than today, but in this case the chief mode of social control adopted was public regulation.)

Professional economists, while not ignoring income distribution effects, have tended to be more concerned with the second objective of competition policy -- the resource-allocation objective. This is a less obvious objective, but a highly relevant one for broad economic goals such as productivity growth. To many economists, the greatest objection to monopoly (again using the extreme example) is that it distorts the way scarce human and physical resources are brought together and used to meet the many demands of consumers. It leads, in other words, to inefficiency. The monopolist's prices are too high, relative to other prices, and because the usual adjustment machinery is not operative, they remain so. As a result, "relative prices become unreliable as indexes of relative scarcities and relative demands ... too little will be produced and too few resources utilized in [monopolistic] industries with high margins; and too much will be produced and too many resources utilized in industries with low margins."[1] These distortions may occur primarily in final consumer markets, such as the market for some kinds of household appliances, or they may originate further back, say in the market where the appliance-maker buys his steel. They may include distortions of production methods, as for example where a high monopoly price for a certain kind of production machinery may cause the appliance-maker to use less of it than he ideally should. But wherever in the production and distribution process the distortion occurs, it will have an adverse effect on the quantities and varieties of products reaching the consumer and on the prices he pays for them.

When the statement is made that monopoly results in inefficiency, a different and broader standard of efficiency is being applied than might well be used by an investor deciding whether or not to put his money into a company. To him, a large and growing sales volume and a consistent record of well-maintained earnings and dividends will seem conclusive evidence of efficiency. But the "efficiency" that is relevant for problems of competition and monopoly is a different, economy-wide concept. It poses the question of how well the economy is doing one of its basic jobs -- that of allocating resources between different tasks, and in this way determining what goods and services get produced, how they are produced, and for whom they are produced. Viewed in this light, the investor's hypothetical company may not look so good. The conclusion may emerge that, from the standpoint of the general public interest, and having regard to all the marketing and production opportunities and other circumstances that were present, the sales volume of the industry to which the company belongs should have grown twice as fast, with lower prices and profit margins.

It would be wrong, however, to leave the impression that the consequences for efficiency of a relative absence of competitive pressure are invariably an esoteric matter, beyond the capacity of an ordinary intelligent person to discern. As everyday observation will confirm, lack of strong competition in a company's product market increases the risk of sloppiness, poor use of productive resources, and excessive production and distribution costs. An environment is created in which both waste and a comfortable, if not necessarily spectacular, profit margin can persist, undisturbed by clear and urgent signals from the market.

This brings us to a fundamental tenet relating to competition policy. The institution and maintenance of a competition policy such as presently exists in Canada may be taken to reflect a belief that, over the greater part of the economy, competitive market forces are potentially capable of allocating resources better and more cheaply, with a less cumbersome administrative overhead, than any alternative arrangement such as wholesale public ownership and control, detailed government regulation of enterprise, or self-regulation by large industrial units within a corporate state. The function of competition policy is not to bring about a textbook regime of "perfect" competition in all the various markets making up the system, but rather to encourage the liberation of the system's maximum competitive potential, "imperfect" though this may be. The resulting competition is valued not for itself, but for what it can accomplish in putting resources to work efficiently and effectively. Thus the market does the job, and the government's main responsibility, so far as efficiency in resource allocation is concerned, is to see that the market is free to do the best job of which it is capable. Competition is relied upon as the prime mechanism of social control:

> The legislation postulates the continuing existence of a free enterprise economy, actuated by the profit motive, in which those who wish to compete for economic gain should, to the largest extent possible, be allowed to compete free from artificial restraints imposed upon them by their competitors or other members of trade or industry. What Parliament contemplates, as expressed in this legislation, is the regulation of industry by the forces of competition rather than regulation by members of industry itself.[2]

Competition and Efficiency

It will be a recurrent theme of this Report that Canadian competition policy should aim primarily at bringing about more efficient performance by the economy as a whole. *Competition should not itself be the objective* but rather the most important single *means* by which efficiency is achieved. First, however, it is necessary to say something about the nature of competition in a modern economy and its relationship to efficiency.

As is well known, the great majority of markets do not fulfil the conditions of the economist's abstract model of "perfect" competition, wherein there are many fully informed producers and consumers, the market operates with exceptional swiftness and efficiency, and no individual seller or buyer has any significant leverage or market power. At the other end of the scale, the case of pure monopoly is also very rare in real life, especially if one is inclined to take a broad view of the possibilities of product substitution. Most markets (the North American market for automobiles is a good example) fall between these limits, in the grey zone of imperfect competition. Sellers are sometimes relatively few, and some of them may be big and powerful. The moves made by any one seller may be much affected by his expectation of how the others will react, in which case the situation may be described as one of "oligopoly". Many variants and degrees of imperfect competition are to be found, with factors such as the amount of import competition exerting an important influence. In some cases, the imperfection of competition may partly reflect successful efforts by firms to differentiate their products -- to use product features and design, packaging and advertising, to persuade the consumer that what he is buying is significantly different from what the firm's competitors are offering.

Most markets thus being in one way or another imperfect, the model of perfect competition remains essentially an abstraction, useful for purposes of formal economic analysis because it is one end of a range, providing a point of reference and standard of comparison. (Moreover, it is not wholly without some predictive power in real-life situations.) But it cannot be and has not been a simple guide for the application of competition policy. Whatever deficiencies may be laid at the door of Canadian competition policy, any allegation that it has amounted to a systematic, if futile, attempt to impose perfect competition on the economy cannot be sustained on the evidence of reports and cases under the Combines Investigation Act.

To note the abstract quality of the perfectly competitive model, however, is very far from saying that economic analysis has little to contribute to competition policy. The nature and characteristics of imperfectly competitive markets have been extensively studied, and while this process has as yet failed to produce a satisfactory model or set of models that can be relied upon to predict what will happen in each of the many varieties of imperfectly competitive situations that are found in real life, a number of useful inferences have been drawn. Principles and concepts have been evolved that have a strong appeal to common sense and can be utilized to good effect in practical policy administration. One such principle is the desirability of keeping open for the buyer an adequate number of real options. However, what is deemed adequate in any particular case must inevitably be tempered by other considerations such as the technological conditions of production in an industry, which may make the optimal situation one of a relatively small number of plants producing on a large scale.[3] Subject to this qualification, a buyer will generally prefer to have three or four actual or potential suppliers of an item rather than only one. A typical concern of competition policy is to look into situations where real options available to the customer are in the process of being unjustifiably reduced.

Another concept highly relevant to competition policy in a world of imperfect competition is that of the ease of entry into an industry.[4] For customers to be faced with only one or two suppliers of an item may be a tolerable situation if it would be relatively easy for other firms (including importers) to enter the business. The possibility of this occurring will tend to make the existing suppliers less tempted to exploit their customers to the point where their profit levels might attract new firms into the industry. But where it is very difficult and expensive for outsiders to break in (they might, for example, have to put very large sums into initial plant and equipment outlays and advertising), the customer is likely to be more vulnerable.

Still other concepts and principles are useful for assessing product differentiation and the many types of nonprice competition that are encountered in imperfectly competitive markets -- for example, competition in respect of product features and after-sales service. A basic principle here is that competition is to be valued according to the real net benefit it yields to the ultimate consumer. Some types and degrees of nonprice competition may pass this test while some may not. For example, the net benefit to the consumer of trading stamps and some other promotional devices has frequently been called into question. Despite such criticisms, it is still too widely assumed that *any* form of vigorous business rivalry amounts to healthy competition and is therefore good for the economy.

It must be added that imperfections of competition do not always arise primarily on the selling side of the market. Buyers, too, (supermarket and department store chains, for example) can wield substantial market power in their dealings with suppliers, as was pointed out forcefully in some of the briefs submitted to us. Assessment of such situations can often be peculiarly difficult, not least because of the natural tendency of most people to sympathize with any underdog. But while it may seem hard, here again analysis and policy are likely to be soundest if the primary consideration continues to be the interest of the consumer rather than that of any particular producer. This means, for one thing, that relations between, say, retailers and suppliers should never be considered independently of the state of affairs in the final market where retailers meet consumers. Where that final market is characterized by vigorous competition of a type beneficial to consumers, a "squeeze" being experienced by suppliers may largely represent a normal "upstream" transmission of competitive pressures, perhaps exacerbated in some cases by the temporarily disturbing introduction of more efficient production and distribution techniques. Where, on the other hand, the final market is not notably competitive, the squeezing of suppliers may be more in the nature of an exercise of market power, possibly tending towards an eventual elimination of independent suppliers and a backward extension of noncompetitiveness through vertical integration. Even here, however, the real crux of the situation remains the noncompetitiveness of the final market. Only those policy actions that in one way or another correct this (such as by reducing barriers to the entry of new retailers) are likely to have much beneficial effect.

"Dynamic" Competition

In using economic analysis for purposes of competition policy, it is important to view competition and efficiency in dynamic rather than purely static terms. That is, they must be seen in a context of economic change over time, with new products, industries and methods of distribution constantly coming forward and old ones dying off.

This point, which over the course of a generation has come to be widely recognized by economists and administrators, was first made in a major way by the late Joseph Schumpeter. Schumpeter's study of the historical rise of capitalism led him to the belief that the central impulse of economic progress was "the perennial gale of creative destruction", incessantly revolutionizing the economic structure from within. This, in his view, necessitated the rejection of:

> ... the traditional conception of the *modus operandi* of competition. Economists are at long last emerging from the stage in which price competition was all they saw. As soon as quality competition and sales effort are admitted into the sacred precincts of theory, the price variable is ousted from its dominant position. However, it is still competition within a rigid pattern of invariant conditions, methods of production and forms of industrial organization in particular, that practically monopolizes attention. But in capitalist reality as distinguished from its textbook picture, it is not that kind of competition which counts but the competition from the new commodity, the new technology, the new source of supply, the new type of organization (the largest-scale unit of control for instance) -- competition which commands a decisive cost or quality advantage and which strikes not at the margins of the profits and the outputs of the existing firms but at their foundations and their very lives. This kind of competition is as much more effective than the other as a bombardment is in comparison with forcing a door, and so much more important that it becomes a matter of comparative indifference whether competition in the ordinary sense functions more or less promptly....[5]

Not only did Schumpeter find invention and innovation, in a very broad sense, to be the key to progress; he also made a case that some degree of monopoly and restrictive practice was necessary to "steady the ship" and provide the sort of environment in which technical progress and innovation could occur. At the same time, however, he did not conclude from his analysis that all competition policy should be discontinued. He was prepared to recognize, for example, that some restrictive business practices were less an essential safeguard for the early stages of new product development than they were an ultimately futile but temporarily disrupting effort to fight inevitable change. What he did urge was a more flexible and discriminating approach to competition policy:

> Even as now extended however, our argument does not cover all cases of restrictive or regulating strategy, many of which no doubt have that injurious effect on the long-run development of output which

> is uncritically attributed to all of them. And even in the cases our argument does cover, the net effect is a question of the circumstances and of the way in which and the degree to which industry regulates itself in each individual case. It is certainly as conceivable that an all-pervading cartel system might sabotage all progress as it is that it might realize, with smaller social and private costs, all that perfect competition is supposed to realize. This is why our argument does not amount to a case against state regulation. It does show that there is no general case for indiscriminate "trust-busting" or for the prosecution of everything that qualifies as a restraint of trade.[6]

The Schumpeter hypothesis, which was originally developed on a basis of extensive but relatively crude empirical observation, has remained a rich source of controversy and a spur to further economic research and testing up to the present day. It has, for example, been a major stimulus to the large volume of factual investigation, either completed or under way, into relationships between research and innovative activity on the one hand and the size and other characteristics of companies on the other -- a matter touched on in Chapter 5 of this Report. This and other evidence have been variously interpreted, and the present state of the argument is difficult to summarize. It is not necessarily inconsistent to feel that, while certain degrees of corporate bigness and associated phenomena are appropriate in some industries as a means of helping to bring about socially desirable levels of research, invention and innovation, too *little* competition would remove one of the most important spurs to these types of activity. One American authority, Richard Caves, has reached the conclusion that "some degree of concentration is needed to promote research and innovation, but whether existing structures provide too much or too little remains debatable".[7] Another, Jesse W. Markham, suggests that Schumpeter's theory ought to be treated as a "threshold theory", which states that "some departure from a state of perfect competition (or the presence of some monopoly) is a necessary concomitant of innovation, but it does not follow that twice this volume of departures, somehow measured, should lead to twice the volume of innovations". He goes on to say that the intensive statistical analysis of invention that has occurred since Schumpeter "provides no basis for either condemning or beating the drums for bigness or for concentration on the grounds that they either stifle or promote technical progress ... corporate size and market power in excess of Schumpeterian threshold levels appear to be with us, and for this and other reasons are still legitimate concerns of public policy."[8]

Where there would probably be a wide measure of agreement would be on the proposition that competition must be seen in its dynamic dimension. To the greatest extent possible, competition policy should be administered in such a way that due account is taken of the competitive impact of, and the desire for, new products and new methods of production and distribution.

The New Industrial State

A much more recent work than Schumpeter's, dealing with matters of industrial organization, is J. K. Galbraith's *The New Industrial State*. This book has already been widely read and discussed, and for this reason should be mentioned at least briefly here. It covers, of course, a considerably wider territory than competition policy. It is nothing less than an attempt to discern, on the basis of developments observable in certain sectors of the U.S. economy, some central tendencies of modern industrial societies. Walter Adams, at the outset of what later becomes a distinctly critical article, summarizes Galbraith's main argument thus:

> He finds that the giant corporation has achieved such dominance of American industry that it can control its environment and immunize itself from the discipline of all exogenous control mechanisms -- especially the competitive market. Through separation of ownership from management, it has emancipated itself from the control of stockholders. By reinvestment of profits (internal financing), it has eliminated the influence of the financier and the capital market. By brainwashing its clientele, it has insulated itself from consumer sovereignty. By possession of market power, it has come to dominate both suppliers and customers. By judicious identification with and manipulation of the state, it has achieved autonomy. Whatever

> it cannot do for itself to assure survival and growth, a compliant government does on its behalf -- assuring the maintenance of full employment, eliminating the risk of and subsidizing the investment in research and development, and assuring the supply of scientific and technical skills required by the modern technostructure. In return for this privileged autonomy, the industrial giant performs society's planning function. And this, according to Galbraith, is not only inevitable (because technological imperatives dictate it); it is also good. To be sure, Galbraith recognizes that the industrial state poses a grave problem for the esthetic and other non-economic values of our civilization. But this is simply a matter for future negotiation between our intellectuals and the technostructure. So far as the economic system is concerned, the only remaining task, it seems, is to recognize the trend, to accept it as inexorable necessity, and, presumably, not to stand in its way.[9]

So far as competition policy is concerned, the essential issue raised by Galbraith is whether the U.S. economy has gone, or soon will have gone, so far along the lines he describes that any attempt to strengthen competition and market forces would be largely an exercise in futility. He concedes that antitrust policy still has a marginal usefulness in some areas, but for the most part he appears to regard it as a piece of harmless deception. In the sectors of the economy with which he is principally concerned, he sees no value in it:

> It follows that the antitrust laws, in seeking to preserve the market, are an anachronism in the larger world of industrial planning.[10]

It is clearly apparent that, as in some of his previous works, Galbraith in *The New Industrial State* deliberately set out to be provocative. It is equally apparent that he has been successful. Economists, in particular, have taken up the challenge in respect of several of the major arguments. A recurring criticism is that of excessive generalization. There seems little doubt that the tendencies described in the book may be found in certain parts of the U.S. economy. The vital question for public policy is how pervasive these tendencies are -- how representative they are of what is going on or soon will be going on in the American economy as a whole. Many critics believe them to be a great deal more special and less representative than does Galbraith.

What of the relevance of the book for Canada? Is market competition in Canada dying and beyond resuscitation? Bits and pieces of evidence relating to this matter are available -- for example, the industrial concentration data referred to in Chapter 5. There are, however, large gaps, and answers to the questions posed above must be in part impressionistic. On this basis, it would be our conclusion that, over the greater part of the Canadian economy, and provided they are supported by adequate competition policy and other appropriate policies, competitive market forces can be an important factor making for efficient economic performance. We would note in passing that a substantial proportion of the American industrial landscape painted by Galbraith appears to involve industries much of whose output flows into defence and space programs. It is not really surprising if in such industries the managerial role of the "technostructure" is very significant, relations with government are close, and the role of market forces is attenuated. Somewhat similar situations are to be found in Canada, but as might be expected from the relatively smaller size and complexity of Canadian defence and space programs, they bulk less large in the economy.

The above is not meant to be an out-of-hand dismissal of the importance for Canada of *The New Industrial State*. On the contrary, the issues raised by Galbraith are worthy of consideration in all industrialized countries. One issue suggested by the book is the general role of the corporation (particularly the large corporation) in a democratic state. What is the chief goal of large corporations? Is it still, in the final analysis, some kind of profit-maximization (perhaps on a very long-run basis); or has it, as Galbraith suggests, become something decidedly different? Is it desirable, in the interests of society as a whole, that large corporate organizations should concentrate their resources and energies primarily on the achievement of their own business goals? How far should they go into what might be described as "extracurricular activities" -- assuming community leadership, setting up foundations, contributing to educational and charitable causes, and in other ways endeavouring to live up to codes of good corporate citizenship? These are not idle speculations, for, unlike most individuals, many "corporate citizens", in both their main and their subsidiary activities, determine the use of very large amounts of resources. How well these resources are used, from the point of view of the total society, is of much significance. So too, therefore, are the social responsibilities of corporations and the locus of decision-making power within them.

We earlier characterized competition as a means of social control of the economy, contrasting it with alternative means such as public ownership and public-utility-type regulation. A further question suggested by a reading of *The New Industrial State* is whether, in cases where competition was seen to be no longer effective as a means of social control, inexorable pressure would not fairly soon develop for the institution of other means. Even the most intelligent policies for the preservation and encouragement of competition are bound to be seen by businessmen subject to them as something of a nuisance and a harassment. But this view should be tempered by considering the other policy options that might well be exercised in the absence of effective competition.

In the case of an oligopolistic and product-differentiating industry selling directly to consumers, one policy option that may need to be exercised, even if matters have not yet reached the stage where major alternative means of social control are being considered, is a heightened emphasis on consumer protection and consumer information. Policies in these areas may, to some extent, remedy a lack of competitiveness (particularly price competitiveness) in a market. For example, better product information from an unbiased source may enable the consumer to form a lower and more realistic estimate of how much a particular piece of product differentiation is really worth to him. Acting on this estimate, he may bring about a shift in the market towards a more even confrontation of products and sharper price competition.

Competition Policy and Economic Goals

The discussion to this point of the objectives of competition policy may be recapitulated as follows:

-- the main objective of competition policy should be that of obtaining the most efficient possible performance from the economy;

-- at any given moment, the economy should be using the resources available to it in ways that most contribute to raising total output in accordance with consumer demands;

-- the efficiency of resource use must, however, be seen in dynamic as well as static terms, which implies among other things the recognition of the importance of research, invention and innovation;

-- but the dynamic view also implies that as demands change and technology advances, resources should move freely into new and better patterns of use, and it is important therefore that monopoly and restrictive practices should not be allowed to get in the way of this process and prevent the economy from deploying its resources to better advantage in a changing world.

Essentially, we are advocating the adoption of a single objective for competition policy: the improvement of economic efficiency and the avoidance of economic waste, with a view to enhancing the well-being of Canadians. In conjunction with other policies, competition policy should seek to develop an economic environment in which beneficial change will be initiated and carried through, and in which real income will be maximized.

This concentration on one objective is not meant to imply any necessary disparagement of other objectives, such as more equitable distribution of income and the diffusion of economic power, which have been entertained for competition policy in the past. It is simply that we believe:

(1) that a competition policy concentrated on the efficiency objective is likely to be applied more consistently and effectively; and

(2) that there exist more comprehensive and faster-working instruments, particularly the tax system and the structure of transfer payments, for accomplishing the deliberate redistribution of income and the diffusion of economic power, to whatever extent these are thought to be desirable.

On the point of consistency, it may be explained by way of example that a competition policy that assigned equal importance to maximizing economic efficiency and diffusing economic power would be likely on occasion to run into a conflict of goals. It is a stern reality of a competitive market system that from time to time some competitors go to the wall. If this occurs mainly because of predatory or exclusionary tactics practised by other competitors, there may well be a good case for competition policy to intervene. But if the squeezing out of competitors appears to be part of a process likely to produce increased efficiency and lower costs and prices (if, for instance, a number of small corner stores are being forced out of business by the entry of new, low-cost, mass distributors) then a dilemma is faced. The economic efficiency goal might well suggest letting the process work itself out; the goal of diffusing economic power would call for intervention. By recommending that efficiency be the sole objective of competition policy, we are in effect saying that no individual competitor, corporate or otherwise, has an inherent right to stay in business.

It must not be thought, however, that the single-minded pursuit of efficiency would invariably work against the diffusion of economic power, or indeed against the achievement of more equal income distribution. Most of the time, action to promote efficiency would also result in some progress towards the other goals mentioned. For example, while we do not believe that an efficiency-oriented competition policy would necessarily be concerned to guarantee the survival of already-established enterprises in an industry, we do strongly believe that such a policy would be very much concerned with eliminating barriers to the entry of new enterprises, some of which would often be relatively small enterprises.

If, then, the objective of competition policy can be taken to be the promotion of economic efficiency and the reduction of economic waste, how may this be related to the five economic goals for Canada elaborated by the Economic Council in successive Annual Reviews? These goals, it will be recalled, are full employment, a high rate of economic growth, reasonable stability of prices, a viable balance of international payments, and an equitable distribution of rising incomes.

Some economic policies are capable, at least upon occasion, of facilitating the attainment of more than one goal. At the same time, however, policies tend to be specialized in their application, and to be more relevant for one goal than for others (hence the need for a skilful blending of policies in order to work towards all goals simultaneously). This is clearly true of competition policy which, though it has at least some bearing on all five goals, is most relevant for the goal of rapid economic growth. To the extent that the policy works as it should, it opens the way for market forces to operate more freely at all stages of the productive process and improves the prospects of rapid productivity growth. A specific example will illustrate this. As has already been mentioned, one of the typical preoccupations of competition policy is to lower unnecessary barriers to the entry of new firms into industries. In other words, there should be no unneeded roadblocks in the way of the person who thinks that he can come in and do the job better and cheaper. Thus an important element in the 1951 decision to ban resale price maintenance in Canada was the view that there should be nothing to prevent a retailer from trying to operate on a basis of high volume and low mark-up. It is just such a basis of operation that has made possible the retailing revolution of the last 40 years and the increase in productivity that has accompanied it.

The liberation of market forces, which competition policy seeks to achieve, helps to produce a pattern of output more closely related to consumer needs. This point was made in the Council's *Interim Report on Consumer Affairs:*

> High standards of performance in the Canadian economy -- including particularly the maintenance of high employment, strong productivity growth and

> reasonable price stability -- will provide a basis for achieving important and continuing improvements in consumer welfare and real living standards. However, these improvements will only be realized fully and effectively if adequate attention is paid to the process of relating productive efforts as closely as possible to the needs and aspirations of consumers. To a large extent this can be achieved by the operation of flexible markets sensitive to changing consumer preferences.[11]

A competition policy aiming at economic efficiency can be fairly readily related to a second major goal of the Canadian economy, that of a viable balance of international payments. In general, a policy that strives to maintain an adequate degree of competition in the domestic market will tend to harden the economy's muscles and render it better able to meet the tests of international competition. From time to time, however, certain conflicts may occur -- for example, where conditions in foreign markets make it appropriate for exporting enterprises to form consortia or other types of intercompany association. It may be difficult to prevent these consortia from impinging back upon the domestic market and running afoul of competition policy there. The Webb-Pomerene Act in the United States and some of the 1960 amendments to the Canadian Combines Investigation Act were attempts to resolve this type of conflict.

There is also some relationship between competition policy and the goal of reasonable price stability. Under postwar conditions, a virtually universal problem of industrial countries has been to keep the general level of prices from rising, even at times of substantial unemployment.[12] On balance, over a succession of relatively soft and relatively buoyant phases of economic activity, an effective competition policy helps to slow the longer-term upward price rise. To the extent that opportunities for the exercise of market power are reduced, the ability to pass cost increases on into price increases is diminished, with the result that a greater incentive is created to seek efficiencies and ways of keeping costs and prices down. This in turn eases the task of the monetary authorities, who are less likely to have their hand forced by situations where monetary action can only decelerate the rise in the general price level by bringing about an unacceptably high level of unemployment.

Turning now to the goal of full employment, there is no direct and obvious relationship between this and competition policy. The prime requisite for full employment is an adequate level of aggregate demand, and the "big levers" of fiscal and monetary policy can in principle provide this equally well under monopolistic or competitive conditions. As has been suggested, however, there is an indirect relationship. If full employment is to be well sustained, there must be good performance in respect of other goals, notably that of reasonable price stability and of the productivity component of rapid economic growth. To the extent that competition policy assists the attainment of these other goals, it contributes indirectly to the attainment of full employment. For example, in so far as competition policy makes stability in the general price level any easier to achieve, it mitigates the policy problem of the "trade-off" between the goals of full employment and reasonable price stability, thus making it possible to press more vigorously towards the attainment of full employment.

The fifth of the Council's goals is an equitable distribution of rising incomes. The desire to prevent or lessen the income transfer that occurs between buyer and monopoly seller has provided one of the reasons for instituting competition policy in the past. The position has already been taken, however, that deliberate changes in the distribution of income are best brought about by relying mainly on policies other than competition policy.

We are left, then, with the proposition that while there is some relationship between competition policy and all five of the goals, the main link is by way of the encouragement of efficiency and rapid economic growth. This leads to a further proposition, to the effect that the most significant relationships between competition policy and other economic policies are with those policies (usually of a somewhat longer-term nature) that have a major bearing on the efficiency and productivity of the Canadian economy, and on the state of competition within it. This group includes tariff policy and other commercial policies, policies such as manpower mobility programs designed to facilitate the transfer of resources in the economy, and other policies aiming at restructuring the Canadian economy -- for example, in the direction of greater scale and specialization of production.

Competition Policy

It is important to appreciate both the potentialities and the limitations of competition policy. How much it can accomplish in the way of improving economic efficiency is heavily conditioned by the setting of other economic policies and other aspects of the general economic environment. In Canada, the intensity of import competition in domestic markets is crucial. To a considerable degree, Canadian competition policy has represented an attempt to provide a partial substitute for the greater intensity of competition that would have prevailed in the absence of tariffs.

The future effectiveness of competition policy in Canada will depend very much on how well it can be co-ordinated with other economic policies. The present situation in this respect could be greatly improved. Agreement on policy objectives will be a first essential. If the objective of maximizing economic efficiency can be kept well to the fore in respect both of competition policy and of other policies to which it is closely related, it should be possible to put an end to the unhealthy situation whereby, despite the stepped-up informational efforts of its administrators, competition policy is still too frequently regarded as a highly specialized and esoteric activity whose ultimate goals are wrapped in legal enigmas. While there will always be certain legal complexities to be faced, there is no reason that we can see why competition policy should not take its place as part of an interrelated structure of policies directed towards common economic ends.

Problems in Applying Competition Policy

Even where there was a consensus on the objectives of competition policy, however, the practical application of the policy would pose some special problems. If economic efficiency is taken as the basic objective, the policy should in principle be applied in such a way as to take account of all the important factors that bear upon efficiency in each individual case. Yet the law should be clear, give fair warning, and lend itself to reasonably speedy application. These principles are not always easy to reconcile in practice, and much criticism of competition policy reflects this underlying dilemma.

Why, it is frequently asked, should there be, in the application of competition policy, so much preoccupation with competition as such? We stated above that the ultimate objective should be economic efficiency rather than competition for its own sake. Why then should public policy in this area be concentrated on removing impediments to competition -- on restraining certain types of market *conduct* such as collusive price-fixing, or on trying to prevent the emergence of certain types of market *structure* such as monopoly? Why not by-pass all this, go to the heart of the matter, and focus directly on the efficiency of business *performance?*[13] If the consumer is obtaining efficient and otherwise satisfactory performance from industry, why should it matter what structures and patterns of business conduct, what conditions of competition, lie behind that performance?

These questions have been posed, not only by businessmen, but also by some economists. The general notion of replacing the complex legal trappings of competition policy by something more in the nature of an expert review panel that would simply address itself to the question of whether an industry's or firm's performance was generally progressive and efficient is an eternally seductive one. The great difficulties involved only become apparent when one gets down to the details of turning it into practical public policy:

> What will be lacking is any basis for deciding whether the firm's performance was good or bad in light of its opportunities. The record may reveal that output has grown ten times in the period under study; it will not reveal whether or not output could have grown fifteen times if price policy had been different or if more vigorous efforts had been made in product development, in foreign marketing, or in cost reduction. The record may show that expenditures of money and of the time of trained men on research and development were large and continuous, and that the decrease of inputs per unit of output as well as the flow of new and improved products were great; it will not in general show whether returns per dollars or per professional man-hour were high or low, or would have been higher or lower had the situation or conduct of the firm been different than it in fact was. True, there may be exceptional situations in which the spectacular quality of the results overwhelms question, or in which the almost total

> lack of effort speaks for itself. Yet even in such cases the problem is not completely solved. Would a big research effort in the poorly performing industry pay for itself? Could the excellent performer have bettered even its own spectacular record if it had operated under different market conditions?[14]

There is also the problem that good performance in the past gives no necessary assurance of similar performance in the future. To be really meaningful, enforcement of the policy would have to be continuous, with a large bureaucracy to second-guess all important managerial decisions. Such a system would be virtually indistinguishable from detailed public regulation of industry.

As against this, a competition policy more or less like Canada's present one, which places emphasis on market conduct and to a lesser degree on market structure, can be seen to have important advantages of simplicity and low overhead. In principle, at any rate, it should only be necessary to ensure that market conduct and market structure are such as to provide an acceptable degree of competition. The attainment of efficient industrial performance can then be left to market forces, without any need for vast supervisory efforts and detailed bureaucratic surveillance.

There are important choices and "trade-offs" to be made in the application of competition policy. To obtain certain advantages, it is sometimes necessary to make certain sacrifices. Thus it may be thought desirable to apply the policy in such a way as to examine in some depth the economics of individual cases, with much attention being devoted to past business performance and likely future performance. But this will tend to slow up proceedings and to render their outcome less predictable. If, by contrast, a high value is placed on speed and certainty, it may be decided to go another route and to promulgate clear bans on specific kinds of business conduct, with the courts not required to engage in comprehensive economic analysis of individual cases.

Between these two extremes, there are of course many intermediate positions. Also, the application of competition policy need not be all of a piece. In one sector, such as merger policy, there may be a leaning towards a discretionary approach, with speed and certainty being sacrificed in favour of greater economic analysis of individual cases. In another sector, such as policy towards collusive price-fixing, detailed depth-analysis of individual cases may be judged less necessary, with the result that the law can be given more the form of an outright prohibition. The policy recommendations to be made later in this Report embody just such a varied approach.

Notes and References

[1] T. Scitovsky, "Economic Theory and the Measurement of Concentration", *Business Concentration and Price Policy*, New York, National Bureau of Economic Research, 1955, p. 104.

[2] D. H. W. Henry, Q.C. (Director of Investigation and Research under the Combines Investigation Act), Address to the New York State Bar Association, Antitrust Law Section, New York, January 30, 1964 (mimeo.).

[3] In a Preface to a selection of readings on combines policy, one Canadian authority on industrial organization and competition policy states, "Perhaps the most useful approach is the eclectic one which, while recognizing that large size and 'fewness' are concomitants of modern industrial organization, emphasizes the importance of the availability of adequate alternatives to buyers and sellers, whatever may be the source of the economic pressures accounting for the provision of such alternatives." L. A. Skeoch, *Restrictive Trade Practices in Canada*, Toronto, McClelland and Stewart, 1966, p. x.

[4] Joe S. Bain's *Barriers to New Competition*, Cambridge, Mass., Harvard University Press, 1956, is a standard reference on this topic.

[5] Joseph A. Schumpeter, *Capitalism, Socialism and Democracy*, 3rd edition, New York, Harper & Row, 1942, p. 84.

[6] *Ibid.*, p. 91.

[7] Richard Caves, *American Industry: Structure, Conduct, Performance*, Second Edition, Englewood Cliffs, N.J., Prentice-Hall, 1967, p. 104.

[8] Jesse W. Markham, "Market Structure, Business Conduct, and Innovation", *American Economic Review*, vol. 55, no. 2, May 1965, pp. 325,331-332.

[9] Walter Adams, "A Blueprint for Technocracy", *Science*, vol. 157, August 4, 1967, p. 532. Two other important critiques of the Galbraith work are J. E. Meade's "Is the New Industrial State Inevitable?", *Economic Journal*, June 1968, p. 372; and Scott Gordon's, "The Close of the Galbraithian System", *The Journal of Political Economy*, July-August 1968, p. 635.

[10] John Kenneth Galbraith, *The New Industrial State*, Boston, Houghton Mifflin, 1967, p. 197.

[11] Economic Council of Canada, *Interim Report -- Consumer Affairs and the Department of the Registrar General*, Ottawa, Queen's Printer, July 1967, p. 19.

[12] This problem was extensively discussed in the Economic Council of Canada's *Third Annual Review*, Ottawa, Queen's Printer, 1966, pp. 33-193.

[13] Market *conduct* may be defined as how a firm behaves (e.g. how it reacts to moves made by its rivals) in all the markets in which it deals, whether these be the product markets where it sells its output or the factor markets from which it draws materials, labour and other inputs. Market *structure* consists of the significant features of a market that affect the behaviour of firms buying and selling in that market. It includes such things as the degree of monopoly or concentration, product differentiation, barriers to the entry of new firms, and the growth rate of market demand. Market *performance* embraces the ultimate outcome of market activity and how that outcome relates to broad economic goals such as rapid economic growth.

[14] Carl Kaysen and Donald F. Turner, *Antitrust Policy, An Economic and Legal Analysis*, Cambridge, Mass., Harvard University Press, 1959, pp. 53-54.

CHAPTER 3

COMPETITION POLICY IN EUROPE AND THE UNITED STATES

Most of the world's major industrial countries now have significant competition policies, although both the vigour of the policies and the degree of emphasis with which they address themselves to particular business practices and situations vary considerably from one country to another. In most European countries the long-standing tradition of acceptance of restrictive agreements or cartels has, since the Second World War, given way to increasing recognition of the merits of a competitive economy. U.S. competition policy, or antitrust policy as it is more familiarly known, remains, however, unique in the comprehensiveness of its coverage, in the energy given to its enforcement and in the widespread public acceptance of its underlying presumptions regarding the intrinsic virtues of a competitive private-enterprise economy.

Over the years there has grown up around the subject of U.S. antitrust policy and its administration a truly formidable literature addressed to both the economic and legal aspects. In Europe, by contrast, the veins of commentary available for exploration are not as rich or extensive, since much of the European legislation in this field has either been introduced for the first time or substantially amended in the 1950's or 1960's. For this reason, we commissioned a thorough study of competition policy in five European countries (France, Sweden, Denmark, the Federal German Republic and Britain), a report on which will be published in the near future.[1] Only a summary condensation of those aspects of foreign competition policies that are particularly relevant for Canada will be attempted here; the reader interested in pursuing the subject of foreign experience further should refer to the study and to the short list of major works on U.S. antitrust given in Appendix II.

The discussion here will focus on four principal areas of interest for competition policy: restrictive agreements, dominant firms, mergers, and certain business practices. Rather than spell out in detail all the circumstances in which particular business practices and situations may be called into question, the discussion will emphasize national attitudes with regard to each of these areas -- attitudes that are reflected in policy approaches, in the wording of legislation, and (particularly in the United States) in the judicial interpretation of legislation. The concluding section will examine the administrative framework through which foreign competition policy is enforced, and the remedies that are available to bring about any desirable changes in business practices.

Restrictive Agreements

Concern about agreements in restraint of trade among competitors has always been one of the prime reasons for introducing competition policy; yet this area, perhaps more than any other, is illustrative of the range of choices facing policy-makers. On the one hand, there is the American approach whereby restrictive agreements are condemned as criminal offences; on the other hand, there is the European practice of specifying the circumstances under which restrictive agreements may be permitted. However, it must be quickly added that in terms of effects, the two approaches are not as far apart as the above overly simplified statement might suggest. While it is true that in all five of the European countries studied agreements in restraint of trade may be approved and operated, in all of them there is an underlying element of prohibition. With only a few exceptions, the general tendency over the last few years has been to tighten up exemptions and to define more narrowly the circumstances under which restrictive agreements may be operated.

Within the five European countries, however, the treatment of restrictive agreements in relation to the public interest varies considerably. At one end of the scale is Britain, where there is a general presumption that such agreements are not in the public interest, and where those seeking to gain approval of agreements must justify their continuation by passing them through one of the exemption "gateways" specified in the Restrictive Trade Practices Act. These gateways permit a restriction to be defended on the following grounds: protecting consumers against injury, counteracting restrictive measures taken by others, enabling the negotiation of fair terms with a preponderant supplier or customer, preventing a serious and persistent adverse effect on employment, or preventing a reduction in the volume or earnings of export business. However, the most important gateway in practice is the one that allows an agreement to proceed on proof "that the removal of the restriction would deny to the public as purchasers, consumers or users of any goods ... specific and substantial benefits or advantages enjoyed or likely to be enjoyed ... by virtue of the restriction". All gateways give rise to difficulties in interpretation, but none more than this "benefits and advantages" gateway. If an agreement is allowed through a gateway, a balancing test remains: the Restrictive Trade Practices Court must be satisfied that the agreement is, on balance, not contrary to the public interest. This assessment involves the Court in the task of weighing conflicting interests and competing economic analysis and, generally, in making policy decisions.

At the other end of the scale is the position on restrictive agreements taken in Sweden, where there is no general presumption as to whether or not agreements in restraint of trade are in the public interest, and where the key question is whether the agreements produce harmful effects. To be deemed harmful, an agreement between Swedish firms must be one that "unduly affects the formation of prices, restrains productivity in business, or impedes, or prevents the trade of others".

In the United States, restrictive agreements are condemned as a criminal offence under Section 1 of the Sherman Act of 1890. The wording of the Act affords no opportunity for evasion. The courts are only concerned with establishing that an agreement does or does not exist, and have always refused to consider whether the objectives of the agreement or the resultant prices or profits have been "reasonable". The vigorous enforcement of this Section has effectively prevented the appearance in the American economy of the cartelization experienced by numerous European countries, especially in pre-Second-World-War years when there was virtually no competition policy in Europe. The illegality of conspiracy to restrain trade is a firmly established feature of the environment within which U.S. business operates, and business conduct is powerfully influenced by the "relatively large probability that offences in this category will be prosecuted and punished with the full backing of public opinion".[2]

Experience in the five European countries and in the United States indicates that two types of restrictive agreements have usually been accorded favourable treatment. In all of the countries studied, export agreements may be granted exemption from the general prohibition on agreements in restraint of trade. In the United States, the Webb-Pomerene Export Trade Act of 1918 exempts from a ruling of illegality under the Sherman Act agreements between American exporters in respect of matters such as price and market-sharing, provided the agreement does not affect domestic prices of the product in question or otherwise lessen competition, and provided further that the existence of the agreement does not damage exporters of the same product who are not parties to the agreement. Most European countries grant approval to production rationalization agreements; the German legislation spells out in some detail the circumstances under which such approval may be granted, while in France the conditions necessary to obtain approval for a rationalization agreement are left to the discretion of the administrative tribunal. In Britain, agreements designed to promote officially approved productivity or price stability objectives may be removed from the reach of the 1956 Restrictive Trade Practices Act on the authority of a designated government department.

Dominant Firms

In addition to concern with agreements and practices in restraint of competition, the legislation of the five European countries reflects an awareness of the special public interest in the conduct of "dominant firms". The definition of a dominant firm is expressed in the legislation in such imprecise phrases as a firm that possesses the ability to exert "a substantial influence on price, production, distribution or transport conditions" (Denmark), one that has no competitors or is not exposed to "any substantial competition" (Germany), or one that occupies a position characterized by a "monopoly situation or the manifest concentration of economic power" (France). Obviously the impact of public policy based on such vaguely expressed concepts will depend on their interpretation and application to individual cases. Only in Britain is the method of determining market dominance expressly spelled out. The section of the 1948 Monopolies and Restrictive Practices (Inquiry and Control) Act relating to dominant firms applies when "at least one-third of all the goods of that description which are supplied in the United Kingdom or any substantial part thereof are supplied by or to any one person".

In all of the countries but Britain and the United States, there is no power to prevent the emergence of market dominance, such as by a prohibition of mergers, or to destroy an established position of dominance by requiring the splitting-up of large market-dominating firms. Instead, such firms are subject to supervision or regulation, an approach sometimes described as preventing the "abuse of dominant positions". In Denmark, for example, a dominant firm may be requested to register with the Monopolies Control Authority. If the Authority finds "unreasonable prices or business conditions, unreasonable restraint ... unreasonable discrimination", it will attempt, by negotiation, to obtain a satisfactory change in the dominant firm's policies; if negotiations fail, the Authority has the power to issue orders to the dominant firm, including an order to make supplies available to firms whose freedom of trade has been unreasonably restrained by the dominant firm's refusal to sell. Most important of all, a registered dominant firm must obtain permission to increase its prices from the Monopolies Control Authority, unless special exemption is granted. Given the restriction on the firm's freedom of action, it is not surprising that appeals from a finding of market dominance are frequent.

In France and Germany, little use has yet been made of the dominant-firm provisions. The French legislation in this field is of relatively recent date, while the original German legislation, which contained a relatively limited concept of abuse of a position of market dominance, confining it to matters relating to prices, terms of sale and tying arrangements, was amended only in 1966 to a more general concept which allows action to be taken against any firm "not exposed to any substantial competition" if the Cartel Authority believes it is abusing or exploiting its position of market power.

In Britain, the Board of Trade is authorized to refer to the Monopolies Commission situations in which the "one-third of the market" criterion applies. The guidelines given to the Commission for its assessment of whether or not the public interest is adversely affected by the monopoly itself or by practices associated with it are extremely general. Account is to be taken of all relevant matters, including economical production and distribution, efficient organization of industry, encouragement of new enterprise, effective distribution of labour, materials and capacity, technical improvements and market expansion. The Commission's findings, and the recommendations it may make to remedy any adverse effects on the public interest, are published. The Commission's role is an advisory one. The responsible Ministry (normally the Board of Trade) decides what, if any, action to take on the strength of the report. Although the power to issue binding orders is present, the Board of Trade has usually preferred to obtain an assurance from the firms in question that the practices complained of will be discontinued or modified.

The British approach to the dominant firm is thus essentially ad hoc, in contrast to that of the other countries studied. There are no regulations applying to dominant firms as such. Whether a dominant firm is, or is not, subject to some sort of supervision will depend on whether or not it has been the subject of a reference to the Monopolies Commission, a situation that has led to criticisms on the grounds of discrimination. The overall effect of the system depends on the initiative of the Board of Trade in referring cases to the Commission, on the determination with which the Commission's recommendations are pressed, and on the Commission's skill in making its public interest assessment.

The most explicit part of U.S. policy regarding dominant firms is to be found in Section 2 of the Sherman Act and in the body of case law under it. Section 2 states that "every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several states, or with foreign nations, shall be deemed guilty of a misdemeanor". Since what is prohibited is the act of *monopolizing*, but not the existence of *monopoly* as a type of economic structure, this Section raises the very complex issue of what sort of conduct constitutes an illegal act. The decisions in some of the earlier court cases, such as United States Steel in 1920, established that neither the existence, attainment nor maintenance of a monopoly position was an offence in the absence of coercive or predatory conduct. However, the conviction of the Aluminum Company of America in 1945 of a Section 2 offence dramatically altered this position. Alcoa's monopoly position had not been achieved by overtly predatory conduct, nor had it been thrust upon it. Rather, practices admittedly normal and prudent, such as building capacity ahead of demand, were found to have had a monopolizing effect and were so condemned. Thus, although the possession of a monopoly position was not, in and of itself, an offence, the Alcoa conviction went "very far in the direction of making large relative size illegal".[3]

The concept of the dominant firm plays some implicit role in other areas of U.S. antitrust policy, in the sense that certain practices such as exclusive-dealing and tying arrangements are, on the whole, more likely to be condemned when they are carried on by a dominant firm. Furthermore, dominance would appear to be a significant criterion in scanning individual mergers, particularly in the light of court decisions and the recent Merger Guidelines issued by the U.S. Justice Department.

Mergers

Only in the United States, Britain and, to a lesser extent, in the Federal German Republic does competition policy deal in a meaningful way with mergers. In Germany, a 1966 amendment expanded the definition of mergers that must be reported to the Cartel Authority but did not affect the basic principle of the German approach to mergers: that mergers need not be expressly granted prior approval, nor should mergers be liable to dissolution.

Merger policy in the United States is principally incorporated in the Clayton Act, passed in 1914 in an attempt to supplement effective antitrust enforcement with mechanisms by which certain business practices likely to promote monopoly may be dealt with in their incipiency, at a stage early enough to prevent the emergence of the monopoly. Unlike the Sherman Act, the Clayton Act is not criminal but civil law. The Act condemns certain business practices employed by individual firms only when their use may "substantially lessen competition or tend to create a monopoly". In other circumstances, the same practices may be considered acceptable. The effect of the legislation clearly depends on the interpretation of certain terms such as "substantially lessen competition", preceded by the equally important "incipiency" doctrine implicit in the term "may be".

Competition Policy

Modern U.S. merger policy effectively dates from the 1950 Celler-Kefauver amendment to Section 7 of the Clayton Act. Prior to 1950, Section 7 was thought to be applicable only to horizontal mergers in which one company acquired the stock or other share capital of one of its competitors.[4] Mergers involving the acquisition of the actual physical assets of a company could and did proceed freely, impeded neither by Section 7 of the Clayton Act, nor by the Sherman Act which had proven ineffective in this role. The 1950 amendment extended the application of Section 7 to nonhorizontal mergers (i.e. to mergers of firms not in a directly competitive relationship to one another) and to mergers carried out via transfer of physical assets. The amendment instructed the courts to strike down all mergers where "in any line of commerce in any section of the country the effect of such acquisition may be to substantially lessen competition, or to create a monopoly".

As interpreted by the Supreme Court, the amended Section 7 has been a powerful instrument in inhibiting mergers. Of overriding importance has been the Supreme Court's view of the nature of the competition and the competitive process Congress desired to protect, especially the part to be played by small independent enterprises. Successful attacks have been conducted against all three types of mergers: horizontal, vertical and conglomerate. The incipiency doctrine has been crucial, with the probable economic consequences of the attacked merger the focus of court concern.

After almost 20 years of experience with Section 7 there now exists a considerable degree of certainty in the United States as to the circumstances in which a merger is likely to run afoul of competition policy. The accumulation of experience in the courts led the Department of Justice in May 1968 to issue its *Merger Guidelines* in which it indicated the type of mergers it intends to challenge in future. The Guidelines set forth percentage shares of markets controlled by the parties proposing to merge: if the actual market shares are at or above these figures, a challenge will likely be issued. There is some variability in the guiding percentages; thus, in the case of a horizontal merger, the market share standards become stricter the higher the degree of concentration in the industry generally. In addition, a horizontal acquisition that swallows up an unusually effective competitor, or even a firm with unusual competitive *potential*, will likely be challenged. Vertical mergers, between firms in a supplier-customer relationship, will be challenged if they significantly raise barriers to the entry of new firms into either market, or if they allow the merged firm to use its access to raw materials or other supplies it controls in such a manner that other firms requiring these supplies are hurt, competition is lessened, and it becomes harder for new firms to enter industries where access to the kind of supplies in question is essential.

The Guidelines are less precise in the case of conglomerate mergers, although the market share holdings of a merger involving a *potential* competitor (i.e. a firm that *might*, left to itself, have entered one of the markets where its merging partner was active) are spelled out, and a merger designed to prevent the entry of a potentially "disruptive" firm will be opposed. Conglomerate mergers that significantly increase the danger of reciprocal buying will be challenged, as may mergers that increase the market power of a leading firm in a relatively concentrated or rapidly concentrating market.[5]

In Britain, the decision to bring mergers within reach of the law dates from 1965 when the Monopolies and Mergers Act introduced the principle that certain mergers should be liable to examination and, in the light of the public interest, either permitted, prohibited, or, if already consummated, dissolved. This gave recognition to the fact that the confines of the 1956 Act, which had created the Restrictive Practices Court to deal with restrictive agreements between separate firms, needed to be widened to encompass mergers between previously separate firms that could produce results very similar to those brought about by restrictive agreements.

The assessment of the implications of the merger for the public interest is made by the Monopolies Commission to whom the Board of Trade is authorized to submit mergers that exceed either a certain absolute size or a certain share of the market. The importance of the Board's role in determining how many of the mergers eligible for reference are actually referred to the Commission is evident from the fact that the

Commission may only examine those mergers which the Board, at its discretion, refers to it. At least one merger proposal which the parties realized might be difficult to justify in terms of the public interest was abandoned when the Board indicated that it planned to submit the matter to the Commission.

In assessing the public interest implications of the merger, the Monopolies Commission will, on the one hand, estimate the possible efficiency benefits to be gained and, on the other hand, make a judgment as to the consequences of the merger for competition. It may, on its own initiative or at the direction of the Board of Trade, examine other matters as well. There is no presumption that mergers referred to the Commission are against the public interest, nor is there any onus on those proposing to merge to convince the Commission that an exemption is justified. The Commission publishes a report stating the reasons for its findings and its recommendations. The Board, while not obligated to follow the Commission's recommendations, has done so in the first seven merger references.

An appreciation of mergers policy in Britain must also take account of two other Acts. The 1966 Industrial Reorganization Corporation Act embodies a positive philosophy of encouraging mergers and other structural changes in sectors of the economy where market forces are considered inadequate to produce those reorganizations thought to be required in order to increase productivity. The concern of the 1966 Act, it seems fair to say, is with industries in which firms are found to be too small to meet international competition. The Industrial Expansion Act of 1968 allows the government to provide financial support to specific projects, industries or sectors of industries to stimulate industrial change (including change coming about by merger) with a view to promoting "efficiency and productive capacity for industry and its technological advance". Thus British policy provides the means by which mergers may be actively encouraged in some areas of the economy and effectively blocked in industries where effects detrimental to the public interest are likely to ensue.

Resale Price Maintenance

The one major exception to the general rule that U.S. competition policy tends to be "tougher" than its European counterpart is to be found in the field of resale price maintenance. Here it is the European law which is more or less prohibitory, while the American is permissive.

Both Denmark and Sweden have prohibited resale price maintenance, in sharp contrast to their negotiatory approach to other restrictive practices. Although exemption from the Scandinavian ban on resale price maintenance is possible and although the wording of the exemption clauses gives substantial discretion to the Swedish Board and to the Danish Control Authority, both have in fact granted exemption sparingly and both have revoked exemptions when the original justification no longer appeared valid. In France, too, where one of the major objectives of competition policy is to encourage the modernization of the distribution sector of the economy, the approach to resale price maintenance is quite strongly prohibitory, with little scope for exemptions.

In Britain, the passage of the Resale Price Act in 1964 marked a dramatic change from the permissive approach of the 1956 Restrictive Trade Practices Act which, while declaring the *collective* enforcement of resale price maintenance to be unlawful, allowed enforcement by *individual* firms. The 1964 Act established a more general prohibition with exemption "gateways". To claim exemption, a seller must come before the Restrictive Practices Court, and a provisional exemption applies until the Court has ruled on the application. The exemption gateways are expressed in terms of the interests of consumers in relation to quality, number of retail establishments, retail prices, health, and post-sale service. If a product passes through a gateway, a balancing public interest test remains. Many products with a long history of resale price maintenance have not been registered for provisional exemption and others have not been defended when the opportunity to do so arose. The Court's refusal to grant the requested permission to practise resale price maintenance, in the first two cases to come before it, strengthened still further the reluctance of firms practising resale price maintenance to seek the Court's approval. It seems likely that in the near future, resale price maintenance will be employed only in the case of a few products possessing sufficiently peculiar characteristics that the Restrictive Practices Court sees its way clear to granting an exemption from the general ban.

In all of the countries studied, advocacy of resale price maintenance appears to come mainly from two quarters: from manufacturers of branded merchandise, who voice their fears that their heavily advertised products will be used as "loss leaders", and from small businesses fearful of the price-cutting tactics of their larger competitors. National policy in Germany and the United States can be said to reflect the influence of these two concerns. In Germany, the law condemns resale price maintenance in general, but the significance of this condemnation has been substantially reduced by the permission granted to producers of "branded articles which are competing in price with similar goods of other producers or dealers" to practise resale price maintenance. Publishing firms are also exempt from the ban. This permission may be withdrawn by the Cartel Authority if the practice is abused. A recent amendment strengthened the abuse provisions by stating that certain practices would henceforth be taken as presumptive evidence that abuses had occurred. The abuses in question were: the causing of an "increase in the prices of the goods affected" or "preventing a lowering of their prices" or "restricting their production or their distribution" in a "manner not justified by general economic conditions", as well as the disappearance of competition with similar goods.

U.S. policy in this field reflects the American tendency sometimes to protect small business even at the expense of economic efficiency -- in this case, primarily, the economic efficiency of the distribution system. This tendency has been a long-standing feature of the "fair-trade" laws passed in the early 1930's by many of the state legislatures under which resale price maintenance could be practised. However where interstate commerce was affected, resale price maintenance could still run afoul of the federal Sherman Act. To prevent such a conflict the Millar-Tydings amendment to the Sherman Act was passed in 1937. This amendment provided that nothing in that Act should render resale price maintenance illegal when agreements of that description are lawful when applied to intrastate transactions. In 1951, however, one of the most controversial features of fair-trade laws was ruled by the Supreme Court to constitute an offence under the Sherman Act. This was the so-called "non-signer" clause, which provided that once a manufacturer's resale price had been prescribed by contracts with one distributor, no other distributor could knowingly undercut that price. To overrule this decision of the Supreme Court, Congress passed the McGuire Act amendment to the Federal Trade Commission Act, clarifying the legality of resale price maintenance. Continued opposition to the enforcement of the non-signer provision and to fair-trade laws in general is reflected in action taken in many of the state Supreme Courts to rule such legislation unconstitutional, as well as in the 1955 Report of the Attorney General's National Committee to Study the Antitrust Laws, which recommended the repeal of both the Millar-Tydings Act and the McGuire Act.

Price Discrimination

Concern for the preservation of small business also figured in the thinking which led, in the United States, to the passage of the Robinson-Patman amendment to the Clayton Act in 1936. Prior to this amendment, Section 2 of the Clayton Act had branded as illegal the use of discriminatory pricing policies as a predatory tactic designed to eliminate competitors. To a considerable extent, the Robinson-Patman amendment was a response to certain retailing developments in the depression years. Large retail chain stores, particularly in the food trade, were putting increasing competitive pressure on small outlets. There was also concern over the ability of large buyers to extract price concessions from their suppliers.

The resulting piece of legislation has been more heavily criticized by informed observers than any other aspect of U.S. antitrust. Among other things, the amendment has been held to embody a confusion of purpose; it cannot, as it were, make up its mind whether price discrimination is to be suppressed where it operates as an anticompetitive device, or whether the objective is rather to protect small business from price disadvantages. Furthermore, enforcement has concentrated on price differences rather than price discrimination, and there have been severe administrative problems.[6]

It is widely maintained that while the amendment may have resulted in the suppression of some anticompetitive pricing practices, it has also prevented acceptable and even desirable forms of differential pricing, e.g. those which can be justified by cost differences, and those which constitute one of the more important ways in which price competition periodically "breaks out", to the benefit of the consumer, in oligopolistic markets. One observer's general verdict is that "no statute better demonstrates the legislative folly of trying to define 'sin' in detail".[7]

Exclusive Dealing, Requirements Contracts and Tied Sales

It is appropriate at this point to refer briefly to the U.S. treatment of exclusive dealing, requirements contracts and tied sales -- trade practices which are found notably in the automobile service station industry in Canada, and which the Economic Council was specifically requested to consider as part of its study of competition policy. The main consideration of them will be found in Chapter 6 of this Report.

In the United States, these practices are principally dealt with under Section 3 of the Clayton Act, although in the case of tied sales, action may also be taken under the Sherman Act and the Federal Trade Commission Act. The Clayton Act condemns these practices when their effect "may be to substantially lessen competition or tend to create a monopoly...."

In determining whether or not competition has been substantially lessened, the courts generally look to the market share of the firm employing the practice, the absolute amount of trade involved, and the availability of alternatives for firms that have been excluded by the contracts or practices under examination. Assessing the competitive impact of a practice in any particular case is a complex matter, and the courts have come to rely on certain relatively easily obtained information as pointing unambiguously to competitive implications. Where certain criteria are satisfied, there is deemed to be a *prima facie* substantial lessening of competition.

The courts ruled in 1922, for example, that a system of exclusive-dealing contracts employed by a manufacturer with 40 per cent of the market did substantially lessen competition and so violate Section 3; in 1923, a Section 3 charge was dismissed on the grounds that the supplier, with 1 per cent of the market, did not substantially lessen competition by his exclusive-dealing contract. The *form of the contract* was similar in the two cases; the *share of the market* as defined in each of the two cases produced the differing verdicts.

In 1949, the Supreme Court, in the important *Standard Stations* decision, found a firm's requirements contracts covering less than 7 per cent of the sales in the relevant area to be in violation of Section 3. The contracts, which required independent service station dealers to purchase from Standard Oil all their requirements of certain products, were renewed from year to year and were similar to contracts used by all six of Standard's competitors. The Court, while agreeing that the duration of the contracts was not excessive and that Standard did not by itself dominate the market, nevertheless held that an offence had been committed because competition had been foreclosed in a substantial share of the market. This decision changed the focus of Section 3 from one that rested on the alleged dominant position of the supplying firm to one that looked, as well, at the volume of business affected by the contract in question.

As to tying arrangements in the United States, it seems fair to state that they are less likely than exclusive-dealing contracts to be considered an acceptable form of business behaviour. They have frequently earned severe condemnation from the courts, with such terms as "pernicious effect on competition" and "lack of any redeeming virtue" being applied. The Supreme Court in 1962 indicated that one of the reasons for antitrust concern with tying agreements was that "they may destroy the free access of competing suppliers of the tied product to the consuming market".

Administration of Competition Policy

The experience of other countries throws useful light on the administrative problem discussed in the concluding section of the previous Chapter: that of determining whether to lean towards *per se* prohibitions of anticompetitive behaviour, or towards a more discretionary procedure involving considerable case-by-case examination of probable economic effects.

The United States uses both techniques. In Europe, some broad prohibitions are to be found, but they are usually subject to more or less important exemptions, and in general the European approach leans much more towards the discretionary end of the spectrum. Such an approach is typically less demanding of policy-makers but more demanding of those who are charged with administering competition policy. To no small extent, indeed, the latter are really called upon to create the policy. Where, for example, there are exemptions to broad prohibitions, the administrators must assess the economic circumstances surrounding the agreement or practice and decide whether, in the light of these circumstances, the agreement or practice should be allowed to continue. As a succession of such decisions occurs, the shape of the policy is gradually clarified, provided of course that the decision-makers have taken care to avoid major inconsistencies.

European countries have tended to avoid the direct use of criminal law in their competition policies, in marked contrast to the situation in Canada and the United States. Instead, the examination of the practices of individual business firms is undertaken and assessed by administrative tribunals such as the British Monopolies Commission and Restrictive Trade Practices Court, the French Technical Commission on Combines and Dominant Positions, the Swedish Freedom of Commerce Board and the Monopolies Control Authority of Denmark. These tribunals are normally composed of business and other interest groups as well as members of the legal profession. Only Germany departs from this procedure, adopting instead the principle of administering competition policy through the Federal Cartel Office, composed entirely of public servants. Although the character of the procedures before the tribunals varies from the somewhat legalistic British examination to the less formal activities of the Swedish Board, the enforcement machinery in European countries appears to be better suited to the examination of the underlying economic evidence and probable economic effects than in the United States. The American courts have, it is true, gone a considerable distance in this direction, but even there a special body in the form of the Federal Trade Commission has been instituted to supplement the work of the courts.

In most of the European countries, the legislation now contains more or less detailed specification of the criteria against which business practices restrictive of competition and exemptions from the prohibition on restrictive agreements are to be assessed. This is particularly true in Britain where the interpretation of exemption gateways has had a considerable deterrent effect, leading as it has to a dismantling of many restrictive agreements of long standing without any attempt at a formal defence. While the value of criteria both to administrators and to the business community must be recognized, such experience as that with the Robinson-Patman Act in the United States warns of the dangers sometimes involved in specifying criteria in too detailed a form. A golden mean must be sought: the administrators have to be given some guidance, but not so much that they are deprived of the flexibility necessary for the successful operation of the discretionary approach.

Remedies to Combat Anticompetitive Practices

The effectiveness of competition policy depends as much on the remedies at the disposal of administrators to bring about appropriate changes in business conduct and industrial structure as it does on the administrative machinery itself. The United States draws upon a wider assortment of alternative remedies than does Canada. Once its investigations uncover evidence that warrants a charge, the U.S. Department of Justice must decide whether to proceed by criminal prosecution or civil action. A criminal case can lead to the punishment of offenders for past offences, and is considered appropriate in those cases where the law is clear and the facts indicate a flagrant offence and plain intent to restrain trade unreasonably. The deterrent efficacy of the Act requires such criminal prosecutions. In order, however, to remedy the situation rather than merely punish the guilty, an additional civil action is often instituted. In the civil case, a decree containing injunctions regulating the industry in the future can be obtained, and it is for this reason that the Department of Justice frequently brings concurrent criminal and civil proceedings.

In the case of a criminal charge under the Sherman Act, the accused firm may plead *nolo contendere* -- a plea that may or may not be accepted by the

U.S. Department of Justice. Such a plea, while not an admission of guilt, enables the court to impose fines or other punishment as if the case had been fought and lost by the defence. In a civil suit under the Clayton Act, the equivalent of *nolo contendere* is to enter into negotiations with the Department to arrive at a consent decree, under which the firm involved agrees to modify or discontinue a particular practice without going through the process of a trial. Where a consent decree is agreed upon, the approval of a court must be obtained; any infringement of the decree then becomes punishable as contempt of court.

When the Federal Trade Commission, the tribunal which administers the civil Federal Trade Commission Act and (concurrently in some areas with the Department of Justice) the Clayton Act, believes that a business practice is in violation of the law and that its termination would be in the public interest, it issues a formal complaint. Thereupon, a Hearing Examiner, who is a legal member of the Commission's staff, acts as a court of first instance. The Hearing Examiner reaches a decision and, if appropriate, issues on behalf of the Commission a cease-and-desist order. The Commission may review the Examiner's decision either on its own account or on appeal by an aggrieved party. The Commission's cease-and-desist order, unless appealed, has the force of law. Any violation is subject to fine. Appeals from the Commission's decisions are restricted to matters of law; its findings of fact are final. The effect of this restriction does, of course, depend on what meaning is given by the Appeal Court to the phrase "matter of law". A company against which a complaint has been issued can negotiate a consent order with the Commission's prosecuting lawyers, without the matter going before a Hearing Examiner. The Commission may accept the settlement arrived at and promulgate the indicated cease-and-desist order, or it can reject the order submitted and refer the case to the Hearing Examiner.

Consent orders have been a particular feature of U.S. merger policy. They may call for total or partial divestiture of the acquired company or, more commonly, for a prohibition on future acquisitions by the acquiring company in fields related to those in which the acquired company operated. A formidable enforcement burden is placed upon the Commission and the Department of Justice by their responsibility for policing cease-and-desist orders, whether obtained by consent or resulting from litigation.

An individual or firm, damaged as a result of a restrictive agreement or anticompetitive practice carried on by another, may, under both the Sherman and Clayton Acts, be able to claim treble damages for the injury. Both *nolo contendere* pleas before the Department of Justice and the acceptance of consent orders by the Federal Trade Commission without a formal case lessen the possibility of a treble-damage suit by private individuals, since there is no court finding of fact on which to base damages. The deterrent effects of a possible treble-damage suit depend on the nature of the offence, the measurability of the damages, and the amount of the damages suffered by individual persons or businesses relative to the cost of suing for damages. Although an antitrust conviction makes available *prima facie* proof of certain facts in a private suit, the courts still face the difficult task of establishing that the private individual or business was injured by the illegal conduct, and of determining the extent of the damage suffered.

It should be emphasized again that where negotiatory procedures are used, or where exceptions are made to broad prohibitions, the enforcement agency will more often than not find itself required to exercise some continuing surveillance over the agreements and practices that have been either modified by negotiation or granted exemption. This task may come to absorb a significant proportion of the time and resources of the agency.

Purely negotiatory enforcement procedures appear to have had some effect, notably in Sweden, where the Freedom of Commerce Board attempts to work out appropriate changes in business conduct with the firm in question. However, Sweden is both an open economy and a unitary state. There has evolved a long tradition of co-operation between business, labour and government with a view to providing aggressive competition in the world economy. In such an environment the mere publicity given to, for example, the registration of cartel arrangements has led in many cases to their abandonment. But where such a tradition has not evolved, and where too, as in Canada, business relates to provincial as well as to federal and local governments, purely negotiatory enforcement is not likely to be as effective. A backstop of stronger remedies must normally be available.

Conclusion

The modest objective of this Chapter has been to indicate briefly certain aspects of foreign experience with competition policy that have exerted a particularly significant influence on the policy recommendations contained in later chapters. There is undoubtedly a great deal more in foreign experience that is relevant for Canada, and as that experience continues to accumulate, it will be important for Canadians to study it.

In drawing lessons from abroad, appropriate allowance must of course be made for differences between the Canadian and foreign economic environments. This has often been pointed out with reference to the United States. Although competition policies in Canada and the United States, as instituted in the late nineteenth century, were in many ways a response to common concerns, their subsequent divergence has been partly a reflection of certain rather deep-seated differences between the two countries. Among these may be mentioned the greater constitutional freedom of the federal government in the United States to enact laws affecting commerce; the stronger feeling of ideological commitment in the United States to private enterprise, competition and the diffusion of economic power; and the smaller size and greater openness and world-trade orientation of the Canadian economy. Perhaps the most important implication of the latter difference is that the Canadian economy is less able than its U.S. counterpart to afford a competition policy that, on occasion, may be prepared to sacrifice economic efficiency for other ends, such as the preservation of small business.

As for European experience, what has to be chiefly remembered is that much of it has been related to a tradition of rather more detailed governmental intervention in the operations of private industry than has existed in Canada. One might make some exception to this statement in the case of Sweden, with its unique degree of industrial self-regulation in certain areas. But here again, the tradition is rather a different one from Canada's, and this affects the range of practicable techniques for competition policy.

All this having been said, however, it remains a fact that with significant competition policies now being practised in many more countries than before the war, there is a richer and more varied experience on which to draw. More than ever, therefore, the continuous observation and analysis of foreign developments should be an important part of the conduct of competition policy in Canada.

Notes and References

[1] James P. Cairns, *The Regulation of Restrictive Practices -- Recent European Experience*, Economic Council of Canada, Special Study (forthcoming).

[2] A. D. Neale, *The Antitrust Laws of the United States of America*, Cambridge, Mass., Harvard University Press, 1960, p. 425.

[3] Carl Kaysen and Donald F. Turner, *Antitrust Policy, An Economic and Legal Analysis*, Cambridge, Mass., Harvard University Press, 1965, p. 107.

[4] In fact, the Dupont decision handed down in 1957 was based on the unamended Clayton Act (i.e. prior to the Celler-Kefauver amendment). In this decision, the Court ruled against Dupont's acquisitions of General Motors stock, thereby interpreting the unamended Act as covering vertical mergers as well as mergers between firms in a horizontal relationship.

[5] Some more recent developments in respect of the Merger Guidelines should be noted. In testimony before the House of Representatives Ways and Means Committee on March 12, 1969, Richard W. McLaren, Assistant Attorney General, Antitrust Division, U.S. Department of Justice, stated as follows:

> At the Senate Judiciary hearing on my confirmation in January, I stated that I was not persuaded that Section 7 will not reach purer types of conglomerate mergers than have been dealt with by the courts thus far. In public statements since that time I have tried to warn businessmen and their lawyers that they cannot rely on the Merger Guidelines issued by my predecessors in this area --

that we may sue even though particular mergers appear to satisfy those Guidelines -- and that, to be safe, firms desiring to merge should learn our enforcement intentions by applying for a Business Review letter.

[6] Kaysen and Turner, *op. cit.*, pp. 181-182.

[7] Neale, *op. cit.*, p. 464.

CHAPTER 4

BRIEF HISTORY AND ASSESSMENT OF CANADIAN COMPETITION POLICY

In contrast both to the discretionary civil law approach which characterizes competition policies in Europe, and to the combination of civil and criminal law used in the United States, Canadian anticombines policy has always been framed in terms of criminal law. The power of the federal government to enact criminal legislation is firmly entrenched in the Constitution and has been upheld by various rulings of the Supreme Court. Among the consequences of the criminal law basis of anticombines policy are the requirements that offences be proceeded against whenever they are believed to have been discovered and that the Crown, to win its case, must prove guilt beyond a reasonable doubt. These requirements have hitherto considerably narrowed the scope in Canada for effective competition policy directed towards economic ends.

In tracing the historical evolution of the policy, the discussion here will touch only lightly on developments prior to 1950, the history of that period having been well summarized in the Report of the MacQuarrie Committee. Much of the Chapter will be given over to an account of changes in the legislation since the MacQuarrie Report, while in the concluding section, a brief assessment of the effectiveness of the legislation will be presented. A more detailed history and assessment of Canadian competition policy will appear in a special study commissioned by the Economic Council, to be published at a later date.[1]

Basic Legislative Provisions to 1950

The cornerstone of Canada's present combines legislation was laid by Parliament in 1889 when it passed an Act prohibiting conspiracies and combinations in restraint of trade. The legislation defined as unlawful any agreement to limit unduly facilities for transporting, producing, storing or selling any article, or to restrain commerce in it, or to unreasonably enhance its price. Also forbidden was any agreement to unduly prevent or lessen competition in relation to an article or to the price of insurance "upon persons or property". With some modification, these provisions were imported into the Criminal Code in 1892 as indictable offences, where they remained until the consolidation of the Combines Investigation Act in 1960.

The first Combines Investigation Act was passed in 1910 in an attempt to remedy a weakness in the original legislation: the lack of any special machinery for investigation of alleged combines offences. In this Act, the definition of the kind of "combine" activity that could be investigated was set out in language similar to the wording of the combination offence in the Criminal Code, with the significant addition of the words "merger, trust or monopoly". A qualification introduced into the Act was that to be unlawful the combination, merger, trust or monopoly must have "operated or be likely to operate to the detriment or against the interest of the public, whether consumers, producers or others". This comprehensive definition was retained in the new 1923 Combines Investigation Act, which, as subsequently amended, is the law today. An interesting feature of the 1923 Act was that it did not restrict itself to trade in "articles" and the price of insurance: in principle, at least, trade in services was also included, although no cases relating to services were brought to court. However, the restriction to articles and the price of insurance reappeared in the legislation of 1937 and has remained to the present day.

In 1935, Section 498 of the Criminal Code was amended to bring price discrimination within the reach of public policy for the first time. Under the shadow of the Great Depression, there had emerged considerable concern about the large spreads between prices received by producers and those paid by consumers. There was disquiet also about price advantages obtained by large buyers that were deemed to discriminate against small competitors. These considerations were reflected in a new prohibition which banned the granting of discriminatory discounts and predatory price-cutting. This provision was transferred from the Criminal Code to the Combines Investigation Act in 1960 and remains in the Statute today.

Machinery for Investigation and Enforcement to 1950

As already noted, the establishment of the machinery required for the detection and investigation of alleged combines, missing from the legislation of 1889, made its first appearance in the Combines Investigation Act of 1910. This Act contained a provision whereby any six citizens could apply to a superior court judge for an order directing an investigation into the activities of parties thought to constitute a combine. On issuance of an order, the Minister of Labour was required to appoint a board composed of one representative of the applicants, one representative of the parties alleged to be a combine and a third member to be designated by the other two. The board was given the necessary powers to permit it to carry out a full inquiry and was required to transmit to the Minister a report of its findings and recommendations. Following publication of the report, continuation of activities by the parties named as a combine in the report constituted an indictable offence. But the legislation still failed to provide any continuity of administration. Since the boards were constituted on an ad hoc basis, they ceased to function once an inquiry had been completed, leaving behind no means to ensure that their recommendations were carried out.

Dissatisfaction with this situation led Parliament to include, in the 1919 Board of Commerce Act, a provision establishing a permanent board of three commissioners charged with the responsibility of administering a second new Act, the Combines and Fair Prices Act. (Together, these two Acts replaced the 1910 Combines Investigation Act, which was repealed.) The board could begin an inquiry on application from one citizen or on its own initiative, and retained the wide powers of investigation held by the previous ad hoc boards. In addition, if a combine were found to exist, the board could issue "cease and desist" orders directed at the cessation of offending practices. Noncompliance with such orders was deemed an indictable offence. This legislation, however, was found *ultra vires* of the federal legislature, for reasons discussed below, and in 1923 a permanent Registrar was appointed to administer the new Combines Investigation Act of that year. This official was empowered to hold a preliminary inquiry on his own initiative, on formal application of six persons, or on ministerial direction. If this preliminary investigation revealed that a formal inquiry was warranted, such an inquiry was conducted either by the Registrar or by an ad hoc commissioner. In 1935, the Dominion Trade and Industry Commission Act transferred the administration of the Combines Investigation Act and the powers of investigation and inquiry to a new three-man commission. However, parts of this Act were declared by the Supreme Court to be unconstitutional, and although the Dominion Trade and Industry Commission continued to have a legal existence until 1949, it did not exercise any functions in the area of combines legislation.

It is worth digressing briefly to note the reasons given for the two findings of unconstitutionality mentioned above. In its 1921 judgment on the Combines and Fair Prices Act and the Board of Commerce Act, the Judicial Committee of the Privy Council attached particular significance to the power of the Board to make orders prohibiting (a) the accumulation of articles that were necessaries, and (b) the withholding of such articles from sale because of sellers' dissatisfaction with prices fixed by the Board. Also, the Board could regulate profits, and deal with cases individually, rather than merely follow principles of general application. It was the view of the Privy Council that this power of a federally appointed board to regulate particular trades and businesses could not be upheld under the constitutional heads of either criminal law or trade and commerce.

In its finding that the 1935 Dominion Trade and Industry Act was *ultra vires* of the federal legislature, the Supreme Court focused notably on a part of the Act that reflected the economic environment and attitudes of the Depression years. The Act empowered the Dominion Trade and Industry Commission, if it found that wasteful and demoralizing competition existed in an industry and that agreements among persons in the industry to modify competition would not unduly restrain trade or operate against the public interest, to recommend approval of such agreements. (Like the National Recovery Act in the United States, the Dominion Trade and Industry Act embodied an attempt to attack some of the major symptoms of the Great Depression, whereas today the principal remedy to any such situation would be judged to lie, not in throwing competition policy into reverse, but in the more fundamental and efficacious step of expanding aggregate demand in the economy through the use of fiscal and monetary policy.) Section 14 of the Act, however, was found unconstitutional by the Supreme Court, and this effectively nullified the main purpose of the legislation even though other parts of the Act were later upheld by the Privy Council. As in 1919, Parliament had attempted to give an administrative tribunal power to regulate the operation of combines and similar business arrangements by administrative direction, and once again the attempt was disallowed.

Following the Supreme Court ruling, Parliament in 1937 again vested the administration of competition policy in a single permanent official (the Commissioner), whose role it was to conduct investigations under the Combines Investigation Act, although a special or ad hoc commissioner could also be appointed. The Commissioner was empowered to compel the attendance of witnesses, secure testimony under oath and require the production of documents. In 1949 the Act was amended to facilitate prosecutions. One amendment resulted from the acquittal of the defendants in the Ash-Temple (Dental Supplies) case on the grounds that there was no proof that actions of company officers had been authorized by their firms. The amendment provided that documents found in the possession of individuals acting as officers, employees, agents or representatives of businesses were admissible as *prima facie* evidence against the company.

Remedies in the Legislation to 1950

The Combines Investigation Act of 1923 stipulated that anyone offending the prohibition against combines was liable to a penalty not exceeding $10,000 or two years' imprisonment for individuals and not over $25,000 for corporations. A further penalty provided for the reduction or removal by executive action of the tariff on an article where the court found that a combination had unduly enhanced prices or denied the public the benefits of reasonable competition. This tariff provision, which continues in effect today, has been a long-standing feature of Canadian competition policy, dating back to an 1897 amendment to the Customs Tariff Act. Finally, a provision first introduced in 1910 and carried forward to the present via the Act of 1923 enables the Exchequer Court to revoke patent protection where exclusive rights are used to limit unduly competition in the market for a particular product.

Publicity has always been considered to be a deterrent against violations of the principles of competition policy. In sponsoring the legislation of 1910, the Honourable W. L. M. King, then Minister of Labour, implied that criminal prosecution was secondary to investigation and publicity in effective public control of combines. In the Act of 1923, the Minister of Labour was required to publish the report issued at the conclusion of a Commissioner's inquiry within 15 days, unless the Commissioner recommended against such action. This provision was retained in subsequent amendments.

The Situation as of 1950

By 1950, then, there existed fairly substantial machinery for the investigation and enforcement of prohibitions against anticompetitive practices and situations, including combinations, mergers, trusts and monopolies, and also certain unfair trading practices. The law provided for prosecution in the courts and gave the Commissioner extensive powers to enter premises, seize documents, and order the attendance of witnesses to testify under oath. Penalties consisted of fines, imprisonment, and the removal of tariff protection or patent rights. Finally, publicizing the results of the Commissioner's inquiries was intended to have a punitive effect, and the fear of publicity was regarded as a deterrent to anticompetitive practices.

The MacQuarrie Report and the Amendments of 1951-52

A controversy involving publicity and the suspension of anticombines activity during the Second World War, when production, the allocation of resources, and the setting of prices were subject to direct control, led to the establishment of the MacQuarrie Committee to review the legislation. In December 1948, the Combines Commissioner, Mr. F. A. McGregor, forwarded to the Minister of Justice the results of his inquiry into the flour-milling industry. In it, Mr. McGregor concluded that the leading milling companies had maintained price-fixing agreements since at least 1936, that these agreements were maintained in force during the war, and that the firms colluded in bidding for government contracts. Despite the requirements of the Act, the Report was still unpublished in October 1949. Mr. McGregor resigned on October 29, calling, in his letter of resignation, for "an even stronger statute than the Act in its present form, and a clear statement of government policy with respect to its enforcement". Tabled in the House of Commons on November 7, the flour-milling report raised, among other things, the issue of an industry being condemned for carrying out policies sanctioned by the Wartime Prices and Trade Board during the war and tacitly allowed by the government in the subsequent period of decontrol.

Faced with a barrage of criticism for its handling of the matter, the Government in 1950 appointed the MacQuarrie Committee to study the purposes and methods of the Combines Investigation Act and related Canadian statutes as well as those of other countries. The Committee was instructed to recommend any amendments desirable to make the Combines Investigation Act "a more effective instrument for the encouraging and safeguarding of our free economy".

After hearing representations from interested parties and conducting studies of its own, the Committee issued its Report in two parts.[2] In response to the Government's specific request for opinions on resale price maintenance, an Interim Report, dated October 1951, dealt exclusively with this matter. The Committee assessed this practice against two standards: the desirability of a free economy and the need for economic efficiency. It concluded that resale price maintenance on the growing scale then practised was not justified. The Committee recommended that it should be made an offence for a manufacturer or other supplier:

"1. To recommend or prescribe minimum resale prices for his product;

2. To refuse to sell, to withdraw a franchise or to take any other form of action as a means of enforcing minimum resale prices."

In connection with its examination of resale price maintenance, the Committee looked also at "loss-leader" selling. The latter practice, though condemned as monopolistic and not conducive to the general welfare of the public, was not viewed as presenting any immediate danger in the then current period of inflation and relative scarcity.

The Interim Report was considered by Parliament in December 1951, and an amendment to the Combines Investigation Act was passed which made it an offence to fix minimum resale prices, although suggested resale prices were still allowed.

The final Report of the Committee was issued in March 1952. Despite strong statements about the need for public policies in support of competition to be "adaptable to complex and rapidly changing problems", the Committee refrained from recommending any substantial change in the concept or direction of the combines law. One impediment to change was the constitutional problem. The Committee stated that publicity and criminal prosecution had been the principal means used against monopolies, "mainly because the legislation has been based on the federal power over criminal law and has been upheld by the courts on this ground". Recognition was given to "another view" to the effect that the federal power over trade and commerce would give Parliament complete jurisdiction in monopoly situations, at least those involving international and interprovincial trade. But, because neither of these views had been sanctioned by judicial decision, the Committee preferred to leave the question of extending the scope of the legislation to some future time. As the Report stated: "Our recommendations are directed to the strengthening and improving of the procedures, organization and remedies laid down in the Act rather than to revolutionizing them."

The chief recommendation of the MacQuarrie Committee was in regard to administration. The Committee proposed that there be a separation of function between investigation and research on the one hand and appraisal and report on the other. The Committee had received representations from the business community that the existing Commissioner was placed in the position of both prosecutor and judge. To effect a separation, the Committee recommended that the duties of the Commissioner be divided and assigned to two separate agencies: an agency for investigation and research, and a board for appraisal and report. The amendments to the Combines Investigation Act introduced in 1952 provided for a Director of Investigation and Research and for a Restrictive Trade Practices Commission consisting of not more than three members appointed by Governor in Council. The Director could initiate inquiries, but the powers needed to pursue an inquiry effectively -- seizure of documents, oral examination of witnesses, and orders for written returns -- could only be exercised after authorization by a member of the Commission. The Commission was to hear and appraise all evidence presented to it by the investigation and research agency as well as such other evidence as was necessary to ensure that persons under investigation had full opportunity to be heard.

The Committee recommended that the board report to the Minister, that the public report be retained for its deterrent effect, and that the scope of the Report be widened. The Committee was also concerned about the various areas of government policy which impinged on competition policy:

> Numerous other aspects of the Federal Government policy may greatly contribute to strengthen or weaken monopoly power. Money lending, currency management, negotiation of international trade agreements, import and export controls, public works, taxation, technological research may all directly or indirectly affect the interests of particular business groups. The way our legislation on banking, insurance companies and corporations is framed and administered may also greatly affect the monopolistic picture of our industry.

To effect the desired co-ordination of government policy, the Committee recommended, first, that administrative procedures be designed to ensure close liaison between the proposed board and other government departments whose activities might affect the competitive structure of the economy, and secondly, that the board should be empowered to recommend any legislative or administrative change within the competence of Parliament if "such change could be used as an effective remedy to correct an undesirable monopolistic situation or practice". Although no administrative procedures to ensure a greater degree of liaison were in fact established, the legislation of 1952 did direct that the report of the Restrictive Trade Practices Commission "review the evidence and material, appraise the effect on the public interest of arrangements and practices disclosed in the evidence and contain recommendations as to the application of remedies provided in this Act or other remedies".

With regard to offences, the Committee proposed no new prohibitions to strengthen the merger or monopoly provisions in the Act or to curb discriminatory or injurious monopolistic practices. In the body of the Report, discriminatory practices were defined to include quantitative price discrimination (via unjustified quantity discounts) and spatial forms of price discrimination such as freight equalization and freight allowance, and zoning or basing-point price systems. Other more injurious practices were said to be "derogatory and harassing practices, price wars, 'loss leaders', threats and spreading of false information". The Government followed the advice of the Committee and, in the legislation of 1952, left the sections dealing with offences virtually unchanged, except that the provision relating to price discrimination was amended so as to prohibit only the systematic practice of price discrimination rather than any single act. The Committee did suggest that the Minister refer the loss-leader practice for review by the proposed new investigation and research agency and by the new board, but the subsequent study by these bodies led to no recommendations for changes in the Act.

The legislation of 1952 also incorporated the Committee's principal recommendation regarding remedies: that existing statutory limits on fines should be abolished and that the fine in each case should be at the discretion of the court. The Committee also suggested further use of supplementary judicial remedies such as the judicial restraining order. Accordingly, a provision was inserted in the Act authorizing the court to issue an order prohibiting the repetition or continuation of an offence. In a conviction under the merger, trust or monopoly clause, the court was empowered to order dissolution of the merger or monopoly "in such manner as the court directs".

The Committee's recommendation that research into monopolistic situations and practices should become "one of the most important assignments of the investigation and research agency" led to the introduction of a new section in the Act. Section 42 provided that the Director of Investigation and Research, on his own initiative, or on direction from the Minister, or at the instance of the Commission, should carry out an investigation of monopolistic situations or restraint of trade in relation to any commodity that might be the subject of trade or commerce. Such a "general inquiry" would be dealt with in the same manner as an inquiry involving a possible infraction of the law. In line with the suggestion of the Committee, the publication of the results of such a general inquiry should await subsequent review of the evidence by the Commission which should then forward the report to the Minister for publication. Since 1952, five such reports have been published, relating to: loss-leader selling; discriminatory pricing practices in the grocery trade; automobile insurance; drugs; and tires, batteries and accessories sold through service stations.

The 1960 Amendments

Only in 1960, when further amendments were introduced into the combines law, did the Government follow the MacQuarrie Committee's recommendation that the Criminal Code provision relating to combinations be brought into the Combines Investigation Act. In this process, the definition of "combine" was dropped, the word "trust" was eliminated, and separate provisions were enacted defining mergers and monopolies and making them offences only where they were likely to be, or to operate, "to the detriment or against the interest of the public".

In addition, Parliament attached certain provisions to the combination or conspiracy section of the Combines Investigation Act. In a rather unusual turn of phrase, one of the new provisions directed that "the court shall not convict the accused if the conspiracy, combination, agreement or arrangement relates only to one or more" of certain matters, including exchange of statistics, defining of trade terms, co-operation in research and development, or restriction of advertising, or some other unobjectionable activity. Nevertheless, by a second new provision, Parliament made it plain that such an agreement must not be used as a device for breaching the fundamental prohibition of combinations or conspiracies.

A further new provision related to export agreements. Parliament provided that "the court shall not convict the accused if the conspiracy, combination, agreement or arrangement relates only to the export of articles from Canada". A qualification was added, however, to the effect that the provision does not apply if the agreement reduces the volume of exports of an article, works to the specific detriment of Canadian exporters or would-be exporters, or lessens competition unduly in the domestic market.

The section banning resale price maintenance was also amended. The law passed in 1952 included a provision making it an offence for a supplier to refuse to sell to a dealer who would not maintain the supplier's prices. In 1960, Parliament provided a group of defences for suppliers charged with refusing to sell. Henceforth no inference unfavourable to the accused could be drawn if he satisfied the court that "he and any one upon whose report he depended had reasonable cause to believe and did believe" that the buyer was using the goods as loss leaders, was making a practice of misleading advertising in regard to such articles, or was not providing the level of servicing that his customers might reasonably expect. While Parliament in this amendment obviously viewed these practices with disfavour, it did not go so far as to prohibit them directly.

Parliament did, however, insert in the Act a provision to outlaw misrepresentation of the ordinary price of an article ("misleading price advertising"). Another new prohibition banned discriminatory promotional allowances. This latter provision had the twofold purpose of preventing discrimination in distribution and of limiting promotional expenditures.

Also in 1960, the prohibition of price discrimination on a territorial basis was strengthened by making it illegal for a seller to engage in a policy of selling articles in any area at lower prices than he exacted elsewhere in Canada if the effect or tendency or design was to substantially lessen competition or eliminate a competitor.

A change was also introduced in the procedure for prosecutions under the Act. Although proceedings in any case under the Act could continue to be launched in any superior court of criminal jurisdiction, they could henceforth also be instituted by the Attorney General of Canada in the Exchequer Court of Canada provided that all the accused consented to this. (An exception to this procedure was made for misleading price advertising, which offence was made punishable on summary conviction.) The new procedure had the advantage of by-passing intermediate appeal and of moving cautiously in the direction of a single, specialized court to hear competition policy cases.

In addition, in 1960 the scope of the injunction provision was extended to grant the courts power to dissolve an offending merger or monopoly without the necessity of first obtaining a conviction.

Assessment of the Present Combines Investigation Act

There exists no neat, scientific method for assessing the economic impact of a piece of legislation such as the Combines Investigation Act. A simple count of the number of cases brought to court over a period and the percentage won or lost tells rather little; indeed, it may be misleading inasmuch as publicity and deterrence have traditionally been supposed to play an important role in Canadian competition policy. The perfect anticombines law, if such a thing could be imagined, would be known to all, and 100 per cent effective in its deterrence, with the result that no cases whatever would occur! But the present law is far from perfect and its actual deterrent effect can only be assessed very impressionistically. Many people are understandably reluctant to discuss how their behaviour may have been influenced by criminal legislation, and the use of some such technique as a "deterrence survey" of Canadian businessmen would be unlikely to yield reliable results.

We have put forward in this Report the view that the encouragement of economic efficiency should be the objective of Canadian competition policy, and it is accordingly in relation to this objective that the present legislation should be assessed. This is a difficult task, however, inasmuch as the state of efficiency of the Canadian economy at any point in time and changes that may have occurred in its efficiency over time reflect the influence of a vast number of factors in addition to the Combines Investigation Act. Much the same thing may be said about the intensities and types of competition prevailing in the Canadian economy: they too are the product of many influences of which the Combines Investigation Act is but one.

Like most assessments of economic policy, therefore, that of Canada's present competition policy must be undertaken on a basis of imperfect knowledge. An initial point worth making is that over the postwar period, the scope of the legislation and the breadth and vigour of its enforcement have on balance increased.

More research has been done; a greater number and a wider range of industrial situations have been investigated; and the legislation has become a more important factor in the minds of businessmen and hence in the operation of the economy. Partly because of this greater volume of activity, and partly also because of greater efforts to publicize the nature and objectives of the legislation, the Act has become better known to important elements of the public, and by virtue of this fact alone may well have increased somewhat in deterrent power.

It must immediately be added, however, that there appear to be few grounds for supposing that the total impact of the legislation on economic efficiency has been more than modest. Certainly, the impact has been uneven. The Act has mainly been effective in restraining only three kinds of business conduct deemed to be detrimental to the public: collusive price-fixing, resale price maintenance, and misleading price advertising. A fair number of instances of each type of practice have been struck down by the courts, and partly because of the examples thus provided, there has probably been an appreciable deterrent effect as well.

It is unlikely that the Act has done much to affect efficiency via changes in the structure of the Canadian economy. The main claim that might be advanced is that the banning of resale price maintenance has probably encouraged the entry into some sectors of price-cutting retailers. It is possible too that other prohibitions of conduct in the Act may have had some indirect effects on economic structure. But in respect of corporate mergers, which are one of the most important means by which changes in industrial concentration and other dimensions of economic structure take place, the Act has been all but inoperative. The only two cases brought to court under the merger provisions (the *Canadian Breweries* and *Western Sugar Refining* cases) were both lost by the Crown, and were not appealed. There may have been certain deterrent effects in this area (the Director's *Annual Reports* indicate that some prospective mergers have been abandoned following consultations under the "program of compliance" discussed below), but the Crown's lack of success in the courts has presumably limited the amount of deterrence achieved.

There have been no court cases in respect of the section of the Act dealing with price discrimination. As to whether this section has exerted any important deterrent effect, opinions differ. One qualified observer has made the following comment:

> Those who are called upon professionally to advise on problems relating to combines legislation are impressed by the importance attached to it by the business community. It is probably equally true to say that the prohibition against predatory pricing has at least eliminated grosser attempts by large organizations to pre-empt a market or to drive competitors out of business.[3]

It should be carefully noted that the economic impact of the Combines Investigation Act is not solely a function of the terms of the law itself and the way in which it has been interpreted by the courts. The resources available for its enforcement, including notably resources consisting of persons skilled in economic analysis, have also been a very important factor. Had these resources been greater, so too would have been the economic effects of the legislation. Still another factor has been the size of fines imposed upon offenders. In general, these have not been such as to contribute greatly to the total deterrent effect of the Act.

Pursuing further the assessment of Canada's present competition policy, it is enlightening to look first at some of the points often raised by those who feel that the policy is not vigorous enough, then to turn to the views of those who feel on the whole that the policy is too vigorous. Some of these differing views are distilled from written submissions that we have received on the subject of combines, mergers, etc., while others are taken from other available literature. Many of the opposing positions in this field are of many years' standing, reflecting in some cases basic underlying dilemmas in the formulation and application of competition policy.

Those who would make Canadian competition policy more vigorous put much of their emphasis on the uneven effectiveness and incomplete coverage of the Combines Investigation Act. It does not, for example, extend to most service industries. Then there is the question of whether, if it be granted that presently illegal price and other agreements tend to have adverse effects on consumers, these same effects may not come about in other ways that the Act does little or nothing to bar. May they not come about, for example, if instead of entering into an agreement, the firms involved simply merge? Even this may not be necessary: in cases where the number of firms in an industry is relatively small, there may exist a sufficient measure of tacit understanding among them that their economic behaviour is not greatly different from what it might be if they had either merged or formed a collusive agreement. The condition of oligopoly, with firms following a price leader or otherwise acting upon "recognition of mutual dependence", appears to be fairly common in the Canadian economy.[4]

In addition to urging that more be done about mergers and oligopoly, some of those who favour a more vigorous competition policy have advocated the extension of the Act to cover a wider range of trade practices. The Act now covers refusal to sell only when used to enforce resale price maintenance. Other practices not now covered by the Act include the exclusive-dealing and tying arrangements described in the "T.B.A." Report of the Restrictive Trade Practices Commission.[5]

But, while some observers have felt that Canadian competition policy is not vigorous enough, others (particularly businessmen) have criticized it in other ways. The business briefs that have been received by the Economic Council in connection with the Government's Reference include most of the criticisms that Canadian businessmen have made of the Act over the last several years. Of criticisms that deal not with detailed procedures under the Act or with the repugnance to businessmen of its criminal law basis, but rather with its general character, philosophy, and approach, the following four would appear to be the most important:

(1) Proceedings under the Act are often extremely drawn-out, leaving accused firms in a state of uncertainty for long periods of time.

(2) Additional uncertainty is produced by failure to spell out offences clearly, with the result that businessmen often do not know whether their contemplated course of action will bring them into contravention of the Act.

(3) Since the main underlying objectives of the Act are economic in nature, it is inappropriate that the courts, in deciding whether an offence has been committed, should not give more attention than they do to the probable economic effects of the business actions complained of. In other words, there should be less relative emphasis on industrial *conduct* and *structure*, and more on economic *performance*.

(4) By the restraints that it exerts on agreements, mergers and monopolies, the Act hampers the achievement of greater "rationalization" and specialization of Canadian industry, the promotion of exports, and the building-up of large-scale, research-based enterprises.

It is worth pausing to consider a little further these four criticisms, for they help to illuminate some basic problems that all countries with competition policies have had to face in the formation and development of such policies.

To begin with, there is a certain incompatibility, already commented upon in previous chapters, between criticisms (1) and (2), which call for greater speed and certainty in the application of competition policy, and criticism (3), which calls for more flexibility, discretion, and consideration of economic effects. Greater speed and certainty could be obtained by redrafting the entire Act as a series of relatively clear and unqualified *per se* offences; this would undoubtedly accelerate procedure and give businessmen a more precise idea of whether their proposed actions were likely to attract a prosecution. But the resulting Act, if it were reasonably free of loopholes and comprehensive in its coverage, would likely be found intolerably rigid.

Conversely, however, a move to have the courts give greater consideration to economic performance and probable economic effects would tend to lengthen procedures and increase uncertainty. As it is, many recent price-fixing cases have taken five years or more to complete from the opening of the initial investigation. How much longer would they have taken if the courts had had to consider, in addition to evidence bearing on whether or not a combine existed, a full range of evidence concerning the alleged economic effects (past, present and future) of the combine? The difficulties that are involved in basing competition policy very largely on economic performance criteria and the analysis of probable economic effects were pointed out in Chapter 2.

Another dilemma is suggested by criticism (4) in the list above, concerning mergers, monopolies, rationalization, and specialization. The typical problem is that whereas a proposed merger or agreement regarding specialization, exports, or both, may give some promise of bringing about longer production runs and lower unit costs, with possible favourable implications for international competitiveness, it may also create a monopoly or near-monopoly in the domestic market, with possible unfavourable implications for the domestic consumer. Much will, of course, depend on other circumstances, such as the extent to which the domestic market is protected from foreign competition by tariffs or transportation costs.

Returning to the matter of uncertainty, it is normally thought desirable for criminal law to be characterized by an especially high degree of certainty and fair warning. The Combines Investigation Act is notable for the use of a large number of qualifying words and phrases such as "unduly" (Section 32 on combinations), and "having the effect or tendency of substantially lessening competition or eliminating a competitor, or designed to have such effect" (Section 33A on price discrimination). On the face of things, these qualifications might seem likely to produce considerable uncertainty. Regard must be had, however, to the jurisprudence as well as to the letter of the Act. Where there has been little jurisprudence, as in the section on price discrimination, much uncertainty does exist; but where the courts have been more active, as in the section on combinations, the state of affairs under the Act has become clearer. Thus the word "unduly" ("to prevent, or lessen, unduly, competition in the production, manufacture, etc....") has acquired a specific quantitative significance. It has been interpreted in such a way that a price agreement covering the whole of the relevant market can now virtually be said to be illegal *per se*, while an agreement covering less than the whole but well over half of the market runs a substantial risk of being held illegal.

An important point about the jurisprudence in this area is that while the courts have been prepared to consider economic evidence relating directly or indirectly to the share of the market covered by agreements, they have steadfastly declined to consider evidence relating to the economic *effects* of agreements. This is well brought out in the decision of Mr. Justice Spence in the *Fine Paper* case:

> Surely the determination of whether or not an agreement to lessen competition was "undue" by a survey of one industry's profits against profits of industry generally, and a survey of the movement of the prices in that one industry against the movement of prices generally, would put the Court to the essentially non-judicial task of judging between conflicting theories of economy and conflicting political theories. It would entail the Court being required to conjecture -- and by a Court it would be nothing more than mere conjecture since a Court is not trained to act as an arbitrator of economics -- whether better or worse results would have occurred to the public if free and untrammelled competition had been permitted to run its course.[6]

The quantitative, share-of-market interpretation that the courts have placed on "undueness" has been such as to allow the striking-down of a considerable number of price agreements. But in respect of mergers, where a similar piece of qualifying language prevails, the effects have been very different. In *Rex v. Canadian Breweries Limited*, the trial judge, Chief Justice McRuer, stated that it was not the motive but the effect of the merger that was important -- "whether it has operated to the detriment or against the interest of the public, or is likely to do so". Chief Justice McRuer asserted that these words, applied to mergers, had substantially the same meaning as "unduly", applied to combinations. It followed that if the effect of a merger was to virtually eliminate competition, an offence had been committed; otherwise not.

To demand that a price agreement, in order to be declared illegal, must embrace most of the relevant market leaves considerable room for successful prosecution by the Crown, since if an agreement had not this characteristic, its prospects of effectiveness would in most cases be too low to induce anyone to enter into it. But to apply a similar market standard to mergers all but rules out successful prosecution by the Crown since few mergers virtually eliminate competition even though some of them have considerable and long-lived effects on competition.

Establishing the share of the market covered by a price-fixing agreement is a relatively simple operation, since the area covered by the agreement itself is of considerable assistance in defining the market. However, the delineation of the relevant market in cases involving mergers and other restrictive practices confronts the Director of Investigation and Research, the Restrictive Trade Practices Commission and the courts with a more difficult task. Sometimes the task is virtually synonymous with that of defining industry boundaries, an industry being thought of as a group of sellers who market a certain product or range of products. But in a world of product differentiation and product substitution, where should market lines be drawn? Should one think in terms of the market for a particular kind of steel product, of the market for all steel products, or of the market for steel, aluminum, plastics and perhaps some other materials? The decision will turn on how readily market buyers can substitute one material or item for another. The geographic extent of markets, transport costs, and the relative costs of producing the substitute products will have to be taken into account. The result is very much a matter of judgment. For purposes of competition policy, market boundaries, if not always industry boundaries, should be drawn as narrowly as is required to ensure that no substantial group of buyers *within* the boundaries should be unable readily to substitute one product for another.

The present situation of Canadian competition policy with respect to mergers provides a good illustration of an area where it has proved impossible, within the confines of criminal court procedure, to provide the sort of examination of complex economic phenomena that would adequately satisfy the protection of the public interest. The MacQuarrie Committee was well aware of this kind of problem and attempted to devise a means of dealing with it while at the same time adhering to the assumption that the criminal law basis of Canadian combines legislation would have to be continued for the time being. In proposing the creation of a board very similar to what shortly thereafter emerged as the Restrictive Trade Practices Commission, the Committee was not only concerned to separate the functions of prosecutor and judge previously lodged with the Commissioner under the Combines Investigation Act; it also hoped to provide a means whereby significant economic issues in matters brought before the Commission could be thoroughly aired and reported on, and remedies other than (or in addition to) criminal prosecution could be proposed.

The task conceived for the Commission was an extremely difficult and challenging one, and if the expectations of the MacQuarrie Committee have not been wholly fulfilled in practice, this should not be taken as any reproach to the diligence and vigour with which members of the Commission have discharged their duties. The Commission has made some highly useful original contributions to the evolution of competition policy in Canada. Examples of such contributions would include the Commission's report on ocean shipping conferences and its active participation in certain general inquiries under Section 42 of the Combines Investigation Act. But it must be said also that, on the whole, the Commission itself has not been able to escape from the criminal law strait jacket to the degree hoped for by the MacQuarrie Committee. For reasons some of which are readily understandable, the Commission has paid close attention to the interpretation of the Combines Act by the courts and, to a considerable extent, has assimilated its role to that of the courts. It has not ventured into broader economic analysis to the extent that was anticipated and has not, by and large, provided an adequate solution to the problem of dealing with practices and situations that do not lend themselves well to treatment via the normal procedures of criminal courts.

Another means that has been utilized in an attempt to overcome some of the rigidities and other disadvantages of the present legislation has been the development of a "program of compliance" by the Director of Investigation and Research under the Combines Investigation Act. Under this program, businessmen have been encouraged to discuss with the Director *in advance* courses of conduct which they are contemplating, in order to determine whether the adoption of such courses would lead him to launch an inquiry under the Act.

Altogether, it is apparent that there are numerous causes for dissatisfaction with the present situation of Canadian competition policy. It cannot be expected that such a policy will ever please everyone. Remedies for undesirable situations must be provided, and those on the receiving end of these remedies will rarely if ever enjoy the experience. But it does appear to us that a point has been reached where competition policy can be restructured to meet, at least partly, some of the more serious and important criticisms that have been made of it, and where it can also be better related to national economic objectives. Thus altered, it should be able to command a wider measure of that public understanding and support that are essential to its successful operation.

Notes and References

[1] Joel Bell, *The Development of Canadian Antitrust Legislation,* Economic Council of Canada, Special Study (forthcoming). For other general references, see J. A. Ball, *Canadian Anti-Trust Legislation,* Baltimore, The Williams and Wilkens Company, 1934; Richard Gosse, *The Law on Competition in Canada,* Toronto, The Carswell Company Limited, 1962; G. Rosenbluth and H. G. Thorburn, *Canadian Anti-Combines Administration, 1952-60,* Toronto, University of Toronto Press, 1963.

[2] *Report of the Committee to Study Combines Legislation and Interim Report on Resale Price Maintenance,* Ottawa, Queen's Printer, 1952.

[3] Gordon Blair, "Combines: The Continuing Dilemma", *Contemporary Problems of Public Law in Canada,* O. E. Lang, ed., Toronto, University of Toronto Press, 1968, pp. 18-19.

[4] Economic Council of Canada, *Third Annual Review,* Ottawa, Queen's Printer, 1966, pp. 132-136.

[5] Restrictive Trade Practices Commission, *Report on an Inquiry into the Distribution and Sale of Automotive Oils, Greases, Anti-Freeze, Additives, Tires, Batteries, Accessories, and Related Products,* Ottawa, Queen's Printer, 1962.

[6] *Regina v. Howard Smith Paper Mills, Limited, et al.* (1954), O.R. 543 at 571.

CHAPTER 5

SOME STRUCTURAL ASPECTS OF CANADIAN INDUSTRY

The preceding chapters have discussed the appropriate objectives of competition policies and the legislation and administration of these policies both in Canada and abroad. It is of course impossible to draw inferences about appropriate Canadian policy from a comparative study of national policies without having regard to the economic environment within which each set of policies operates. While the Canadian environment clearly has many aspects that are similar to those found elsewhere, it also has a number of distinctive features that need to be taken into account in any assessment of present Canadian policies and proposals for their revision.

How does one obtain information about the features of the Canadian economy that are relevant for competition policies? Unfortunately, much of the information about the structure and practices of Canadian businesses, and about the process of their interaction with other private and public practices and policies has been neither collected nor examined. Neither consumers nor businessmen, nor the designers and administrators of public policies operate in a situation where their information is perfect or anywhere near perfect. Certain salient features of the Canadian economy have, however, been subject to some examination, and it is on the basis of available knowledge of these features that public and private decisions must be made. This information is available from a number of different sources. The major collectors of information are usually, though not always, public bodies such as the Dominion Bureau of Statistics and other federal and provincial government departments and agencies. The documentation of cases under the Combines Investigation Act, reports of the Restrictive Trade Practices Commission and the Canadian Tariff Board are notable sources, as are certain Royal Commission reports, and industry studies carried out under nongovernmental auspices.

For the most part we have been able to rely in this Reference upon the very substantial body of documented analysis of the Canadian economic environment that had accumulated prior to the time our work commenced. To some degree, however, we felt it necessary to expand this knowledge to embrace here and there some sections of hitherto unexplored or inadequately explored territory. Thus, while we have been able to rely on existing work in the area of scale and specialization and the size of Canadian markets, we felt the need to improve and bring up to date knowledge about industrial concentration in Canada and about postwar merger activity. We have also devoted some resources to throwing additional light on aspects of business behaviour directed to the specific activities of research and development. While our contribution within this Reference to existing knowledge about the Canadian economic environment has been modest, and while the sum total of existing knowledge in relation to the size and complexity of the environment is much less than it should be, it is nonetheless adequate to distinguish the desirability and direction of certain changes that should be made in our competition policies. The changes are of two kinds. The first kind involves changes in competition policy based upon long-standing features of the Canadian economy with which our existing policies, for a number of reasons, have never been able to deal adequately. The second kind of change reflects the need to update policies to meet changing technological and other features of the environment that have evolved since the MacQuarrie Report on combines legislation in 1952.

We propose in this Chapter to discuss some of the salient features of the Canadian economic environment, then to proceed in the following Chapter to the policy changes that we recommend.

Market Size, Scale and Specialization

One of the most obvious limits on efficient use of available resources is the size of the market into which the goods and services produced by those resources are channeled. In an open economy such as Canada's, market size is affected to a considerable extent by the tariff policies adopted by both foreign and Canadian governments. Tariffs erected by other countries hamper the efforts of Canadian producers to move beyond national borders and compete for sales in world markets. Tariff barriers set by Canada shelter the domestic market from the inroads of foreign suppliers, and increase the tendency for Canadian manufacturers to try to provide a full range of the requirements of Canadian consumers. Attempts by Canadian manufacturers to supply the wide range of products desired by consumers all too often result in inadequate specialization and short production runs. There are, of course, other impediments limiting market size; in some industries, transportation costs and nontariff barriers such as patents and the valuation placed on imports for customs purposes may have a more powerful impact.

The size of the market for the output of a particular industry in turn determines the number of firms or plants of minimum efficient size required to produce, distribute and market the product. One of the consequences of Canada's economic structure is that the conditions which tend to call for a relatively small number of relatively large firms also generate in many instances small, or at any rate inadequately specialized, plants operating at levels too low for maximum economic efficiency. How does this come about and why does it persist? Part of the answer may lie in the greater urgency of the pressures generated by the Canadian environment to achieve scale economies *other than at the plant level*. These would include economies to a firm in respect of such things as distribution, advertising and possibly in some cases overall management. The drive to capture such economies may help to explain why firms are relatively few and large in many Canadian markets. But this fewness of firms in turn may, over time, tend to lessen competitive pressures to the point where inefficient *plants* are able to persist. Inadequate specialization is especially marked in industries where the distribution system offers marketing advantages to firms producing a "full line" of products. In such cases, while the industry may contain the number and size of *firms* consistent with efficient production of its *total* output, maximum efficiency in terms of individual *products* is unlikely to be achieved because each of the firms is producing a full line instead of specializing in a few items only. It is important to stress at this point that the situation that has been described should not necessarily be attributed to inefficient management. Once a pattern of multiproduct output is established, it is not necessarily in a firm's own interest to specialize. An attempt to do so may not only place a firm at a marketing disadvantage vis-à-vis other firms that still offer a full line of products; it may also expose the firm to a price war if it tries to convert its lower unit costs on specialized items into lower prices.

The evidence on scale and specialization in many industries leaves little room to doubt that existing market forces are often incapable of bringing about minimum cost levels. Eastman and Stykolt's study[1] of 16 widely representative Canadian industries showed that plants of minimum efficient size (taking into consideration both scale and specialization) produced on the average only 43 per cent of the output of these industries. This was in sharp contrast to a similar study by Bain which showed that in the United States the average was 80 per cent.[2] In only four of the Canadian industries was 75 per cent or more of the output produced in plants where full advantage was taken of available production economies. There are still important unanswered questions in this area -- questions that relate to the extent of the gap between minimum efficient size and the average size of plants in each of the industries and to cost differences between plants of different sizes. But it is known that cost differences can be quite large and indications are that the cumulative detrimental effect on the Canadian economy of inadequate plant size across a broad spectrum of industries is considerable.[3]

The proposed changes in competition policy presented in Chapter 6 of this Report have been influenced in two important respects by the evidence on scale and specialization in Canadian industry. This evidence has had a direct bearing on our recommendation that specialization agreements, under appropriate safeguards, should be permitted, and secondly that, in evaluating a merger, weight should be given to the effect on cost levels in addition to other factors. One of the key questions that had to be answered was whether the shortfall between actual and potential performance in the area of scale and specialization was sufficiently important to justify provisions in our recommended policy which could in some cases result in less, rather than more, competition. In reaching an affirmative answer to this question, we hasten to add that the approval of specialization agreements must be on a selective basis -- they are by no means appropriate for all industries. A case-by-case appraisal also appears to be required in dealing with mergers where it is necessary to sort out and evaluate the variety of reasons that may underlie a decision to merge. It is interesting to note that the admittedly imperfect evidence from a survey conducted by the Combines Branch, discussed below, suggests that the exploitation of greater scale and specialization opportunities did not rank among the main factors motivating the extensive merger activity that took place in Canada during the postwar period. This is not to say that the other motives were necessarily inappropriate or that greater efficiency resulting from economies of scale and specialization did not in fact come about as a result of the merger. But it does point up the necessity of a case-by-case appraisal, in the light of surrounding circumstances and taking into account all relevant factors, in order to predict with any degree of confidence both the possible economies and the potential adverse effects on competition that may result from mergers, and indeed from other types of business practices.

The existence of tariff protection on many final products produced in Canada raises important potential obstacles to efficiency. The tariff may act as an effective upper limit on prices; in other words, the laid-down (or tariff-paid) cost of imports into Canada is used in some cases as the limit above which manufacturers may not price their products, regardless of how many other competitors they face or how large a share of the market they control. This limit price is not necessarily a level that affords producers high or excessive profits, but the fact that it does exist and that it is easily recognizable may reduce the need to strive continuously to achieve efficiencies. In a number of manufacturing industries, Canadian producers may in fact be able to hold prices below the upper limit set by the tariff, but they are under little or no pressure to do so. The tariff in these industries provides a margin within which inefficiencies may persist; this is true regardless of whether or not advantage is taken of the full margin of tariff protection. In addition, the fact that the limit price is clearly defined by the laid-down cost of imports may have implications for conduct that are relevant to the analysis of competition policy. It may be less difficult, for example, to achieve a tacit consensus among firms in a Canadian manufacturing industry in respect of their pricing policies than it is in the United States where situations in which similar upper limits exist and appear to play a significant role in business pricing decisions are apparently less widespread. The laid-down cost of imports into Canada can be taken as the price that would be charged if market power was fully exercised in the sheltered Canadian market. This indication of market power may weigh critically in assessing the implications of such things as mergers or specialization agreements which, on the one hand, promise efficiency gains in production but, on the other hand, produce increased industrial concentration or something very similar in its economic effects.

It has been argued that the reduction of tariffs following the Kennedy Round and the change in the Canadian economic environment which these reductions will bring about will be such as to make possible a major dismantling of competition policy. This seems highly unlikely. Nominal tariff rates will still be fairly high -- on the average about 15 per cent. In many industries the effective protection provided by the new tariff rates will be about the same as before the Kennedy Round, because the reduction of the tariffs on inputs used by these industries offsets the decrease in protection on their own output.[4] Nevertheless, the reduction of tariffs on a broad front should result in some inducement for industries to move towards larger scale and increased specialization. Domestic tariff levels *have* come down. Moreover, foreign markets have been made more accessible to domestic producers. The market discipline and the opportunities created by the multilateral tariff reductions should result in a more efficient structure of Canadian industry. But the continuation of substantial tariff and nontariff barriers for some time into the future is another reason behind the need for public policies geared to promote efficiency.

There are of course some industries in which market size, industrial structure and business conduct are not conditioned by the level of tariff barriers. Where the product is perishable, such as milk, or where the bulk or weight of the product is high relative to its value (e.g. cement), the potential area served by a plant is determined by economies of scale, transportation costs, and the geographic distribution of buyers. The markets served by many retail and wholesale distributors and by many service-producing establishments are also, by their nature, local, and are, moreover, a large and growing part of the economy.

A further force influencing the Canadian environment is the presence of factors outside Canada that tend to restrain competition significantly in some industries even in the complete absence of a Canadian tariff. For instance, the main potential foreign competitor might be the corresponding U.S. industry, and this industry might itself be highly oligopolistic and in many ways relatively noncompetitive. The comparative lack of competition in a Canadian industry closely linked to its American counterpart via parent/subsidiary or other affiliate relationships would have to be regarded as due in large measure to the competitive situation in the United States. In such cases all that national competition policy can realistically accomplish is to restrain any attempt to abuse a position of market dominance.

It is obvious from this brief look at some of the elements of Canadian economic structure and associated business conduct that competition policy cannot deal with these aspects on the basis of any universal law. But it is equally clear that in some cases they may be of sufficient importance that policy must be devised to take account of them on an individual basis. For example, while the power to introduce tariff reductions must reside with the government, cases may come up where a lowering of the tariff barrier may be a highly appropriate means to ensure that efficiency gains, such as result from a merger, for example, are passed on to the consuming public.

Concentration

The level of concentration -- the extent to which a small number of firms account for the bulk of an industry's output -- has an important bearing on the state of competition in an industry. Where concentration is high, so too are the risks of strong market power, low competitive pressure, inefficiency and poor resource allocation. One must be very careful however not to be overly simplistic and to translate measures of concentration into indexes of market power, for concentration is only one of the variables helping to produce these undesirable conditions. But the higher the level of concentration, the more likely it is that certain undesirable practices will occur. For instance, more stress is likely to be placed on nonprice forms of competition, and both the ease of reaching joint decisions on pricing and the temptation to do so are likely to be greater. Where, on the other hand, there are 20 or more firms in an industry with no three or four of them highly dominant, the probability of firms being able to reach joint binding decisions on price, either through explicit agreement or through some form of implicit bargaining, is slight. The tendency to engage in secret price-cutting would likely override even a formal agreement. Many studies have proven that there exists on the average a positive relationship between high levels of concentration and high profit levels.[5] The ability to maintain earnings, year after year, over and above the amount required to cover costs plus a reasonable return on invested capital, is an indication that something is amiss in the efficiency of resource use in the economy. (One cannot, however, turn this coin around and infer that where earnings just cover costs plus a reasonable return on capital, efficiency necessarily reigns. As was observed in Chapter 2, lack of competitive pressure in an industry may lead to sloppiness, poor cost control, and merely comfortable profits.)

Changes in the level of concentration in a particular industry can be brought about by a number of factors. Among the most important are the speed at which the industry grows; shifts in the size of plants and firms required to maximize efficiency; the importance of technology embodied in patents held by existing firms; the size and availability of capital investment required for a new firm to break into the industry; other barriers to entry; and the extent of merger activity which has taken place within the industry.

It is obvious from even this very brief list that industrial concentration is *one* of the elements to be taken into account in the design of a competition policy which strives to promote economic efficiency. What is not so obvious is the degree of importance to attach to concentration in the Canadian context. At the outset of our work, the only available empirical evidence was a study by Rosenbluth based on 1948 data for 96 Canadian industries. In order to update this work, the Council commissioned Professor M. Stewart to undertake a study based on various industry bulletins published by the Dominion Bureau of Statistics. The results of this study, which is shortly to be released, are summarized briefly in Appendix III. But for present purposes it is sufficient to note that in more than one-third of Canadian manufacturing industries in 1964 as few as eight firms within each industry accounted for 80 per cent or more of the shipments of that industry. At the other end of the scale, however, in another group of industries again accounting for more than one-third of total manufacturing, 20 or more firms were required to account for 80 per cent of total shipments of their respective industries. A comparison of shifts in aggregate industrial concentration over time suggested that, although more than one-half of the manufacturing industries for which reasonably comparable data were available over the period were more concentrated in 1964 than they had been in 1948, more than one-third had a lower level of concentration.

Thus one can only conclude that in some parts of the Canadian economy certain industries may have a high and increasing degree of concentration. One cannot, however, determine from the figures whether the degree of concentration in these industries is such that full advantage is being taken of economies of scale. Clearly such an assessment must rest on a much more penetrating analysis of individual firms and a finer classification of the industries within which they operate. What one can say is that if concentration levels in each of these industries were lower and falling, there would be less need for concern over mergers and trade practices with a potential for detrimental effects on efficiency. Except in circumstances where there is public control over the entry of new competitors into an industry, high concentration is a necessary, although by no means sufficient, condition for market power. Where there is no significant market power in an industry, then practices of individual firms, such as tied sales and refusals to deal, for example, are not likely to result in detrimental effects on the public interest, because the buyers of the industry's product can turn to other producers for their supplies. Indeed, in the absence of market power it is much less likely that potentially detrimental practices will exist at all.

Mergers

The discussion so far has highlighted the fact that the behaviour of firms is influenced by the structure of the industries within which they operate. But this is not a one-way process. What firms do affects, in turn, the structure of industries. All forms of market behaviour have the capacity to change industrial structure. Policies of existing firms with respect to pricing, advertising, and research and development can exert a powerful influence on what size and other characteristics a new firm must have to enter an industry successfully, and on the capacity to survive of some of the firms already in the industry. These policies ripple out to produce gradual changes in the structure of industries, giving competitors the opportunity to adjust their own policies if they feel this to be necessary. Abrupt changes in structure, brought about by sharp alterations in conduct, are therefore rare.

There is, however, one exception to this general statement: mergers between competitors and between customers and suppliers have an immediate and sometimes substantial impact on the structure of industry.

Mergers are brought about in two principal ways. An acquiring firm may purchase all of the assets of another company, or it may secure enough of the voting stock of the acquired company to ensure effective control. Mergers have two effects, both of which are of concern to efficient resource use and to competition policy. The first relates to the increase in market power brought about by the merger. If the acquired and acquiring companies are in the same industry, a merger will obviously reduce the number of firms, whereas a merger between companies in a customer-supplier relationship leads to an increase in the degree of vertical integration within the industry. Alternatively, in the case of a merger of firms engaged in unrelated activities, the merger will have no necessary impact on those aspects of market structure which have hitherto been most studied and analysed. But the fact that the analysis of such "conglomerate mergers" is still in its relative infancy calls for caution in reaching conclusions on how they affect business structure and conduct.[6] The second effect produced by a merger is that by increasing the volume of assets and sales under the control of individual firms, they increase the rate at which cost-saving opportunities may be exploited. Other effects of mergers, such as changes in the degree of foreign control of Canadian industries, fall outside the ambit of competition policy.[7]

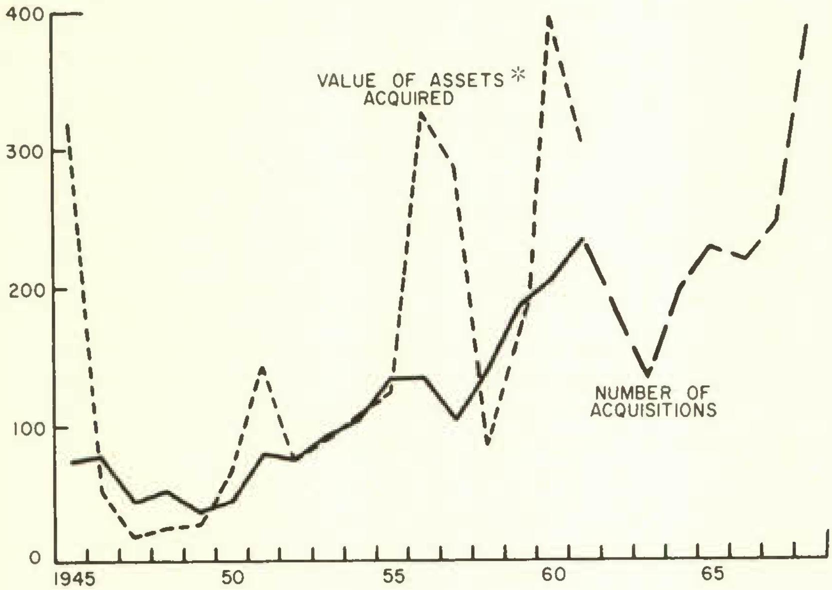
The Combines Branch of the Department of Consumer and Corporate Affairs recently completed a survey of mergers taking place among firms whose activities fell within the jurisdiction of the Combines Investigation Act and which made any publicly recorded acquisitions from the beginning of 1945 to the end of 1961. Coverage of sectors such as manufacturing, mining and trade appears to have been virtually complete. However, there was only fragmentary coverage of acquisitions by firms in the service sectors, such as financial institutions, most utilities, advertising agencies and real estate companies. The survey recorded 1,826 acquisitions over the 16-year period, acquisitions being defined as the purchase of the whole or part of an operating business capable of sustaining an independent operation and costing in excess of $10,000.

The annual breakdown of the number of acquisitions and the volume of assets acquired is shown in Chart 5-1. Two characteristics stand out. The first is that there were some wide fluctuations in both the number and value of acquisitions and, second, that there was a fairly strong upward trend over the period, particularly in the number of acquisitions. As was discovered in the United States,[8] the number of acquisitions bears a fairly close statistical relationship to a number of major economic variables, but particularly to the average level of stock market prices. Since mergers seem to respond positively to generally buoyant economic circumstances, as reflected in stock market prices, and given the apparent determination on the part of Canadian and foreign governments not to permit any prolonged slowdown in economic activity, an environment favouring a high level of merger activity is likely to persist into the foreseeable future.

Other results of this survey are to be found in Appendix III to this Report.

Chart 5-1

MERGER ACTIVITY IN CANADA, 1945-61[(1)]



* MILLIONS OF DOLLARS, DEFLATED TO 1949 BASE

(1) Mergers covered in the survey include only acquisitions made in the period 1945-61 by companies whose activities fall within the Combines Investigation Act. Data pertaining to the number of acquisitions undertaken in 1962 to 1967 were tabulated from published sources.

Source: Questionnaire Survey, Combines Branch; Economic Council of Canada.

In the previous Chapter, attention was drawn to the fact that the Canadian courts' interpretation of the existing merger section of the Combines Investigation Act has been such that acquisitions by firms with substantial market power are not precluded by law. In the light of what has been said about the potential dangers inherent in an overly concentrated industrial structure, and in view of the somewhat rough indications that in some industries in Canada concentration could be approaching a danger point, Canada's stance with regard to mergers gives grounds for concern. On the other hand, there is evidence of a need for greater specialization in some lines of Canadian production so that potential economies of scale can be fully realized. How can Canadian policy resolve this dilemma? Certainly, the state of existing knowledge about industrial concentration, scale and specialization, is not such as to lend itself to any crude, mechanistic formula which weds these factors together. What appears to be needed is some sort of selective approach where certain merger proposals are examined for possible detrimental effects on the public interest in efficient resource use, with careful attention being paid to the circumstances of the particular industry involved. But given the possibility of initiating such a procedure, one may understandably want to ask how many of the mergers that have taken place in this country in the past might have been regarded as appropriate candidates for a public interest examination. Careful note should be taken of the exact question being asked: not "How many mergers should have been disallowed?", but "How many mergers might well have been examined for evidence of possible detrimental effects on the public interest?"

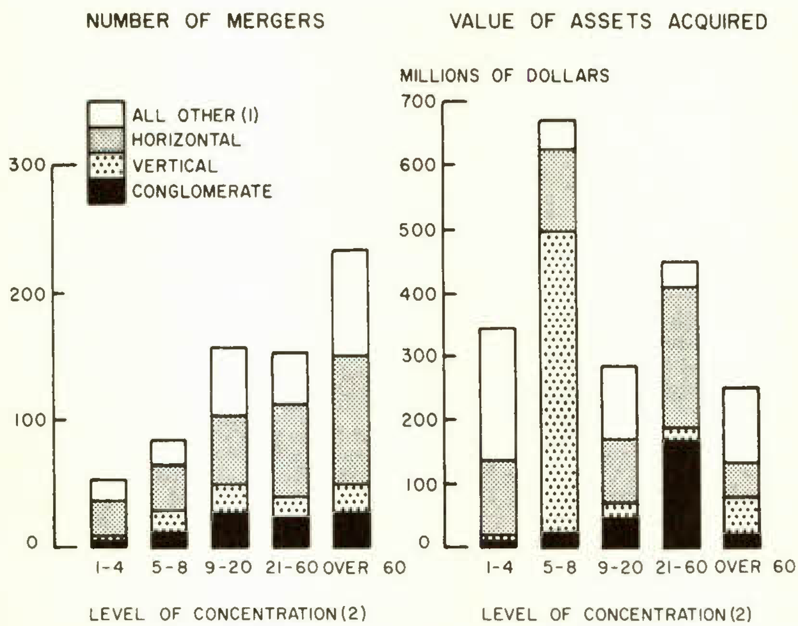
Presumably, the mergers selected for examination would, by and large, be those that appeared to confer substantial increases in market power on the acquiring companies, and particularly those that enhanced an already substantial degree of market power. The identification of market power is often a difficult task. Even in the initial phases of the selection process, an agency charged with screening out mergers for examination would be bound to take account of numerous factors. Here, the procedure employed is necessarily much cruder. Two rough estimates are attempted.

The first of these estimates is based on a cross-classification of 76 per cent of the acquisitions of manufacturing companies during the period 1945-61 (the remaining 24 per cent were not included since the industries in which the acquired firms could be placed were broader than the classification for which concentration data were available). These mergers are classified according to (a) the types of acquisition and (b) the levels of industrial concentration prevailing in each of the manufacturing subclassifications where mergers occurred. It is assumed for purposes of the estimate that only in rather highly concentrated industries would increases in market power resulting from mergers be worrisome enough to call for a public interest examination. If "rather highly concentrated" industries are taken to be those where eight or fewer of the largest firms accounted for 80 per cent of total shipments, this immediately drops the number of possible candidates for examination to 136. If one assumes that the 18 mergers falling into our "catch-all" conglomerate category have no detrimental effect on the public interest, this figure drops to 118. This would represent 17 per cent of the total number of mergers and 49 per cent of total value of assets acquired. The data on which this estimate is based is summarized in Chart 5-2, while the detail may be found in Table A-4 in Appendix III.

A second estimate is somewhat more sophisticated, involving a case-by-case appraisal of 997 acquisitions by manufacturing firms. Various factors bearing on market power are taken into account, including the level of concentration in the industry of both the acquiring and acquired firms, the market relationship and size of the acquired and acquiring firms and where available the size ranking of the firms in their respective industries. Another factor taken into account was the history of merger activity of the acquiring firm. On this basis, it appears that about 8 per cent of acquisitions, accounting for 34 per cent of total acquired assets, might have qualified for a public interest examination.

Chart 5-2

TYPES OF MERGERS AND THE LEVEL OF CONCENTRATION OF THE MANUFACTURING INDUSTRIES WITHIN WHICH THE ACQUIRED FIRMS WERE OPERATING, 1945-61



(1) Includes mergers described as "Geographic Market Extension", "Product Extension" and "Other Horizontal", data for which are shown separately in Table A-4 in Appendix III.

(2) Number of firms required to account for 80 per cent of shipments in 1964. Because levels of concentration were estimated from grouped data, they may be expressed as fractions of firms. In the Chart, wherever such fractions fall between the upper and lower values of two adjacent bars, the industry was placed in the bar with the higher value; for example, an industry with the concentration level of 4.1 appears as part of the concentration interval 5-8.

Once again, it should be emphasized that both of the above estimates are derived by crude methods. Their main value is the very rough indication which they provide that the institution of a procedure for examining mergers which appeared to involve a possibility of detriment to the public interest would probably affect a fairly small proportion of total mergers.

Returning to the merger survey conducted by Combines Branch, the questionnaire attempted to elicit from the acquiring firms the cost savings that resulted from the acquisitions. (This question was raised in the hope of determining what proportion of the mergers effected between 1945 and 1961 were undertaken in order to realize cost reductions through increased scale.) The replies, which are more fully discussed in the Appendix, were somewhat surprising and must be interpreted with caution. One surprising result, for example, was the large percentage of acquisitions that, in the opinion of the acquiring company, yielded negligible or no economies. Another was the fact that administration and management were considered to be far and away the most important source of economies. This is in contrast to expectations that, particularly where the companies involved were selling the same product in the same market, and where, consequently, much attention might be focused on improving scale and specialization, economies achieved through the integration of plants and the use of raw materials might have appeared more frequently. It must be repeated, however, that one should not read too much into these results. It is very evident to us that this area merits a good deal of further exploration and analysis before firm conclusions can be drawn. Determining the approximate size and nature of the economies which may result from a proposed merger will be one of the most difficult tasks to be faced by those charged with administering Canadian competition policy in a way which furthers the objective of efficient resource use.

Industrial Research, Development and Innovation

Discussion in Chapter 2 of this Report indicated that in formulating competition policy with a view to promoting economic efficiency, it is important to conceive of competition in its dynamic dimension -- that dimension which consists of the irruption onto the industrial scene of new and improved products and new methods of production and distribution. As the writings of Schumpeter and others remind us, there are situations in which this can be the most powerful of all forms of competition.

It is important, however, not to proceed from the above to some such oversimplified conclusion as the following: "Industrial research, development and innovation are very good for the economy; we need more of them; large firms typically devote more of their resources to such things than do small firms; therefore competition policy should never stand in the way of the achievement of greater corporate bigness and industrial concentration." Such an unqualified line of reasoning is unacceptable, not only because competition policy must take into account important factors in addition to R&D and the innovative process but also because the relationship between such activity on the one hand and industrial structure on the other is in reality more complex than the statement suggests.

To be sure, it is a generally accepted proposition that a highly fragmented industry like agriculture, producing for the most part very homogeneous products, is unlikely to generate on its own an adequate volume of R&D and innovative activity. The typical production unit is too small to support a volume of activity likely to lead to useful improvement, and even if the unit were large enough, the improvement (whether it were a new strain of wheat or a better method of cultivation) could be too easily and quickly copied by others to make a sustained research program by an individual farmer worth his while: lacking patent protection (no plant patents are granted in Canada), he could not capture an adequate return for his effort. An analogous situation may be found in at least some sectors of the construction industry. There is a strong presumption that industries of this type, left to themselves, would generate much less R&D and innovative activity than would be socially desirable, and this provides the underlying rationale for the considerable volume of activity mounted by Canadian governments in such fields as agricultural and building research.

As one moves away, however, from highly fragmented industries into more concentrated sectors of the economy, the picture begins to change. The inducements for firms to carry on R&D and innovative activities become more powerful, and judgments of the extent if any to which these activities fall short of, or exceed, socially optimal levels grow more difficult. Where an industry is dominated by a few large firms, heavy outlays on research and development and particularly on innovation may play a major role in the competitive strategy or rivalry among the few. This is partly because in such an industry the large firms (often possessing substantial retained earnings) will usually find the financial and other resources required for R&D programs and the application of new technology easier to come by, and partly because an individual large firm that innovates successfully will usually be in an immeasurably better position than an individual farmer or a small firm to capture an adequate return for its outlays. Aided, often, by patents and the possession of detailed technical know-how, it may be able to get a significant "jump" on its rivals, or if not that, then at least to keep technologically more or less abreast of them.

All this may at first glance seem entirely commendable; a certain type of competition among the few has helped to generate a high level of R&D and innovative activity within an industry. And, indeed, great benefit for consumers may result. But a caution is in order. Unless the improvements result in lower unit production costs, at least part of which are passed on to the consumer, then what is occurring is a form of nonprice competition. As was indicated earlier, nonprice competition can sometimes bring tangible benefits to the consumer -- it may for example make more extensive the range of available real alternatives. This is not invariably the case, however. Moreover, in respect of some product and process innovations, account must be taken of adverse "external" effects such as traffic congestion, noise, and air pollution. It cannot safely be presumed that *every* new or partly new product puts the consumer far enough ahead to justify, from the point of view of society as a whole, the heavy use of R&D and other resources that may have been required for the product's creation. Large expenditures may have gone into "inventing around" another firm's patented product. The end result may not be all that new and improved; instead it may be just sufficiently different from what was already on the market to furnish the basis for a heavy advertising campaign and a successful sales promotion. This is not meant to deny the existence of some situations in which "inventing around" may be a very necessary part of the competition strategy of some industries. Where, for example, a patent owner sets unreasonably high licence fees, other firms in the industry may be forced into large research outlays to remain competitive. But in other situations, expenditures on innovation and on advertising may play more similar roles than at first seems apparent; both may serve as important and often closely linked forms of nonprice competition. And where outlays are heavy, both may constitute significant barriers to the entry of new competitors into the industry.

The market situation faced by large firms and the types of competition in which they prefer to engage are not the only factors explaining the proportionately lower R&D expenditures of small firms. Particular inventions and innovations, and occasionally even certain kinds of research programs, may require expensive equipment and a large staff to be carried to a successful conclusion. Also, a firm producing a full line of products is likely to have a better chance of finding a use for the unexpected fruits of its research activity than a more specialized firm. This characteristic is important in industries where diversification of output tends to be greater, the larger the size of the company. Finally, as implied in the foregoing discussion, the discovery-invention-innovation process is risky. Failure as well as unexpected benefits may result from research activities, while the crucial innovation stage may involve heavy costs. One of the advantages accruing to firms able to devote a large amount of resources to these activities is that they can pool their risks by undertaking a number of diverse projects.

What evidence is there with respect to expenditures and other measures of research, development and innovative effort, and what does this evidence tell us about the relationship between the size of a firm and such activity? Unfortunately these questions cannot be answered with any degree of accuracy. For one thing, the available statistical evidence is confined mainly to R&D expenditures, but these figures fail to capture "the costs of the other activities that make up the remaining parts of the innovation process".[9] As was noted in the *Fifth Annual Review* of the Economic Council, innovation involves the coupling of the results of R&D with the engineering, design, financing, tooling-up, production and marketing processes required to bring products, processes and services into use. What the data on R&D do tell us is that the main effect of size is on the decision of companies to initiate research and development. A survey by the U.S. National Science Foundation revealed that the percentage of companies performing research and development in three broad size categories increased very sharply in moving from the smaller to the larger categories.[10] However, once the decision to undertake R&D activities has been made, there does not appear to be a consistent relationship between R&D expenditures and corporate size.[11] When smaller companies undertake R&D at all, they do not necessarily devote a smaller proportion of their resources to it than do larger companies. This conclusion is illustrated below with reference to Canadian statistics.

Because virtually all the available statistics of industrial R&D and innovative activity are expressed in terms of R&D expenditure, there is a danger of jumping to the easy assumption that the larger are expenditures, the correspondingly larger and more useful are the innovative consequences which flow from them. In fact, investigation has shown that useful new products and processes can by no means always be traced to the inventive activity of the big battalions. Important inventions have been created by firms of all sizes, with smaller firms contributing at least a proportionate share of the inventions surveyed.[12] A recent scientific panel study for the U.S. Government listed a number of twentieth century contributions as having originated with independent inventors and small organizations: xerography, DDT, insulin, penicillin, titanium, terylene/dacron, the zipper, the automatic transmission, the jet engine, the FM radio, the helicopter, air conditioning, the Polaroid Land camera, and the oxygen steelmaking process.[13]

Another U.S. investigation compared the contribution of innovations by the four biggest firms and the remaining smaller firms in three industries: iron and steel, petroleum refining, and bituminous coal.

In iron and steel, the share of the four biggest firms in innovations was smaller than their share of the product market. The reverse was true in the petroleum and coal industries.[14] These results suggest two questions which it is important to ask about research, development and innovation in a given industry. The first is: How much, on average, must be invested in R&D and in innovation in this industry in order to bring new products and new processes to the market? The second is: How many firms in this industry are big enough to be able to undertake investments of that size?

Here again the available aggregate industry statistics focus only on R&D, and therefore fail to provide a complete answer. What is known is that overall levels of expenditure on R&D alone are heavily influenced by a relatively small number of firms in a few particular industries. Of 684 companies that had their own "intramural" research programs in 1965, five accounted for one-third of expenditures and 50 for three-quarters. Breaking intramural expenditures down on an industry basis, about 60 per cent of expenditures were made by firms in the electrical, aircraft and chemical industries. Computations performed on behalf of the Economic Council by the Dominion Bureau of Statistics on the relationship between size of companies and R&D in the chemical and electrical products industries indicated that there was some tendency for R&D expenditures as a percentage of sales to increase with company size. However, as is shown in Table A-6 in Appendix III, there are considerable variations from industry to industry.

While "intramural" activities are concerned mainly with the search for new knowledge and new inventions, innovative activity draws heavily on technological information from the existing knowledge base. The fact that approximately 95 per cent of our patents are granted for inventions created outside of Canada is evidence of Canada's dependence on foreign sources for much of our technology. However, statistics on net payments abroad for patents, licences and technical know-how do not necessarily reflect the total cost of importing technology. Parent companies may elect to take higher profits from their subsidiaries in lieu of specifically earmarked payments. With this cautionary warning, it is nevertheless of some interest to note that 825 companies reporting R&D expenditures in 1965 also reported spending $25 million for patents and licences from abroad, most of which went to parent and affiliated companies.[15] Moreover, there has been a movement in recent years towards increased R&D expenditures in Canada relative to payments for R&D outside Canada.[16]

Once again the serious limitations inherent in the data serve to emphasize with what caution the available statistics must be interpreted, and with what care the consideration of R&D and innovative activity must be introduced into the formulation and application of competition policy. One useful conclusion appears to be that firms of many different sizes have important roles to play in the development of inventions and innovations. Small firms do well in the early development of inventions, but large firms may have important advantages in carrying inventions through to the stage of widely used processes and products.

Because of the difficulty of arriving at generalizations about the relationships between R&D and innovative activity, industry structure and firm size, here as in other areas a selective approach on the part of competition policy is required. Scale economies in R&D and innovation will have to be taken into account in merger evaluations. However, given the distribution of such activity by industries, the importance of this factor will probably vary greatly from merger to merger, depending on the industries in which the merging firms operate.

The questions raised in this Chapter about market size, scale and specialization, the role of the tariff, industrial concentration, mergers and research, development and innovation have influenced the formulation of the recommendations outlined in the following Chapter. The fact that no hard and fast answers to these questions have sprung from either the empirical work that had already been done or from such efforts as we were able to make ourselves has led us to one major conclusion: although each of these aspects can have a significant influence on competition and on the degree of efficiency with which resources are used, the sectors of competition policy where decisions turn importantly on these aspects must be based on a case-by-case approach where economic analysis can be brought to bear on the examination of specific factors influencing the behaviour and performance of individual firms. That the present Combines

Investigation Act fails to provide for such an approach is evident from the discussion in the previous Chapter. We turn now to our suggestions for a new approach.

Notes and References

[1] H. C. Eastman and S. Stykolt, *The Tariff and Competition in Canada*, Toronto, Macmillan, 1967, Table 1, Chapter 3. Many of the industries referred to in this study are more narrowly defined than the DBS classifications used later in the present Chapter. Also, see D. J. Daly, B. A. Keys, and E. J. Spence, *Scale and Specialization in Canadian Manufacturing*, Staff Study No. 21, Economic Council of Canada, Ottawa, Queen's Printer, 1968, for additional evidence and references to other studies.

[2] Joe S. Bain, *Barriers to New Competition*, Cambridge, Mass., Harvard University Press, 1956, p. 185.

[3] It is very important, when considering the effect of size of production units on resource allocation, to distinguish between differences in total costs per unit and differences in value added per unit. A percentage difference of 5 per cent in total costs per unit, say, will reflect a 15 per cent difference in the resources used if the value added is a third of total cost. See Ronald J. and Paul Wonnacott, *Free Trade Between the United States and Canada*, Cambridge, Mass., Harvard University Press, 1967, Chapter 15, for an estimate of the cost to Canada of the U.S. and Canadian tariffs due to the impact on the size of markets available to Canadian producers, and consequently on the size of production units.

[4] James R. Melvin and Bruce W. Wilkinson, *Effective Protection in the Canadian Economy*, Special Study No. 9, Economic Council of Canada, Ottawa, Queen's Printer, 1969.

[5] The most recent studies confirming a widespread positive relationship between concentration levels and rates of profit are N. R. Collins and L. E. Preston, *Concentration and Price-Cost Margins in Manufacturing Industries*, Berkeley and Los Angeles, University of California Press, 1968, and R. W. Kilpatrick, "Stigler on the Relationship between Industry Profit Rates and Market Concentration", *Journal of Political Economy*, vol. 76, no. 3, 1968, pp. 479-488.

[6] A good discussion of how the presence of large diversified firms changes the analytical and, by implication, policy relevance of the usual definitions of market relationships is contained in Corwin D. Edwards, "The Changing Dimensions of Business Power", published in *Das Unternehmen in der Rechtsordnung*, C. F. Mueller, Karlsruhe, Federal German Republic, 1967.

[7] For an extensive discussion of the acquisition of Canadian firms by foreign firms, see Grant L. Reuber and Frank Roseman, *The Take-Over of Canadian Firms, 1945-61*, Special Study No. 10, Economic Council of Canada, Ottawa, Queen's Printer, 1969.

[8] See S. R. Reid, *Mergers, Managers, and the Economy*, New York, McGraw-Hill, 1968, pp. 1-120, for a review of merger activity in the United States and of studies of that activity.

[9] Andrew H. Wilson, *Science, Technology and Innovation* Special Study No. 8, Economic Council of Canada, Ottawa, Queen's Printer, 1968.

[10] *Industrial R and D Trends in Relation to Other Economic Variables*, National Science Foundation, Washington, 1964, Table 54.

[11] D. Hamberg, "Size of Firm, Oligopoly and Research: The Evidence", and F. M. Schrier, "Size of Firm, Oligopoly and Research: A Comment", *Canadian Journal of Economics and Political Science*, February and May 1965. Also see C. R. McConnell and W. C. Peterson, "R & D: Some Evidence for Small Firms", *Southern Economic Journal*, April 1965.

[12] J. Jewkes, D. Sawers and R. Stillsman, *The Sources of Invention*, New York, St. Martin's Press, 1958.

[13] U.S. Department of Commerce, Panel on Invention and Innovation, *Technological Innovation: Its Environment and Management*, Washington, U.S. Government Printing Office, 1966, p. 18. Only a selection from the list of inventions by small firms is given here.

[14] E. Mansfield, *Industrial Research and Technical Innovation*, New York, Norton and Company, 1958, Chapter 5.

[15] Dominion Bureau of Statistics, *Industrial Research and Development Expenditures in Canada, 1965*, Ottawa, Queen's Printer, December 1967, Table 10, p. 27. If payments by companies not performing R&D and relying solely on the purchase of patents and licences were included in the survey, the total net payments for technology would be higher.

[16] Dominion Bureau of Statistics, *Industrial Research and Development Expenditures in Canada, 1965*, Ottawa, Queen's Printer, December 1967, Table on p. 14.

CHAPTER 6

A NEW APPROACH TO COMPETITION POLICY IN CANADA

We come now to a first set of specific proposals for a new approach to competition policy in Canada. These proposals relate only to those aspects of business activity where market forces are an important means of social control. They are further restricted, for the moment, to those lines of economic activity (largely related to the production and distribution of goods) that now come within the ambit of the Combines Investigation Act. Later chapters will deal with competition policy in relation to service industries not now covered by the Combines Act, and with sectors of the economy that are largely or wholly state-owned, or are subject to a major degree of direct state regulation.

The basic philosophy that has guided us in formulating these proposals may be recapitulated. Essentially, we take the position that while historically the shaping of competition policy has been influenced to some extent by noneconomic considerations, it is likely to be clearer, more consistent and more effective in the future if it is treated more exclusively as a branch of economic policy. It should, moreover, be better integrated than in the past into the total structure of economic policies.

Competition policy has some bearing on all the major goals for the Canadian economy elaborated by the Economic Council in its successive Annual Reviews. The strongest and most direct bearing, however, is on the goal of rapid economic growth. A well-conceived competition policy endeavours to further the achievement of this goal by removing impediments to the attainment of maximum dynamic efficiency in the use of resources by the Canadian economy. Fundamentally, of course, efficiency and growth are desired not for their own sake but for the many and varied benefits that they bring to Canadians as consumers of goods and services. The maximization of the flow of benefits to ultimate consumers should accordingly be a key concept in the application of competition policy to particular situations.

Competition Policy

It is important to keep in realistic proportion the potential role of competition policy as an engine for improving the workings of markets and thus promoting efficiency and growth. In the first place, many other factors help to condition the operation of markets. The tariff position, the strength of import competition, whether the industry is also an export industry facing important competition abroad, and government policies at all levels in respect of such matters as taxation, and governmental purchasing may be mentioned. The degrees and types of market competition that prevail are a product of the total economic environment and not of competition policy alone.

In the second place, competition policy cannot itself supply the creative dynamism (one might also speak of "dynamic tension") in both production and distribution that is in the long run the consumer's most powerful ally in a market system. There must exist a set of attitudes and an institutional structure that are conducive to beneficial change -- to the introduction of useful new goods and services, along with better and cheaper methods of producing already established goods and services. Given these preconditions, with which it may creatively interact, competition policy can play a modest but useful facilitating role. It can help to wear down barriers to change, to expose previously sheltered areas of waste and inefficiency to fresh breezes of innovation, and more generally to liberate the creative forces already latent in the system. The principal result, as we have noted, will be a more efficient use of available resources. Economic growth will be speeded up and the pattern of output more closely related to consumer desires.

How can Canadian competition policy be restructured to play this role more effectively? Our proposals amount to an enlargement of the range of available instruments and procedures so that the policy can be better attuned to the various specific problems with which it has to deal. Some of these problems are of such a character that they can best be dealt with by means of broad and relatively unqualified prohibitions; others are not, and it is here, in this second category, that new policy approaches are most needed.

In the sections that follow, we recommend that Canadian competition policy continue to retain certain broad prohibitions of price-fixing and closely related practices, misleading advertising, and resale price maintenance. The definition of these offences and of legal "defences" available to alleged offenders would be altered somewhat, but the offences would remain in large measure *per se* and also criminal. All other matters of relevance for competition policy, including mergers and a wide range of trade practices, would become the responsibility of a new, civil law tribunal. New procedures permitting specialization and export agreements to be operated in certain circumstances would be set up.

If false hopes have been aroused that in the course of our work we would seek to resolve the problems of specific industries whose situations have been brought to our attention, it should be clearly stated that from the outset we decided to confine our attention to devising an improved general framework for competition policy. Given the number of industries in Canada, the number of man-hours required for a thorough study of even one industry, and the Council's lack of the very special expertise required to analyse and adjudicate particular competition policy cases, we believed this general approach to be sound.

Retention of Certain Broad Prohibitions

For competition policy to prohibit a practice *per se*, or to prohibit it subject only to a few clearly defined exceptions, is a course worthy of consideration if the practice in question appears upon analysis to be inimical to the public interest and rarely if ever productive of any substantial public benefit. Where such conditions exist, the cost of striking down those few instances of the practice capable of producing some net benefit to the public may be judged to be outweighed by the greater clarity and certainty of a *per se* ban.

Whether or not to utilize a *per se* ban, or something close to it -- that is, a prohibition with relatively few exemptions or conditions attached -- is thus a question that must usually be decided by a balancing of advantages and disadvantages. Our own consideration of the range of practices and situations that is now, or might be in the future, of interest in relation to competition policy has led us to the view that five practices now dealt with in the Combines

Investigation Act should be subject to essentially *per se* prohibition under criminal law. These practices are as follows:

(1) collusive arrangements between competitors to fix prices (including bid-rigging on tenders);

(2) collusive arrangements between competitors to allocate markets;[1]

(3) collusive arrangements between competitors to prevent the entry into markets of new competitors or the expansion of existing competitors;

(4) resale price maintenance; and

(5) misleading advertising.

All five practices are already subject to something close to *per se* prohibition under Sections 32, 34, 33C and 33D of the Combines Investigation Act. With respect to resale price maintenance (Section 34) and misleading advertising (Sections 33C and 33D), the nature of what is prohibited emerges with reasonable clarity from the language of the statute. This is not true, however, of Section 32. Here, it is necessary to consult the jurisprudence in order to clarify what is prohibited and to discover what the main practical effect of the Section has hitherto been to strike down collusive price agreements embracing all or a substantial proportion of the relevant market.

In recommending that these five practices continue to be treated as, to a considerable extent, they are already treated under the existing law, we are in effect making a judgment that none of them is likely, except possibly on rare and sporadic occasions, to result in appreciable public benefit.

To deal first with collusive arrangements to fix prices, allocate markets or exclude competitors, we would propose that Section 32 of the Combines Investigation Act be rewritten so as to become as much as possible a *per se* ban of these practices. Such a rewriting, it might be hoped, would make clearer the nature of what is being prohibited and invest the Section with a greater degree of those characteristics of certainty and fair warning that are thought to be particularly desirable in a piece of criminal law. The rewriting would reduce the scope of the Section. However, as will shortly be seen, we are proposing other arrangements in respect of undesirable practices that might now be found illegal under Section 32 but might escape prosecution under the Section as revised.

A definitive redrafting of Section 32 will not be attempted here; that is best left to experts. We gave some consideration to whether, in a Section 32 revised along the lines we have proposed, there would still be a need to retain the qualifying word "unduly", but were able only to arrive at an appreciation of the significant arguments that could be made both for and against retention. On the one hand, the retention of "unduly" would preserve a link with an extensive jurisprudence developed over many years. If the word were dropped, one of the problems that might arise would be the possible exposure to prosecution under Section 32 of certain co-operatives and relatively loosely organized chains of grocery supermarkets and auto accessory stores whose emergence on the retail scene has by and large brought about an increase in effective competition. Some other qualifying language, possibly requiring considerable clarification through jurisprudence, might have to be inserted into the Section to exempt the organizations mentioned. Finally, it is argued that "unduly" furnishes some protection against the swamping of the courts and other parts of the enforcement machinery with a host of minor cases.

On the other side, it is argued simply that the retention of "unduly" would compel the courts to continue to engage in the task of measuring markets, and in this and other ways prevent the three criminal offences here being discussed from being as "invested with certainty" as they otherwise might be. There would be some loss of clarity and public understanding, and consequently of deterrence.

If the decision were made to retain "unduly", it would nevertheless perhaps be possible to exempt from its scope the rigging of bids on tenders. This practice could surely be prohibited without any qualification whatever.

Two specific exemptions or "gateways" in a revised Section 32 appear desirable. The first, which would replace the present subsections (4) and (5), would be for "registered export agreements". The second would be for "registered specialization agreements". Such agreements would not give rise to offences under the Combines Investigation Act. Definitions of export and specialization agreements and descriptions of the procedures whereby they would be subjected to public interest tests in order to qualify for registration are given in a later section of this Chapter.

No major change appears to be required in subsections 34(1), (2), (3) and (4) dealing with resale price maintenance, the fourth of the practices recommended for *per se* treatment, although some attention might be given to the possibility of specifically requiring a manufacturer who printed a retail price on a package to indicate clearly that it was a suggested price only. Subsection 34(5), however, might well be given major reconsideration. This subsection, inserted in 1960, provides certain defences against a charge of enforcing resale price maintenance by refusing to sell. It reads as follows:

> Where, in a prosecution under this section, it is proved that the person charged refused or counselled the refusal to sell or supply an article to any other person, no inference unfavourable to the person charged shall be drawn from such evidence if he satisfies the court that he and any one upon whose report he depended had reasonable cause to believe and did believe
>
> (a) that the other person was making a practice of using articles supplied by the person charged as loss-leaders, that is to say, not for the purpose of making a profit thereon but for purposes of advertising;
>
> (b) that the other person was making a practice of using articles supplied by the person charged not for the purpose of selling such articles at a profit but for the purpose of attracting customers to his store in the hope of selling them other articles;

(c) that the other person was making a practice of engaging in misleading advertising in respect of articles supplied by the person charged; or

(d) that the other person made a practice of not providing the level of servicing that purchasers of such articles might reasonably expect from such other person.

The provision of these defences implies that the practices to which they refer (loss-leadering including "bait-and-switch" tactics, misleading advertising and inadequate servicing) are undesirable. If that is in fact the case, consistency and fairness would seem to demand that they be more directly and generally prohibited. To discourage an undesirable practice by weakening the prohibition of another is not a sound principle.

We therefore recommend that misleading advertising be dropped as a defence from Section 34. (Misleading price advertising is already subject to direct prohibition under Section 33C of the Combines Investigation Act, and, as noted below, other misleading advertising would be dealt with under a proposed new Section 33D now before Parliament.) It does not seem possible to deal directly with inadequate servicing, which would be a difficult charge to prove, and which has not figured in any of the jurisprudence on Section 34 since 1960. We recommend that it be dropped as a defence under Section 34 and that no direct governmental attempt be made to enforce adequate servicing on distributors.

Turning now to loss-leadering, this has already been the subject of an inquiry by the Restrictive Trade Practices Commission,[2] but judging from submissions that we have received, many businessmen believe that the practice has lately been having injurious effects in a number of markets. We recommend that this matter be subjected to an early general inquiry by the civil tribunal that we propose in a later section of this Chapter. The purpose of the inquiry would be to determine (a) in what ways and to what degree this practice appears to be detrimental to the public; and (b) to the extent that it does appear detrimental, to recommend to the government appropriate remedies of a more direct and general character than those contained in the present subsection 34(5). At that stage, loss-leadering could appropriately be dropped as a defence against a charge of resale price maintenance.

The question of misleading advertising brings us to the last of the five practices recommended for *per se* prohibition. Misleading price advertising is the subject of Section 33C of the Combines Investigation Act, a Section that does not appear to require any change of wording. The practice in question amounts to a species of fraud, of just the kind that most tends to bring a market system into disrepute. Advertising can of course be misleading with respect to matters other than price, and the amendments to the Criminal Code, recently passed by Parliament, include a provision that brings into the Combines Investigation Act, as a new Section 33D, Section 306 of the Criminal Code which deals with a broad range of misleading advertising. The new Section 33D in conjunction with 33C treats all forms of misleading advertising as *per se* criminal offences, thereby removing any justification that may have existed for making misleading advertising by a distributor a defence against a charge of resale price maintenance.

A word is in order about the general procedure that might be followed in enforcing the five prohibitions here being discussed. The existing Combines Investigation Act gives the Director of Investigation and Research the option, when he has reason to suppose that an offence is being or is about to be committed, of sending the matter to the Restrictive Trade Practices Commission. Alternatively, he may refer the matter directly to the Attorney General of Canada who will consider whether legal proceedings should be instituted. We recommend that in respect of the five *per se* prohibitions, the second course should be the one normally followed in the future. Only on those occasions when a case presents novel economic features that appear to require careful analysis should the more roundabout route be followed. Especially if Section 32 is rewritten as we have suggested, occasions of this sort are likely to be rare, and for the most part there would not appear to be good reasons for retaining in the procedure a stage of hearing, review and appraisal such as may now be carried out by the Restrictive Trade Practices Commission. The main effect of such a retention would be to lengthen procedure unnecessarily. This does not mean that there should not continue to be an important place in other sectors of competition policy for the type of work that has heretofore been performed by the Commission, by way of hearing, review and appraisal, and by way also of the publication of reports. But, as will shortly be seen, we are proposing that these functions of the Commission become part of the duties of the new tribunal.

Proposed Change to a Civil Law Basis

Most of our remaining recommendations for Canadian competition policy rest upon the assumption that it will be possible in this field to enact civil legislation that will be found by the courts to lie within the constitutional powers of the federal government. There can be no certainty concerning this matter until the courts have had an opportunity to pronounce upon it, but on the basis of highly competent advice, we are sufficiently persuaded both of the need for civil legislation and of the improved prospects for obtaining it that we are prepared to make this assumption.

There appear to be two ways in which the road could be opened for the federal government to enact civil legislation. We have no special preference between them, and we leave the choice to those expert in constitutional matters. The first way would be for the federal government to reach agreement with the provinces to make an appropriate change in the constitution. The change might well involve an enlargement of the trade and commerce power. The second way would be, within the existing constitution, to refer proposed legislation to the Supreme Court of Canada for the Court's opinion on its constitutional validity. Again, the issue would perhaps be most likely to turn on whether the legislation lay within the powers of the federal government under the trade and commerce head of Section 91 of the British North America Act.

It could be that the prospects of success via either route would be enhanced if the federal government sought only to enact civil legislation in respect of goods and services affecting international and interprovincial trade. Here again, this is a matter best left to experts.

We would like to make it emphatically clear that in recommending such a test we intend no implication whatever that the federal government should seek exclusive occupancy of the field of competition policy under civil law, or that only the federal government is competent to manage competition policy in Canada. On the contrary, while it is clear that a considerable proportion of Canadian economic activity crosses provincial and international boundaries, and would be impossible to subject effectively to any provincial competition policy, we believe that the provinces could play a most useful role in respect of other lines of activity under their existing constitutional powers. Their assumption of such a role would be a most welcome development. If the recommendations of this Report are largely framed in terms of federal legislation, this is because a federal presence is clearly indispensable and the federal government has hitherto been, to all intents and purposes, the sole active occupant of the field. But the door to provincial participation should be left widely ajar. Such activity by the provinces would be in many ways a natural extension of their already considerable activity in the field of consumer protection. We recommend that before preparing new legislation embodying major changes in competition policy, the federal government should take the initiative in proposing that discussions of competition policy and related policies be arranged between the Minister of Consumer and Corporate Affairs and appropriate provincial ministers.

The best outcome, in our view, would be for the federal government to obtain the advantages of a civil law basis for some of its competition policy and for the provinces also to interest and involve themselves in the field. Having regard to the need for federal civil legislation to pass a constitutional test, we have tried to frame our proposals for such legislation in terms of a concept, which we believe to be valid, of the Canadian economy as a coherent entity, with numerous links of interdependence between its various parts. Evidence to support this concept will be found in Appendix IV. It should also be noted that the rules and criteria incorporated in our proposals are all couched in general terms and are intended to be of general application. At no point do they focus *a priori* upon particular industries, or upon particular regions or provinces of Canada.

The basic reasons for seeking to place some of the federal government's competition policy on a civil law basis would be to improve its relevance to economic goals, its effectiveness, and its acceptability to the general public. The greater flexibility afforded by civil law is especially to be desired in those areas of the policy that do not lend themselves well to relatively unqualified prohibitions and that may in addition call for some case-by-case consideration of the likely economic effects of particular business structures or practices. The unsuitability of criminal law in such areas has been well described as follows:

> The present constitutional foundation for the Combines Investigation Act rests on the power of the Parliament of Canada to enact criminal law. This has contributed to the rigidity and inflexibility of the law and its administration. Criminal offences must be proved beyond a reasonable doubt. Charges must be expressed and proven in the categorical manner specified in the statute. The present provisions for injunctive proceedings against existing or proposed arrangements can only add limited flexibility because they must rest on the capacity of the Crown to meet the rigorous standards of criminal proof. Courts have no latitude to consider all the economic and commercial qualifications which might apply to particular cases and are compelled to adopt an "all or nothing" approach in deciding whether offences have been committed. In addition, the classification of commercial arrangements as criminal has created a bad psychological background for administration, which, as early as 1910, was recognized by Mackenzie King and has undoubtedly militated against whole-hearted acceptance of the legislation by the business community.[3]

Proposed New Tribunal

While the shifting of part of Canada's competition policy onto a basis of civil legislation would be an important and necessary step forward, it would, in our view, be necessary to accompany this step with the formation of a specialized tribunal. Merely to enact civil law in this area, then to leave the ordinary civil courts to cope with it as best they could, would surely impose an unfair burden on those courts. Judges would in principle be required to make, virtually on a continuing basis, difficult balancing judgments founded upon complex economic arguments and analyses.

This problem might be dealt with in one of two ways. The first would be to attach to an existing court such as the Exchequer Court of Canada a panel of lay experts to assist in the adjudication of competition policy cases. The second would be to set up an entirely new tribunal whose members would be so selected as to bring to their work a mixture of relevant expertise in economics, business, and law. Our preference has leaned to the latter alternative on the grounds that this would be more likely to give the elbow-room and flexibility of operation that would appear to be necessary in the hearing and adjudication of complex economic issues. As will be seen, the body that we propose would, like any ordinary civil court, carry out functions of hearing, adjudication and the imposition of remedies. In addition, however, it would engage in economic analysis and in the issuance of reports similar to many of those now issued by the Restrictive Trade Practices Commission so that the important process of public education, the documentation of particular cases or inquiries, and the formulation of recommendations thereon would be continued. The new tribunal would absorb the functions and perhaps also some of the qualified personnel of the Restrictive Trade Practices Commission.

Notwithstanding its special nature, the tribunal would retain some of the characteristics of a court. In particular, it would ensure the right of interested parties to be heard in accordance with the principles of natural justice. It would, for example, make known to the parties all evidence bearing or likely to bear upon its decisions.

On the other hand, the tribunal's proceedings would be less formal than those of a court and, it might be hoped, devoid of any strong sense of crime and punishment. Hearings would ordinarily be public. The prevailing atmosphere would ideally be one of a collective search for understanding of business practice and its economic effects, and for the progressively clearer discernment of the nature of the public interest in particular cases. In line with this objective, the tribunal might wish to give witnesses considerable freedom in their presentation of evidence.

The tribunal might be named the "Competitive Practices Tribunal". Its membership should be large enough to enable it on occasion to sit as two separate panels. There might be as many as seven full-time members, who should possess a blend of experience and qualifications appropriate to the very difficult tasks with which they would be faced, and also be able to take a balanced and unbiased view of economic questions. The individual members would have to take particular care to avoid any conflicts of interest arising out of matters coming before them.

While, as will be indicated in Chapter 9, the tribunal would be able to draw upon the economic expertise of the staff of the Department of Consumer and Corporate Affairs, it should also have, in part as an assurance of independence, a small expert staff of its own. In addition to its ordinary research duties, the staff might on occasion be called upon by the tribunal to provide factual information and analysis which the tribunal considered to be essential for the adjudication of a case or the conduct of a general inquiry, and which was not forthcoming from any other source. Information thus provided by the staff would be made available to other parties to the case or inquiry.

Functions of the Tribunal

All the functions of the tribunal would be exercised in accordance with a general statement of principles, contained in a preamble to the legislation bringing the tribunal into being. The wording that follows is not an attempt at final legal draftsmanship, but only an attempt to suggest the general character of the statement:

> It is hereby declared that whereas competitive market forces provide an important means whereby the total productive resources available to the Canadian economy may be employed as efficiently as possible to maximize real income and the economic welfare of Canadian consumers, whether directly or through the development of mutually beneficial trade with other countries,
>
> (i) there should be established a tribunal to be known as the Competitive Practices Tribunal;

(ii) and this tribunal, acting within the powers hereinafter granted to it, should endeavour to impose and/or recommend means of removing or forestalling impediments to the effective working of competitive market forces (including notably competition with respect to price) for the benefit of the people of Canada.

On the basis of some such statement, and having regard to certain more specific considerations set out at appropriate points in the body of the legislation, the tribunal would perform the following principal functions:

(1) examine certain corporate mergers to determine whether any such mergers were on balance not in the public interest, and in cases where they were judged to be not in the public interest, impose or recommend appropriate remedies;

(2) examine certain types of proposed intercompany agreements respecting exports and the specialization of production to determine whether the agreements were on balance in the public interest, and in cases where they were judged to be in the public interest, place the agreements in a public register and designate them as "registered" export or specialization agreements;

(3) examine the employment of certain trade practices to determine whether such employment was on balance not in the public interest, and in cases where it was judged to be not in the public interest, impose or recommend appropriate remedies; and

(4) sponsor general inquiries similar in character to those now provided for in Section 42 of the Combines Investigation Act, and report on such inquiries.

The remedies that the tribunal itself would be empowered to apply would consist of the issuance of interim and final injunctions. Interim injunctions could be utilized in cases where it appeared desirable to prevent a merger from being consummated or a trade practice from continuing until the tribunal had had an opportunity to determine whether the merger or practice was on balance not in the public interest. Final injunctions could be utilized when a decision had been reached that the merger or practice was not in the public interest. The tribunal would be empowered to recommend other remedies to the Minister of Consumer and Corporate Affairs. Such recommendations might or might not be accompanied by the issuance of an injunction. The tribunal might undertake to remove an injunction if certain other remedies were applied.

All decisions of the tribunal and all reports on general inquiries would of course be made public. It would be expected that, in reporting on matters involving issues not previously confronted, the tribunal would discuss these issues at some length and describe in some detail the economic analysis that it had employed. The furtherance of public education in matters relating to competition policy would be considered one of the important duties of the tribunal. Maximum availability of all information genuinely relevant to a case or inquiry should be one of the tribunal's touchstones.

Appropriate rights of appeal from the tribunal to the courts on questions of law would be authorized.

Procedure Regarding Mergers

The previous Chapter emphasized that the basic reason for public policy to be concerned with mergers is that in the majority of cases they result in permanent changes in the structure of industry -- changes that may have important implications for the future performance of the economy. These implications may be for good or ill or a mixture of both, and can usually be foreseen only very imperfectly. On the good side, mergers may be an important means by which owners who wish to divest themselves of a business or part of a business can do so with a minimum of disruptive economic effects. They may also be the most appropriate means of achieving certain cost savings, or of bringing about industrial reorganizations made necessary by changes in patterns of demand or in the technical conditions of production. On the bad side, mergers may bring about significant increases in market power capable of redounding to the disadvantage of consumers, and that can be extremely difficult to reverse or offset once the merger has been completed.

This is plainly an area where public policy must tread warily, avoiding *per se* rules and simple *a priori* assumptions that mergers are generally good or generally bad. It would not be at all inconsistent, in Canadian circumstances, for public policy to act against certain mergers while positively encouraging certain others -- those which, for example, were regarded as part of a necessary reorganization of an industrial sector to meet changing world trading conditions. We would suggest that in instances where the federal government, through the Department of Industry, Trade and Commerce, might on occasion act as a marriage broker and actively seek to bring about certain mergers deemed to be in the public interest, prior consultations between this Department, the tribunal and the Department of Consumer and Corporate Affairs should take place. Such public sponsorship, provided it were based on adequate study of the particular industrial structures involved, would be entirely in accord with our general philosophy of approach to mergers. The precise machinery by which prior consultation might be arranged, we leave to others; for the present, our immediate concern is to recommend a procedure for safeguarding the public, to the greatest extent possible, against the adverse effects of mergers undertaken on the initiative of a firm or group of firms. The role of the Competitive Practices Tribunal in this regard would be to examine those mergers that appeared to contain a significant potential for harm, and where such a potential was found, to balance this off carefully against any potential for good that was also found (both good and bad potentials to be viewed, of course, from the standpoint of the economy as a whole and the general public interest). Having made its balancing assessment, the tribunal would, according to its findings, make one of three types of decision:

(1) block the merger unconditionally;

(2) allow it to proceed unconditionally; or

(3) allow it to proceed in altered form, or subject to other conditions designed to ensure that potential disadvantages were reduced to the point where they were outweighed by potential good effects.

One of the fundamental tasks of the tribunal would therefore be to keep itself fully informed about merger activity. This would be needed, *not* to investigate every one of the many mergers going forward in Canada each year, but to facilitate the examination of those that appeared to contain a significant potential for harm. As was stated in Chapter 5, it is our impression that the number of mergers that would require examination by the tribunal would constitute a relatively small proportion of the total.

A very important part of the procedure with regard to mergers would be a process of selection. It would be essential that this process ensure timely consideration of all mergers in which there was a significant potential for harm. Appropriate procedures should be initiated to accomplish this objective in a regular and comprehensive way. If necessary, a registration procedure could be implemented.

It might be well to provide the tribunal with the power to issue interim injunctions to stay the "scrambling" of the assets of merging firms while the hearings were in progress. In the light of its early experience, the tribunal would specify a time limit within which it would bind itself to render decisions on mergers.

During the hearings, it would be the responsibility and prerogative of the Director of Legal Proceedings -- an official to whom we will refer in Chapter 9 -- and his staff to place before the tribunal evidence concerning the likely effect of the merger on competition and the public interest. The parties to the merger would also be invited to give evidence. The tribunal might also call for factual evidence from its own professional staff, or any other appropriate source, subject to the proviso that such evidence be made available to the Director and to the parties to the merger.

In its examination of a merger, the tribunal might be expected to have regard to all aspects of the merger that were related in any important way to the tribunal's general terms of reference. It would be primarily concerned with whether the merger was likely to lessen competition to the detriment of final consumers, and whether there were likely to be any offsetting public benefits. In addition, and without restricting the generality of the foregoing, the tribunal would be requested to pay attention to the following matters *in so far as they appeared to be of substantial economic importance in any particular case:*

(1) the degree of effective control over the acquired firm or firms that the merger conferred upon the acquiring individual or firm (in assessing effective control, the tribunal would be expected to look not only to the size of the purchase but also to such matters as the composition of the board of directors of the acquired company, if this seemed relevant);

(2) the history of previous acquisitions by the acquired and acquiring firms and by other firms within the affected industry or industries;

(3) the shares of relevant markets held by the acquired and acquiring firms;

(4) the amount and intensity of domestic and import competition in relevant markets;

(5) the situation, both before and after the merger, regarding financial and other barriers to the entry of new competitors into the relevant markets;

(6) the likelihood that an acquired firm, had it continued its separate existence, would have been a vigorous and effective competitor in relevant markets;

(7) the existence of possible alternative buyers of the acquired firm or firms; and

(8) the likelihood that the merger would be productive of substantial "social savings", i.e. savings in the use of resources (including resources used for such purposes as research and development), viewed from the standpoint of the Canadian economy as a whole.

The process of referring a merger to the tribunal would normally be in the hands of the Director of Legal Proceedings. He would be concerned with the likely effect of the merger on competition, and also, more specifically, with items (1) to (7) inclusive in the above list. He would leave the consideration of item (8), dealing with social savings, to the tribunal, which in many cases would find itself required to perform a balancing assessment between possible detrimental effects on competition and possible beneficial effects in the form of social savings. It should be pointed out in this connection that what appear to be cost savings to individual firms are not always "social savings", i.e. savings for the total economy. Thus, for example, a firm that has grown larger by acquiring another firm may be able to obtain certain supplies more cheaply purely by virtue of its greater bargaining power. There are various possible outcomes in terms of profits and prices, but there is no saving in terms of the real resources (the physical amounts of labour, capital, etc.) required to produce and transport the supplies in question. No real resources are freed for other uses in the economy. On the other hand, an example of a cost saving to a firm that was also a social saving would be the case of a company that had grown through acquisition to the point where it was able to order its raw materials by unit trainloads and so benefit from a lower freight rate. In this instance there would be a social saving arising from the fact, of which the lower freight rate was a reflection, that moving goods in unit trainloads requires lesser total inputs of capital and labour. Thus resources would be freed, and the economy as a whole would gain.

Attention should be drawn to the fact that the list of considerations to be taken into account, where important, in merger cases has been cast in sufficiently general terms that the tribunal would be able to address itself to any class of merger, whether horizontal, vertical or conglomerate. That is to say, there would be no built-in restriction as to the market relationship between acquired and acquiring firms that would have to prevail in order for the tribunal to examine a merger.

Conglomerate mergers between firms that are in neither a competitive nor a customer-supplier relationship to one another have only recently begun to appear in any number in Canada. There is relatively little experience of them and even less analysis of their nature and modes of operation. It is therefore difficult at present to discern what significance they may have in relation to the public interest. But since some of them are, or may soon become, very large enterprises, ramifying into many sectors of the Canadian economy, the tribunal would be expected to examine them as and when any possibilities of adverse effects on the public interest become apparent.

There are means other than mergers (for example, arrangements involving major financial institutions with intercompany links via interlocking directorates) by which the activities of a number of firms can be brought under a significant measure of centralized managerial control. Suitable drafting of the legislation setting up the tribunal would permit it to examine such developments where they seemed of possible significance for competition policy. The power of general inquiry, to be specified later, might be a useful tool in this regard.

It would be open to the tribunal to indicate to the parties involved that whereas a merger appeared to be not in the public interest in its original form, it might be judged acceptable in some other form (for example, if the extent of the total acquisition was reduced). Also, following the same procedure as that employed by the U.S. Federal Trade Commission in the issuance of consent decrees, the tribunal might approve a merger subject to certain conditions being observed, e.g. that the merged firms engage in no further acquisitions within a certain market. Another possibility would be for the tribunal to pronounce against a merger but to indicate that if the situation were to be materially altered in certain ways (for example, by changes in tariffs and/or other trade barriers that had the effect of injecting a new element of foreign competition), the merger would be eligible for reconsideration.

Specialization and Export Agreements

In the discussion in the previous Chapter, reference was made to the opportunities available to Canadian industry for cost reductions based on longer production runs, and to the fact that market forces cannot always be relied upon to bring about the exploitation of these opportunities. It seems to us that firms considering themselves to be in this position should be given a chance to satisfy the proposed tribunal that they could, by means of specialization agreements, achieve longer production runs and lower unit costs. The tribunal would also have to be satisfied that a substantial part of any cost savings realized was likely to be passed on to Canadian consumers of the affected products.

A specialization agreement would be defined as a temporary agreement between firms to accomplish a restructuring of production and distribution with a view to increasing the scale and specialization of Canadian output and, in this way, reducing costs. Those desiring to draw up such an agreement would be required to place an outline proposal before the tribunal. If the tribunal judged that there was a reasonable chance of achieving an agreement likely to be in the public interest, it would direct the prospective parties to confer in the presence of a hearing examiner -- a servant of the tribunal for whom we shall shortly be specifying additional functions -- and to draw up a full draft agreement. This agreement would subsequently be examined by the tribunal and, if approved, entered in a public register. To negotiate, or to attempt to negotiate, a specialization agreement in accordance with the above procedure would not be an offence under the Combines Investigation Act.

During the period that the agreement remained in force, the tribunal would be entitled to satisfy itself that the agreement was being operated in accordance with its original objects and was not being abused in any way. The tribunal might at its discretion specify a time period at the end of which experience under the agreement was to be thoroughly reviewed and a decision reached as to whether the agreement needed to be continued any longer.

A somewhat similar procedure would be provided in respect of export agreements, which would be defined as agreements between firms to form consortia or other selling groups for the purpose of improving the competitive position of Canadian goods in foreign markets. In examining any such agreement, the tribunal would be expected to give consideration to the likely impact of the agreement on the volume and value of exports, on the export business of other Canadian firms not parties to the agreement, on the conditions of entry into the export industry concerned, and most particularly on the state of competition in the Canadian domestic market for the goods in question. An important reason for assigning this matter to the tribunal would be to facilitate the fullest consideration of ways in which any likely adverse effects of export agreements on domestic markets could be mitigated or offset, to the point where the agreements could be judged to be in the public interest.

The procedure for negotiating export agreements would be essentially similar to that already proposed for specialization agreements. Again, negotiation according to the laid-down procedure, with the hearing examiner present, would not be an offence under the Combines Investigation Act. There would be no limit to the term of export agreements, but the tribunal would have the right to satisfy itself that agreements were not being abused. Parties to existing export agreements who wished to avail themselves of the protection of the new procedure would have to apply for registration.

In examining proposed export agreements, the tribunal would have to take cognizance of any international obligations that Canada might assume in respect of competition policy. This question is discussed in Chapter 8.

Procedure Regarding Certain Trade Practices

Another area of activity for the tribunal would be that of certain trade practices not covered by broad prohibitions or by such of the tribunal's proposed functions as have already been described. The philosophy of approach would be essentially the same as what has been suggested for mergers. That is, none of the practices would be treated as undesirable *per se*. Rather, the presumption would be that while the practices could well be harmless or even beneficial to the public in some circumstances, they could be harmful in others. The tribunal's responsibility would be to examine cases where harmful effects were suspected and, upon finding that harm was indeed being done, to impose and/or recommend appropriate remedies. One feature of some importance would be the provision of an interim injunctive procedure whereby, if a practice was before the tribunal for examination, and if it appeared that the continuation of the practice was likely to bring about a significant change in the relevant market circumstances, such as the bankruptcy of a buyer because of a refusal to sell, a temporary suspension of the practice could be promptly ordered by the tribunal pending final disposition of the case.

The tribunal would be given, in the legislation, a list of trade practices, defined in rather broad terms, as well as the criteria to be applied in the examination of these trade practices. In the light of this list and these criteria, it would be expected to establish, as it worked through cases referred to it, the principal types of circumstances under which the designated trade practices were detrimental to the public.

Two routes are proposed for bringing a trade practice to the attention of the tribunal. The first would be for the Director of Legal Proceedings, if he had reason to believe that the practice was within one of the classes of practice listed in the tribunal's terms of reference and was detrimental to the public interest, to request that the tribunal hold hearings regarding the practice. The second route would be for private parties deeming themselves to be affected by the practice to submit a request for a hearing to the hearing examiner. If the examiner determined that there appeared to be public interest grounds for subjecting the practice to a full hearing before the tribunal, he would recommend to the tribunal that hearings be held. If the continuation of the practice threatened to bring about a change in the relevant market circumstances before the tribunal had reached its decision, the Director or the hearing examiner, in referring the trade practice, could recommend to the tribunal the issuance of an interim prohibitory injunction.

As will be noted later, the tribunal would have a general power of inquiry, not linked to its injunctive powers, into any possibly harmful practice or situation relating to competition policy. However, the *particular* classes of trade practice, the employment of which in certain circumstances would be referrable to the tribunal via the procedures outlined above, would include the following:

(1) Refusals to deal, including refusals under franchise arrangements, but excluding refusals to deal connected with the enforcement of resale price maintenance and covered by Section 34 of the Combines Investigation Act;

(2) Basing-point pricing and other horizontal arrangements other than those prohibited by the revised Section 32 of the Combines Investigation Act;

(3) Exclusive-dealing and tying arrangements, including "full-line forcing" and directed buying;

(4) Market-access arrangements;

(5) Predatory practices;

(6) Price discrimination, including discriminatory promotional allowances; and

(7) Consignment selling.

It should be re-emphasized that none of the above classes of practices would be an offence or be banned as such. Only where there was reason to suppose that their use in a particular situation might be having a deleterious effect on the public interest would they become the subject of hearings by the tribunal. Argument and evidence would then be received by the tribunal from the parties involved in the practice and from the Director of Legal Proceedings. Factual evidence could also be requested from the tribunal's professional staff, subject again to the proviso that such evidence be made available to the parties involved in the practice and to the Director of Legal Proceedings.

In examining any trade practice, the tribunal, having regard to its general terms of reference, would, above all, be concerned with whether the practice was likely to lessen competition to the detriment of final consumers. Not the interest of particular competitors but the interest of ultimate purchasers would be paramount. Subject to this overriding consideration, the tribunal would be invited to give attention to the following more specific matters:

(1) whether the practice was being engaged in by person(s) or firm(s) accounting for a substantial share of the relevant market;

(2) the extent to which the practice was likely to foreclose sources of supply or channels of distribution to other participants in the market;

(3) what alternative sources of supply or channels of distribution, if any, were available or could readily be made available to other participants in the market;

(4) whether the practice was likely to encourage or discourage cost-lowering innovation in methods of distribution;

(5) whether the practice could be justified as an effective means of creating a market for a new product, or of introducing an established product into a new market; and

(6) whether the practice was likely to make it possible for one or more competitors to eliminate or exclude other competitors from the market by means other than superior performance, on a sustained basis, in supplying goods and services to the public.

Where a trade practice was found detrimental to the public, the tribunal could itself impose a remedy by issuing a permanent injunction prohibiting the practice. In addition, or alternatively, the tribunal could recommend to the federal government other remedies, including notably the issuance of special licences to import duty-free. Again, as with mergers, the tribunal could undertake to lift a prohibitory injunction if other remedies were applied. A "consent decree" or negotiatory procedure would also be open; i.e. the tribunal might undertake not to issue an injunction prohibiting a practice, provided certain conditions were observed by the parties engaging in the practice. For example, the parties might be required to alter the practice in some respects, so as to prevent certain deleterious effects.

Distribution of Petroleum and Related Products

This is an appropriate point at which to recall that in the press release of July 22, 1966, requesting the Economic Council to study combines, mergers and other matters, the then President of the Privy Council made special mention of the so-called "T.B.A." Report of the Restrictive Trade Practices Commission. The following is the relevant passage:

> Referring to the Report of the Restrictive Trade Practices Commission concerning the Distribution and Sale of Automotive Oils, Greases, Anti-Freeze, Additives, Tires, Batteries, Accessories, and Related Products (1962) (T.B.A. Report), the Minister said that in studying the recommendations of the Commission the Government has viewed most sympathetically the recommendations in that report which are intended, if possible, to improve the situation which has given rise to much concern on the part of the service station dealers in their relations with their oil company suppliers, particularly in relation to the practices of exclusive dealing and tying arrangements, as well as consignment sales. The Government has given a great deal of careful thought to the whole matter and is of the opinion that the recommendations of the Commission, if implemented, would be unlikely to give the relief sought by the service station dealers if the legislation must be drafted in terms of criminal law as is the case at present in view of the constitutional law decisions of the courts. It is therefore the intention of the Government that this particular recommendation for amendment of the legislation should be taken up and considered as part of any revision of the Act as a whole in the light of both the views of the Economic Council and the constitutional position as it may emerge.[4]

In its Report, the Restrictive Trade Practices Commission had recommended that exclusive-dealing and tying arrangements and market-access agreements and arrangements be prohibited under the Combines Investigation Act where such agreements or arrangements were likely to "lessen competition substantially, tend to create a monopoly or exclude competitors from a market to a significant degree".[5] For our part, we do not recommend that these practices be made criminal offences under the Combines Investigation Act. Instead, we have included them in the list of trade practices that would be referrable, under civil law, to the proposed Competitive Practices Tribunal in any case where there was reason to suppose that they might lessen competition to the detriment of final consumers.

Since the appearance of the Report by the Restrictive Trade Practices Commission, three major inquiries into gasoline retailing and associated matters have been carried out in the provinces of British Columbia, Alberta and Nova Scotia.[6]

Our recommendations regarding the work of the Competitive Practices Tribunal in the field of trade practices would cover a good deal of the same territory embraced by these inquiries. The reports, for example, make recommendations in respect of tied sales, exclusive dealing, consignment sales, and basing-point pricing. Under our proposal, it would be open to the tribunal to examine all of these matters, including in its consideration the three provincial reports with all their accompanying published studies, submissions and minutes of evidence. It would be important also that the tribunal consider evidence relating to other provinces, so that in formulating any recommendations it may consider appropriate, account could be taken of the degree to which conditions in the industry varied from province to province.

Some of the matters dealt with in the reports, such as the terms of mortgages, leases and conditional sales contracts, would probably be found to fall under the constitutional powers of the provinces to deal with matters concerning property and civil rights in the provinces. Here again, however, there would be much to be gained in arriving at remedies which were national in their scope, and in avoiding situations in which significantly different ground rules were applied to different parts of Canada. With this in mind, provincial governments might wish to consult regarding these problems and try as much as possible to co-ordinate and make consistent both their diagnosis and their remedies. Such consultation could benefit considerably from the tribunal's analysis and judgment. Using its broad powers of inquiry, to be outlined below, the tribunal would be able to undertake a thorough and careful investigation of all problems in this industry, and where its analysis pointed to the need for action by the provinces, make any recommendations it considered would be effective. If the provinces so requested, the tribunal could work closely with them in arriving at a satisfactory set of remedies.

We would hope that in their analysis and appraisal both the tribunal and the provinces would give particular care to the definition of relevant markets, and would consistently bear in mind the interests of the final consumer of service station products.

Advertising

The general subject of the economic benefits and costs of advertising is both difficult and complicated and only two aspects of it are touched upon in this Report. The practice of misleading advertising was discussed earlier in this Chapter. We come now to a second economic aspect. At issue in recent cases in both the United Kingdom and United States has been the economic power which advertising may confer. The argument centres on the degree to which a firm engaging in extensive advertising impedes or prevents the entry of new firms into the market for that product. New entrants, even those with superior products, may not have access to the resources that will permit them to inform consumers of the merits of their product, given the imperfection of channels of information. Thus inability to achieve an adequate sales level in turn prevents them from achieving those economies of scale in production which are essential to making their product competitive in price with established products. Consumer detriment thus arises from the existence of imperfect information channels and the inability of the challenging firm to acquire funds for advertising or to attain economies of scale at some higher level of output. Barriers to entry in the form of heavy advertising outlays have concerned a number of observers. In the United States, a recent study showed large advertising expenditures to be very closely associated with high levels of concentration and above-average profits.[7]

Advertising as a barrier to entry would be of concern to the Competitive Practices Tribunal under its proposed terms of reference. Where relevant, advertising could be taken into account in both merger and trade practice cases, as well as in general inquiries.

General Inquiries

A final function of the tribunal would be to sponsor and report upon certain types of general inquiry. Its role in this respect would be similar to that provided for the Restrictive Trade Practices Commission in Section 42 of the Combines Investigation Act. We propose that Section 42 be retained in the Act, except that the tribunal should take the place of the Commission. In addition, the legislation setting up the tribunal should provide for similar inquiries into all matters falling within the tribunal's broad field of competence. As under Section 42 of the Combines Investigation Act, such inquiries would be carried out by the Director of Investigation and Research upon his own initiative, upon direction from the Minister of Consumer and Corporate Affairs, or at the instance of the tribunal. The tribunal would have the same responsibility as the Restrictive Trade Practices Commission now has to report on such inquiries to the Minister.

As to the fundamental purpose of general inquiries, this would still be much as it was envisaged by the MacQuarrie Committee in 1952:

> At least our main industries should be the objects of continuing study and observations. Facts should be systematically assembled concerning the behaviour of an industry and its current policies bearing on prices, production, innovation, investment, costs, profits, market areas, business practices, the use of patents, corporate structures and inter-relations as well as any other matter affecting competitive conditions. We need to know much more in detail than we now do the various aspects of the movement of concentration of economic power in Canada. Large business units raise a special problem for public policy but factual knowledge is much too scanty to warrant any specific proposal. Judgment on the giant enterprise cannot be final before extensive empirical research has provided the facts concerning their organization, their processes of business policy formation and their performance. Our knowledge in the wide field of monopolistic practices is just as inadequate. Such practices as discrimination, "loss-leaders", price leadership, tying contracts, combination

> sales, advertising, basing-point systems and probably many others should be subjected to empirical studies in order to know their extent, their operation, their effects and the remedies to cope with them if necessary. Finally, some attention should be given to the field of remedies in order to add to the rather restricted list of weapons we are now using to combat undesirable monopolistic situations and practices.[8]

While a number of important general inquiries have been carried out under Section 42 of the Combines Investigation Act, much remains to be done in order to achieve the objectives set forth by the MacQuarrie Committee. In some instances, general inquiries, some of which might well be of a continuing nature, would no doubt bring to light practices and situations detrimental to the public interest, leading the tribunal to recommend appropriate remedies to the federal government. Among such remedies might be additions to the classes of trade practice referrable to the tribunal. There would also be the possibility that in the light of experience the tribunal might decide that a certain well-defined practice met the rigorous requirements of a *per se* offence under the Combines Investigation Act. In this event, the inclusion of the offence in that Act would be recommended.

It would be essential, however, to conceive the purpose of general inquiries as something much larger than that of simply adjusting the "thou-shalt-not" features of competition policy to changing economic circumstances. The fundamental purpose would be to broaden and deepen understanding of the structure and operation of the Canadian economy, and in so doing to furnish a better basis for the formulation of a wide range of economic policies.

Monopolies and Dominant Firms

It will have been observed that nowhere in our proposals is there any special provision for dealing with monopoly and dominant-firm situations *as such*. But this does not mean that the existence of such situations or of tendencies towards their emergence would be without significance for competition policy. They would, in fact, be of considerable significance for the tribunal's operations with respect to both mergers and trade practices. It would be implicit in the criteria listed earlier that, in examining any merger, the tribunal would place appropriate weight on whether the merger was likely to bring about a situation of market dominance or monopoly. Similarly, in examining a trade practice, the tribunal would have regard to (a) whether the practice was being engaged in by a monopolist or dominant firm (in which case its implications would inevitably be viewed in a different light than if it were only being engaged in by one of a number of strong competitors), and (b) whether the practice was likely to bring about market dominance or monopoly "by means other than superior performance, on a sustained basis, in supplying goods and services to the public".

To put the matter in another way, competition policy would be concerned with monopoly and dominant-firm situations both in their incipiency and in their actuality. There would be no barrier to the achievement of market dominance or monopoly via the route of internal company expansion and superior efficiency. But the achievement of dominance or monopoly via merger or via the employment of "exclusionary" trade practices would be open to examination and questioning. Where market dominance or monopoly had already been achieved, trade practices would tend to be scrutinized more carefully than under other circumstances. If this proved insufficient, resort could be had to the power of general inquiry in order to determine what undesirable practices or situations existed and to recommend how they might best be remedied. In extreme cases of dominance or monopoly, the tribunal might recommend to the government that it reduce the dominance or monopoly by special legislation to divide the enterprise into smaller units. On the other hand, a tariff reduction might obviate the need for so drastic a step. Still a further alternative would be to conclude that the situation was one calling for resort to direct public regulation; as we observe later, this option should be considered very much a last resort.

Conclusion

The main general point to be made about the proposals in the present Chapter is that they embody a new approach to some important areas of competition policy in Canada. Only Sections 32 and 34 of the Combines Act, as revised, and Sections 33C and 33D would be retained as criminal offences, while Sections 33 on mergers and monopolies, 33A on price discrimination, and 33B on promotional allowances would be replaced by the new proposals which involve a shift to a civil law basis. This shift requires that provision be made for a greater use of economic analysis in the consideration of individual cases. As a result, it should prove possible for competition policy to adapt itself more readily to the changing circumstances of the Canadian economy.

If acted upon, our proposal to set up a Competitive Practices Tribunal would be a very significant step. We are fully conscious of the magnitude and complexity of the task that we are proposing for the tribunal. It would be asked to evaluate, from the point of view of the public interest, mergers, specialization agreements, export agreements, and a variety of trade practices. Not only would there be problems of economic analysis; there would also be decisions to be reached requiring comparisons of public benefits and public detriments -- decisions partly reflective of value judgments. Inevitably, the significance of legislation in areas subject to the tribunal's assessment would depend to a considerable extent on the tribunal's judgment. Its task could not be regarded as merely applying clear criteria to the facts of particular cases. It would therefore be most important that the membership of the tribunal and its staff be of the highest calibre. It would also be important, however, that the goals to be achieved and the principal criteria to be applied should be spelled out sufficiently clearly that the tribunal could feel itself to be guided by the considerations regarded as important by Parliament in passing the legislation.

Since the formation of the tribunal would be a distinctly new departure, it would seem wise to make provision for a thoroughgoing review of the tribunal's operations and of Canadian competition policy generally. Following the example of the Bank Act, this review should be decennial, with the first review taking place no more than 10 years after the legislation setting up the tribunal first comes into effect. Given the rapid structural and other changes that are likely to occur in the Canadian and world economies over the next decade, it may be anticipated that even the most flexible and forward-looking set of competition policies will in some measure be overtaken by events and thus require reassessment.

Notes and References

[1] It would probably be necessary to qualify this prohibition sufficiently to allow the continuance of such practices as that whereby a group of drug stores in an area arrange that one or more of their number remain open on Sundays and to permit the operation of formal franchise operations. We later propose that franchise arrangements containing a possibility of damage to the public interest be included in the responsibilities of a civil law tribunal.

[2] Restrictive Trade Practices Commission, *Report on an Inquiry into Loss-Leader Selling*, Ottawa, Queen's Printer, 1955.

[3] Gordon Blair, "Combines: The Continuing Dilemma", *Contemporary Problems of Public Law in Canada*, O. E. Lang, ed., University of Toronto Press, 1968, p. 159.

[4] Press Release of July 22, 1966, issued by the President of the Privy Council, Ottawa. See Appendix I.

[5] Restrictive Trade Practices Commission, *Report on an Inquiry into the Distribution and Sale of Automotive Oils, Greases, Anti-Freeze, Additives, Tires, Batteries, Accessories and Related Products*, Ottawa, Queen's Printer, 1962, pp. 133-135.

[6] The provincial studies are: "Gasoline Marketing in the Context of the Oil Industry", *Report of the Gasoline Marketing Enquiry Committee*, Queen's Printer for Alberta, 1969; *Report of the Royal Commission on Gasoline Price Structure*, Queen's Printer for British Columbia, 1966; and *Report of the Royal Commission on the Price Structure of Gasoline and Diesel Oil in Nova Scotia*, Queen's Printer for Nova Scotia, 1968.

[7] W. S. Comanor and T. A. Wilson, "Advertising, Market Structure and Performance", *The Review of Economics and Statistics*, November 1967.

[8] *Report of the Committee to Study Combines Legislation*, Ottawa, Queen's Printer, 1952, pp. 43-44.

CHAPTER 7

COMPETITION POLICY AND THE SERVICE INDUSTRIES

Reference has already been made to the fact that Canadian competition policy as now embodied in the Combines Investigation Act embraces for the most part only goods-producing and some goods-distributing activities. Other activities remain largely outside the Act. This exclusion is indeed an anomaly, especially given the rapid postwar growth of employment in the service sector of the economy. As was noted in the *Fifth Annual Review* of the Economic Council, the greater part of the labour force is now employed in service-producing industries, reflecting a shift that has come about as a result of increased mechanization of most goods production, an absolute decline in employment in agriculture, and a rapid upsurge in demand for services. Consumers today demand a wide range of repair and maintenance services for their larger stocks of durable goods. A fast-growing and capital-intensive economy has given birth to new and expanded financial services to better deploy the pool of savings available for productive investment. The higher qualifications demanded of the labour force have stimulated the growth of educational and training services. Higher incomes have helped to expand requirements for a variety of professional services. Several more items could be added to the list.

Concern about the exclusion of service industries from the anticombines law has been voiced in a number of quarters. The 1967 Report of the Joint Senate-House Committee on Consumer Credit, under the chairmanship of Senator Croll, suggested that the Combines Investigation Act be extended to cover "captive" sales finance companies. The 1968 Report of the Batten Royal Commission on Consumer Problems and Inflation, otherwise known as the Prairie Provinces Cost Study Commission, contained a recommendation that the scope of the Act be extended to embrace at least all financial institutions. The first Minister of Consumer and Corporate Affairs, Mr. Turner, stated in the House of Commons:

> I do not want in any way to anticipate the current study undertaken by the Economic Council of Canada which, by virtue of a reference made by this

> government on July 22, 1966, is reviewing the Combines Investigation Act, but I should like to say that since services amount to about 35 per cent of our gross national product it seems strange to me that goods should fall within the ambit of the act and services should not.[1]

The usual economic definition of "service industries" embraces all industries other than primary resource industries, utilities, manufacturing and construction. Some service industries may be closely allied to particular commodities or classes of commodities (pharmacies, retail and wholesale grocery stores and inland water transport are examples), but their activities are deemed to lie outside the production of tangible goods. Actually, in terms of activities, the statistical separation of service production from goods production can rarely be complete. Production statistics are typically broken down by industries, by firms and by plants or establishments, and these in turn may be classified according to whether their *major* activities are goods production or service production. But many categories of goods production contain a minor element of service production and vice versa. For example, firms that specialize in retailing and financing are deemed to belong to "service industries", but manufacturing firms that provide some of these services for themselves are still classified in "goods industries". Again, lawyers, accountants or economists who set themselves up in specialized partnerships are in "service industries", but if they join the payroll of a large construction firm they are, for most purposes, statistically transferred to "goods industries". Only a detailed cross-classification of employment by industry and occupation will reveal the true state of affairs.

Even in terms of a "standard" statistical breakdown of production into goods and service industries, the bald statement that the Combines Investigation Act does not extend to service industries is not really true. The position is in fact even more anomalous, in that the Act covers some activities carried out by service industries but not others. Basically, it endeavours to protect competition in respect of "articles" and of the price of insurance. But the reference to articles embraces not merely the production and manufacture of articles, but their "purchase, barter, sale, storage, rental, transportation or supply". Thus it is that much of the activity of retail and wholesale trade, of the transportation of physical goods, and of the storage and rental of goods, is covered by the Act. In addition, the major services supplied by hotels, restaurants and taverns are believed to be included, although this has not yet been tested by the courts. Some other parts of the boundary line have, however, been clarified by court decisions. For example, it seems fairly well established that anticompetitive practices carried on in service industries may be thwarted by the Combines Act when the effect of these practices is to limit unduly competition in the market for particular articles. On the other hand, it appears that a completed house or building does not fall within the legal interpretation of an article.

Some of the principles applying in this area are documented in the 1967-68 Report of the Director of Investigation and Research, where the outcome of some recent cases is discussed. In one of these cases, *Regina v. J. W. Mills and Son Limited, et al.*, the services of freight forwarders engaged in assembling small shipments into railway car lots were ruled as being within the purview of the Act even though the forwarders did not own or operate transportation facilities. (This decision is being appealed to the Supreme Court.) In *The Queen v. Canadian Warehousing Association*, the contention that the storage of household goods was not governed by the Act was dismissed on the grounds that the widest meaning of the clause "article ... that may be the subject of trade or commerce" would include even privately owned goods that are not for sale. In *The Queen v. Canadian Coat and Apron Supply Limited*, a charge of price-fixing was sustained against a group of companies in the linen-supply industry whose function was to provide customers with cleaned and ironed towels, uniforms and related articles.

The construction industry offers instances of the confused state of affairs in respect of the applicability of the Act to service activities. What happens, for example, with regard to contractors whose main purpose is to install plumbing or electrical wiring and fixtures or to lay flooring or to pave roads? A case involving the Electrical Contractors Association of Ontario was only one of several which established the rule that these pure service activities were within the Act in so far as they affected unduly competition in the market for various construction materials. But in a more recent case against nine Ontario paving companies *(The Queen v. K. J. Beamish Construction Co. Limited, et al.)*, the Crown was not successful in securing a conviction on alleged price collusion and rigged tendering, even though the court agreed that these practices had been carried on over a period of several years in connection with municipal tenders on road work. Mr. Justice Schroeder stated in his decision on the case:

> Section 32 is concerned only with agreements or arrangements of the kind prohibited with respect to tangible things -- articles or commodities that may be the subject of trade or commerce, and does not touch or concern agreements or arrangements which relate solely to the provision of services.... There is not the slightest doubt that the actions of the respondents were completely devoid of business ethics.... Be that as it may, the Court is here concerned with the legality of the respondents' conduct rather than with its moral aspects.... Viewing the evidence in the present case in its entirety I cannot escape the conclusion that the contracts in question are predominantly contracts for work and labour, in which the materials were supplied only incidentally ... the evidence does not suffice to establish beyond a reasonable doubt that they had entered into a combine to prevent or lessen competition unduly or otherwise in the sale, supply or transportation of 'articles' as defined by the statute.... While the methods employed by the respondents in presenting rigged bids were reprehensible in the highest degree and cannot be condoned, the Court is called upon to determine whether their conduct ... fell within the penal provisions of section 32.... I cannot be persuaded that the Crown has proven anything beyond a conspiracy to prevent or lessen unduly competition in the performance of work and labour in the resurfacing of Provincial and Municipal roadways.... It follows that greatly as one must deplore the conduct of the respondents in hoodwinking the Department of Highways and the municipalities with which they dealt, the offence charged has not been proven and, not without some reluctance, I would dismiss the appeal.[2]

Thus a price-fixing conspiracy in an area of considerable importance escaped a finding of illegality because of the failure of the Act to cover services specifically.

It will be evident that there is no precise answer to the question of which activities carried on by service industries fall within the ambit of the Combines Act and which do not. Although the recent jurisprudence has tightened the link between services and goods, one cannot say that the end result has been to bring all article-related services within the reach of competition policy. The courts must still proceed on the basis of case-by-case examination of the impact of competition-restricting practices in service industries on the market for particular goods.

Exemption from the Combines Act via Regulation

In attempting to measure the economic significance of those areas where Canadian competition policy does not now extend, one must consider the question of whether other forms of social control in these areas are effectively protecting the public interest in efficient resource use. In Chapter 2 of this Report, we noted that competition policy constitutes the most indirect form of social control of industry, obviating or lessening the need for other forms of control. Where competition is weak or moribund, there are likely to be pressures to impose more direct public controls by way of regulation or even public ownership. Such pressures have indeed arisen in service industries, many of which operate under varying degrees of public regulation. Transportation, broadcasting and other forms of communication, public utilities and financial services spring readily to mind. It cannot simply be concluded, however, that the fact that these industries are regulated makes the application of competition policy unnecessary. Great care must be exercised to determine what particular *activities* of an industry are regulated and the extent to which the regulation really takes the place of the kind of social control normally supplied by vigorous competition. Many industries are regulated only in respect of certain parts of their activities and the regulation may or may not bear directly on such matters as price. One does better really to speak of "regulated activities" rather than "regulated industries" and to pay close attention to the nature and scope of the regulation that prevails.

Competition Policy

It is clear from the terms of the Combines Investigation Act, from statements by its administrators, and from certain court decisions, that the existence of regulation does not automatically result in a blanket exemption from the influence of competition policy. Mention has already been made that the transport of commodities, although subject to direct regulation by all three levels of government, is specifically covered by the Act. Some of the activities of regulated monopolies, such as Bell Canada Limited, are also within the scope of the Act. As the Director of Investigation and Research of the Combines Branch noted before the House of Commons Standing Committee on Transport and Communications:

> The telecommunications industry is an example of an industry which is in part subject to regulation by a government agency, in part subject to the Combines Investigation Act, and in part subject to neither of these forms of control.[3]

In the case of Bell, the rates for its telephone services are regulated by the Canadian Transport Commission, while the manufacture and sale of communications equipment is subject to the Combines Act, but the provision of many communications services other than telephones appears to be exempt both from the Combines Act and from specific regulation as to price.

In the jurisprudence to date, there has been only one case, *Regina v. Canadian Breweries Limited*, in which direct regulation was a central point at issue. Chief Justice McRuer of the Ontario Supreme Court addressed himself to the problem of determining how much room was left for competition policy in an industry in which the product was sold at controlled prices through government-supervised outlets. The Crown attempted to uphold its claim that the active program of mergers and acquisitions undertaken by the company constituted an offence under the merger provisions of the Combines Investigation Act. But the Chief Justice ruled that, to constitute an offence, the effect of a merger must be such as to virtually eliminate competition. He stated in part:

> ...when I apply the Combines Act as an act designed to protect the public interest in free competition,

> I am compelled to examine the legislation of the provinces to see how far they have exercised their respective jurisdictions to remove the sale of beer from the competitive field and to see what areas of competition in the market are still open. Having made this examination, I must then decide whether the formation or operation of the merger lessened or is likely to lessen competition to an unlawful degree in the areas where competition is permitted.[4]

His review of the regulations affecting the industry led to the conclusion that the acquisitions did not result in any undue restraint on competition:

> When a Provincial Legislature has conferred on a Commission or Board the power to regulate an industry and fix prices, and the power has been exercised, the Court must assume that the power is exercised in the public interest. In such cases, in order to succeed in a prosecution laid under the Combines Act with respect to the operation of a combine, I think it must be shown that the combine has operated, or is likely to operate, so as to hinder or prevent the Provincial body from effectively exercising the powers given to it to protect the public interest.[5]

The charge was dismissed.

The assumption that the regulation of prices is exercised in the public interest brings us close to a discussion of the economic objectives of regulation -- a subject taken up in the following Chapter. But in passing, it should be noted that the assumption made in the beer decision has not gone unchallenged. One economist, Professor J. C. H. Jones, has pointed to a crucial distinction which he argues should be made in determining the extent to which competition policy is free to operate in "regulated industries". He states:

> Provincial authorities can fix retail prices and not protect the public if all they are doing is putting a standard mark-up to the price the brewer quotes at wholesale, but exerting no influence over this quoted price.[6]

Chief Justice McRuer did examine the questions of which prices were regulated and whether the delegated authority was being exercised by the various provinces concerned, rather than by the industry. His conclusion was that the provincial regulators were setting prices, in addition to regulating advertising and distribution outlets, and that the only areas left open for competition were those affecting quality, taste, services and packaging. In these areas, competition in the brewing industry was judged to be without restraint.

Applicability of the Combines Act: An Industrial Classification

Given the prevailing uncertainty as to which activities of which service industries are now covered by the Combines Investigation Act, and given the further uncertainty regarding the degree to which the existence of direct regulation would in any case remove some service activities from the purview of the Act (the present status of some goods industries being uncertain for the same reason), any attempt to measure the economic significance of activities not now covered by the Act is bound to be arbitrary. Nevertheless, Table 7-1 attempts to show the contribution to 1967 Gross Domestic Product made:

(1) by industries whose activities are *largely* governed by the Combines Act;

(2) by industries where regulation and/or public ownership provide the chief means of social control; and

(3) by industries where there is no "public presence" of any of the three sorts mentioned.

The Table reveals that the Act at present applies to only slightly more than half of total domestic output. Of the balance, approximately 5 per cent reflects agricultural output where in many cases prices and other matters are regulated by marketing boards, while other service industries whose rates are affected by regulation account for another 12 per cent of output.

This leaves a residual group of industries, accounting for 31 per cent of output (see "Other service industries" in the Table), that is subject neither to the Combines Act nor, except in some of the smaller subcategories, to a significant measure of direct public regulation. Some of these residual "industries" are, however, subject to social control in the form of public ownership: the 7 per cent of output accounted for by "public administration and defence" should be deducted for this reason. A further deduction of roughly 4 per cent should be made on account of the mainly noncommercial activities of educational institutions, health and welfare agencies, and religious organizations. This brings the residual down to a final, approximate figure of 20 per cent, representing the output share of a vast array of business, personal and recreational services, as well as real estate and financial services. It would be primarily these services that would be affected by any decision to extend the coverage of the Combines Act by dropping the present restriction to "articles" and the price of insurance. (With regard to the above figures, it is important to bear in mind that they are on a net-value-added basis, and that a compilation based on gross output or sales would show somewhat different results.)

The published history of the present Combines Act and its predecessors yields little explanation as to why the Act is not more comprehensive in its coverage. The inclusion of the price of insurance in the original legislation of 1889 was undoubtedly influenced by the previous discovery of a combine in that industry. During the course of the debate on that Act, criticisms by a member of the House of Commons over the exclusion from the legislation of lawyers and doctors went unanswered by the government. The Combines Investigation Act of 1923 did in fact appear to include most, if not all, services in the definition of a combine, but because most prosecutions during this period were based on the section of the Criminal Code prohibiting combinations rather than on the Combines Investigation Act, the position with regard to services was never clarified by the courts. In the process of amending the Act in 1935, the Bennett government originally introduced a bill which contained the same definition of a combine as did the 1923 Act. Following an unrecorded discussion by the Senate Banking and Commerce Committee, however, the Senate returned to the House, and the House eventually accepted, an amended bill which restricted the scope of the Act to activities pertaining to articles and the price of insurance. In 1949, the question of including services surfaced again, but the then Minister of Justice, Mr. Garson, opposed the move.

Table 7-1

THE CANADIAN ECONOMY BY SECTORS, CLASSIFIED ACCORDING TO THE APPLICABILITY OF THE COMBINES INVESTIGATION ACT

(Gross Domestic Product at factor cost, 1967)

	($ million)	(Per cent)
A. Sectors Largely Subject to the Combines Investigation Act		
Forestry	563	1.04
Fishing and trapping	146	0.27
Mining, quarrying and oil wells	2,212	4.08
Manufacturing	13,606	25.12
Construction	3,304	6.10
Storage other than grain	27 [1]	0.05
Wholesale trade	2,585	4.77
Retail trade	4,776	8.82
Insurance	734 [1]	1.35
Hotels, restaurants and taverns	789 [1]	1.46
Subtotal	28,742	53.06
B. Sectors Largely Exempt from the Combines Investigation Act		
Agriculture	2,479	4.58
Grain storage	102 [2]	0.19
Service industries		
a) Regulated [2]		
Transportation	3,190	5.89
Air transport		
Water transport		
Railway transport		
Truck transport		
Taxicab operations		
Pipeline transport		
Other transport		
Services incidental to transportation		
Communication	1,364	2.52
Radio and television broadcasting		
Telephone systems		
Telegraph and cable systems		
Post office		
Electric power, gas and water utilities	1,757	3.24

Table 7-1 (cont'd.)

	($ million)	(Per cent)
b) Other service industries[2]		
Financial institutions, real estate agencies, and real estate operators	4,782[1]	8.83
Public administration and defence[3]	3,961	7.31
Community, business and personal services	7,789[1]	14.38
Education and related services[3]		
Health and welfare agencies		
Religious organizations		
Motion picture and recreational services		
Services to business management		
Personal services		
Miscellaneous services		
Subtotal	25,424	46.94
Total	54,166	100.00

(1) Estimated on basis of the 1949 weight which this sector had in a larger sector of which it forms a part.

(2) The distinction between regulated and nonregulated industries is of necessity an arbitrary one. Regulated services include only those in which prices are affected by regulation. The nonregulated group includes banks and other financial institutions where regulation is not directed primarily at competitive pricing for financial services.

(3) Mainly government monopolies.

Source: Dominion Bureau of Statistics and Combines Investigation Branch.

Competition Policy

The present position of services vis-à-vis competition policy in Canada is inconsistent not only with the philosophy of competition policy outlined earlier in this Report, but also with the position taken by other industrial countries. Competition policy in the United States embraces all commercial activities; any exceptions arise either from specific amendments to the legislation or from judicial interpretations as to the authority of federal antitrust laws. In Britain, the Monopolies and Mergers Act of 1965 had the effect of extending the Monopolies and Restrictive Practices (Inquiry and Control) Act of 1948 to services. Acting under the authority of this new legislation, the Board of Trade has given to the Monopolies Commission references to inquire into practices pertaining to insurance, estate agents' fees and the professions. Of the other OECD countries, only Ireland follows the Canadian practice of limiting the scope of antitrust legislation to activities related to goods or commodities.

Competitive and Other Characteristics of Service Industries

Those who argue that competition policy should be extended to service industries at present exempt from the Combines Act might reasonably be asked to answer two questions. First, do the activities in question have characteristics such that the economic efficiency objective of competition policy is not relevant for them? Second, is competition not already functioning in these areas, even without benefit of the Combines Act, in a way that promotes efficiency and protects consumers from exploitation?

The economic characteristics of the group of services with which we are concerned are many and varied. They do, however, have in common certain elements which distinguish them to some extent from tangible goods. To begin with, services are of course intangible, a characteristic that limits the consumer's ability to conduct an informed search for the best value. Because he cannot examine and assess the "product" prior to purchase, he is normally restricted (household repairs are a good example) to a selection based on producers' general reputations and on price estimates. All too often, the latter turn out to be greatly understated. The consumer is often in a much more dependent relationship with suppliers of services than with suppliers of goods. In respect of such things as electricity and gas, he requires the service on a continuing basis, which increases his vulnerability to exploitation. If he is dissatisfied with the price or quality of the service, he cannot easily hold off and haggle or quickly switch to a substitute "product". In addition, once he has purchased a service, the consumer can neither return nor resell it.

In most service markets, too, there is a notable absence of import competition. More than that, the markets are often not national or even regional in scope, but local. This arises primarily from the "nontransportability" of many services. In such fields as repair and maintenance, professional services and the like, the intangible nature of the "product" requires the supplier to deal directly with the final consumer, which in turn limits the geographical extent of the market. Competition may be virtually non-existent in some rural areas where consumers have a much smaller range of choice than city dwellers requiring similar services. The fact is that competition policy may be *more* needed to foster efficiency in service markets, particularly in sparsely populated areas, than it is in goods markets where imports often provide a good deal of competition.

It should be noted, however, that while the market for some service activities not now subject to the Combines Act is confined to local areas, other service industries operate in national markets. This is true, for example, of some of the activities of financial institutions, whose relatively small measurable contribution to Gross Domestic Product understates their central importance to the economy. The need to protect the savings of the public and to pool risks helps to bring about, in some parts of the financial "industry", a large scale of operations and relatively high concentration. Another noteworthy feature of the industry is that in some areas competition which might otherwise be forthcoming from foreign institutions and/or their Canadian branches and subsidiaries has been curtailed by special legislation.

Competition Policy

The kinds and intensities of competition found in service markets vary greatly. Some services, such as those emanating from certain parts of the construction industry, may involve highly competitive suppliers selling to equally competitive and knowledgeable builders. In sharp contrast are situations where suppliers operating under circumstances of limited competition sell services to only one or two buyers. A good example of this is the situation between doctors in Saskatchewan and the provincial government. Under such circumstances of "countervailing power", the price for the provision of the service arrived at in the bargaining process may not be much different from that which would have prevailed under more competitive conditions, but this result can by no means be guaranteed.

The limited geographical size of many service markets, the difficulty which the buyer often has in assessing the product before purchase, and the impossibility of returning the product if it proves unsatisfactory, all combine to produce a situation where price discrimination of a type harmful to the public interest in an efficiently functioning economy can be relatively easily practised. There is of course a place, in service industries as in goods industries, for price differences which are justified by the lower unit cost of servicing large orders. But less benign discrimination, reflecting a misuse of bargaining power that may squeeze small buyers in ways that hinder rather than promote efficiency, may also occur. There is obviously a useful role to be played by competition policy in repressing undesirable price discrimination in service industries.

Thus the conclusion can be drawn that while there are important differences in the nature of the products supplied by goods and service industries respectively, these differences are not such as to render an efficiency-oriented competition policy less relevant for service industries. On the contrary, it may in some ways be more relevant.

This brings us to the second of the two questions raised earlier: Is competition already functioning satisfactorily in service industries to such a degree that the extension of competition policy to such industries is not really required? Our search for answers to this question has taken us not only to those few cases under the Combines Act where service industries were shown to be engaged in price-fixing and market-sharing activities, but also to press reports of anticompetitive practices in the service field. An examination was also undertaken of relevant letters directed to Box 99, the mailing address for consumer complaints to the federal Department of Consumer and Corporate Affairs. It is of course the case that press reports and letters of complaint fall far below courtroom standards of evidence that certain activities in the service sector are reducing competition to the detriment of the public. Such proof positive could in most cases only be obtained by setting up the formal machinery for investigation and analysis that already exists for goods industries. But there is, we believe, sufficient information available to support the contention that markets for some services are not functioning satisfactorily, and to justify the setting up of formal machinery. The information referred to relates to a variety of fields; ambulance services, real estate, television repairs, and medical services are among the examples. Misleading advertising, both as to price and otherwise, appears to be as much of a problem in the service sector as it is in the goods sector. One particular form of misrepresentation -- the provision of highly inaccurate estimates to the potential buyer of such things as removal services and a variety of repair work -- seems indeed to be more rife in the service sector. It may be recalled also that in recent years the service component of the Consumer Price Index has risen a good deal faster than the goods component. Even if the application of competition policy to the full range of service activities contributed only modestly to reducing the rate of increase, the contribution would still be worth having.

Basic Recommendations Regarding Services

There is, in our view, enough evidence pointing to the existence in the service sector of anticompetitive practices detrimental to the public interest to lead to the conclusion that the continued exemption of parts of this sector from competition policy cannot be justified. We therefore recommend, first, that the *per se* provisions of the revised Combines Investigation Act be made applicable to *all commercial activities*, including services provided in connection with the sale or rental of land and buildings and the unregulated activities of "regulated industries". The only major exemptions would be those which already exist in respect of bona fide trade union activities, and arrangements between fishermen in British Columbia and their customers. Some *de facto* exemptions would of course also continue in respect of activities clearly subject to alternate social control in the form of direct regulation or public ownership.

One of the effects of the recommended change would be to bring services related to "articles" immediately and clearly within the scope of the Act, without the protracted and socially wasteful litigation which the wording of the present legislation makes necessary in such cases. Personal services, such as those of hairdressers and travel agencies, would also be included, as would such business services as those provided by advertising agencies, building cleaners and telephone answering firms. The professions, financial institutions, a broad range of communications services, and all recreational services, including professional sports, would also be covered in so far as other types of social control did not apply.

We recommend, secondly, that the purview of the proposed Competitive Practices Tribunal embrace all economic activities, whether goods-producing or service-producing, coming under the head of the constitution which provides the basis for the tribunal's exercise of civil powers.

Professional Services

The extension of competition policy to service industries not now covered by it may meet with some objections and raise some special problems, but none appear insurmountable. The lack of published evidence forces a resort to conjecture, but it is likely that past reluctance to extend the Combines Act to service industries may have stemmed partly from an unwillingness to interfere with the time-honoured custom of allowing professional bodies to fix their own fees and control entry into their professions. More recently, however, such developments as the emergence of new arrangements for financing medical care have drawn public attention to fee-setting and other economically significant practices of professional bodies. It has become highly appropriate to consider anew why these practices should not be subjected to some suitably structured system of checks and balances.

Competition policy provides one such system, but two others (collective bargaining and direct regulation) must also be taken into account. For any given self-employed group, the appropriate arrangement may consist of one of these systems separately, or two or more in combination.

In its recent Report, the [Woods] Task Force on Labour Relations recommended that certain designated groups of self-employed persons be given access to collective bargaining. These groups did not, however, include self-employed professionals. The Task Force took note of the existence of collective economic action by self-employed professionals, but made no recommendation either for or against the recognition of this as collective bargaining, with the protections that such a recognition would imply. It did express concern over the possible use of professional licensing as a restrictive device and suggested further study in this area. The following are the relevant passages of the Report:

> Where self-employed professionals choose to act collectively to establish fee schedules or otherwise to protect their economic interests, a case can be made that they too be required to act through an organization other than their licensing body in order to avoid a temptation to employ licensing as a restrictive device to reduce entry and control market supply. We suggest that this subject receive further investigation; it would be an appropriate assignment for the Incomes and Costs Research Board whose creation we recommend in a later section.
>
> We are concerned about accessibility to collective action by groups of self-employed persons who are economically dependent for the sale of their product or services on a very limited market or who for other reasons may have economic characteristics of employees. We have in mind such groups as fishermen, owner-drivers of taxis, and independent owner-drivers of trucks and delivery vans. We recommend that the Canada Labour Relations Board be given discretion to recognize these groups as bargaining agents within a specified market and

> that upon such recognition they receive the protection of section 410 of the *Criminal Code* and section 4 of the *Combines Investigation Act* from the criminal law of restraint of trade and from the operation of combines legislation, except where there is evidence of a collusive arrangement between such groups and those who employ their services.[7]

In the interests of clarity, we discuss first fee-setting for self-employed groups, leaving for later consideration the question of professional licensing. When may collective bargaining be considered a valid and practicable check-and-balance system for determining the remuneration of a self-employed group, whether professional or not? The answer, it seems to us, is when there is a genuine bargaining situation in which the group in question is confronted with an appropriate amount and kind of countervailing power on the other side of the table. Perhaps the best example of such a situation would be that involving doctors and a government of a province where Medicare is in effect: there is a certain balance of forces, and one of the parties has a strong interest (in this case, a political interest) in restraining increases in the price of services to the public.

It is more difficult to conceive of collective bargaining operating as an effective check-and-balance in the case of, say, lawyers. With whom would such a group as a county or provincial law society bargain? Lawyers' clients are many and varied, and not readily organizable into an "employer" interest for collective bargaining.

A second system would allow professional bodies to set their own rates of remuneration, provided that there was brought to bear upon these decisions, either at the time they were being made, or by way of subsequent governmental review and ratification, an effective "public presence" in order to ensure that the consumer interest was adequately safeguarded. Such arrangements would have to be embodied in provincial statutes or regulations of a kind that would in practice insulate the system from federal competition policy legislation.

The third system would of course be the application of competition policy to self-employed professional groups. Some modification of the policy as it related to such groups might be required; in some areas, for instance, agreement on fees appears to be necessary in order that the operators of private and public insurance plans may forecast likely calls on their funds. The solution to this difficulty might be to provide that designated professional bodies could *suggest* the rates at which their services would be provided to the public, but that attempts to *enforce* these rates on individual members would be banned as illegal price-fixing. Many professions do not now enforce their tariffs; in those that do, there is some reason to believe that many individual members would welcome the freedom to charge below the suggested scale.

As a general rule, arrangements for determining the remuneration of self-employed professional and other groups should be subject to competition policy. Where, however, a group prefers a collective-bargaining or public-regulatory arrangement, and where conditions are such that this arrangement constitutes an adequate check-and-balance system, it would be in order to grant an exemption from competition policy in respect of those matters specifically covered by the alternative arrangement.

Turning now to licensing and other ways in which control may be exercised over the entry of persons into professions and institutions for professional training, it is clearly in the public interest that a close watch be kept on quality standards in professions such as medicine and the law. It is equally clear that this watch must be kept to a large extent by persons who are themselves members of these professions and have the requisite knowledge and experience to perform the task properly. But there is also a public interest in ensuring that the power to regulate the quality of professional services is not used in an unduly restrictive way, and that the size of likely future needs for professional services is kept in mind. This aspect of the public interest is all the more relevant in an age when a large proportion of the cost of professional training is a charge on the general taxpayer.

The question of the licensing of entry into professions was treated in the *Report of the Ontario Royal Commission Inquiry into Civil Rights*, which stated in part:

> We have made it clear that the power to admit a licensee is not conferred to protect the economic welfare of the profession or occupation. Those professions or occupations which have been granted self-governing status are charged with a responsibility not only to see that persons licensed are qualified, but that all qualified applicants are licensed. The public has a genuine and very real interest in knowing that the members of the self-governing bodies are properly trained and have good ethical standards. The technical nature of the services performed by the members of such bodies makes it very difficult for the layman to assess the competence of the practitioner and gauge the value of the services he has received. The public must be able to rely on the judgment of those who are empowered to decide that persons licensed to practise a profession or engage in a self-governing occupation are qualified. That being so, the responsible and experienced members of a profession or occupation on whom the power of self-government is conferred should be in the best position to set the standards to be met and the qualifications of anyone who aspires to enter the profession or occupation. But it must be recognized that each of the self-governing bodies has been given a statutory monopoly through its licensing powers. What has to be guarded against is the use of the power to license for purposes other than establishing and preserving standards of character, competence and skill.[8]

The Commission made a recommendation, which we endorse, that lay members should be appointed to the governing bodies of self-governing professions to represent consumers' interests and to check any tendency towards the exercise of power in the interests of the profession rather than that of the public. This device could be useful in respect not only of licensing but also of other economically significant activities of professional bodies, including that of fee-setting under the public-regulatory option already referred to. There would be some question of lines of responsibility: who would appoint the consumer representatives to the professional body, and to whom would they report? Appointments might perhaps be made by appropriate provincial ministers after consultation with organizations broadly representative of consumer interests. The consumer representatives might then report back both to the government that appointed them and to the consumer organizations. If these arrangements stimulated more widespread and more informed discussion of the public interest in the adequate provision of high-quality professional services, this would be all to the good.

In so far as the affairs of professional bodies are now subject to regulation by statute, these statutes are almost entirely provincial. It follows that this is an area where considerable intergovernmental co-operation is likely to be required in order to arrive at that mixture of competition policy and other policies that best protects the public interest. We urge that this co-operation be forthcoming.

Financial Services

Financial institutions offer an instructive illustration of the fact that whether direct regulation obviates the need for competition policy depends critically on what kind of regulation prevails. Regulation may at times be irrelevant for the achievement of the objectives of competition policy. The chartered banks, for example, operate under the Bank Act which sets out, among other things, the capital requirements necessary to obtain a bank charter and the types of assets in which a bank may invest. These regulations are designed to ensure the protection of savings and the stability of the monetary system; they have little or nothing to do with efficiency in the supply of banking services. Other provisions of the Act, however, have a more direct bearing on competition. The Act spells out, for example, the steps that must be taken by banks contemplating a merger, ending with the requirement that the proposed merger must be approved by the Minister of Finance and by the full Cabinet. But there is no mention of the criteria that the Minister and his advisers should use in deciding whether or not to recommend approval of the merger.

Many of the recent changes in the Bank Act reflect the special emphasis placed by the Royal Commission on Banking and Finance on the need for more competition among financial institutions. Although the Commission did not specifically raise the possibility of applying the Combines Act to all financial institutions, the similarity between its approach and the objectives of competition policy is plainly evident in the following passage taken from its Report:

> To the extent that legislation itself can do so, it should prevent the spread of practices and arrangements which inhibit competition, and to this end we believe that certain prohibitions should be written into the law. First, we recommend that all agreements among banking institutions affecting the terms and conditions of borrowing or lending be prohibited unless specifically approved by the Minister of Finance. While it would be quite impossible to prevent members of a close financial community from discussing matters of common interest, the habit of formal or informal agreement can and should be broken. So far as we can determine, rate agreements serve no useful purpose in the public interest.[9]

A ban on rate agreements on loans and deposits was incorporated into the revised Bank Act of 1967. Other recommendations of the Commission designed to foster competition in the financial area which have since been incorporated into the legislation include the attempt to prevent abuses of market power by limiting to 10 per cent a bank's investment in the voting stock of any one large corporation, including specifically trust and loan companies. Also, no person may now be appointed a director of a chartered bank who is a director of another chartered bank, of a Quebec Savings Bank or of a deposit-accepting trust and loan company, or who is a director of a company owning more than 10 per cent of the voting stock of a bank or trust or loan company.

The present Bank Act therefore reflects two different aspects of policy, both of which are designed to protect the public interest in the activities of the banking system. The primary focus of the legislation is on the need to ensure the stability and solvency of the chartered banks. But as the ban on rate agreements indicates, once this basic requirement is met, then the public is deemed to have a right also to the benefits of effective competition and efficient resource use in the financial system. Nor does there appear to be any reason why the extension of competition policy to all financial institutions cannot be a major factor making for efficiency in this area. Indeed, it is our view that the application of competition policy is as relevant to the provision of financial services as it is to other fields. The Director of Legal Proceedings and the tribunal should be given the authority to investigate and, where appropriate, strike down practices in the financial area that are inimical to the public interest in competition and efficiency.

The principal problem posed by the extension of competition policy to the financial industry concerns administration. The Superintendent of Insurance, now located in the Finance Department, has the responsibility of administering the federal Acts regulating insurance companies, trust companies and mortgage loan companies. He is also the official responsible for the administration of the Small Loans Act, which regulates rates charged by finance and small loan companies on certain of their loans. In reporting under the first head of this Reference, on the subject of consumer affairs, we suggested that at some later date consideration might be given to transferring the Superintendent's functions in respect of small loans to the Department of Consumer and Corporate Affairs.[10] In the light of our present proposal to extend competition policy to financial institutions, it now seems to us that a good case could be made for relocating *all* the functions of the Superintendent in the new Department. These functions have a basic similarity to other functions relating to corporations that are already the responsibility of the Department, and their transfer would ensure greater co-ordination in carrying out the task of protecting consumers' dual interest in the solvency of financial institutions and in competition.

A similar logical case, founded on considerations of administrative co-ordination and efficiency, could be made in favour of transferring to the Department of Consumer and Corporate Affairs the Inspector General of Banks, who is charged with duties of supervision and inspection relating to the chartered banks and the Quebec Savings Banks. The government might feel, however, that certain traditional links between the banks and broad financial policy as administered by the Finance Department were of such a nature that the Inspector General should remain where he is. In that event, arrangements could no doubt be devised whereby the Department of Consumer and Corporate Affairs would assume responsibility for the application of competition policy to those activities of the banks that were not regulated by the Bank Act and subject to surveillance by the Inspector General.

The extension of competition policy to the banks would not appear to create any serious conflicts with the objectives of monetary policy as administered by the Bank of Canada. On those rare occasions when it was found necessary to limit competition for deposits by an interbank agreement on interest rates, a request or approval to this effect by the Minister of Finance, in accordance with the relevant provision of the Bank Act, would appear to be sufficient to protect the agreement from a charge under the Combines Act. For greater certainty, however, and in the interests of public information, the passage of an Order-in-Council setting out details of the ceiling would serve notice that considerations of monetary policy for the time being superseded those of competition policy, and that the banks in complying with the ceiling were temporarily placing themselves under direct regulation in respect of rates.

As stated earlier, our recommendation that competition policy include a *per se* ban on price-fixing agreements is based on the belief that rarely, if ever, do such agreements bring benefit to the economy and to consumers. In the provision of some financial services, price agreements now exist that are tolerated, if not condoned, by federal and provincial regulatory authorities. Among such agreements are those relating to minimum commission rates on stock exchange transactions and to the rates charged by fire and casualty insurance companies belonging to the Canadian Underwriters' Association. If the public is in fact best served by permitting these practices to continue, they should be protected by appropriate regulatory legislation. The regulations should, however, spell out explicitly what sorts of agreements are to be allowed and under what circumstances. It would be a good thing, too, if the promulgation of regulations in this area could be preceded by informed discussion and public debate, in which the views of those responsible for the administration of competition policy and interested members of the public could be elicited. There is a place for the use of regulation as a means of social control -- a considerable part of the next Chapter of this Report is indeed devoted to this matter; but the rationale for the regulation should be well understood, and the boundaries between regulated activities and those subject to competition policy clearly defined.

Summary

There is much to be gained by extending competition policy to all commercial activities including services. The *per se* approach here recommended for price-fixing and market-sharing arrangements is as relevant for service activities as it is for goods. Only in the financial area is there much likelihood that some rate agreements may be found to serve the public interest, and here the existence of legislation and regulation affords the opportunity for such agreements to be subject to government surveillance. The discretionary authority given to the tribunal in examining mergers and trade practices which may in some circumstances be against the public interest in the sale of goods is also well suited to deal with some of the inefficiencies and anticompetitive business practices that are to be found in the sale of services. The power of general inquiry vested in the tribunal would provide opportunities for exploring the existence of practices detrimental to competition and efficiency, for furthering public education about the economic role of service industries, and for pointing out useful directions for policy to take in the future. In this connection, we urge the tribunal and the Department of Consumer and Corporate Affairs to investigate possibilities for improving the quality and quantity of information so that consumers may be better equipped to select alternative suppliers of particular services. The question of estimates could usefully be examined from the viewpoint of encouraging greater accuracy in the estimation of costs to householders and other buyers who are attempting to allocate their resources intelligently.

The recent growth of service industries has been rapid, and it is likely that rising affluence will promote continued relative expansion in this area of the economy. Public policy initiatives to promote more efficient resource use in the service sector will therefore be extremely timely.

Notes and References

[1] Hansard, March 19, 1968, p. 7808.

[2] *Regina v. K. J. Beamish Construction Co. Limited, et al.* [1968], 2 C.C.C., 5.

[3] Evidence of D. H. W. Henry, Q.C., Director of Investigation and Research, Combines Investigation Act, before the House of Commons Standing Committee on Transport and Communications, *Minutes of Proceedings and Evidence*, December 7, 1967, p. 386.

[4] *Regina v. Canadian Breweries Limited*, 126 C.C.C., 133 at 146.

[5] *Regina v. Canadian Breweries Limited*, 126 C.C.C., 133 at 167.

[6] J. C. H. Jones, "Mergers and Competition: The Brewing Case", *Canadian Journal of Economics and Political Science*, November 1967, p. 556.

[7] *Canadian Industrial Relations* [The Report of the Task Force on Labour Relations], Ottawa, Queen's Printer, 1969, pp. 139-140.

[8] [Ontario] *Royal Commission Inquiry into Civil Rights*, Report No. 1, vol. 3, Toronto, 1968, p. 1172.

[9] *Report of the Royal Commission on Banking and Finance*, Ottawa, Queen's Printer, 1964, p. 370.

[10] Economic Council of Canada, *Interim Report -- Consumer Affairs and the Department of the Registrar General*, Ottawa, Queen's Printer, 1967, pp. 24-25.

CHAPTER 8

SOME SPECIAL PROBLEMS OF COMPETITION POLICY

The purpose of this Chapter is to focus on two problems relating to competition policy that have only been hinted at in earlier parts of this Report. The first of these concerns methods of social control over industry other than the market-oriented method, hitherto the principal subject of discussion. In this Chapter, we examine those areas of industrial activity subject in varying degrees to government regulation or ownership, with particular emphasis on the question of how their operation might be better related to the broad efficiency objective that we have already indicated as appropriate for the so-called "market sector" of the economy. We advocate the application of a suitably modified version of competition policy to regulatory agencies and government-owned enterprises.

Further in this same problem area, we also examine more briefly, from the same standpoint, the impact on industrial efficiency of government subsidy and procurement policies and certain other activities. Our examination is selective; it does not, for instance, extend to broad government policies such as monetary and fiscal policy, even though these may have implications for economic efficiency.

The second major problem considered here is that of the international aspects of competition policy. Hitherto, the aspect that has engaged most public discussion has been that of the extraterritorial reach of one country's competition policy into the domain of another. Recently, however, additional and more important economic aspects have been coming to the fore, suggesting a need for new forms of international co-operation and perhaps eventually for a new international agency or institution.

COMPETITION POLICY IN RELATION TO GOVERNMENT REGULATION AND OWNERSHIP

If efficiency in the use of resources is to be the main objective of competition policy as applied to the "market sector" of the economy, it should be fully as relevant an objective for the government-regulated and government-owned sectors, notwithstanding the different arrangements for social control there in effect. A great deal has been said about the need for efficiency in the ordinary departmental operations of government, although critics have not always made clear whether they desire a contraction of governmental functions, a more efficient discharge of existing functions, or some combination of both. At all events, growing concern over rising governmental expenditures and tightness in capital markets has added impetus to the development within governments of goal-oriented, planned and programmed budgeting systems, whose purpose is to clarify policy objectives and to improve the efficiency with which those objectives are attained. But little attention has thus far been paid to the role that government-owned enterprises and government regulations may play in enhancing or diminishing the efficiency of resource use in the economy as a whole.

Most public discussion of government regulation, for example, has centred on the judicial authority for regulatory decisions, on the relationship between regulatory agencies and the legislature, and on the protection of the civil liberties of those affected by regulation. These are important issues, but so too are the economic effects of regulation. The hidden costs to the economy of poor regulatory performance provide, in our view, a strong justification for applying the underlying principles of competition policy, in suitably modified form, to the regulated sector of the economy, the more so since some parts of this sector, such as regulated communications activities, are likely to grow rapidly in relative economic importance over the next few years.

Objectives of Regulation

Among the most common reasons for instituting economic regulation is the desire to control business conduct and performance in industries with an inherent tendency towards natural monopoly. Presumably, regulation is here introduced in an effort to achieve what the market plus competition policy cannot do in the way of ensuring efficiency in the use of resources, the protection of consumers from exploitation and the preservation of the health and safety of the public. However, not all economically significant regulations are formulated exclusively on economic-efficiency or consumer-protection grounds. At times, governments have imposed regulations designed to achieve other objectives such as safeguarding national culture, ensuring a national presence in institutions considered vital to sovereignty, or limiting hours of work and the number of outlets offering particular goods and services in given locations. These may be valid objectives, but their pursuit may impose economic costs, which should as far as possible be estimated, publicly discussed, and taken continuously into account as the regulatory process goes forward.

At times, regulation may involve a complex mixture of socio-political and economic objectives. For example, much of the widespread regulation in agriculture appears designed to ease the impact on farmers of sharp, short-term price fluctuations and of longer-term structural adjustments. Unfortunately, some though not all of the regulation appears to operate more as symptomatic relief than as an effective means of bringing about, as smoothly as possible, essential changes in the industry. The danger that regulation may work more as a brake than a shock absorber must be constantly guarded against.

Regulatory Agencies

A particular regulatory statute may spell out in some detail the various regulations that are to be imposed on an industry. Alternatively, it may contain only broad guidelines, the details of which are to be filled in by the Governor in Council or by a regulatory agency. The immediate reasons for which a legislature delegates its authority to semi-independent boards and commissions are various. The nature of the activity to be regulated may be so complex that the task must devolve upon experts. Or there may be a need to insulate regulation-making from short-term political pressures, or to relieve government departments from an administrative burden. The delegation of broad and substantial powers to a semi-independent board may be a legitimate response to a situation where regulation is extending into a new and complex area, necessitating an ad hoc approach while experience is being accumulated. On the other hand, it may at times amount to little more than an attempt by the legislature to pass on to someone else awkward political decisions that should really be part of the legislature's own responsibility.

Although regulatory boards may be responsible to a designated minister or to the legislature itself, the regulations they promulgate are seldom subjected to searching scrutiny. Publication of regulations in the appropriate federal or provincial gazette is frequently required, but this normally fails to reach the broad audience necessary for adequate public debate, which should in any case be instituted at an earlier stage, before decisions have hardened. Frequently, the only voice heard is that of the affected industry, which may help to explain the oft-noted tendency for regulatory bodies increasingly to reflect the interests of the industries they regulate. The lack of more generalized and more effective public debate may stem from a widely held but highly questionable assumption that government action always works to the public benefit. As one British writer puts it:

> The situation can be explained by the widespread public belief that the state is the impartial servant of the public good, distinguished from all other economic units by reason of its altruism in a world dominated by self-interest....
> So activities which would be viewed unquestioningly by the public as vices, when encountered in the private sector, are not merely transformed into virtues when practised by the state, but are compounded and extended through the ballot box and the fiscal process.[1]

The absence of clear-cut objectives and the lack of public attention to the regulations themselves have created many problems in the course of the long history of regulation in Canada. One of these involves the relationship between a regulated industry and those nonregulated industries whose goods or services provide close substitutes. In any dynamic economy, new institutions, new industries and new products are constantly springing up, sometimes providing competition in areas previously considered to be the preserve of natural monopolies and therefore subjected to fairly close regulation. Unless a continuing lookout is kept for the emergence of new competition, the regulations may prevent the established firms from responding appropriately to this new competition. Such was the observation of the MacPherson Commission, appointed to inquire primarily into problems afflicting the railways.

The Commission found it necessary at the outset of its study to enlarge the immediate scope of its work and to relate the role of the railways to the competition that emanated from other types of transportation. This was a significant departure from the focus of previous inquiries into the performance of the railways.

Competing modes of transportation that had emerged in response to the development of secondary industry, particularly trucking and water carriers, were not subject to rate regulation "in any real sense" in the words of the Commission. They could set their prices at levels that attracted some of the traffic formerly carried by the railways. Imposed in the mid-nineteenth century when the railways exercised a substantial monopoly, the existing regulation restricted the freedom of the railways to vary rates in the face of competition. In its Report, the Commission noted:

> But the more competition is limited, the more the pricing of any individual movement will tend to be opportunistic, unrelated to the costs properly associated with the service performed. This, as a matter of course, finds its effects in the misallocation of resources in transportation, and distorts to a greater or lesser degree resource allocation in the rest of the community.
>
> Public action, therefore, in developing a National Transportation Policy, must seek to encourage competitive forces where the structure of the industries permits pervasive and effective competition to operate, and to regulate where it does not. In practice this amounts to developing agencies of regulation which recognize that freedom of pricing will bring efficiencies in those sectors of the transportation industry where the firms can be numerous and achieve satisfactory economies with commitments of capital small in relation to the total market.[2]

The Commission then went on to design a policy (subsequently embodied in considerable measure in the National Transportation Act of 1967) that attempted to limit rates only "where evidence of monopoly exists" but which in other areas did nothing to inhibit the "free play of competition or cushion the rough blows of competition in that segment of the whole transportation industry where a large number of firms will bring efficiency and flexibility".

One cannot help but be struck by the similarity between the recommendations advanced by the MacPherson Commission and the Porter Royal Commission on Banking and Finance. Both were established to study the problems faced by particular industries in the 1960's, and both foresaw that by weakening regulatory bonds and allowing competitive market forces to be given their head, governments would help to bring about a situation where these industries would serve the public more efficiently.

The Regulatory Process

The most economically significant direct government regulations that may be imposed on a line of business activity are those bearing on prices or rates, on conditions of entry, and on the amount and standard of services provided. Prices or rates may be fixed directly by the regulatory authority, or indirectly through restrictions on profits or rates of return on investment. The entry of new competitors into a line of activity may be regulated by licensing or other devices. Finally, regulation may require an enterprise to provide services (for example, railroad branch line services or airline feeder services) to a degree and of a standard that would not otherwise be provided.

In Canada, prices and rates are today set by regulatory bodies in such fields as agriculture, transportation, public utilities, telephone services, and publicly operated insurance schemes. To carry out their functions, the regulators must have access to detailed knowledge of the particular industry whose rates are being set: its revenues, its costs and the value of its assets, together with some conception of what might constitute a reasonable rate of return on investment in the industry. They must also have insight into the problems of the industry and be prepared to consider how these problems relate to the public interest. Even where the regulators' expertise and analytical ability are of a high order, however, they are likely to be confronted with substantial difficulties. Regulation of prices and rates of return may reduce the industry's incentive for efficient operation at the lowest possible cost. This is not invariably so; in some cases, the public-spiritedness and progressiveness of the industry's managers may go far to compensate for the lack of the usual market incentives. As a general rule, however, it has to be recognized that so long as a comfortable level of profits is being earned below the ceiling of the fixed price, management may be insufficiently stimulated to install new cost-saving technology.

When profits come to be squeezed, more interest in cost-saving technology naturally becomes apparent, but even then much managerial energy may flow into an attempt to persuade the regulatory authority that a rate increase is needed. The existence of a ceiling may, of course, benefit consumers if prices would otherwise be forced upwards under pressure of rising costs. But such benefits are short-lived and result in misallocation of resources not only in the regulated area, but in other sectors of the economy as well.

Essentially similar problems are encountered when rates of profit or return on investment rather than prices as such are regulated. Often, in situations of this type, much will be said about the "reasonableness" of prices and profits, but it must be asked whether costs are "reasonable" also, and what standards of reasonableness are being employed. Lacking any thoroughly trustworthy standards, one is left only with a suspicion that under more competitive conditions, prices and profits, or costs, or all three, might be appreciably lower than they are.

As was noted earlier, the MacPherson Commission advocated a policy of rate-setting only where competitive pressures were lacking. This seems to us an appropriate guiding light. The imposition of fixed rates by regulatory bodies should normally be considered a last resort, to be employed only where other means of social control appear certain to be ineffective.

Another type of regulation -- that affecting the entry of new competitors into an industry -- commonly involves governmental licensing of participants in certain economic activities. In some instances, the licensing is comparatively routine and permissive, and mainly of significance as a source of government revenue. In other instances, however, it may so operate as to restrict appreciably the number of competitors in a line of activity.

Such restriction is sometimes made necessary by technical considerations. Thus the limited number of radio and television frequencies unavoidably restricts the number of stations that may be allowed to operate (although technological advances may raise the limit from time to time), and competition is to that extent constrained. But restrictive licensing is not confined to this type of case. Municipal licensing of barber shops and taxis is an example of a widespread form of licensing whereby the number of competitors is restricted on grounds that have little or nothing to do with technology. Among these other grounds may be the desire of the licensing authority to ensure that participants in the licensed activity are of good character, adequately trained and capitalized, and generally likely to maintain appropriate standards of competence, cleanliness and vehicle repair. But mixed with this, or independent of it, may be a more general view that in the absence of restrictive licensing, the activity is likely to be characterized by chronic oversupply and a high rate of bankruptcies.

This view finds a certain cautious support in the literature of professional economics. It is recognized that a number of industries, constituting a relatively small proportion of total industry, have a chronic tendency to be overcrowded or "sick". The resulting situation does not necessarily work to the advantage of the consumer nor does it always further the objective of maximizing economic efficiency. Sometimes, for example, numerous small and inefficient producers may charge comparatively high prices and divide the business, rather than compete on a price basis.

There are, then, some few situations, including that of the skilled professions treated in the previous Chapter, where some degree of restrictive licensing can be justified as being in the public interest. But the decision to resort to such licensing should be based on careful observation and analysis of the activity in question. Moreover, the standards by which applicants for licences are to be judged should be clearly and publicly spelled out. Where no health, safety, technology, or "sick industry" considerations are involved, it should be a general policy of licensing authorities to license all comers. Finally, the work of the licensing agency should be subjected to periodic public review in order to ensure that the public interest continues to be promoted.

In addition to imposing rules in respect of rates and entry, regulatory agencies may stipulate that certain services must be provided even on an uneconomic basis. This type of regulation is frequently to be found in the transportation industry where certain privileges may be accorded to railways or airlines on condition that transportation facilities are made available to certain regions at a price that does not cover costs. Since regulatory bodies normally allow industries under their jurisdiction to earn a reasonable rate of return, however defined, on their overall operations, the provision of unprofitable services involves the pricing of other services at levels higher than would otherwise obtain. The users of profitable routes are thereby paying an indirect subsidy to uneconomic lines. Subsidization of this kind, and other more direct subsidies including farm subsidies, depletion allowances and the like, put federal and provincial governments squarely in the field of determining resource allocation among various claimants. There should be a careful and continuing examination of whether such subsidies are provided in a fashion that minimizes the costs involved, maximizes the opportunities for private decision-making, and places the burden of the subsidy where it belongs -- sometimes on the public at large, but sometimes on that part of the public receiving the major benefit from the subsidy.

Mergers in Regulated Sectors

When mergers occur in regulated industries, they may or may not require the approval of the regulatory authority. In the previous Chapter, for example, we noted that under the Bank Act, banks proposing to merge required the approval of the Minister of Finance but that the Act did not specify the criteria to be considered in assessing merger proposals. We believe that the process of arriving at decisions regarding mergers in regulated fields could well be improved if the views of the Department of Consumer and Corporate Affairs and the Competitive Practices Tribunal were sought out.

A provision in the National Transportation Act provides a useful precedent. The Act requires that notice of merger between companies in transportation fields under federal jurisdiction must be given to the Canadian Transport Commission, and the Commission must in turn give notice to the Director of Investigation and Research under the Combines Investigation Act. We strongly urge that this precedent be adopted by all regulatory bodies, and that the procedures be more formalized; the mere giving of notice does not necessarily ensure that the Department of Consumer and Corporate Affairs will have enough time to make an adequate assessment, or that its views will be received by an attentive audience. We recommend that the Department have and be seen to have a major role in respect of all mergers, including those within industries under the jurisdiction of a regulatory agency such as the Canadian Transport Commission, and those involving one company under such jurisdiction and another outside its scope. In many instances, the latter type of merger is not subject to the approval of the regulatory authority, despite the fact that such mergers may frustrate the attempts of the authority to achieve its basic objectives and in this and other ways work to the public detriment.

Economic Assessment of Regulation

On the whole, the process of economic regulation is difficult, cumbersome and time-consuming. These are characteristics that can be very disadvantageous in a fast-growing and fast-developing economy. To regulate an economic activity effectively, in such a way as to encourage a maximum contribution towards the achievement of overall efficiency in the economy, can be a highly demanding task. Precisely for this reason, the regulatory process stands in need of careful outside assessment.

Such an assessment is of course notably required at the very outset, when the question of whether or not to regulate is still being debated. Believing as we do that competitive market forces, where available, provide the surest stimulus to the efficient production of goods and services, we suggest that governments should regulate only those activities where competition would be either extremely feeble or overly wasteful of resources (the natural monopoly and "sick industry" cases); where genuine and important issues of health and safety, standardization, disclosure of information or fraud are involved; or where other well-defined non-economic or quasi-economic objectives are at stake and can only be furthered through regulation. The selection of the particular activities to be regulated should be done with great care and consideration, in such a way as to provide the public with the fullest possible information regarding the criteria to be used with respect to entry and prices and the likely amount of any economic costs that may be incurred.

We especially urge that all legislation setting up economic regulation contain as clear-cut as possible a statement of objectives, both to give guidance to the regulators and to provide a standard against which their performance can be assessed. The excellent preamble to the National Transportation Act of 1967 is a model to be emulated in this regard.

Once regulation has commenced, there should be established a procedure for periodic review to determine, firstly, whether the need for regulation persists, and secondly, if it does persist, whether the regulatory process is working in the direction and conforming to the objectives that the legislators intended, with as little damage as possible to economic efficiency. The prime responsibility for instituting such a review should lie with the legislature itself. With regard to broadcasting, for example, the general nature of the legislature's responsibility for regulations was conceived by the Committee on Broadcasting (1965) in the following terms:

> It is for Parliament to define the goals of the public enterprise and to ensure that the goals assigned to a public agency are achieved. It is not, we believe, possible for Parliament to supervise the details of the productive process or its administration without damaging the performance that Parliament itself has stipulated.
>
> Specifically, for the control of a public broadcasting system -- and in this context, we regard the public control of the privately owned broadcasters and that of the publicly owned agency as equally important -- the first task of Parliament is to set the goals. It must say clearly what it wants the broadcasters to do. In the past, Parliament has not stated the goals and purposes for the Canadian broadcasting system with sufficient clarity and precision, and this has been more responsible than anything else for the confusion

> in the system and the continuing dissatisfaction which has led to an endless series of investigations of it....
>
> Having set clear goals for the broadcasting agencies and delegated to an autonomous agency responsibility for the detailed supervision and control of the broadcasting system, it only remains for Parliament to establish a procedure to ensure that the goals it has set are in fact being met. The delegation of responsibility to the broadcasting agency is not, of course, any permanent surrender of Parliament's jurisdiction. Parliament remains supreme and can at any time redefine the goals or revise the form and powers of the agency. Until it does so by appropriate legislation, the goals remain and the powers of the agency remain, but Parliament should hold the agency accountable for the attainment of the specified goals.[3]

At the federal level, a committee of the House of Commons or Senate, or a joint committee of both, is the device that springs most readily to mind for the purpose of carrying out regular reviews of regulation and regulated activities. The House of Commons Special Committee on Statutory Instruments will no doubt be giving some attention to this matter, inasmuch as its terms of reference direct it to consider "procedures for the Review by this House of instruments made in virtue of any statute of the Parliament of Canada". These terms embrace regulatory activity by government departments as well as by semi-independent agencies.

Various arrangements for the review of regulation are clearly possible, and it will be for Parliament to decide what arrangements best suit particular activities. We would urge only that review arrangements make adequate provision for a consideration of the economic aspects of regulation.

Some industries (the construction industry is a good example) are governed by regulations imposed by all three levels of government, and it would be desirable to find some way of inquiring into the overall effects of existing pyramids of regulation, including their consequences for efficiency and consumer satisfaction. A suitable federal-provincial forum for this purpose might be set up as an ad hoc offshoot of regular federal-provincial meetings on other topics. At the very least, some simplification and rationalization of the three-level regulatory structure might be achieved.

In view of its fields of expertise and its particular interest in the maximization of economic efficiency, it would be logical for the Department of Consumer and Corporate Affairs to be called upon for its views whenever economically important regulatory policies are being formulated or reviewed within the federal government. Further than this, the powers of general inquiry given to the Department and to the Competitive Practices Tribunal under the proposed new legislation should be broad enough to permit study, where appropriate, of government-regulated and government-owned activities in the economy, even though the other clauses in the legislation may not in practice be applicable to these activities. While delicate situations may sometimes arise, the Department and the tribunal should consider it part of their duty to draw attention to remediable situations in respect of government-regulated and government-owned activities that are clearly at variance with the objective of maximizing economic efficiency. The Department should dedicate some specialized part of its research resources to this class of problem.

Government Enterprises

A third type of social control over industrial activities, occurring sometimes in conjunction with and sometimes independently of direct regulation, is the ownership of business enterprises by governments. In Canada, some of these enterprises are in the position of competing with privately owned enterprises in the same industry. Their performance as competitors may exert a significant influence on standards of efficiency in the industry as a whole. In some of their activities they may be pace-setters for the industry; in others they may be followers.

Some of the corporations now operating in Canada under federal or provincial ownership are subject to a certain degree of scrutiny and review with regard to efficiency, but the focus is almost exclusively on expenditures. At the federal level, for example, some enterprises may be required to submit their capital and/or operating budgets to Treasury Board, while a year-end audit of their financial statements is undertaken by the Auditor General. Others may operate with a much greater degree of independence on a purely commercial basis with no particular efficiency requirement by the legislature that has established them other than that they pay their way out of earned revenues.

We strongly urge the federal government to commit itself to the principle that the door be left open as widely as possible for the objectives of competition policy to permeate all of its activities, including those of its own enterprises. How far this door can be pushed open depends of course on the constraints imposed by objectives other than efficiency which influence the conduct of government activities. But to the fullest extent possible, acceptance of such a commitment not only by ministers but by heads of government enterprises and those down the line is highly to be desired.

Unless a federally owned enterprise has been specifically charged by Parliament to act otherwise, its use of practices such as refusals to deal or discriminatory buying (for instance, giving arbitrary preferences to domestic suppliers) should be subjected to the same tests in respect of efficiency as those appropriate for private enterprises. In cases where expenditures of federal government enterprises are scrutinized by Treasury Board and the Auditor General, the responsibility for ensuring that such enterprises do not engage in anticompetitive practices should be shared by these officials and the minister to whom the enterprise reports. The Department of Consumer and Corporate Affairs should draw to the attention of appropriate officials such evidence of the existence of undesirable practices by government enterprises as may come to light through its contacts with businessmen and consumers.

We urge provincial governments to accept a similar commitment and to make appropriate arrangements for ensuring that their enterprises uphold the efficiency objectives of competition policy wherever other objectives specified by the legislature do not intervene.

Government Departmental Activities

Government purchasing policies and contracts have a direct bearing on resource allocation and efficiency within the economy. Here again, certain procedures for review and scrutiny are already in place. Funds required to finance a particular program operated by a federal department go through several stages of examination, beginning with Treasury Board approval of the necessary appropriation, and ending with the Auditor General's examination and report to the Public Accounts Committee. But there is rarely, if ever, a watchful outside eye kept on the intervening period between appropriation and outlay. No one subjects departmental business dealings to the same criteria in respect of anticompetitive practices as apply to the dealings of private businessmen, nor can it be safely assumed that government purchasing policies are at all times bent on the achievement of efficient resource use. Again, objectives other than competition policy may intervene, but it is desirable that these other objectives should be clearly and publicly specified and that their possible detrimental effects in terms of economic efficiency should receive recognition. Subject to whatever constraints these other objectives may impose, it is important to ensure that the effect of departmental expenditure programs is not such as to distort the efficient use of resources. By unjustifiable discrimination among suppliers of goods and services or by favouring the large "reliable" firm to the exclusion of smaller and quite possibly more efficient suppliers (the letting of contracts by tender by no means necessarily guards against such a bias), government purchasing programs may not only impose unnecessary charges on the taxpayer, but also give uncalled-for encouragement to industrial concentration or other structural changes detrimental to the spirit of competition policy.

Treasury Board, the Auditor General and the Public Accounts Committee should actively concern themselves with an examination of the means by which federal departmental purchasing programs are carried out. Departmental officials should not hesitate to call upon the Department of Consumer and Corporate Affairs for whatever assistance that Department might furnish in measuring the effects of particular purchasing policies on economic efficiency. The Department, in turn, should pass on whatever information or complaints it may come across in respect of purchasing programs to the officials of the department concerned.

INTERNATIONAL ASPECTS OF COMPETITION POLICY

No discussion of competition policy would be complete without taking into account economic decisions and activities that are undertaken outside Canada. The relative efficiency of resource allocation in the rest of the world, taken as a whole, influences directly the well-being of Canadians, as does the degree to which our own resources are used to enhance or detract from the possibility of achieving an efficient use of human and physical resources on a world-wide basis. These are difficult questions, bearing not only upon the efficiency with which existing productive resources are now being used, but upon the pattern of production and the geographical location of productive facilities in the future.

The rise of the international corporation, controlling productive and distributive facilities in a number of countries, is an indication that there exists a recognizable entity called the world economy. In its present-day form, the international corporation is able within its own organization to make a variety of choices as to where it will expand production and sell output, and as to which outputs and inputs it will move internationally and in what proportions. Placing notable emphasis on the movement of technical information and other business information, it has become a major vehicle for so-called "technological transfer" between countries.

It is by no means naive to look on the world as such corporations do and to consider issues of the locus of productive and distributive facilities, the maximization of economic efficiency and other matters relating to competition policy from an international as well as a domestic standpoint. The fact is that if nations fail to pursue policies designed to promote more efficient resource use on a world-wide basis, and to act upon a recognition of the many different channels through which goods and services, including information, can with advantage be transferred, they will incur, both individually and collectively, a heavy cost in forgone output.

Obviously, these are questions on a scale and of an importance vastly transcending the typical day-to-day preoccupations of competition policy and the practicable administrative purview of the Department of Consumer and Corporate Affairs. The whole field of trade policy, for example, is involved. For many of the relevant areas, the prime responsibility lies and must continue to lie with other departments and agencies of government. But the Department of Consumer and Corporate Affairs should be kept informed on matters significantly related to its own major policy objectives and should be afforded the opportunity to make a timely and useful contribution to interdepartmental discussion of such matters.

Some of the main policies in respect of which there appears a reasonable prospect of obtaining fruitful international co-operation, and so promoting more efficient international resource use, may be enumerated. Conditioning resource use in a very fundamental way, tariff policies have from the beginning done much to shape the need for competition policy in Canada. What further reciprocal tariff reductions can be negotiated internationally will therefore be crucial. Already, however, the progressive reduction of tariffs in the postwar period has helped to throw into sharper relief the importance of various *non*tariff barriers to the international movement of goods and services. We leave for consideration in later reports of this Reference barriers associated with national patent, trademark and copyright systems, but mention here certain other barriers that might well be the subjects of international negotiation. These include regulations affecting such things as health protection, the grading and labeling of products, and construction standards -- all areas where national governments have legitimate regulatory functions, but where regulation can too often be employed as a protective device against foreign goods and services. The answer to this problem would seem to lie in patiently negotiated *common* international regulations, coupled with understandings that countries would not use such measures restrictively and would consult on the basis of well-defined codes affecting each area of regulation. This aspect of international competition gets little attention, primarily because it is so tedious. But agreement here would make it possible to facilitate competitive international trade flows, by reducing barriers and granting to the buyer a greater degree of assurance that he was not comparing one country's apples with another country's oranges.

Another apt candidate for international negotiation would be the purchasing policies followed by governments and their utilities and other enterprises. It is often the practice for these policies to discriminate in favour of domestic suppliers. The course of negotiations here might run from the provision of information on existing practices to the reaching of standstill agreements, and eventually to the signing of mutual undertakings to reduce domestic preferences.

In this broad landscape of policies affecting the efficiency of resource use on the international scale, national competition policies as usually conceived occupy a significant if hardly dominating part of the picture. They give rise to certain policy problems at the international level, in part because, although competition policies have been more widely adopted in the postwar period, their vigour and comprehensiveness vary markedly from country to country.

Two broad types of international problems in this area may be distinguished:

(1) unwanted extraterritorial impacts of one country's competition policy upon the economy of another; and

(2) problems calling for competition policy action that are beyond the scope of any one country's policy to resolve.

The principal mechanisms by which such problems are or might be dealt with appear to be three in number. The first mechanism involves bilateral consultative arrangements between countries, of which the 1959 Fulton-Rogers agreement between Canada and the United States is an example. Arrangements in effect between countries participating in the OECD Committee of Experts on Restrictive Trade Practices represent a small and tentative first step towards a second type of mechanism: that of multilateral agreements for consultation and co-ordinated policy action. A third mechanism, which a truly international competition policy would call for in dealing with problems beyond the capacity of any one country or even small group of countries to resolve, would be some form of supranational agency. This must realistically be regarded as lying some distance in the future, although some of the elements of such an agency may be discerned in that section of the European Economic Commission which is concerned with the administration of the clauses of the Treaty of Rome dealing with restrictive practices.

With regard to the first type of problem cited above (the unwanted extraterritorial impact of another country's competition policy), this has at various times been examined by Canadians both as a problem of economics and as a problem of national sovereignty, with the United States of course the other country chiefly in mind. We do not feel that we can usefully comment here on the sovereignty aspect; we note only that this aspect was treated in the Report of the [Watkins] Task Force on the Structure of Canadian Industry.[4]

So far as economic considerations are concerned, it may be said that impacts of any significance on the Canadian economy as a result of U.S. antitrust decisions have up to now been few and far between, and that there do not appear to be any strong reasons for supposing that the Fulton-Rogers procedures for advance consultation will not be adequate to head off possible unwanted impacts in the future. One new problem that might conceivably arise would be as a result of a scheme to rationalize one of the "miniature replica" sectors of Canadian secondary industry -- a sector characterized by too many plants and too short production runs in relation to the size of the market. If some of the firms involved in the prospective rationalization were subsidiaries of large U.S. companies, would the parent firms prevent their participation for fear of getting into trouble with U.S. antitrust? No categorical answer is possible to this question, but it has been a practice of U.S. antitrust authorities not to penalize companies for actions they or their subsidiaries undertake abroad at the formal behest of host governments. Assuming the continuation of this practice, a Canadian rationalization scheme that was largely or wholly embodied in a statute or government regulation would seem to be free of U.S. antitrust consequences, although it would no doubt be wise to utilize the Fulton-Rogers procedures if only as a means of demonstrating to U.S. representatives how the scheme made economic sense in Canadian circumstances.

Competition Policy

Turning now to problems calling for competition policy action which may be beyond the capacity of Canadian policy to resolve alone, we pass into an area where lack of solid information and analysis prevents any very firm statements from being made. Indeed, it is precisely this lack of information that would seem to be the first matter requiring international action. Further than that, the two major classes of problems worth discussion, however tentative, are those relating to international cartels and large international corporations.

It is unfortunate that the most recent published information of any comprehensiveness regarding the effect on the Canadian economy of international cartels dates back to 1945, when F. A. MacGregor, Commissioner of the Combines Investigation Act, undertook a study. In it, he documented the effects on Canada of three types of private cartels: arrangements between foreign suppliers of goods imported into Canada, arrangements by which Canadian subsidiaries of foreign companies were allotted exclusive access to the domestic market, and arrangements in which Canadian exporters participated with producers in other countries. Commissioner MacGregor noted that the short-term balance of national advantage and disadvantage from such arrangements was difficult to assess, and added:

> Any such balancing of national advantage and disadvantage from the operation of cartels is, however, misleading. Canada has a more serious interest in the totality of cartelization than in the mere sum of the effects of particular cartels. For cartel agreements are simply one important part of a network of restrictive practices, private and governmental, which spread over the world in the period between the two World Wars. For example, high tariffs, import quotas, discriminatory currency practices, exchange controls, subsidization of exports, contributed to the division of world markets and prevented the efficient use of world resources. National and private restrictive practices which impede the use of new technology, divide up markets and limit output are obstacles in the way of expansion in the flow of goods and services which, in the words of the Lend Lease Agreement, "are the material foundations of liberty and welfare of all peoples". Any narrow gains

> through such restrictive practices are lost in the curtailment of employment and production when such devices are extensively adopted. The interest of Canada in the revival of world trade and in the adoption of policies of expansion transcends any such balancing of possible advantages and disadvantages. The importance of an effective international policy to remove the serious restrictive elements in cartel operations as part of a general attack on all hampering trade restrictions is of much greater significance than the direct effect of the elimination of each separate undesirable cartel agreement.[5]

Although 24 years have passed, and much of the structure of restrictions described by the Commissioner has happily been dismantled, it cannot be assumed that significant international cartel arrangements affecting Canada no longer exist. It does appear that a combination of the increased importance of U.S.-based international companies in world business and the reluctance of such companies to enter into cartels, for fear of U.S. antitrust consequences if not for other reasons, may have reduced the scope for such arrangements. But there is information, including some contained in written briefs to the Economic Council, that suggest the persistence of noteworthy international cartels.

In formulating our recommendations in Chapter 6 on the subject of registered export agreements, we made what we believed to be a realistic assumption: that concerted international action to weaken or break up international cartels will be slow in coming. If and when it does come, the qualifications for registered export agreements will have to be re-examined in the light of whatever obligations Canada assumes as a participant in multicountry competition policy action.

For the immediate future, it would seem well for the Department of Consumer and Corporate Affairs to devote some of its resources to discovering from available sources as much as possible about the effects on Canada of present-day international cartels. The subject might lend itself to a contract study. Once the areas where vital information was lacking had been established, steps could be taken within appropriate international bodies to see if some of the gaps might be filled with the aid of other countries. These bodies would include, as well as GATT and OECD, the United Nations Commission on Trade and Development (UNCTAD) which has evinced an interest in restrictive practices. The launching of a formal general inquiry in Canada by the Competitive Practices Tribunal might also be considered if this seemed likely to add substantially to the stock of available information.

The subject of the large international corporation has only rather recently engaged the attention of serious analysts, and the time is far from ripe to make definitive pronouncements on the nature and behaviour of this class of institution, if indeed it can really be said to constitute a single class. Whatever its true nature, it does appear to have impressive potentials for both good and ill. Its capability for acting as a high-speed mechanism for the transfer of knowledge and as an otherwise useful and efficiency-maximizing component of a truly international economy has already been noted. However, its size and geographical spread naturally raise concerns about the possibilities of market power and abuses of that power on a scale too great to be effectively countered by the competition policy of any one country. Some projections done by Professor J. N. Behrman are quite startling: they suggest that the output of international corporations might rise from about one-eighth of the non-Communist world's GNP in 1967 to about one-third in 1987. By the latter date, the output of the non-Communist world might be about equally divided between international corporations, the United States (excluding international corporations), and other countries.[6] This would indeed seem to imply great market power, and if serious abuses of that power took place, this could well be the circumstance that called into being a supranational agency in the field of competition policy.

In the shorter run, however, the main need would again seem to be for information, including particularly information concerning the extent to which international corporations pose problems for Canadian competition policy significantly different and harder to deal with than problems emanating from domestically owned parts of the economy.

In general, it seems clear that the future holds a likelihood of gradually increasing international action in respect of competition policy -- at first mainly in the realm of consultation and information-gathering, then later perhaps in the domain of agreed action to deal with problems international in their scope. Canada should participate in this development and urge it forward in those areas of particular interest to her. Because of intercountry differences in approaches to competition policy, progress on a broad front may be slow. But this need not prevent smaller groups of like-minded countries from reaching arrangements on problems of concern to them. The nonparticipation of only a few major countries in an international cartel or other anticompetitive practice may be enough to weaken greatly its restrictive effects.

Notes and References

[1] C. K. Rowley, "Monopoly in Britain: Private Vice but Public Virtue?", *Moorgate and Wall Street*, Autumn 1968, pp. 37-38.

[2] *Report of the Royal Commission on Transportation*, vol. II, Ottawa, Queen's Printer, 1961, pp. 15-16.

[3] *Report of the Committee on Broadcasting*, Ottawa, Queen's Printer, 1965, pp. 91-93.

[4] *Report of the Task Force on the Structure of Canadian Industry*, "Foreign Ownership and the Structure of Canadian Industry", Ottawa, Queen's Printer, 1968. The Task Force recommended that three steps be taken: (1) legislate to prohibit the removal of commercial records and data from business concerns within federal jurisdiction by reason of a foreign court order; (2) use a "guiding principles" questionnaire to elicit information on the operational impact of foreign antitrust legislation on the Canadian subsidiaries of foreign corporations; and (3) enact legislation to prohibit Canadian compliance with foreign antitrust orders, decrees or judgments.

[5] F. A. MacGregor (Commissioner, Combines Investigation Act), *Canada and International Cartels: An Inquiry into the Nature and Effects of International Cartels and Other Trade Combinations*, Ottawa, Queen's Printer, 1945, pp. 54-55.

[6] J. N. Behrman, *An Essay on Some Critical Aspects of the International Corporation*, Economic Council of Canada, Special Study (forthcoming).

CHAPTER 9

IMPLEMENTATION AND ADMINISTRATION OF COMPETITION POLICY

It would be a misallocation of resources if we attempted to make comprehensive and highly detailed recommendations concerning the administration of competition policy by the Department of Consumer and Corporate Affairs and the proposed Competitive Practices Tribunal. To a very considerable extent, proposals for day-to-day administrative arrangements should be worked out by those who have had long experience in administering this type of policy. We cannot, however, entirely neglect the subject of administration. The point was made earlier that the effective operation of competition policy involves some very special and acute problems of administration and enforcement, problems that are often not adequately appreciated by policy critics. The significant changes in the philosophy, structure and application of Canadian competition policy which we have proposed will clearly require substantially altered administrative arrangements. There is some obligation, therefore, to provide at least a general idea of the possible shape of these arrangements.

To begin with, there should be in the background some reasonably coherent view of the overall mission of the Department of Consumer and Corporate Affairs and its appendages. Taken purely at its face value, the name of the Department might well give rise to an impression that it embraces the larger part of those functions of the federal government that are of major interest to consumers and corporations. Such an impression would be false. In our *Interim Report on Consumer Affairs*, we recognized the impossibility of assigning all federal functions affecting the consumer to the Department of Consumer and Corporate Affairs, and, accordingly, recommended the actual transfer to the new Department of only a small proportion of such functions. However, we did urge most strongly that the Department play, in the field of consumer affairs, "a central co-ordinating role within the federal government".

Would it be a logical extension of this recommendation that the Department should play a similar co-ordinating role in the field of corporate affairs? We think not. Examined closely, most of the functions affecting corporations that have been assigned to the

Department have in common a rather special character. To a large extent, they deal with areas where government intervenes in the relations between corporations and consumers in order to play a mediating and in some instances a policing role. The nature of the role is clear enough in such fields as consumer protection and competition policy, although in the latter area the consumer interest may be at one or more removes, as in a case under the Combines Act involving relations between a manufacturer and a supplier of raw materials. The role is not so evident in respect of such things as the Bankruptcy Act and the Companies Act. Here, surely, the concern is with the relations between corporations, creditors and investors. But the ultimate individual investor and depositor in corporations and their creditors is really none other than the consumer in one of his many economic roles, so that the provisions of the Bankruptcy Act and the Companies Act which endeavour to safeguard the interests of investors and creditors may be regarded as being, in the final analysis, forms of consumer protection. In a similar vein, our later report on patents, copyrights, trademarks and registered industrial designs will attempt to point out the significant relationship between these responsibilities of the Department and the consumer interest.

We continue, therefore, to view the mission of the Department of Consumer and Corporate Affairs as being primarily the advancement of the consumer interest -- conceived, however, in very broad terms. The dominant underlying theme of the present Report has been the desirability of directing competition policy towards the maximization of economic efficiency, real income and consumer welfare. This objective should serve as a guide not merely for competition policy, but for all the activities of the Department of Consumer and Corporate Affairs.

Despite the fact that many federal government functions of great relevance to the consumer are not direct responsibilities of the Department, the Minister and staff of the Department should feel themselves to have, and should be generally recognized to have, a useful and relevant point of view to bring to bear upon Cabinet and other intragovernmental discussions of these functions. Accordingly, when policy is being reviewed or formulated in areas such as tariffs, taxes, subsidies, government purchasing policies, and activities of regulatory agencies and government-owned enterprises, where there are likely to be significant effects on the consumer interest in an efficiently performing Canadian economy, provision should be made for the Department of Consumer and Corporate Affairs (and in appropriate cases, the Competitive Practices Tribunal) to participate in a timely and effective way. The Department of Consumer and Corporate Affairs should take the initiative in suggesting the creation of new machinery of interdepartmental consultation (and in some cases, intergovernmental consultation) wherever this seems to be required.

Internal Organization of the Department of Consumer and Corporate Affairs

Turning now to administrative arrangements within the Department, we propose only to recommend some broad changes designed to bring the structure of the Department more into accord with the concept of a unified departmental mission and with our recommended changes in Canadian competition policy.

For the present, our proposals chiefly concern the types of activity now carried out by the Combines Investigation Branch and the Consumer Affairs Branch. We leave for later reports administrative proposals affecting such other units as the Patent and Copyright Branch; however, our present proposals have been designed to provide a structure to which the other branches of the Department could, in due course, be appropriately related.

Under existing arrangements, the Combines Investigation Branch and the Consumer Affairs Branch have a number of functions in common. Both engage in research and informational activities. Both also have operating functions including the investigation of possible breaches of the law and associated regulations, and the setting in motion, whether through the courts or otherwise, of appropriate enforcement machinery whenever breaches are discovered.

The Consumer Affairs Branch is a relative newcomer to the scene and is still in the process of building, notably on the side of economic research. It will be essential for the effective discharge of consumer affairs functions to have available a strong research base. As for the Combines Investigation Branch, a major implication of our proposals for competition policy is that, here too, there should be some enlargement of the research base, this notwithstanding the provision of some research resources to the Competitive Practices Tribunal. We have opted for a competition policy directed more clearly and predominantly than in the past to the achievement of economic ends, a policy that will require for its success a first-rate job of economic fact-gathering and analysis.

A real danger in the present administrative arrangements, it seems to us, is that the Consumer Affairs Branch may tend to be regarded by people not closely in touch with it as a kind of poor relation (a glorified "hot line" or consumers' complaint bureau), in contrast with a Combines Branch that addresses itself to serious economic and legal problems. This would be a travesty of the conception of consumer affairs that underlay our *Interim Report* on that subject. It would also be completely at variance with our conception of a basic economic mission for the Department. The responsibilities of the present Consumer Affairs Branch and of the Combines Branch are directed towards what in the final analysis are common economic ends, and the means that they employ for attaining those ends have many similarities also.

One way of dissipating this danger would be simply to amalgamate the Consumer Affairs Branch and the Combines Branch. This would have the advantage of pooling available resources of legal and economic talent, with the result that the use made of those resources could be more flexible and efficient. They could be deployed to deal with the most pressing problems of any given time, regardless of the distribution of these problems between the consumer affairs sector and the competition policy sector.

It seems to us, however, that such an amalgamation would create too large and unwieldy a unit. Moreover, it would not deal with a second danger which is apt to threaten any organization in which major research and operational functions must co-exist. This is the danger that research resources will be largely taken up with the day-to-day needs of the operational side for information and analysis, with the result that more basic, longer-term research, ultimately just as necessary for the support of operations, does not receive adequate attention.

We therefore propose a different arrangement under which the present Combines Branch and Consumer Affairs Branch would disappear and be replaced by two new units organized along different functional lines. One unit or branch, to be called the Research and Information Branch and to be headed by a Director, would be concerned with the provision of economic research and informational services in relation to competition policy and other aspects of consumer affairs. It would also furnish economic research and informational services, as required, to the Patent and Copyright Branch and other parts of the Department. An important longer-term aim of the research unit would be the gradual accumulation of a body of knowledge about many aspects of the workings of the Canadian economy at the industry level. Priorities would need to be established and a long-term research plan adhered to which was insulated from the day-to-day needs of the enforcement authorities.

A second branch, to be called the Legal Proceedings Branch and also to be headed by a Director, would be concerned with enforcement functions. It would address itself to all aspects of legal proceedings. Among other things, it would be responsible for the preparation of cases to go before either the Competitive Practices Tribunal or the ordinary courts. Following somewhat the example of its opposite number on the research side, it would provide necessary legal services to other parts of the Department. We would regard it as important so to arrange matters that as many as possible of the Department's competition policy and other cases were handled by government lawyers. Provincial bar regulations in some provinces may stand in the way of this, but it may well be that any such impediments could be discussed at one of the regular federal-provincial meetings of Attorneys General, and appropriate action agreed upon. There appears to be no advantage and considerable inefficiency in the present arrangements whereby lawyers in private practice are briefed to take combines cases. The procedure is not only time-consuming, involving as it does considerable duplication of effort, first inside then outside the Combines Branch, but also tends to inhibit the development of a high degree of specialization and legal expertise in combines cases.

Although most of the Department's economists would be located in the Research and Information Branch, there would have to be some economic expertise in the Legal Proceedings Branch also, in order to provide the necessary economics "back-up" for the immediate preparation of cases. Obviously, there would have to be extremely good co-operation and communication between the two branches, and the structure of their interrelations would have to be worked out with care. Steps would also have to be taken to continue certain public safeguards. The present right and responsibility of the Director of Investigation and Research to publish an annual report, for example, might in future be held jointly by the Directors of the new branches.

The administrative position of the Competitive Practices Tribunal vis-à-vis the Department would have to be thought through in some detail. It would be absolutely essential for the Tribunal to have, and to be seen to have, a high degree of independence in its decision-making. It should be in nobody's pocket -- least of all that of the Department, whose lawyers would be appearing before it. This crucial requirement of independence is one of the reasons why we have recommended that the Tribunal have an adequate economic research staff of its own.

At the same time, independence need not and should not mean isolation. Expertise in the field of competition policy will always be limited, and the Tribunal and its staff should have no hesitation in communicating informally with the available experts, whether these be located in business firms, in universities, in the Research and Information Branch of the Department, or wherever. The proposed civil law basis for the Tribunal's operations and the large content of persuasion and public education in its approach to competition policy problems should make such contacts easier to arrange with propriety. Where a general inquiry was being carried out, a large measure of co-operation between the Tribunal's staff and the Research and Information Branch of the Department would be essential.

Enforcement of the Law: The Primacy of Prevention and Deterrence

The cheapest and most efficient way in which a law can promote the ends envisaged for it by the legislators is for that law to be so administered and enforced, and so understood and accepted by the public, that the fewest possible infractions occur. Prevention and deterrence, rather than convictions, are the elements to be maximized in the long run, even though convictions may make an indispensable contribution to deterrence, particularly during the early history of the law. The only proper way in which to judge how well a law has been administered and enforced is to examine, as best one may, how much progress has been made towards achieving the law's fundamental objectives. The number of cases brought to court, and the percentage of those cases won, may be very unreliable guides to this. Depending on circumstances, high numbers and percentages may just as well be an indication of poor administration and enforcement as they are of good.

Criminal Offences

It will be recalled that we have proposed the following five offences for essentially *per se* treatment under criminal law:

(1) collusive arrangements between competitors to fix prices;

(2) collusive arrangements between competitors to allocate markets;

(3) collusive arrangements between competitors to prevent the entry into markets of new competitors or the expansion of existing competitors;

(4) resale price maintenance; and

(5) misleading advertising.

The problem of obtaining maximum deterrence in respect of these offences should be relatively straightforward. In the first place, the law should be clear and its objectives widely appreciated. What it prohibits and, of equal importance, what it does not prohibit, should be known. Both potential offenders and those who may be injured by offences should be aware of the law and of the remedies and sanctions that it provides.

A continuing program of publicity is obviously desirable if public understanding and acceptance of the purposes of competition policy is to be achieved. The present Director of Investigation and Research under the Combines Investigation Act has done an outstanding job of publicizing the legislation to lawyers and businessmen through the medium of speeches, lectures and seminars. While this program should certainly be continued, more attention now needs to be given to acquainting the general public, partly through the mass media, with the nature and purpose of competition policy and its relation to other policies affecting consumers.

The compliance program conducted by the Director of Investigation and Research has provided an effective means of helping businessmen to avoid infractions of the law. The need for it would not be entirely eliminated by the changes that we have proposed. In continuing such a program, however, care should be exercised to avoid stepping over the fine line which divides stating what the law *is* from a *de facto* creation of new jurisprudence in the course of a private interview. (We have no reason to believe that this line has been transgressed in the past; we note it only as a persisting hazard of any compliance procedure.) Where there exists uncertainty about the boundaries of the criminal part of the Combines Investigation Act as revised, but where the officers of the Crown are convinced that this uncertainty can be reduced, they should bring a case in the boundary area on the first appropriate occasion. It should be a high-priority objective to give the courts full opportunity to clarify the interpretation of the law where it needs clarifying.

Programs of publicity and compliance, then, can do much to help bring about prevention and deterrence. They must, however, be supported by a widespread belief that infractions of the law stand a heavy risk of being detected and proceeded against, and for this to exist there must be a credibly vigorous and comprehensive program of enforcement. From the points of view of both deterrence and equity, it is not good for people to think that either they or others have a considerable chance of "getting away with it". It is to be hoped that strong enforcement in the first instance will fairly quickly produce a state of affairs where chances of flouting the law undetected are generally rated as low, with the result that less enforcement activity will be necessary from that point on.

Sanctions should continue to consist of fines, imprisonment and prohibition orders, the latter being necessary to ensure the discontinuance of the anticompetitive behaviour. Fines, to be meaningful, should be large enough to hurt, having regard to the size of the enterprise or enterprises involved. Where provincial practices permit, the lawyers of the Legal Proceedings Branch should suggest fines rather than wait upon the request of the court. It might be well also to follow the practice of the Food and Drug Directorate, which makes publicly available lists of convicted offenders under the legislation for which it is responsible.

An important element of deterrence in the U.S. antitrust laws is provided by the possibility that conviction on antitrust charges may lead to civil suits by private parties believing themselves to have been injured by the anticompetitive behaviour for which the defendants have been convicted. If successful, complainants in such suits may recover treble the amount of damages which they are judged to have sustained. It would seem to be worth exploring whether the deterrent effect of the criminal law portions of Canadian competition policy could be enhanced by opening up an avenue for single-damage suits by private parties.

Civil Offences

Enforcement of that part of competition policy assigned to the Competitive Practices Tribunal would necessarily evolve somewhat differently. Again, prevention and deterrence would be major long-run objectives, but they could only develop gradually. As of the day on which the tribunal opened its first hearing, no offences, in any strict sense, would exist. Only as the tribunal's decisions accumulated and consistent patterns emerged would it become clear that certain kinds of mergers and trade practices, in certain circumstances, stood a high likelihood of being found undesirable by the tribunal and subjected to injunctive or other remedies. In this fashion, and assuming appropriate diligence on the part of the Directors of Legal Proceedings and of Research and Information in locating and bringing before the tribunal instances of the kinds of merger and practice in question, a deterrent effect would build up.

It is to be hoped that the tribunal would in fact achieve much of its effectiveness through techniques of public education and persuasion. To this end, it would be important that the tribunal put much effort into reporting fully to the public on its decisions and explaining their economic rationale. Some sort of compliance procedures would be very likely to spring up naturally in respect of mergers and trade practices. This could be a useful adjunct to other educative techniques, provided the rule suggested earlier (that a compliance procedure should seek to explain existing law but not in any sense to create new law) was faithfully followed. The tribunal should be expected to feel a strong obligation fully to publicize and explain any important jurisprudential development -- any real or apparent change of line. The device of issuing general guidelines, as advance public notice of the view which the tribunal intended to take in the future in respect of certain types of merger or trade practice, might occasionally be utilized. Here again, the tribunal would be expected to lay out a suitable economic analysis as a basis for its decision.

If, in the face of hopes to the contrary, it became apparent that a practice which the tribunal had found to be undesirable in a number of cases continued to be repeated and that, therefore, deterrence was not operating effectively, the tribunal could inquire more generally into the practice, seeking to determine why it was so prevalent and what more effective remedies might be recommended to the government.

Importance of Adequate Resources

The proper carrying out of the proposals in this Report would require an increase in the annual cost to the federal treasury of administering Canadian competition policy -- now approximately one million dollars. We believe that the potential benefits to the Canadian economy of a competition policy more effectively oriented towards the achievement of economic efficiency would justify an increase of reasonable proportions in the resources available. As a form of social control of industry, well-working competitive markets supported by competition policy are remarkably cheap by comparison with alternatives such as direct regulation.

Review and Assessment of Competition Policy

Law must be kept up to date if the public is to retain respect for it, and to this end we have recommended a decennial review of competition policy. This should not be taken to imply, however, that no interim review should be contemplated. On the contrary, a virtually continuous review should take place, with particular attention being devoted to how new departures in the policy are working out in practice. Some of this review should be internal, within the Department of Consumer and Corporate Affairs, but the greater part should be public and external. Parliament, consumer and producer groups, and interested private citizens should be given every opportunity to observe and understand the workings of the policy. We would particularly commend to the Canadian Association of Consumers and the Canadian Consumer Council the view that competition policy deals with matters of central importance to consumers, and that the administration of the policy by the Department of Consumer and Corporate Affairs and by the Competitive Practices Tribunal should accordingly be subjected to close and critical scrutiny by consumer representatives, assisted as required by economists and other qualified experts. The communications media should make every effort to fulfil their role so that this continuous debate is brought to the attention of all elements of the public. We urge lawyers, academics and other experts to offer constructive criticism of the work of the tribunal, not just to readers of learned journals but also to a broader audience.

Care should be taken to assess the policy in a really meaningful way. It is all too easy to become heavily concerned with conviction statistics and other relative trivia of enforcement. What really counts (and is unfortunately much more difficult to assess) is the extent to which the policy is furthering the public interest in the efficient use of resources by the Canadian economy.

CHAPTER 10

CONCLUSION

In this final Chapter, it is perhaps useful to draw together, even at the risk of repetition, the main principles that have guided us in formulating our recommendations for an effective Canadian competition policy. In the first place, we have taken the view that the general set of competition policy should be one that aims at the achievement of efficient resource use in the Canadian economy. Second, we believe that some form of social control should be exerted over all commercial activities, and that over the greater part of the Canadian economy, efficient resource use will be more readily brought about through policies that maximize the opportunities for the free play of competitive market forces. The use of other forms of social control, namely, government regulation and government ownership, should be brought to bear only on those activities where monopolistic tendencies have all but eliminated competitive market responses, or where the protection of the consumer interest in matters such as health, safety, fraud, disclosure and standardization, among others, requires the implementation of explicit government regulations.

To put at least some flesh on the bones of these principles, we have recommended that an important part of Canada's competition policy legislation be on a civil rather than a criminal base, and that a specialized tribunal be created. Uppermost in our minds in suggesting these changes is the view that certain features of criminal law and procedure, such as the onus of proof beyond a reasonable doubt and the handling of charges by ordinary courts in ways that do not permit a full exploration of economic facts and analyses, are ill-suited to the effective treatment of some situations and practices relevant for competition policy. For this reason, it is suggested that only five business practices should continue to be regarded as criminal offences, and that the language of the statute invest the definition of these offences with a greater degree of certainty and fair warning than is now the case. For the rest, we have made the asssumption that it would prove constitutionally possible for the federal government to establish a civil tribunal, perhaps under the power to regulate trade and commerce. This tribunal would address itself to mergers, business practices and export and specialization agreements. Unlike the five instances where criminal law still appears to be a valid approach, most of the practices to be referred to the tribunal are capable in some circumstances of working to the public advantage, but the distinction between likely good and bad effects may require a difficult weighing of relevant economic circumstances and probabilities, and therefore a kind of expertise that only a body of mixed professional disciplines could provide. The tribunal would be armed with injunctive remedies, with the power to recommend other remedies, and with a power of general inquiry.

Consistent with the principle that some form of social control over commercial activities is highly to be desired, competition policy should be extended to those service industry activities not already covered by it. This area is of increasing economic importance, and it no longer seems logical, if indeed it ever did, to exempt service activities from competition policy.

We have also invited provincial governments to interest themselves in the civil law aspects of competition policy and to participate in its implementation and administration.

These, then, form the major elements of our approach and our recommendations. Some readers of this Report will undoubtedly be disappointed that we have not dealt with all of the suggestions that we have received for detailed changes in the Combines Act, that we have not "solved" such particular competition policy problems as those associated with the relations between oil companies and service stations and with conglomerate mergers, and that we have not tried to fill the large and distressing gaps that presently exist in the stock of thorough and reliable studies of individual Canadian industries. We would indeed like to have done all these things, but given the limitations of time and resources which applied, we felt it best to concentrate our efforts on devising a new framework for competition policy within which matters of the sort mentioned could be more effectively handled.

Some critics, by contrast, may fault us for doing too much by way of extending competition policy well beyond the activities of those private entrepreneurs to whom the Combines Investigation Act now chiefly applies. But our view is that the proper objectives of competition policy extend far beyond the Act and beyond the federal Department of Consumer and Corporate Affairs. A concern for the public interest in efficient resource use should properly extend to other federal government departments, to provincial and municipal governments, and to the great array of government enterprises and regulatory agencies.

Our concept of the role that can usefully be played by an effective and properly administered competition policy has laid great emphasis on efficiency. In doing this, we may have conveyed an exaggerated impression of the power of competition policy to promote efficiency. In fact, sole reliance on competition policy would not be nearly enough. Mention has been made in this Report of the great importance of other policies in promoting efficient resource use. Among such other policies are those relating to taxation, tariff, manpower, government purchasing, and the regulation of transport and other activities. In some of these policies, objectives other than efficiency may at times take a higher priority, and such objectives are by no means necessarily to be disparaged. Nevertheless, all levels of government could well pay increasing attention to the degree to which programs and policies, frequently designed for different purposes and set in place to meet short-run situations, affect the efficiency of resource use. In this Report we have put forward for consideration by governments some possible approaches by which the objectives of competition policy can come to take a more prominent part in their decision-making. In the next Report on this Reference, we will be concerned with another group of government policies -- those relating to patents and copyrights -- which also have a significant part to play in efficient resource allocation and which are closely tied to some elements of competition policy.

The implementation of a new approach to competition policy will require that the public be well informed concerning objectives, methods and limitations. We have made several recommendations in respect of the need for a *continuing* flow of information to the public. Since at the outset there will be no body of case law pertaining to matters coming before the tribunal, close attention will have to be paid to its work if the public is to be informed as to what practices, under what circumstances, are likely to be struck down or altered. To assist in this process of public education, we have invited all sections of the Canadian public to actively interest themselves in the work of the tribunal and have suggested that wide publicity be given to its reports.

The success of our recommendations will depend fundamentally on two things. Reference has been made to the assumption that the proposal for the transfer of a large part of Canada's competition policy to civil law will be found constitutionally valid. But of equal importance, appointments to the tribunal and its staff, and to the professional staff of the Department of Consumer and Corporate Affairs, must be of the highest calibre. Great care must be taken to ensure that appointments are based solely on the high qualifications that the effectiveness of this new body will demand, and that tenure is sufficiently long to enable experience to be built up and an effective unit created. On the other side of the coin, it is of equal importance that those best qualified to serve on this body of experts should be willing to make themselves available and to shoulder the burden of the very difficult tasks which our proposals would place upon them.

Arthur J. R. Smith,
Chairman
David L. McQueen,
Vice-Chairman and Director
Sylvia Ostry,
Director

Paul Babey
W. J. Bennett
François E. Cleyn
Robert M. Fowler
Arthur R. Gibbons
David L. Kirk
Walter C. Koerner
William Ladyman
Stanley A. Little

Donald MacDonald
Ian M. MacKeigan
Maxwell W. Mackenzie
William Mahoney
Hugh A. Martin
J. R. Murray
Marcel Pepin
Charles Perrault
Mrs. A.F.W. Plumptre
Alfred Rouleau
Gabriel S. Saab
Lucien Saulnier
William Y. Smith
Graham Ford Towers
William O. Twaits
Francis G. Winspear

F. Belaire,
Secretary

APPENDIX I

PRESS RELEASE, PRIVY COUNCIL OFFICE, JULY 22, 1966

The President of the Privy Council, the Honourable Guy Favreau, Q.C., today announced that the Government has requested the Economic Council of Canada to undertake a study of certain important aspects of the responsibilities of the Registrar General of Canada and his department under the Government Organization Act, 1966, which is awaiting proclamation.

The terms of reference are as follows:

"In the light of the Government's long-term economic objectives, to study and advise regarding:

(a) the interests of the consumer particularly as they relate to the functions of the Department of the Registrar General;

(b) combines, mergers, monopolies and restraint of trade;

(c) patents, trade marks, copyrights and registered industrial designs."

In making the announcement, the Minister recalled that on May 24, 1966, on second reading of the Government Organization Bill, the Prime Minister informed the House of the Government's intention to ask the Economic Council of Canada to look at the field of consumer affairs along with some of the other functions now to be undertaken by the Registrar General under the new legislation, with a view to providing advice as to the courses of action that seem best suited to meeting the needs of the Canadian people and the Canadian economy in the consumer field.

The Government has decided that as part of this study, the whole question of combines, mergers, monopolies and restraint of trade should be referred to the Economic Council for a fundamental review in the light of current and prospective needs of the Canadian economy; and furthermore, that another aspect of the work of the new department, namely, patents, trade marks, copyrights and registered industrial designs, should also be included in the fundamental economic study to be undertaken by the Council.

Mr. Favreau further stated that the importance of this study cannot be overestimated as a first and necessary step in the determination of a cohesive economic policy in relation to these important matters considered as a whole and in relation to each other with a view to bringing the policy in these matters into harmony with the overall economic policy of Canada and the needs of the consumer and other important segments of the economy.

The Council will be requested to press forward with this comprehensive study as swiftly as is practicable in order that appropriate legislation may be prepared thereafter with a minimum of delay. To expedite this process it is also the intention that officials shall press forward their study in those aspects of these fields which may be advanced without duplication or interference with the work of the Economic Council. In this way it is the Government's intention that the soundest policy may be developed and translated into legislation as speedily as is possible consistent with the clarification of the constitutional position and the proper role of the federal authorities.

The Economic Council will be free to make interim reports on such particular aspects of the study as the Council deems appropriate to enable the Government to consider taking initial steps consistent with the general review.

With particular reference to proposals for amendments to the Combines Investigation Act that have been the subject of discussion in Parliament and the press, and of submissions by individuals and groups, the Minister stated that it is most important that this legislation should not be amended piecemeal. Any amendments to the legislation ought to be in keeping with its fundamental philosophy and in furtherance of it. When consideration is being given to reviewing the general structure and philosophy of the Act, it would be very unwise to enact immediate temporary and piecemeal amendments to correct particular situations. At a time when a general review is in contemplation, such particular measures ought to be taken up and considered in the context of the whole review and any revision that may take place in the light of the findings and recommendations of the Economic Council.

Referring to the Report of the Restrictive Trade Practices Commission concerning the Distribution and Sale of Automotive Oils, Greases, Anti-Freeze, Additives, Tires, Batteries, Accessories, and Related Products (1962) (T.B.A. Report), the Minister said that in studying the recommendations of the Commission the Government has viewed most sympathetically the recommendations in that report which are intended, if possible, to improve the situation which has given rise to much concern on the part of the service station dealers in their relations with their oil company suppliers, particularly in relation to the practices of exclusive dealing and tying arrangements, as well as consignment sales. The Government has given a great deal of careful thought to the whole matter and is of the opinion that the recommendations of the Commission, if implemented, would be unlikely to give the relief sought by the service station dealers if the legislation must be drafted in terms of criminal law as is the case at present in view of the constitutional law decisions of the courts. It is therefore the intention of the Government that this particular recommendation for amendment of the legislation should be taken up and considered as part of any revision of the Act as a whole in the light of both the views of the Economic Council and the constitutional position as it may emerge.

APPENDIX II

SELECTED READINGS -- U.S. ANTITRUST POLICY

An attempt is made in this list to present a variety of viewpoints. From an economic policy viewpoint some of the most useful writings are to be found in some of the Law Journals of U.S. universities. This list is intended to provide material additional to that cited in the notes and references in this Report.

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APPENDIX III

THE STRUCTURE OF THE CANADIAN ECONOMY (CHAPTER 5) --

ADDITIONAL DATA

A. Summary of a Survey of Concentration in Canadian Manufacturing Industries, 1964

In attempting to quantify the degree of concentration that exists in an industry, economists have relied mainly on two kinds of measures, both of which take account of the number of firms and their relative size. The first provides an answer to the question: what percentage of total sales in an industry (or of some other size indicator such as employment, or value of shipments) is accounted for by a specified number of firms? The second approach employs what is called an inverse measure of concentration, and answers the question: how many of the largest firms account for a specified percentage (usually 80) of an industry's sales or employment or shipments? This study uses the latter measure, which was also employed by Rosenbluth in his study "Concentration in Canadian Manufacturing Industries".[1] More than a desire for comparability is reflected in this decision. The number of the largest firms accounting for 80 per cent of shipments is a good indicator of the number of effective competitors; the remaining 20 per cent usually represent fringe competitors.

In this Report, the data on concentration are divided into five classes, with each class consisting of a range of the number of firms required to account for 80 per cent of an industry's shipments. The class intervals are: 1-4; 4.1-8; 8.1-20; 20.1-60; and more than 60 firms. Similar calculations were made for the number of establishments or plants. The results are summarized in Table A-1 below.

A technical note about these calculations is in order here. To obtain concentration levels for firms, the individual industry bulletins of the Dominion Bureau of Statistics, which are on an establishment basis, were examined to obtain the number of establishments in an industry operated by the same company. The calculation was then made on the assumption that in arriving at 80 per cent of shipments for a given industry one must include all the establishments of multi-establishment firms. Although this may result in a downward bias in the number-of-firms figure in some industries, this assumption is consistent with Rosenbluth's findings that establishments operated by multi-establishment firms tend to be larger than those operated by companies with only one plant. Furthermore, in all industries where it was felt that this assumption might be too strong, a check was made by DBS on the basis of unpublished 1962 employment figures. In cases where the employment figures placed the industry in a different concentration category than the calculation based on shipments, the former classification was the one used.

The concentration levels for establishments had, of necessity, to be estimated, since the DBS grouped data could not be disaggregated. The method used was one developed by Rosenbluth whereby maximum and minimum estimates are obtained, then averaged to yield point estimates.

To return to the Table, it is obvious that the level of plant concentration, while fairly high, is considerably lower than the level of firm concentration. The significant differences between plant and firm concentration, particularly in the more concentrated industries, may result from the exploitation of economies of scale arising outside the confines of a single plant. For example, potential economies of scale may be achieved by larger firms in such "extra-plant" areas as marketing, finance, research and development and the use of managerial talent. However, until further research provides more definitive answers, these "extra-plant" economies remain largely uncharted territory. It is also essential to recall at this stage the cautionary statement contained in the body of this Report: that concentration is only one of many determinants of market power. The presence of exports and imports, the narrowness or breadth of the industry delineations, and the division of a number of industries into local and regional markets, all mean that the levels of concentration sometimes overstate and sometimes understate the potential market control of the largest firms. However, the major conclusions are not affected in a significant way when a more carefully selected set of industries is examined.

Table A-1

ESTIMATES OF INDUSTRIAL CONCENTRATION LEVELS:

181 STANDARD INDUSTRIES, 1964

Number of Establishments and Firms Required to Account for 80 Per Cent of Shipments		Cumulative Percentage Distribution of the Number of Industries		Cumulative Percentage Distribution of the Value of Shipments	
		Establishments	Firms	Establishments	Firms
Up to:	4	6.6	14.4	1.4	11.9
	8	25.9	37.0	14.2	33.8
	20	57.4	63.5	42.9	55.2
	60	81.7	82.8	72.7	74.7
More than:	60	100.0	100.0	100.0	100.0

Table A-2

FIRM CONCENTRATION IN 77 INDUSTRIES IN 1948

AND IN 81 INDUSTRIES IN 1964

Number of Firms Required to Account for 80 Per Cent of Employment (1948) or Shipments (1964)		1948	1964
Up to:	4	13.9	17.2
	8	22.5	38.7
	20	37.4	55.1
	60	57.0	73.8
More than:	60	100.0	100.0

Source: The 1948 figures are based on Rosenbluth's study and those for 1964 on the industry bulletins of the Dominion Bureau of Statistics.

The changes in the level of concentration in Canadian manufacturing industries over time are shown in Table A-2. The proportion of economic activity accounted for by the industries with high levels of concentration -- i.e. industries where eight or fewer firms account for 80 per cent of employment or shipments -- increased from 1948 to 1964. However, the comparison is subject to the serious reservation that different size variables were used in the two years. Firm sizes for 77 of the 96 industries investigated by Rosenbluth in 1948 are based on number of employees, while for the 81 industries in 1964 which matched the 77 in 1948 the size variable used was the value of shipments. As Rosenbluth pointed out, using the number of employees to measure firm size as a general rule results in a lower level of concentration than when shipments are used. This deficiency in the data prevents us from arriving at more than a tentative conclusion regarding the trend of concentration over this 16-year period.

Bearing in mind this warning about differences in measurement, the data on concentration were examined to select from the 1964 data those industries that were reasonably comparable with measured industries in 1948, thus permitting an inter-year assessment of change in concentration. These numbered 64. There was an increase in concentration in 36 and a decrease in 23, while in 5 there was virtually no change (within five percentage points). Looking at the value of shipments of these 64 industries in 1964, the 36 industries in which concentration increased accounted for 40 per cent of the total, while 39 per cent came from the 23 industries of decreasing concentration and 21 per cent from the 5 industries in which there was virtually no change.

B. Summary of Merger Activity in Selected Industries in Canada, 1945-61

The Combines Branch of the Department of Consumer and Corporate Affairs conducted a questionnaire survey of publicly reported acquisitions made by corporations whose activities fell within the scope of the Combines Investigation Act. Acquisitions covered the period from 1945-61 and were defined as the purchase of the whole or part of an operating business capable of sustaining an independent operation and costing in excess of $10,000. Coverage of mergers where the acquiring company was engaged in manufacturing, mining and trade was virtually complete but, because of the limited extension of the Act, the survey covered in only a fragmentary way acquisitions by firms in the service industries.

In the body of this Report, mention was made that annual variations in the number of acquisitions undertaken over this 16-year period bore a close statistical relationship to the average level of stock market prices. To be more precise, acquisitions by Canadian-controlled companies were positively related to average Canadian stock prices, and acquisitions by foreign-controlled companies were most closely related to the level of merger activity in the United States, which was in turn positively related to the average level of stock prices in that country.

The distribution of the acquired companies by major industrial sector is shown in Table A-3 below. Because of large differences in the size of acquired companies, the relative importance of various industries as sources of acquisitions depends on whether one looks at the numbers of companies or their values. In either case, the manufacturing sector emerges as being of paramount importance. The trade sector, on the other hand, only merits a large weight when merger activity is measured in terms of the *number* of firms acquired.

Table A-3

PERCENTAGE DISTRIBUTION OF ACQUIRED COMPANIES

BY MAJOR INDUSTRIAL SECTOR, 1945-61

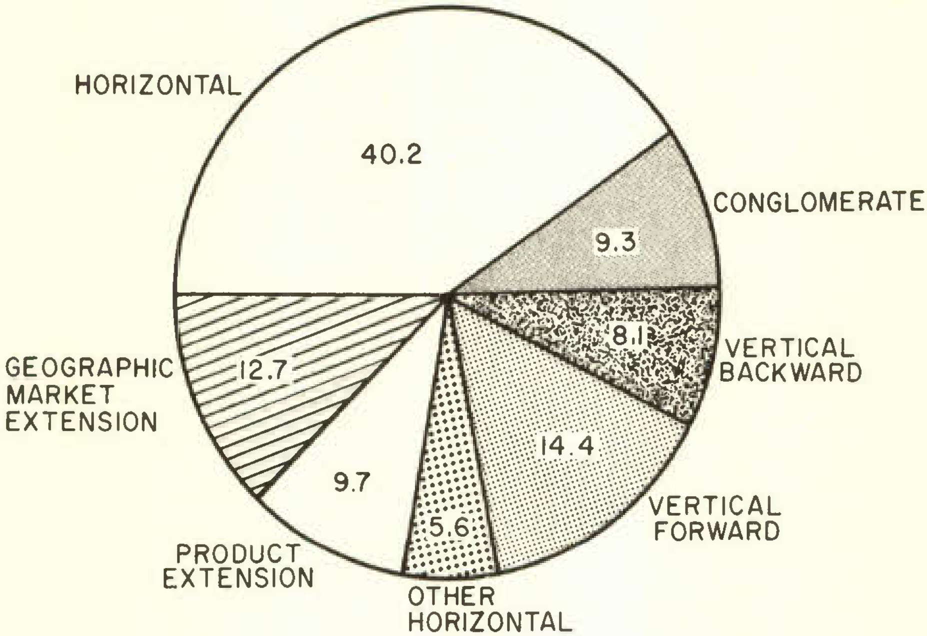
	Number	Assets
	(Per cent)	
Agriculture, forestry, fishing and trapping	1.9	0.9
Mines, quarries and oil wells	6.9	8.2
Manufacturing	49.1	68.3
Transportation, communication and other utilities	7.5	9.6
Trade	29.0	8.7
Finance, insurance and real estate	0.9	2.8
Community, business and research service industries	3.3	0.8
Construction	1.3	0.7

One of the important characteristics of mergers that must be taken into account in gauging their impact on the structure of industries is the market relationship between the merging firms. Chart A-1 summarizes the distribution of the acquisitions by market relationship.

Chart A-1

TYPES OF ACQUISITIONS, 1945-61

(Percentage distribution)



Source: Questionnaire survey carried out by the Director of Investigation and Research, Combines Investigation Act.

The types of acquisitions were established by first examining the market relationship between the main activities of the acquirer and acquired. This relationship was used in all save those cases where no clearly defined relationship -- i.e. where the relationship was conglomerate -- was present. Where, however, there was no clearly defined relationship between firms' *main* activities but one did exist between *subsidiary* activities, the latter relationship was employed as the criterion. The resulting classification of merger activity is of necessity somewhat arbitrary. There is seldom, for example, a clearly defined line between ordinary horizontal relationships, geographic market extension relationships and product extension relationships. Moreover, many of the acquisitions labeled as geographic market extension took place in industries where the acquirer had, in effect, entered the acquired's market area before the acquisition through his sponsorship of national advertising campaigns. Other problems of classification arose in cases where the acquiring firms were already vertically integrated or where they were active in more than one industry.

In Chapter 5 of this Report, attempts were made to estimate, however crudely, the number of mergers undertaken in the 1945-61 period which might have been brought before the proposed Competitive Practices Tribunal, had it been in existence, for examination as to possible detrimental effects on the public interest. It will be recalled that in arriving at a rough figure of 17 per cent out of the total number of takeovers of manufacturing firms that took place in this period, only those mergers that involved the acquisition of firms in highly concentrated industries (industries in which up to eight firms accounted for 80 per cent of the total shipments of the industry) were selected. The relevant data from which this estimate was made and which was depicted in Chart 5-2 are shown in Table A-4.

The questionnaire survey included one question that was put to the acquiring companies in an attempt to elicit the proportion of merger activity that was undertaken in order to realize cost reductions through maximizing economies of scale. The precise question was: "Detail the economies, if any, secured by the merger which were not otherwise obtainable." One possible interpretation of this heading is that only economies resulting from acquisitions that could not be realized by internal growth should be reported. However, the nature of the responses suggests that firms reported on *all* economies, whether or not they could be obtained by other methods of growth.

Table A-4

TYPES OF MERGERS AND LEVEL OF CONCENTRATION (1964) OF MANUFACTURING INDUSTRIES WITHIN WHICH ACQUIRED FIRMS WERE OPERATING,[1] 1945-61

Level of Concentration		Type of Merger: Horizontal	Geographic Market Extension	Product Extension	Other Horizontal	Vertical Forward	Vertical Backward	Conglomerate	Total
1-4	Number	28	9	7	0	1	1	7	53
	Assets in \$ million(2)	*121.2*	*165.6*	*37.1*	*0*	*1.2*	*10.0*	*7.1*	*342.1*
4.1-8		36	9	3	6	11	7	11	83
		125.0	*32.5*	*3.8*	*12.1*	*274.5*	*201.0*	*22.1*	*671.1*
8.1-20		54	17	27	9	9*	13	27	156
		97.3	*55.6*	*51.1*	*9.1*	*9.7*	*14.0*	*45.8*	*282.6*
20.1-60		73	9	22	8	6	10*	23	151
		223.5	*8.4*	*16.5*	*15.4*	*12.1*	*8.5*	*164.8*	*449.2*

Table A-4 (cont'd.)

60.1 and more	101* *55.3*	33 *38.2*	40 *69.8*	11 *7.2*	6 *16.6*	16 *42.1*	27 *18.9*	234 *248.1*
Total	292 *622.3*	77 *300.2*	99 *178.4*	34 *43.7*	33 *314.1*	47 *275.6*	95 *258.9*	677 *1,993.1*

* Includes one acquisition for which neither assets nor amount paid was reported.

(1) Only includes those acquisitions where both the acquiring and acquired firms were classified in manufacturing and where the industry within which the acquired firm was operating could be determined at the narrowest industry level for which concentration figures had been estimated. There were numerous instances in which the acquired firm could only be placed in a three-digit industry that contained several four-digit industries. The 677 acquisitions included in the Table capture 76 per cent of all the acquired firms classified in the manufacturing sector.

(2) Where assets were not reported but the amount paid was, the assets were estimated from the amount paid.

Source: Questionnaire survey carried out by the Director of Investigation and Research, Combines Investigation Act.

There is another factor that might explain the rather surprising results that emerged from the tabulation of the responses. The validity of the responses rests on the assumption that responsibility for completing this part of the questionnaire was placed with someone who had the knowledge to give a complete answer or who was willing to do some research. Even the person most familiar with a particular acquisition may have had difficulty remembering the details if it was a small acquisition that had taken place as long as 17 years earlier. Some of these difficulties are reflected in a nonresponse rate of about 36 per cent on this question. In addition, firms that did respond did not try to provide quantitative information. This made their task manageable, since it is much easier to isolate areas where economies had occurred than to estimate their extent. However, this factor is both a strength and a weakness of the tabulation shown in Table A-5. While it may lend some reliability to the responses in those areas reported to be the most important sources of economies, the crucial question of *how* important still remains unanswered.

There was one questionnaire for each acquisition. In tabulating the responses, problems arose quite frequently when more than one economy was mentioned, since the answers were in essay form and were not ranked. In such cases the economies were ranked on the basis of the impression conveyed to the questionnaire editors of their relative importance. The distribution in Table A-5 is based on the economies that were ranked first. This permits a one-to-one correspondence between, on the one hand, the number of times *any* economies were reported and the number of times *no* economies were reported, and, on the other hand, the number of acquisitions covered. The response rate varied among each of the three categories. In the case of mergers involving a horizontal relationship between manufacturing firms, 71 per cent of the questionnaires attempted to detail reported economies; the response rate covering all acquired manufacturing firms fell to 67 per cent while the broader tabulation for all mergers covered by the survey elicited answers on only 64 per cent of the questionnaires. Nonresponses were eliminated from the tabulations.

Table A-5

PERCENTAGE DISTRIBUTION OF REPORTED ECONOMIES IN ALL ACQUISITIONS AND IN THOSE WHERE THE ACQUIRED FIRM WAS CLASSIFIED IN THE MANUFACTURING SECTOR, 1946-61

Reported Economies	Manufacturing Industry Horizontal	Manufacturing Industry All	All Industry All Acquisitions
Administration and management	33.5	27.2	24.7
Integration of plants and use of raw materials	15.2	9.5	6.5
Volume buying	2.7	2.8	5.4
Cheaper to buy than build	2.7	3.5	4.3
Promotion, selling and distribution	3.1	3.3	4.6
Transportation	4.0	3.2	2.9
Improved position in selling	1.8	1.5	1.9
Integration of nonmanufacturing establishments	1.3	0.7	1.8
Cheaper financing	0.0	0.2	0.9
Now cheaper to produce than purchase commodities	0.9	1.2	0.6
Negligible or no realized economies	34.8	46.9	46.4

Several figures in Table A-5 are worth noting. First, there is the large percentage of acquisitions that, in the opinion of the acquiring company, yielded negligible or no economies. However, the percentage of cases where this occurred was substantially lower for horizontal acquisitions within manufacturing. This is to be expected, since the closer the market relationship between the merging firms, the larger is likely to be the number of points where the same or similar operations are carried on and the greater is the potential for economies to be realized. Conversely, one would expect negligible or no economies to be reported where the merger involved firms having no clearly defined market relationship between their main activities. And in fact this was so in almost 60 per cent of the acquisitions of manufacturing firms that fell into our definition of conglomerate. If those conglomerate mergers involving a broadly horizontal or vertical market relationship between the firms' *subsidiary* activities were included, the actual percentage of conglomerate mergers in which no economies were reported would be even higher.

A second point that stands out is that administration and management were considered to be far and away the most important sources of economies. It is of interest that this was the case not only for all acquisitions but for horizontal market relationships within manufacturing. Given the attention that has been focused on scale and specialization in manufacturing, one might have expected, in looking at reasons for horizontal acquisitions, that responses would have clustered more heavily on economies achieved through the integration of plants and the better use of raw materials. That economies in administration and management were reported more frequently must be regarded as a surprising finding.

Some of the difference in the importance attached by the acquiring firms to these two reasons may be due to the difference in the speed with which they yield cost savings. If plants are too small to fully exploit scale economies, placing them under common ownership will not suddenly make them bigger. Only over a period of years may it be possible to consolidate production in larger plants. However, if the merging firms are duplicating the production of more than one product, they may be able to lengthen production runs by specializing output within the different plants. This should take much less time to accomplish than the building of new facilities. But very little detail was offered in the replies when integration of plants was given as a source of economies, and increased specialization was mentioned in only a small number of cases.

We can only repeat that too much should not be read into these results and that a good deal of further exploration and analysis is required in this area.

C. R&D Expenditures by Firm Size

One aspect of corporate behaviour with which public policy has concerned itself in Canada is research and development. But as Chapter 5 pointed out, competition policy cannot and should not be administered on the basis of any such easily conceived assumption that the larger the size of a firm, the greater the amount of R&D and innovation that will be undertaken, or that a larger volume of R&D expenditures will always necessarily produce benefits commensurate with the resources absorbed. Instead, there will be required a case-by-case approach in the examination of those aspects of market structure, behaviour and performance where R&D plays an important role.

Table A-6 presents an analysis of R&D expenditures undertaken intramurally by 684 companies in 21 broadly defined industries in 1965. Again it is necessary to inject a warning about the limitations of this analysis in light of the lumpiness of the industrial categories. But a count of the size classification of the largest spenders serves at least to refute any simple notion that R&D expenditures rise with firm size. As Table A-6 reveals, in nine industries the highest relative R&D expenditures were incurred by the smallest size class, while middle-sized firms predominated in seven industries and the largest is only five industries. Any assessment of the benefits produced by the expenditures undertaken is beyond the scope of this analysis.

Table A-6

CURRENT INTRAMURAL R&D EXPENDITURES
PER ONE HUNDRED DOLLARS OF SALES,
BY INDUSTRY AND COMPANY SALES, 1965

Industry	Company Size (Sales in millions of dollars) Less than 10	10 to 49.9	50 or More	Total
Mines	1.3	1.5*	0.8	1.0
Gas and oil wells	0.5	0.9*	0.4	1.2
Manufacturing:				
Food and beverages	0.6*	0.1	0.2	0.2
Rubber	0.6	0.6	1.2*	1.2
Textiles	1.6*	1.3	0.6	1.0
Wood	0.2	0.4*	0.1	0.2
Furniture and fixtures	0.4*	0.2	--	0.3
Paper	0.8*	0.5	0.4	0.6
Primary metals (ferrous)	--	0.2	0.5*	0.5
Primary metals (nonferrous)	3.3*	0.2	0.8	0.9
Metal fabricating	1.0*	0.5	0.2	0.5
Machinery	1.1*	0.9	0.9	0.9
Aircraft and parts	3.5	17.0	17.8*	16.7
Other transportation equipment	0.7*	0.3	0.1	0.1
Electrical products	5.1	3.4	5.5*	4.8
Nonmetallic mineral products	0.5	0.7*	0.1	0.5
Petroleum products	--	0.8*	0.6	0.6
Drugs and medicines	3.0	7.0*	--	4.5
Other chemical products	1.5	1.2	2.0*	1.7
Scientific and professional instruments	4.5	7.6*	--	6.7
Other manufacturing	2.9*	0.6	0.2	0.6
Manufacturing -- Total	2.1	1.3	1.1	1.3

* Indicates the size classification of companies undertaking the *largest* volume of R&D expenditures in relation to sales in an industry.

Source: Dominion Bureau of Statistics, *Research and Development Expenditures in Canada*, Table 33.

Notes and References

[1] Gideon Rosenbluth, *Concentration in Canadian Manufacturing Industries*, National Bureau of Economic Research, Princeton, Princeton University Press, 1957.

APPENDIX IV

THE INTERDEPENDENCY OF THE CANADIAN ECONOMY

In Chapter 6 of this Report, we recommend that steps be taken to open a road for the federal government to enact civil legislation in the field of competition policy. In doing so, we explicitly disavow any desire to establish exclusive federal occupancy of this field; on the contrary, we express the hope that the provinces will come to play a useful role in the field under the constitutional powers already available to them. But we must recognize at the same time that the federal government has hitherto been the sole *de facto* occupant of the field, that certain industrial activities international and/or interprovincial in their scope would be impossible to subject effectively to any provincial competition policy, and that there exists a valid concept of the Canadian economy as a coherent whole with numerous links of interdependence between its various parts. In the light of these considerations, and of the severe constraints which the exclusively criminal law basis has imposed on Canadian competition policy in the past, we conclude that it is essential to have a federal "presence" in the field based partly on civil law.

The purpose of this Appendix is to document somewhat further the concept of the Canadian economy as an interdependent organism. This is necessarily done in terms of available statistics, which, though highly suggestive, are far from complete and ideal for the purpose. They cannot, for example, be readily adjusted to give greater weight to "basic" industries such as transportation, banking, steel and cement. Such a weighting might well be justified on the grounds that links of interdependence involving such industries are more strategic than other interindustry relationships.

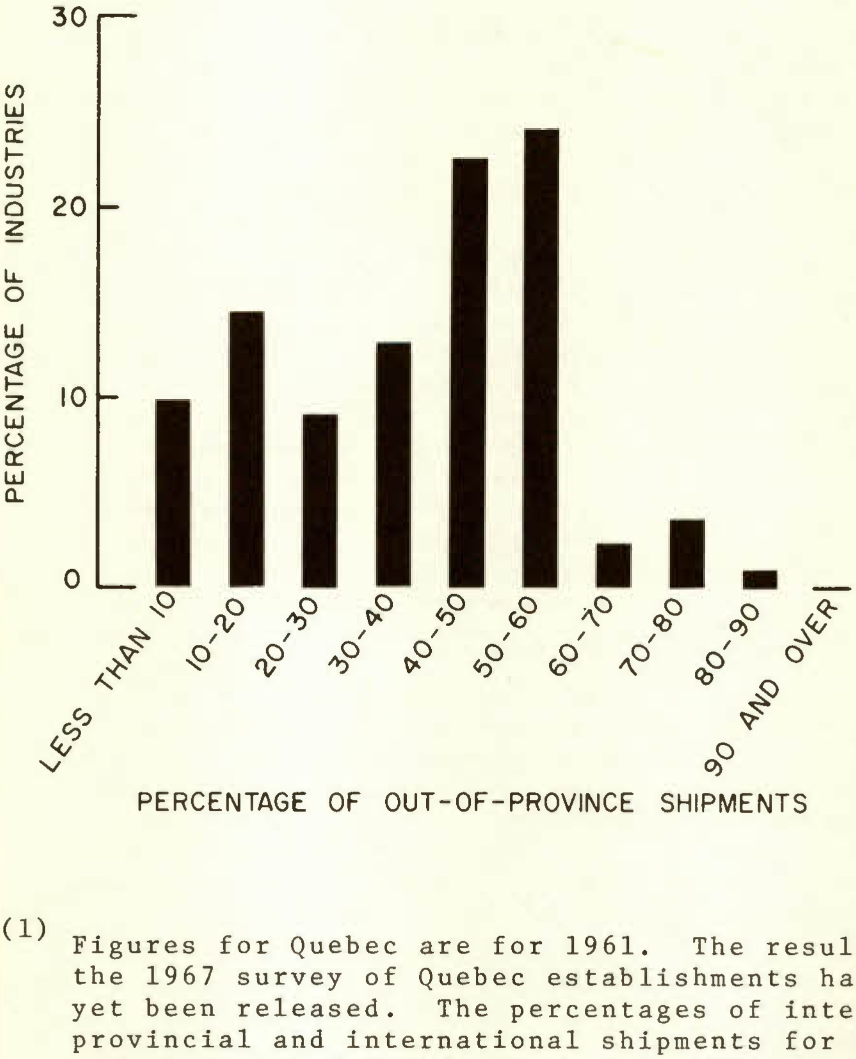
The particular statistical evidence given here related to the extent to which plants in any province or region (a) draw from suppliers, and (b) sell to customers, located in other provinces or regions or in foreign countries. This covers only one aspect of interdependence, and it does not of course clearly isolate the reasons why the degree of interdependence varies from industry to industry. The reasons are many and varied; a few only may be suggested here. A firm's output may be of such a nature that it must locate close to either or both of its sources of supply and its market outlets. As was pointed out in Chapter 5, many service industries, industries producing perishable products, and industries where the bulk or weight of the product is high relative to its value, fall into this category. Some firms not producing for sales direct to consumers may be so strategically located that the bulk of their output may be efficiently produced and distributed within the region in which they are located. Under former tariff and other arrangements, this was to a large extent the situation of the complex of automobile parts and accessory plants serving the major automobile assembly plants in Ontario. Now, however, with the institution of the North American automobile agreement and the growth of assembly operations in Quebec, markets outside Ontario have become relatively more important.

Still other firms may show only a very insignificant degree of reliance on other regions or countries because they are faced with barriers to entry into these areas which frustrate attempts to expand their markets.

It must also be appreciated that the statistics document only what might be called "primary interdependence". They reveal nothing about the secondary effects of firms' purchases and sales. The activities of a firm that buys all its requirements within the region in which its plant is located may still have a very significant, although less direct, impact on other regions from the effect of its purchases on firms that rely on outside sources of supply. Similarly, shipments immediately destined for the same province in which they are produced are often reshipped after further processing to manufacturers outside the province, for use as inputs into their products, or move on directly to consumers in other provinces. Any study of the degree to which industries or parts of industries in any province are related to the economy outside the province should in principle take into account all relationships between industries, both within the province and outside it. Unfortunately, the information with which to make such detailed analysis is not available. The input-output data that are at hand provide, nevertheless, a useful starting point.

Chart A-2

INTERPROVINCIAL AND INTERNATIONAL SHIPMENTS
AS PERCENTAGE OF TOTAL SHIPMENTS BY ESTABLISHMENTS
IN 132 FOUR-DIGIT MANUFACTURING INDUSTRIES
IN CANADA IN 1967(1)



(1) Figures for Quebec are for 1961. The results of the 1967 survey of Quebec establishments have not yet been released. The percentages of interprovincial and international shipments for Quebec and the rest of Canada were combined using the respective shares of each in total Canadian sales in each industry. Where weights were not available, Quebec was given a weight of 35 per cent and the rest of Canada 65 per cent.

The first source of information is data on the destination of shipments made in 1967 by establishments in 132 manufacturing industries in Canada taken from a survey conducted by the Dominion Bureau of Statistics. Based on this tabulation, we have calculated the percentage of the total output of these industries shipped outside the province in which the production facilities were located. As Chart A-2 shows, close to 30 per cent of the manufacturing industries sold over 50 per cent of their output in other provinces and in international markets. In only 10 per cent of the industries tabulated did shipments outside the production region account for less than 10 per cent of the sales of the industry. There were 13 manufacturing industries in this group: feed, wooden boxes, corrugated boxes, engraving and duplicate plates, cement, lime, concrete products, ready-mix concrete, stone products, poultry processing, ice cream, embroidery, and men's clothing contractors. It should be noted that this list is probably incomplete. If the data had incorporated all Canadian manufacturing industries rather than just the 132 manufacturers for which information was available, one might also expect a relatively low percentage of reliance on extraprovincial and international markets to have shown up in such industries as soft drinks, bakeries, flour mills and milk pasteurizing plants. On the other hand, some of the other industries excluded might well have shown above-average degrees of dependency on other regions and other countries.

Table A-7, which supplements Chart A-2, indicates that the picture of dependency on outside markets is not substantially altered if the classification is done on the basis of the *value of shipments* rather than the number of industries.

It is difficult to draw a clear line between "high" and "low" dependence on a purely statistical basis. A firm might sell as little as 5 per cent of its output outside its own province or region; yet the sudden loss of that 5 per cent would be a highly distressing event.

An analysis of the destination of shipments is only one aspect of interdependence. Another concerns the source of raw materials and other inputs used in the productive process. The relevant data on this subject are available only for each of the Atlantic

Provinces. For purposes of a sample presentation here, Nova Scotia -- the largest Atlantic province in terms of economic activity -- has been selected. The basic figures are data for 1960 on the degree to which 58 Nova Scotian firms relied on sources outside the province for their supplies of material inputs. First, however, to provide a reference point for comparisons with Chart A-2, extraprovincial shipments made by these same industries, which include some nonmanufacturing as well as manufacturing industries, are shown in Chart A-3. The higher degree of reliance on interprovincial and international markets shown by manufacturing industries, as compared with nonmanufacturing industries, is one of the significant features of this Chart.

Table A-7

INTERPROVINCIAL AND INTERNATIONAL SHIPMENTS AS PERCENTAGE OF TOTAL SHIPMENTS BY ESTABLISHMENTS IN 132 FOUR-DIGIT MANUFACTURING INDUSTRIES IN CANADA IN 1967(1)

Interprovincial and International Shipments as Percentage of Total Shipments	Percentage of Industries and Shipments Accounted for by Industries in Each Decile Range	
	Industries	Shipments(2)
0- 9.9	9.85	13.52
10- 19.9	14.39	11.34
20- 29.9	9.09	5.53
30- 39.9	12.88	15.06
40- 49.9	22.73	18.26
50- 59.9	24.24	28.94
60- 69.9	2.27	1.16
70- 79.9	3.79	5.33
80- 89.9	0.76	0.79
90-100.0	--	--

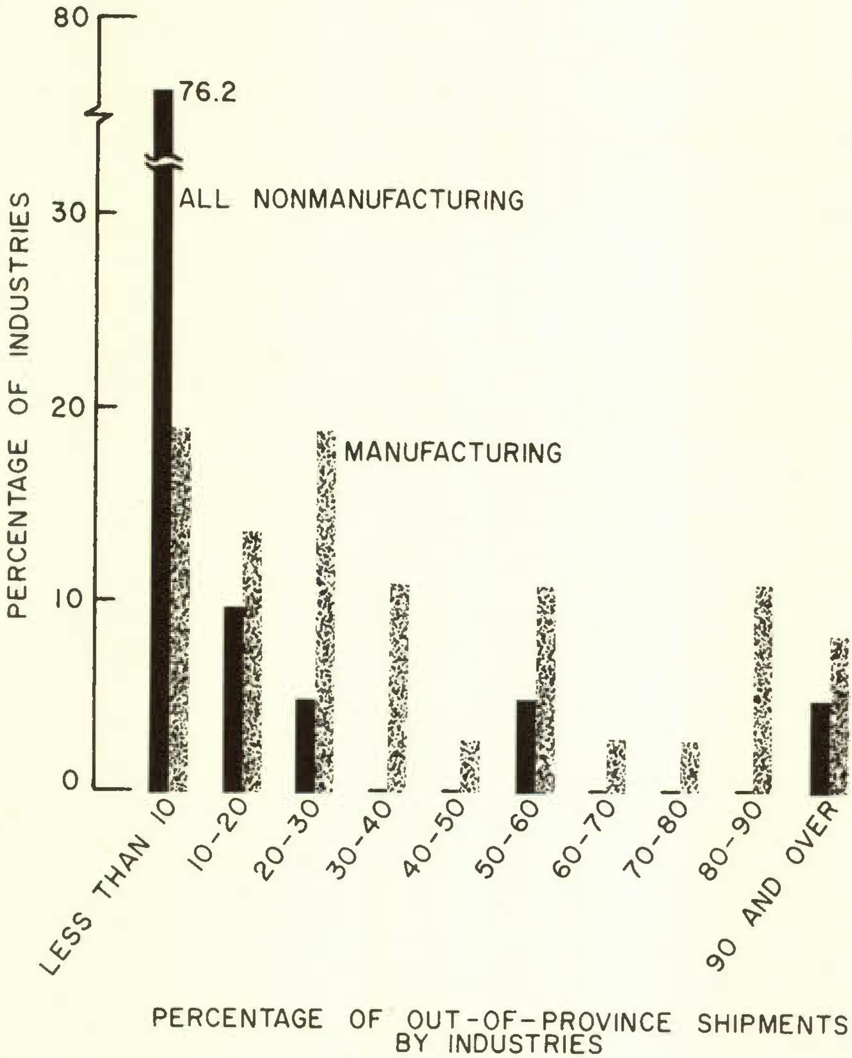
(1) See footnote to Chart A-2.

(2) Based on value of shipments in 1961.

Source: Dominion Bureau of Statistics and Quebec Bureau of Statistics.

Chart A-3

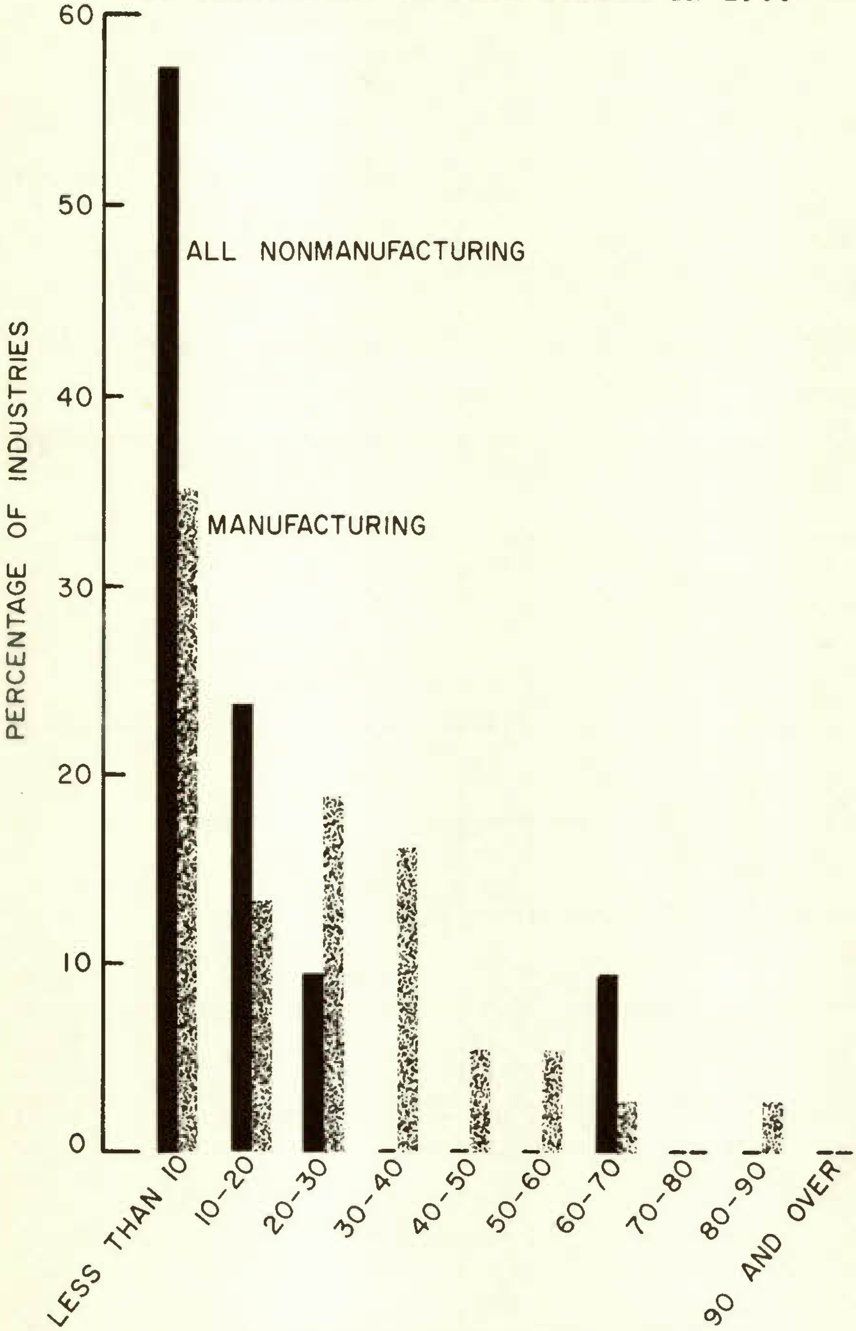
PERCENTAGE OF
INTERPROVINCIAL AND INTERNATIONAL SHIPMENTS AND SALES
FOR INDUSTRIES IN NOVA SCOTIA DURING 1960(1)



(1) The data included here cover 37 broadly defined manufacturing industries, 7 primary nonmanufacturing industries and 14 service industries.

Chart A-4

PERCENTAGE OF MATERIAL INPUTS
NOT PRODUCED IN NOVA SCOTIA
AND PURCHASED OUTSIDE THE PROVINCE
BY INDUSTRIES IN NOVA SCOTIA IN 1960(1)



(1) See footnote to Chart A-3.

Table A-8

PERCENTAGE OF
INTERPROVINCIAL AND INTERNATIONAL SHIPMENTS
CROSS-CLASSIFIED WITH PERCENTAGE OF
OUT-OF-PROVINCE MATERIAL INPUTS:(1)
NOVA SCOTIA INDUSTRIES,(2) 1960

	Shipments										
Inputs	Less than 10	10-20	20-30	30-40	40-50	50-60	60-70	70-80	80-90	90 & Over	Total
Less than 10	M:3 P:2 S:6	M:1 P:2	M:3 S:1			M:1 P:1	M:1		M:2	M:2	M:13 P: 5 S: 7
10-20	S:4		M:2	M:2	M:1					P:1	M: 5 P: 1 S: 4
20-30	M:2 P:1 S:1	M:3	M:1						M:1		M: 7 P: 1 S: 1
30-40	M:1	M:1		M:1		M:1		M:1	M:1		M: 6
40-50			M:1	M:1							M: 2
50-60	M:1									M:1	M: 2
60-70	S:2					M:1					M: 1 S: 2
70-80											
80-90						M:1					M: 1
90 & Over											
Total	M: 7 P: 3 S:13	M:5 P:2	M:7 S:1	M:4	M:1	M:4 P:1	M:1	M:1	M:4	M:3 P:1	M:37 P: 7 S:14

M: Manufacturing industries.
P: Primary nonmanufacturing industries.
S: Service industries.

(1) Inputs include only those not produced in Nova Scotia and purchased outside the province.

(2) 37 manufacturing, 7 primary nonmanufacturing and 14 service industries.

Chart A-4 indicates in a rough way the extent to which the materials and equipment required to produce the goods and services of Nova Scotian industry in 1960 came from sources outside the province. This, however, gives only a partial picture of the dependence on outside resources, because the "imported" materials and equipment include only those items that could not also be obtained from competing sources within the province. "Competitive" items obtained partly from within the province and partly outside it are not included, and this feature of the statistics is not readily remediable. Even on this understated basis, the Chart indicates that nearly a third of Nova Scotia manufacturing industries obtained 30 per cent or more of their material inputs wholly from outside the province. As in the case of shipments, the "external dependency" percentage for nonmanufacturing industries was markedly lower.

Table A-8 combines the data on shipments to other provinces and to international markets with the data on the material inputs not produced in Nova Scotia and purchased from outside suppliers. The first box in this input-output matrix shows that only 11 of the 58 industries tabulated here for the year 1960 were relatively independent of *both* outside markets *and* outside sources of supply. ("Relatively independent" is here defined to mean a degree of dependence on extraprovincial supplies and sales equivalent to less than 10 per cent.)

To sum up, these various figures indicate that even in terms of the two dimensions of interdependency for which some sort of statistics exist, it is possible to identify a major sector of interdependent industry in Canada. The concept of a national economy, characterized by important visible trade flows between itself and other national economies, and between its own provinces and major economic regions, is therefore a valid one. There seems no doubt that the concept would be reinforced if it were possible to delineate statistically some of the "invisible" or service flows between regions, including notably flows of banking, financial and federal government services. It is also worth observing, in the present context, that *potential* as well as *actual* flows between regions are of economic significance: the fact, for example, that a Nova Scotian user of steel made within the province could, if he wished, obtain tariff-free steel from outside the province (subject, of course, to a freight rate) is highly likely to influence the price and other conditions under which he obtains steel locally. One could further develop this example to show how the efficacy of competition policy and the strength of competition in one province or region would affect the strength of competition and consumer welfare in other provinces and regions.

All this leads to the conclusion that an effective competition policy in Canada must be organized, at least in part, on a national basis. We have noted that while provincial governments have not hitherto participated to any important extent in competition policy, they could do so under their existing constitutional powers, and we would urge them to follow this course. But even if this were done, a federal component of competition policy, part of it based on civil powers, is clearly indispensable.

APPENDIX V

A. SELECTED SECTIONS OF THE *EXISTING* COMBINES INVESTIGATION ACT REFERRED TO IN THE TEXT OF THIS REPORT

2. In this Act, ...

(e) "merger" means the acquisition by one or more persons, whether by purchase or lease of shares or assets or otherwise, of any control over or interest in the whole or part of the business of a competitor, supplier, customer or any other person, whereby competition

(i) in a trade or industry,

(ii) among the sources of supply of a trade or industry,

(iii) among the outlets for sales of a trade or industry, or

(iv) otherwise than in subparagraphs (i), (ii) and (iii), is or is likely to be lessened to the detriment or against the interest of the public, whether consumers, producers or others;

(f) "monopoly" means a situation where one or more persons either substantially or completely control throughout Canada or any area thereof the class or species of business in which they are engaged and have operated such business or are likely to operate it to the detriment or against the interest of the public, whether consumers, producers or others, but a situation shall not be deemed a monopoly within the meaning of this paragraph by reason only of the exercise of any right or enjoyment of any interest derived under the *Patent Act*, or any other Act of the Parliament of Canada;

29. Whenever, from or as a result of an inquiry under the provisions of this Act, or from or as a result of a judgment of the Supreme Court or Exchequer Court of Canada or of any superior, district or county court in Canada, it appears to the satisfaction of the Governor in Council that with regard to any article there has existed any conspiracy, combination, agreement, arrangement, merger or monopoly to promote unduly the advantage of manufacturers or dealers at the expense of the public, and if it appears to the Governor in Council that such disadvantage to the public is presently being facilitated by the duties of customs imposed on the article, or on any like article, the Governor in Council may direct either that such article be admitted into Canada free of duty, or that the duty thereon be reduced to such amount or rate as will, in the opinion of the Governor in Council, give the public the benefit of reasonable competition.

30. In any case where use has been made of the exclusive rights and privileges conferred by one or more patents for invention or by one or more trade marks so as

(a) unduly to limit the facilities for transporting, producing, manufacturing, supplying, storing or dealing in any article or commodity which may be a subject of trade or commerce; or

(b) unduly to restrain or injure trade or commerce in relation to any such article or commodity; or

(c) unduly to prevent, limit or lessen the manufacture or production of any such article or commodity or unreasonably to enhance the price thereof; or

(d) unduly to prevent or lessen competition in the production, manufacture, purchase, barter, sale, transportation or supply of any such article or commodity;

the Exchequer Court of Canada, on an information exhibited by the Attorney General of Canada, may for the purpose of preventing any use in the manner defined above of the exclusive rights and privileges conferred by any patents or trade marks relating to or affecting the manufacture, use or sale of such article or commodity, make one or more of the following orders:

(i) declaring void, in whole or in part, any agreement, arrangement or licence relating to such use;

(ii) restraining any person from carrying out or exercising any or all of the terms or provisions of such agreement, arrangement or licence;

(iii) directing the grant of licences under any such patent to such persons and on such terms and conditions as the court may deem proper, or, if such grant and other remedies under this section would appear insufficient to prevent such use, revoking such patent;

(iv) directing that the registration of a trade mark in the register of trade marks be expunged or amended; and

(v) directing that such other acts be done or omitted as the Court may deem necessary to prevent any such use;

but no order shall be made under this section which is at variance with any treaty, convention, arrangement or engagement respecting patents or trade marks with any other country to which Canada is a party.

32. (1) Every one who conspires, combines, agrees or arranges with another person

(a) to limit unduly the facilities for transporting, producing, manufacturing, supplying, storing or dealing in any article,

(b) to prevent, limit or lessen, unduly, the manufacture or production of an article, or to enhance unreasonably the price thereof,

(c) to prevent, or lessen, unduly, competition in the production, manufacture, purchase, barter, sale, storage, rental, transportation or supply of an article, or in the price of insurance upon persons or property, or

(d) to restrain or injure trade or commerce in relation to any article,

is guilty of an indictable offence and is liable to imprisonment for two years.

(2) Subject to subsection (3), in a prosecution under subsection (1) the court shall not convict the accused if the conspiracy, combination, agreement or arrangement relates only to one or more of the following:

(a) the exchange of statistics,

(b) the defining of product standards,

(c) the exchange of credit information,

(d) definition of trade terms,

(e) co-operation in research and development,

(f) restriction of advertising, or

(g) some other matter not enumerated in subsection (3).

(3) Subsection (2) does not apply if the conspiracy, combination, agreement or arrangement has lessened or is likely to lessen competition unduly in respect of one of the following:

(a) prices,

(b) quantity or quality of production,

(c) markets or customers, or

(d) channels or methods of distribution, or if the conspiracy, combination, agreement or arrangement has restricted or is likely to restrict any person from entering into or expanding a business in a trade or industry.

(4) Subject to subsection (5), in a prosecution under subsection (1) the court shall not convict the accused if the conspiracy, combination, agreement or arrangement relates only to the export of articles from Canada.

(5) Subsection (4) does not apply if the conspiracy, combination, agreement or arrangement

(a) has resulted or is likely to result in a reduction or limitation of the volume of exports of an article;

(b) has restrained or injured or is likely to restrain or injure the export business of any domestic competitor who is not a party to the conspiracy, combination, agreement or arrangement;

(c) has restricted or is likely to restrict any person from entering into the business of exporting articles from Canada; or

(d) has lessened or is likely to lessen competition unduly in relation to an article in the domestic market.

33. Every person who is a party or privy to or knowingly assists in, or in the formation of, a merger or monopoly is guilty of an indictable offence and is liable to imprisonment for two years.

33A. (1) Every one engaged in a business who

(a) is a party or privy to, or assists in, any sale that discriminates to his knowledge, directly or indirectly, against competitors of a purchaser of articles from him in that any discount, rebate, allowance, price concession or other advantage is granted to the purchaser over and above any discount, rebate, allowance, price concession or other advantage that, at the time the articles are sold to such purchaser, is available to such competitors in respect of a sale of articles of like quality and quantity;

(b) engages in a policy of selling articles in any area of Canada at prices lower than those exacted by him elsewhere in Canada, having the effect or tendency of substantially lessening competition or eliminating a competitor in such part of Canada, or designed to have such effect; or

(c) engages in a policy of selling articles at prices unreasonably low, having the effect or tendency of substantially lessening competition or eliminating a competitor, or designed to have such effect,

is guilty of an indictable offence and is liable to imprisonment for two years.

(2) It is not an offence under paragraph (a) of subsection (1) to be a party or privy to, or assist in any sale mentioned therein unless the discount, rebate, allowance, price concession or other advantage was granted as part of a practice of discriminating as described in that paragraph.

(3) The provisions of paragraph (a) of subsection (1) shall not be construed to prohibit a co-operative society from returning to producers or consumers, or a co-operative wholesale society from returning to its constituent retail or wholesale members, the whole or any part of the net surplus made in its trading operations in proportion to purchases made from or sales made to the society.

33B. (1) In this section "allowance" means any discount, rebate, price concession or other advantage that is or purports to be offered or granted for advertising or display purposes and is collateral to a sale or sales of articles but is not applied directly to the selling price.

(2) Every one engaged in a business who is a party or privy to the granting of an allowance to any purchaser that is not offered on proportionate terms to other purchasers in competition with the first-mentioned purchaser, (which other purchasers are in this section called "competing purchasers"), is guilty of an indictable offence and is liable to imprisonment for two years.

(3) For the purposes of this section, an allowance is offered on proportionate terms only if

(a) the allowance offered to a purchaser is in approximately the same proportion to the value of sales to him as the allowance offered to each competing purchaser is to the total value of sales to such competing purchaser,

(b) in any case where advertising or other expenditures or services are exacted in return therefor, the cost thereof required to be incurred by a purchaser is in approximately the same proportion to the value of sales to him as the cost of such advertising or other expenditures or services required to be incurred by each competing purchaser is to the total value of sales to such competing purchaser, and

(c) in any case where services are exacted in return therefor, the requirements thereof have regard to the kinds of services that competing purchasers at the same or different levels of distribution are ordinarily able to perform or cause to be performed.

33C. (1) Every one who, for the purpose of promoting the sale or use of an article, makes any materially misleading representation to the public, by any means whatever, concerning the price at which such or like articles have been, are, or will be, ordinarily sold, is guilty of an offence punishable on summary conviction.

(2) Subsection (1) does not apply to a person who publishes an advertisement that he accepts in good faith for publication in the ordinary course of his business.

34. (1) In this section "dealer" means a person engaged in the business of manufacturing or supplying or selling any article or commodity.

(2) No dealer shall directly or indirectly by agreement, threat, promise or any other means whatsoever, require or induce or attempt to require or induce any other person to resell an article or commodity

(a) at a price specified by the dealer or established by agreement,

(b) at a price not less than a minimum price specified by the dealer or established by agreement,

(c) at a markup or discount specified by the dealer or established by agreement,

(d) at a markup not less than a minimum markup specified by the dealer or established by agreement, or

(e) at a discount not greater than a maximum discount specified by the dealer or established by agreement,

whether such markup or discount or minimum markup or maximum discount is expressed as a percentage or otherwise.

(3) No dealer shall refuse to sell or supply an article or commodity to any other person for the reason that such other person

(a) has refused to resell or to offer for resale the article or commodity

(i) at a price specified by the dealer or established by agreement,

(ii) at a price not less than a minimum price specified by the dealer or established by agreement,

(iii) at a markup or discount specified by the dealer or established by agreement,

(iv) at a markup not less than a minimum markup specified by the dealer or established by agreement, or

(v) at a discount not greater than a maximum discount specified by the dealer or established by agreement;

(b) has resold or offered to resell the article or commodity

(i) at a price less than a price or minimum price specified by the dealer or established by agreement,

(ii) at a markup less than a markup or minimum markup specified by the dealer or established by agreement, or

(iii) at a discount greater than a discount or maximum discount specified by the dealer or established by agreement.

(4) Every person who violates subsection (2) or (3) is guilty of an indictable offence and is liable on conviction to a fine in the discretion of the court or to imprisonment for a term not exceeding two years or to both.

(5) Where, in a prosecution under this section, it is proved that the person charged refused or counselled the refusal to sell or supply an article to any other person, no inference unfavourable to the person charged shall be drawn from such evidence if he satisfies the court that he and any one upon whose report he depended had reasonable cause to believe and did believe

(a) that the other person was making a practice of using articles supplied by the person charged as loss-leaders, that is to say, not for the purpose of making a profit thereon but for purposes of advertising;

(b) that the other person was making a practice of using articles supplied by the person charged not for the purpose of selling such articles at a profit but for the purpose of attracting customers to his store in the hope of selling them other articles;

(c) that the other person was making a practice of engaging in misleading advertising in respect of articles supplied by the person charged; or

(d) that the other person made a practice of not providing the level of servicing that purchasers of such articles might reasonably expect from such other person.

42. (1) The Director upon his own initiative may and upon direction from the Minister or at the instance of the Commission shall carry out an inquiry concerning the existence and effect of conditions or practices having relation to any commodity which may be the subject of trade or commerce and which conditions or practices are related to monopolistic situations or restraint of trade, and for the purposes of this Act any such inquiry shall be deemed to be an inquiry under section 8.

(2) It is the duty of the Commission to consider any evidence or material brought before it under subsection (1) together with such further evidence or material as the Commission considers advisable and to report thereon in writing to the Minister, and for the purposes of this Act any such report shall be deemed to be a report under section 19.

B. AMENDMENT TO THE COMBINES INVESTIGATION ACT (RE THE TRANSFER OF SECTION 306 OF THE CRIMINAL CODE) AS PASSED BY PARLIAMENT IN JUNE 1969

33D. (1) Every one who publishes or causes to be published an advertisement containing a statement that purports to be a statement of fact but that is untrue, deceptive or misleading or is intentionally so worded or arranged that it is deceptive or misleading, is guilty of an indictable offence and is liable to imprisonment for five years, if the advertisement is published

(a) to promote, directly or indirectly, the sale or disposal of property or any interest therein, or

(b) to promote a business or commercial interest.

(2) Every one who published or causes to be published in an advertisement a statement or guarantee of the performance, efficacy or length of life of anything that is not based upon an adequate and proper test of that thing, the proof of which lies upon the accused, is, if the advertisement is published to promote, directly or indirectly, the sale or disposal of that thing, guilty of an offence punishable on summary conviction.

(3) Subsections (1) and (2) do not apply to a person who publishes an advertisement that he accepts in good faith for publication in the ordinary course of his business.

(4) For the purposes of subsection (2), a test that is made by the National Research Council of Canada or by any other public department is an adequate and proper test, but no reference shall be made in an advertisement to indicate that a test has been made by the National Research Council or other public department unless the advertisement has, before publication, been approved and permission to publish it has been given in writing by the

President of the National Research Council or by the deputy head of the public department, as the case may be.

(5) Nothing in subsection (4) shall be deemed to exclude, for the purposes of this section, any other adequate or proper test.

2002 SCC 42, 2002 CSC 42
Supreme Court of Canada

Bell ExpressVu Ltd. Partnership v. Rex

2002 CarswellBC 851, 2002 CarswellBC 852, 2002 SCC 42, 2002 CSC 42, [2002] 2 S.C.R. 559, [2002] 5 W.W.R. 1, [2002] B.C.W.L.D. 366, [2002] S.C.J. No. 43, 100 B.C.L.R. (3d) 1, 113 A.C.W.S. (3d) 52, 166 B.C.A.C. 1, 18 C.P.R. (4th) 289, 212 D.L.R. (4th) 1, 271 W.A.C. 1, 287 N.R. 248, 93 C.R.R. (2d) 189, J.E. 2002-775, REJB 2002-30904

Bell ExpressVu Limited Partnership, Appellant v. Richard Rex, Richard Rex, c.o.b. as 'Can-Am Satellites', Richard Rex, c.o.b. as 'Can Am Satellites' and c.o.b. as 'CanAm Satellites' and c.o.b. as 'Can Am Satellite' and c.o.b. as 'Can Am Sat' and c.o.b. as 'Can-Am Satellites Digital Media Group' and c.o.b. as 'Can-Am Digital Media Group' and c.o.b. as 'Digital Media Group', Anne Marie Halley a.k.a. Anne Marie Rex, Michael Rex a.k.a. Mike Rex, Rodney Kibler a.k.a. Rod Kibler, Lee-Anne Patterson, Michelle Lee, Jay Raymond, Jason Anthony, John Doe 1 to 20, Jane Doe 1 to 20 and any other person or persons found on the premises or identified as working at the premises at 22409 McIntosh Avenue, Maple Ridge, British Columbia, who operate or work for businesses carrying on business under the name and style of 'Can-Am Satellites', 'Can Am Satellites', 'CanAm Satellites', 'Can Am Satellite', 'Can Am Sat', 'Can-Am Satellites Digital Media Group', 'Can-Am Digital Media Group', 'Digital Media Group', or one or more of them, Respondents and The Attorney General of Canada, the Canadian Motion Picture Distributors Association, DIRECTV, Inc., the Canadian Alliance for Freedom of Information and Ideas, and the Congres Iberoamericain du Canada, Interveners

L'Heureux-Dubé, Iacobucci, Major, Bastarache, Binnie, Arbour, LeBel JJ.

Heard: December 4, 2001

Judgment: April 26, 2002 [*]

Docket: 28227

Proceedings: reversing (2000), [2000] 9 W.W.R. 205, 2000 BCCA 493, 2000 CarswellBC 1793, 79 B.C.L.R. (3d) 250, 191 D.L.R. (4th) 662, 142 B.C.A.C. 230, 233 W.A.C. 230 (B.C. C.A.); affirming 1999 CarswellBC 3031 (B.C. S.C. [In Chambers])

Counsel: *K. William McKenzie*, *Eugene Meehan, Q.C.*, *Jessica Duncan*, for Appellant
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Robert T. Hughes, Q.C., for Intervener, Canadian Motion Picture Distributors Association
Christopher D. Bredt, *Jeffrey D. Vallis*, *Davit D. Akman*, for Intervener, DIRECTV Inc.
Ian W.M. Angus, for Intervener, Canadian Alliance for Freedom of Information and Ideas
Alan Riddell, for Intervener, Congres Iberoamerican du Canada

***Iacobucci J.*:**

I. Introduction

1 This appeal involves an issue that has divided courts in our country. It concerns the proper interpretation of s. 9(1)(c) of the RadiocommunicationAct, R.S.C. 1985, c. R-2, as am. by S.C. 1991, c. 11, s. 83. In practical terms, the issue is whether s. 9(1)(c) prohibits the decoding of *all* encrypted satellite signals, with a limited exception, or whether it bars only the unauthorised decoding of signals that emanate from licensed Canadian distributors.

2 The respondents facilitate what is generally referred to as "grey marketing" of foreign broadcast signals. Although there is much debate — indeed rhetoric — about the term, it is not necessary to enter that discussion in these reasons. Rather, the central issue is the much narrower one surrounding the above statutory provision: does s. 9(1)(c) operate on these facts to prohibit the decryption of encrypted signals emanating from U.S. broadcasters? For the reasons that follow, my conclusion is that it does have this effect. Consequently, I would allow the appeal.

II. Background

3 The appellant is a limited partnership engaged in the distribution of direct-to-home ("DTH") television programming. It is one of two current providers licensed by the Canadian Radio-television and Telecommunications Commission ("CRTC") as a DTH distribution undertaking under the Broadcasting Act, S.C. 1991, c. 11. There are two similar DTH satellite television distributors in the United States, neither of which possesses a CRTC licence. The door has effectively been shut on foreign entry into the regulated Canadian broadcast market since April 1996, when the Governor in Council directed the CRTC not to issue, amend or renew broadcasting licences for non-Canadian applicants (SOR/ 96-192). The U.S. companies are, however, licensed by their country's Federal Communications Commission to broadcast their signals within that country. The intervener DIRECTV is the larger of these two U.S. companies.

4 DTH broadcasting makes use of satellite technology to transmit television programming signals to viewers. All DTH broadcasters own or have access to one or more satellites located in geosynchronous orbit, in a fixed position relative to the globe. The satellites are usually separated by a few degrees of Earth longitude, occupying "slots" assigned by international convention to their various countries of affiliation. The DTH broadcasters send their signals from land-based uplink stations to the satellites, which then diffuse the signals over a broad aspect of the Earth's surface, covering an area referred to as a "footprint". The broadcasting range of the satellites is oblivious to international boundaries and often extends over the territory of multiple countries. Any person who is somewhere within the footprint and equipped with the proper reception devices (typically, a small satellite reception dish antenna, amplifier, and receiver) can receive the signal.

5 The appellant makes use of satellites owned and operated by Telesat Canada, a Canadian company. Moreover, like every other DTH broadcaster in Canada and the U.S., the appellant encrypts its signals to control reception. To decode or unscramble the appellant's signals so as to permit intelligible viewing, customers must possess an additional decoding system that is specific to the appellant: the decoding systems used by other DTH broadcasters are not cross-compatible and cannot be used to decode the appellant's signals. The operational component of the decoding system is a computerized "smart card" that bears a unique code and is remotely accessible by the appellant. Through this device, once a customer has chosen and subscribed to a programming package, and rendered the appropriate fee, the appellant can communicate to the decoder that the customer is authorized to decode its signals. The decoder is then activated and the customer receives unscrambled programming.

6 The respondent, Richard Rex, carries on business as Can-Am Satellites. The other respondents are employees of, or independent contractors working for, Can-Am Satellites. The respondents are engaged in the business of selling U.S. DTH decoding systems to Canadian customers who wish to subscribe to the services offered by the U.S. DTH broadcasters, which make use of satellites owned and operated by U.S. companies and parked in orbital slots assigned to the U.S. The footprints pertaining to the U.S. DTH broadcasters are large enough for their signals to be receivable in much of Canada, but because these broadcasters will not knowingly authorize their signals to be decoded by persons outside of the U.S., the respondents also provide U.S. mailing addresses for their customers who do not already have one. The respondents then contact the U.S. DTH broadcasters on behalf of their customers, providing the customer's name, U.S. mailing address, and credit card number. Apparently, this suffices to satisfy the U.S. DTH broadcasters that the subscriber is resident in the U.S., and they then activate the customer's smart card.

7 In the past, the respondents were providing similar services for U.S. residents, so that they could obtain authorization to decode the Canadian appellant's programming signals. The respondents were authorized sales agents for the appellant at the time, but because this constituted a breach of the terms of the agency agreement, the appellant unilaterally terminated the relationship.

8 The present appeal arises from an action brought by the appellant in the Supreme Court of British Columbia. The appellant, as a licensed distribution undertaking, commenced the action pursuant to ss. 9(1)(c) and 18(1) ofthe Radiocommunication Act. As part of the relief it sought, the appellant requested an injunction prohibiting the respondents from assisting resident Canadians in subscribing to and decoding U.S. DTH programming. The chambers judge hearing the matter declined to grant the injunctive relief, and directed that the trial of the matter proceed on an expedited basis. On appeal of the chambers judge's ruling, Huddart J.A. dissenting, the Court of Appeal for British Columbia dismissed the appellant's appeal.

9 The appellant applied for leave to appeal to this Court, which was granted on April 19, 2001, with costs to the applicant in any event of the cause ([2001] 1 S.C.R. vi). The Chief Justice granted the respondents' subsequent motion to state constitutional questions on September 4, 2001.

III. Relevant Statutory Provisions

10 The *Radiocommunication Act* is one of the legislative pillars of Canada's broadcasting framework. It and another of the pillars, the *BroadcastingAct*, provide context that is of central importance to this appeal. I set out the most pertinent provisions below. I will cite other provisions throughout the course of my reasons as they become relevant.

11 Radiocommunication Act, R.S.C. 1985, c. R-2

> **2.** In this Act,
>
> "broadcasting" means any radiocommunication in which the transmissions are intended for direct reception by the general public;
>
> "encrypted" means treated electronically or otherwise for the purpose of preventing intelligible reception;
>
> "lawful distributor" in relation to an encrypted subscription programming signal or encrypted network feed, means a person who has the lawful right in Canada to transmit it and authorize its decoding;
>
> "radiocommunication" or "radio" means any transmission, emission or reception of signs, signals, writing, images, sounds or intelligence of any nature by means of electromagnetic waves of frequencies lower than 3 000 GHz propagated in space without artificial guide;
>
> "subscription programming signal" means radiocommunication that is intended for reception either directly or indirectly by the public in Canada or elsewhere on payment of a subscription fee or other charge;
>
> **9.** (1) No person shall
>
> > (*c*) decode an encrypted subscription programming signal or encrypted network feed otherwise than under and in accordance with an authorization from the lawful distributor of the signal or feed;
>
> **10.** (1) Every person who
>
> > (*b*) without lawful excuse, manufactures, imports, distributes, leases, offers for sale, sells, installs, modifies, operates or possesses any equipment or device, or any component thereof, under circumstances that give rise to a reasonable inference that the equipment, device or component has been used, or is or was intended to be used, for the purpose of contravening section 9,
>
> is guilty of an offence punishable on summary conviction and is liable, in the case of an individual, to a fine not exceeding five thousand dollars or to imprisonment for a term not exceeding one year, or to both, or, in the case of a corporation, to a fine not exceeding twenty-five thousand dollars.

(2.1) Every person who contravenes paragraph 9(1)(*c*) or (*d*) is guilty of an offence punishable on summary conviction and is liable, in the case of an individual, to a fine not exceeding ten thousand dollars or to imprisonment for a term not exceeding six months, or to both, or, in the case of a corporation, to a fine not exceeding twenty-five thousand dollars.

(2.5) No person shall be convicted of an offence under paragraph 9(1)(*c*), (*d*) or (*e*) if the person exercised all due diligence to prevent the commission of the offence.

18. (1) Any person who

(*a*) holds an interest in the content of a subscription programming signal or network feed, by virtue of copyright ownership or a licence granted by a copyright owner,

(*c*) holds a licence to carry on a broadcasting undertaking issued by the Canadian Radio-television and Telecommunications Commission under the *Broadcasting Act*,

may, where the person has suffered loss or damage as a result of conduct that is contrary to paragraph 9(1)(*c*), (*d*) or (*e*) or 10(1)(*b*), in any court of competent jurisdiction, sue for and recover damages from the person who engaged in the conduct, or obtain such other remedy, by way of injunction, accounting or otherwise, as the court considers appropriate.

(6) Nothing in this section affects any right or remedy that an aggrieved person may have under the *Copyright Act*.

Broadcasting Act, S.C. 1991, c. 11

2. (1) In this Act,

"broadcasting" means any transmission of programs, whether or not encrypted, by radio waves or other means of telecommunication for reception by the public by means of broadcasting receiving apparatus, but does not include any such transmission of programs that is made solely for performance or display in a public place;

"broadcasting undertaking" includes a distribution undertaking, a programming undertaking and a network;

"distribution undertaking" means an undertaking for the reception of broadcasting and the retransmission thereof by radio waves or other means of telecommunication to more than one permanent or temporary residence or dwelling unit or to another such undertaking;

(2) For the purposes of this Act, "other means of telecommunication" means any wire, cable, radio, optical or other electromagnetic system, or any similar technical system.

(3) This Act shall be construed and applied in a manner that is consistent with the freedom of expression and journalistic, creative and programming independence enjoyed by broadcasting undertakings.

3. (1) It is hereby declared as the broadcasting policy for Canada that

(*a*) the Canadian broadcasting system shall be effectively owned and controlled by Canadians;

(*b*) the Canadian broadcasting system, operating primarily in the English and French languages and comprising public, private and community elements, makes use of radio frequencies that are public property and provides, through its programming, a public service essential to the maintenance and enhancement of national identity and cultural sovereignty;

(*d*) the Canadian broadcasting system should

(i) serve to safeguard, enrich and strengthen the cultural, political, social and economic fabric of Canada,

(ii) encourage the development of Canadian expression by providing a wide range of programming that reflects Canadian attitudes, opinions, ideas, values and artistic creativity, by displaying Canadian talent in entertainment programming and by offering information and analysis concerning Canada and other countries from a Canadian point of view,

(iii) through its programming and the employment opportunities arising out of its operations, serve the needs and interests, and reflect the circumstances and aspirations, of Canadian men, women and children, including equal rights, the linguistic duality and multicultural and multiracial nature of Canadian society and the special place of aboriginal peoples within that society, and

(iv) be readily adaptable to scientific and technological change;

(*t*) distribution undertakings

(i) should give priority to the carriage of Canadian programming services and, in particular, to the carriage of local Canadian stations,

(ii) should provide efficient delivery of programming at affordable rates, using the most effective technologies available at reasonable cost,

(iii) should, where programming services are supplied to them by broadcasting undertakings pursuant to contractual arrangements, provide reasonable terms for the carriage, packaging and retailing of those programming services, and

(iv) may, where the Commission considers it appropriate, originate programming, including local programming, on such terms as are conducive to the achievement of the objectives of the broadcasting policy set out in this subsection, and in particular provide access for underserved linguistic and cultural minority communities.

(2) It is further declared that the Canadian broadcasting system constitutes a single system and that the objectives of the broadcasting policy set out in subsection (1) can best be achieved by providing for the regulation and supervision of the Canadian broadcasting system by a single independent public authority.

Copyright Act, R.S.C. 1985, c. C-42

21. (1) Subject to subsection (2), a broadcaster has a copyright in the communication signal that it broadcasts, consisting of the sole right to do the following in relation to the communication signal or any substantial part thereof:

(*a*) to fix it,

(*b*) to reproduce any fixation of it that was made without the broadcaster's consent,

(*c*) to authorize another broadcaster to retransmit it to the public simultaneously with its broadcast, and

(*d*) in the case of a television communication signal, to perform it in a place open to the public on payment of an entrance fee,

and to authorize any act described in paragraph (*a*), (*b*) or (*d*).

31. ...

(2) It is not an infringement of copyright to communicate to the public by telecommunication any literary, dramatic, musical or artistic work if

(*a*) the communication is a retransmission of a local or distant signal;

(*b*) the retransmission is lawful under the *Broadcasting Act*;

(*c*) the signal is retransmitted simultaneously and in its entirety, except as otherwise required or permitted by or under the laws of Canada; and

(*d*) in the case of the retransmission of a distant signal, the retransmitter has paid any royalties, and complied with any terms and conditions, fixed under this Act.

IV. Judgments Below

***Supreme Court of British Columbia,* [1999] B.C.J. No. 3092 (B.C. S.C. [In Chambers])**

12 In a judgment delivered orally in chambers, Brenner J. (now C.J.B.C.S.C.) noted that there is conflicting jurisprudence on the interpretation of s. 9(1)(c). It was the chambers judge's opinion, however, that the provision is unambiguous, and that it poses no contradiction to the remainder of the *RadiocommunicationAct*. He interpreted s. 9(1)(c) as applying only to the theft of signals from "lawful distributors" in Canada, and not applying to the "paid subscription by Canadians to signals from distributors outside Canada" (para. 20). He reasoned (at paras. 18-19):

> The offence in that section that was created by the language Parliament chose to use was the offence of stealing encrypted signals from distributors in Canada. In my view, if Parliament had intended in that section to make it an offence in Canada to decode foreign encrypted transmissions originating outside Canada as contended by the [appellant], it would have said so. In s. 9(1)(*c*) Parliament could have used language prohibiting the unauthorized decoding of all or any subscription programming in Canada. This, it chose not to do.
>
> The interpretation of s. 9(1)(*c*) asserted by the [appellant] makes no distinction between those who subscribe and pay for services from non-resident distributors and those who steal the signals of lawful distributors in Canada. That interpretation would create a theft offence applicable to persons in Canada who are nonetheless paying for the services they receive. If Parliament had intended s. 9(1)(*c*) to apply to such conduct, it would have said so in clear language. In my view the *quasi* criminal provisions in the *Radiocommunication Act* should not be interpreted in this manner in the absence of such clear parliamentary language.

13 Brenner J. therefore refused to grant the injunctive relief sought by the appellant. He directed that the trial of the matter proceed on an expedited basis.

***Court of Appeal for British Columbia* (2000)79 B.C.L.R. (3d) 250, 2000 BCCA 493 (B.C. C.A.)**

14 The majority of the Court of Appeal, in a judgment written by Finch J.A. (now C.J.B.C.), identified two divergent strands of case law regarding the proper interpretation of s. 9(1)(c). The majority also noted that judgments representing each side had found the provision to be unambiguous; in its assessment, though, "[l]egislation which can reasonably be said to bear two unambiguous but contradictory, interpretations must, at the very least, be said to be ambiguous" (para. 35). For this reason, and the fact that s.9(1)(c) bears penal consequences, the majority held that the "narrower interpretation adopted by the chambers judge ... must ... prevail" (para. 35). Conflicting authorities aside, however, the majority was prepared to reach the same result through application of the principles of statutory construction.

15 Section 9(1)(c) enjoins the decoding of encrypted signals without the authorization of the "lawful distributor of *the* signal or feed" (emphasis added). The majority interpreted the legislator's choice of the definite article "the", underlined in the above phrase, to mean that the prohibition applies only "to signals broadcast by lawful distributors who are licensed to authorize decoding of that signal" (para. 36). In other words, "[i]f there is no lawful distributor for an encrypted subscription program signal in Canada, there can be no one licensed to authorize its decoding". Consequently, according to the majority, there is no contravention of s. 9(1)(c) where a person decodes unregulated signals such as those broadcast by the U.S. DTH companies.

16 The majority characterized s. 9(1)(c) as being clearly directed at regulation of the recipient rather than the distributor, but stated that Parliament had not chosen language that would prohibit the decoding of encrypted signals regardless of origin. Rather, in the majority's view, Parliament elected to regulate merely in respect of signals transmitted by parties who are authorized by Canadian law to do so. Dismissing the appellant's argument regarding the words "or elsewhere" in the definition of "subscription program signal", the majority held that "the fact that a subscription programming signal originating outside Canada was intended for reception outside Canada, does not avoid the requirement in s. 9(1)(c) that the decoding of such signals is only unlawful if it is done without the authorization of a lawful distributor" (para. 40).

17 Basing its reasons on these considerations, the majority held that it was unnecessary to address "the wider policy issues" or the issues arising from the Charter (para. 44). Finding no error in the chambers judge's interpretation, the majority dismissed the appeal.

18 Dissenting, Huddart J.A. considered the text of s. 9(1)(c) in light of the definitions set out in s. 2, and concluded that Parliamentary intent was evident: the provision "simply render[s] unlawful the decoding in Canada of all encrypted programming signals ... regardless of their source or intended destination", except where authorization is given by a person having the lawful right in Canada to transmit and authorize the decoding of the signals (para. 48). She stressed that the line of cases relied upon by the chambers judge "[a]t most ... provides support for a less inclusive interpretation of s. 9(1)(c) than its wording suggests on its face because it has penal consequences" (para. 54), and proceeded to set out a number of reasons for which these cases should not be followed.

19 For one, "the task of interpreting a statutory provision does not begin with its being typed as penal. The task of interpretation is a search for the intention of Parliament" (para. 55). As well, the more restrictive reading of s. 9(1)(c) "ignores the broader policy objective" of the governing regulatory scheme, this being "the maintenance of a distinctive Canadian broadcasting industry in a large country with a small population within the transmission footprint of arguably the most culturally assertive country in the world with a population ten times larger" (para. 49). Huddart J.A. also referred to the existence of copyright interests, and stated that "[i]t can reasonably be inferred that U.S. distributors have commercial or legal reasons apart from Canadian laws for not seeking a Canadian market. ... Yet only Canada can control the reception of foreign signals in Canada" (para. 50).

20 Huddart J.A. declined the respondents' invitation to read s. 9(1)(c) in a manner that "respect[s] section 2(b) of the Charter" (para. 57), relying on Canada (Attorney General) v. Mossop[1993] 1 S.C.R. 554(S.C.C.), in this regard. She then concluded (at para. 58):

> In summary, I am not persuaded the line of cases on which the chambers judge relied establish the provision is ambiguous or capable of contradictory meanings. I do not consider courts have found two entirely different unambiguous meanings for the provision. The words of section 9(1)(*c*), taken alone, provide a clear basis for the determination of Parliament's intention. That meaning is consistent with the purpose of the entire regulatory scheme in the context of the international copyright agreements, with the purpose of the *Act* within that scheme, and with the scheme of the *Act* itself. Those cases interpreting the provision differently have done so with the purpose of narrowing its application to avoid penal consequences of what Parliament clearly intended to have penal consequences, as at least one of the judges taking that view explicitly acknowledged in his reasons. In my view it takes a convoluted reading of the provision to produce the result reached by the court in *R. v. Love* [(1997), 117 Man. R. (2d) 123(Q.B.)], and the decisions that have followed it.

Huddart J.A. would have allowed the appeal and granted the declaration requested by the appellant.

V. Issues

21 This appeal raises three issues:

1. Does s. 9(1)(*c*) of the *Radiocommunication Act* create an absolute prohibition against decoding, followed by a limited exception, or does it allow all decoding, except for those signals for which there is a lawful distributor who has not granted its authorization?

2. Is s. 9(1)(*c*) of the *Radiocommunication Act* inconsistent with s. 2(*b*) of the *Canadian Charter of Rights and Freedoms*?

3. If the answer to the above question is "yes", can the statutory provision be justified pursuant to s. 1 of the *Charter*?

VI. Analysis

A. Introduction

22 It is no exaggeration to state that s. 9(1)(c) of the federal *Radiocommunication Act* has received inconsistent application in the courts of this country. On one hand, there is a series of cases interpreting the provision (or suggesting that it might be interpreted) so as to create an absolute prohibition, with a limited exception where authorization from a lawful Canadian distributor is received: *R. v. Open Sky Inc.*, [1994] M.J. No. 734(Man. Prov. Ct.), at para. 36, aff'd (*sub nom.* R. v. O'Connor)1995106 Man. R. (2d) 37(Man. Q.B.), at para. 10, leave to appeal refused on other grounds(1996), 110 Man. R. (2d) 153 (Man. C.A.); *King v. Canada (Attorney General)*, [1996] N.B.J. No. 449 (N.B. Q.B.), at paras. 19-20, rev'd on other grounds(1997), 187 N.B.R. (2d) 185 (N.B. C.A.); *R. v. Knibb* (1997), 198 A.R. 161 (Alta. Prov. Ct.), aff'd (*R. v. Quality Electronics (Taber) Ltd.*, [1998] A.J. No. 628 (Alta. Q.B.); *ExpressVu Inc. v. NII Norsat International Inc.* (1997), [1998] 1 F.C. 245 (Fed. T.D.), aff'd(1997), 222 N.R. 213 (Fed. C.A.); *WIC Premium Corp. v. General Instrument Corp.* (2000), 272 A.R. 201, 2000 ABQB 628 (Alta. Q.B.), at para. 72; *Canada (Procureure générale) c. Pearlman*, [2001] R.J.Q. 2026 (C.Q.), at para. 81.

23 On the other hand, there are a number of conflicting cases that have adopted the more restrictive interpretation favoured by the majority of the Court of Appeal for British Columbia in the case at bar: *R. v. Love* (1997), 117 Man. R. (2d) 123 (Man. Q.B.); *R. v. Ereiser* (1997), 156 Sask. R. 71 (Sask. Q.B.); *R. v. LeBlanc*, [1997] N.S.J. No. 476 (N.S. S.C.); *Ryan v. 361779 Alberta Ltd.* (1997), 208 A.R. 396 (Alta. Prov. Ct.), at para. 12; *R. c. Thériault*, [2000] R.J.Q. 2736 (C.Q.); aff'd *R. v. D'Argy* (June 13, 2001), Doc. 405-36-000044-003 (C.S. Que.); *R. c. Gregory Électronique inc.*, [2000] J.Q. No. 4923 (C.Q.), aff'd *R. c. Gregory Électronique inc.*, [2001] J.Q. No. 4925 (C.S. Que.); *R. v. S.D.S. Satellite Inc.* (31 octobre 2000), no C.Q. Laval 540-73-000055-980; *R. c. Scullion*, [2001] R.J.Q. 2018 (C.Q.); *R. v. Branton* (2001), 53 O.R. (3d) 737 (Ont. C.A.).

24 As can be seen, the schism is not explained simply by the adoption of different approaches in different jurisdictions. Although the highest courts in British Columbia and Ontario have now produced decisions that bind the lower courts in those provinces to the restrictive interpretation, and although the Federal Court of Appeal has similarly bound the Trial Division courts under it to the contrary interpretation, the trial courts in Alberta, Manitoba, and Quebec have produced irreconcilable decisions. Those provinces remain without an authoritative determination on the matter. This appeal, therefore, places this Court in a position to harmonize the interpretive dissonance that is echoing throughout Canada.

25 In attempting to steer its way through this maze of cases, the Court of Appeal for British Columbia, in my respectful view, erred in its interpretation of s. 9(1)(c). In my view, there are five aspects of the majority's decision that warrant discussion. First, it commenced analysis from the belief that an ambiguity existed. Second, it placed undue emphasis on the sheer number of judges who had disagreed as to the proper interpretation of s. 9(1)(c). Third, it did not direct sufficient attention to the context of the *RadiocommunicationAct* within the regulatory *régime* for broadcasting in Canada, and did not consider the objectives of that *régime*, feeling that it was unnecessary to address these "wider policy issues". Fourth, the majority did not read s. 9(1)(c) grammatically in accordance with its structure, namely, a prohibition with a limited exception. Finally, the majority of the court effectively inverted the words of the provision, such that the signals for which a lawful distributor could provide authorization to decode (i.e., the exception) defined the very scope of the prohibition.

B. Does s. 9(1)(c) of the Radiocommunication Act create an absolute prohibition against decoding, followed by a limited exception, or does it allow all decoding, except for those signals for which there is a lawful distributor who has not granted its authorization?

(1) Principles of Statutory Interpretation

26 In Elmer Driedger's definitive formulation, found at p. 87 of his *Construction of Statutes* (2nd ed. 1983):

> Today there is only one principle or approach, namely, the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament.

Driedger's modern approach has been repeatedly cited by this Court as the preferred approach to statutory interpretation across a wide range of interpretive settings: see, for example, *Stubart Investments Ltd. v. R.*, [1984] 1 S.C.R. 536 (S.C.C.), at p. 578, *per* Estey J.; Québec (Communauté urbaine) c. Notre-Dame de Bonsecours(Corp.)[1994] 3 S.C.R. 3(S.C.C.), at p. 17; Rizzo & Rizzo Shoes Ltd., Re[1998] 1 S.C.R. 27(S.C.C.), at para. 21; *R. v. Gladue*, [1999] 1 S.C.R. 688(S.C.C.), at para. 25; *R. v. Araujo*, [2000] 2 S.C.R. 992, 2000 SCC 65 (S.C.C.), at para. 26; *R. v. Sharpe*, [2001] 1 S.C.R. 45, 2001 SCC 2 (S.C.C.), at para. 33, *per* McLachlin C.J.; *Chieu v. Canada (Minister of Citizenship & Immigration)*, 2002 SCC 3 (S.C.C.), at para. 27. I note as well that, in the federal legislative context, this Court's preferred approach is buttressed by s. 12 of the InterpretationAct, R.S.C. 1985, c. I-21, which provides that every enactment "is deemed remedial, and shall be given such fair, large and liberal construction and interpretation as best ensures the attainment of its objects".

27 The preferred approach recognizes the important role that context must inevitably play when a court construes the written words of a statute: as Professor John Willis incisively noted in his seminal article "Statute Interpretation in a Nutshell" (1938), 16 Can. Bar Rev. 1, at p.6, "words, like people, take their colour from their surroundings". This being the case, where the provision under consideration is found in an Act that is itself a component of a larger statutory scheme, the surroundings that colour the words and the scheme of the Act are more expansive. In such an instance, the application of Driedger's principle gives rise to what was described in *R. v. Ulybel Enterprises Ltd.*, [2001] 2 S.C.R. 867, 2001 SCC 56(S.C.C.), at para. 52, as "the principle of interpretation that presumes a harmony, coherence, and consistency between statutes dealing with the same subject matter". (See also *Murphy v. Welsh*, [1993] 2 S.C.R. 1069(S.C.C.) [a.k.a. *Stoddard v. Watson*], at p. 1079; Pointe-Claire (Ville) c. S.E.P.B., Local 57[1997] 1 S.C.R. 1015(S.C.C.), at para. 61, *per* Lamer C.J.)

28 Other principles of interpretation - such as the strict construction of penal statutes and the "*Charter* values" presumption - only receive application where there is ambiguity as to the meaning of a provision. (On strict construction, see: *Marcotte v. Canada (Deputy Attorney General)* (1974), [1976] 1 S.C.R. 108(S.C.C.), at p. 115, *per* Dickson J. (as he then was); R. v. Goulis198133 O.R. (2d) 55(Ont. C.A.), at pp. 59-60; *R. v. Hasselwander*, [1993] 2 S.C.R. 398(S.C.C.), at p. 413; *R. v. Russell*, [2001] 2 S.C.R. 804, 2001 SCC 53(S.C.C.), at para. 46. I shall discuss the "*Charter* values" principle later in these reasons.)

29 What, then, in law is an ambiguity? To answer, an ambiguity must be "real" (Marcotte, supra, at p. 115). The words of the provision must be "reasonably capable of more than one meaning" (*Westminster Bank Ltd. v. Zang* (1965), [1966] A.C. 182(U.K. H.L.), at p. 222, *per* Lord Reid). By necessity, however, one must consider the "entire context" of a provision before one can determine if it is reasonably capable of multiple interpretations. In this regard, Major J.'s statement in *Canadian Oxy Chemicals Ltd. v. Canada (Attorney General)*, [1999] 1 S.C.R. 743 (S.C.C.), at para. 14, is apposite: "It is only when genuine ambiguity arises between two or more plausible readings, *each equally in accordance with the intentions of the statute*, that the courts need to resort to external interpretive aids" (emphasis added), to which I would add, "including other principles of interpretation".

30 For this reason, ambiguity cannot reside in the mere fact that several courts — or, for that matter, several doctrinal writers — have come to differing conclusions on the interpretation of a given provision. Just as it would be improper for one to engage in a preliminary tallying of the number of decisions supporting competing interpretations and then apply that which receives the "higher score", it is not appropriate to take as one's starting point the premise that differing interpretations reveal an ambiguity. It is necessary, in every case, for the court charged with interpreting a provision to undertake the contextual and purposive

approach set out by Driedger, and *thereafter* to determine if "the words are ambiguous enough to induce two people to spend good money in backing two opposing views as to their meaning" (Willis, *supra*, at pp. 4-5).

(2) Application to this Case

31 The interpretive factors laid out by Driedger need not be canvassed separately in every case, and in any event are closely related and interdependent (Chieu, supra, at para. 28). In the context of the present appeal, I will group my discussion under two broad headings. Before commencing my analysis, however, I wish to highlight a number of issues on these facts. First, there is no dispute surrounding the fact that the signals of the U.S. DTH broadcasters are "encrypted" under the meaning of the Act, nor is there any dispute regarding the fact that the U.S. broadcasters are not "lawful distributors" under the Act. Secondly, all of the DTH broadcasters in Canada and the U.S. require a person to pay "a subscription fee or other charge" for unscrambled reception. Finally, I note that the "encrypted network feed" portion of s. 9(1)(c) is not relevant on these facts and can be ignored for the purposes of analysis.

(a) Grammatical and Ordinary Sense

32 In its basic form, s. 9(1)(c) is structured as a prohibition with a limited exception. Again, with the relevant portions emphasized, it states that:

> No person shall
>
> > (*c*) decode an encrypted subscription programming signal or encrypted network feed otherwise than under and in accordance with authorization from the lawful distributor of the signal or feed. [Emphasis added.]
>
> Il est interdit:
>
> > *c*) de décoder, sans l'autorisation de leur distributeur légitime ou en contravention avec celle-ci, un signal d'abonnement ou une alimentation réseau[.] [Emphasis added.]

The provision opens with the announcement of a broad prohibition ("No person shall"), follows by announcing the nature ("decode") and object ("an encrypted programming signal") of the prohibition, and then announces an exception to it ("otherwise than under and in accordance with authorization from the lawful distributor"). The French version shares the same four features, albeit in a modified order (see Provost C.Q.J. in Pearlman, supra, at p. 2031).

33 The forbidden activity is decoding. Therefore, as noted by the Court of Appeal, the prohibition in s. 9(1)(c) is directed towards the *reception* side of the broadcasting equation. Quite apart from the provenance of the signals at issue, where the impugned decoding occurs within Canada, there can be no issue of the statute's having an extra-territorial reach. In the present case, the reception that the appellant seeks to enjoin occurs entirely within Canada.

34 The object of the prohibition is of central importance to this appeal. What is interdicted by s. 9(1)(c) is the decoding of "*an* encrypted subscription programming signal" (in French, « *un* signal d'abonnement ») (emphasis added). The usage of the indefinite article here is telling: it signifies "one, some [or] any" (*Canadian Oxford Dictionary* (1998)). Thus, what is prohibited is the decoding of *any* encrypted subscription programming signal, subject to the ensuing exception.

35 The definition of "subscription programming signal" suggests that the prohibition extends to signals emanating from other countries. Section2 of the Act defines that term as, "radiocommunication that is intended for reception either directly or indirectly by the public in Canada *or elsewhere* on payment of a subscription fee or other charge" (emphasis added). I respectfully disagree with the respondents and Weiler J.A. in *Branton*, *supra*, at para. 26, "that the wording 'or elsewhere' is limited to the type of situation contemplated in s. 3(3)" of the Act. Subsection 3(3) reads:

> **3.** ...
>
> (3) This Act applies within Canada and on board

(*a*) any ship, vessel or aircraft that is

(i) registered or licensed under an Act of Parliament, or

(ii) owned by, or under the direction or control of, Her Majesty in right of Canada or a province;

(*b*) any spacecraft that is under the direction or control of

(i) Her Majesty in right of Canada or a province,

(ii) a citizen or resident of Canada, or

(iii) a corporation incorporated or resident in Canada; and

(*c*) any platform, rig, structure or formation that is affixed or attached to land situated in the continental shelf of Canada.

36 This provision is directed at an entirely different issue from that which is at play in the definition of "subscription programming signal". Section 3(3) specifies the geographic scope of the *Radiocommunication Act* and all its constituent provisions, as is confirmed by the marginal note accompanying the subsection, which states "*Geographical application*". To phrase this in the context of the present appeal, any person within Canada or on board any of the things enumerated in ss. 3(3)(a) through (c) could potentially be subject to liability for unlawful decoding under s. 9(1)(c); in this way, s. 3(3) addresses the "where" question. On the other hand, the definition of "subscription programming signal" provides meaning to the s. 9(1)(c) liability by setting out the class of signals whose unauthorized decoding will trigger the provision; this addresses the object of the prohibition, or the "what" question. These are two altogether separate issues.

37 Furthermore, it was not necessary for Parliament to include the phrase "or elsewhere" in the s. 2 definition if it merely intended "subscription programming signal" to be interpreted as radiocommunication intended for direct or indirect reception by the public on board any of the s. 3(3) vessels, spacecrafts or rigs. In my view, the words "or elsewhere" were not meant to be tautological. It is sometimes stated, when a court considers the grammatical and ordinary sense of a provision, that "[t]he legislator does not speak in vain". (*Québec (Procureur General) v. Carrières Ste-Thérèse Ltée*, [1985] 1 S.C.R. 831 (S.C.C.), at p. 838.) Parliament has provided express direction to this effect through its enactment of s. 10 of the Interpretation Act, which states in part that "[t]he law shall be considered as always speaking". In any event, "or elsewhere" (« ou ailleurs », in French) suggests a much broader ambit than the particular and limited examples in s.3(3), and I would be reticent to equate the two.

38 In my opinion, therefore, the definition of "subscription programming signal" encompasses signals originating from foreign distributors and intended for reception by a foreign public. Again, because the *RadiocommunicationAct* does not prohibit the broadcasting of subscription programming signals (apart from s. 9(1)(e), which forbids their unauthorized retransmission within Canada) and only concerns decrypting that occurs in the s.3(3) locations, this does not give rise to any extra-territorial exercise of authority. At this stage, what this means is that, contrary to the holdings of the chambers judge and the majority of the Court of Appeal in the instant case, Parliament *did* in fact choose language in s. 9(1)(c) that prohibits the decoding of all encrypted subscription signals, regardless of their origin, "otherwise than under and in accordance with an authorization from the lawful distributor of the signal or feed". I shall now consider this exception.

39 The Court of Appeal relied upon the definite article found in this portion of s. 9(1)(c) ("the signal"), in order to support its narrower reading of the provision. Before this Court, counsel for the respondents submitted as well that the definite article preceding the words "lawful distributor" confirms that the provision "is only intended to operate where there is a lawful distributor". Finally, the respondents draw to our attention the French language version of the provision, and particularly the word « leur » that modifies « distributeur légitime »: a number of cases considering the French version of s. 9(1)(c) have relied upon that word to arrive at the narrower interpretation (see the Court of Quebec judgments in Thériault, supra, at p. 2739; Gregory Électronique inc., supra, at paras. 24-26; and *S.D.S. Satellite*, supra,at p. 7. See also Branton, supra, at para. 25).

40 I do not agree with these opinions. The definite article "the" and the possessive adjective « leur » merely identify the party who can authorize the decoding in accordance with the exception (see Pearlman, supra, at p. 2032). Thus, while I agree with the majority of the Court of Appeal that "[i]f there is no lawful distributor for an encrypted subscription program signal in Canada, there can be no one licensed to authorize its decoding" (para. 36), I cannot see how it necessarily follows that decoding unregulated signals "cannot therefore be in breach of the *Radiocommunication Act*". Such an approach would require one to read words from the exception into the prohibition, which is circular and incorrect. Again, as Provost C.Q.J. stated in Pearlman, supra, at p. 2031: [translation] "To seek the meaning of the exception at the outset, and thereafter to define the rule by reference to the exception, is likely to distort the meaning of the text and misrepresent the intention of its author."

41 In my view, the definite articles are used in the exception portion of s.9(1)(c) in order to identify from amongst the genus of signals captured by the prohibition (*any* encrypted subscription programming signal) that species of signals for which the rule is "otherwise". Grammatically, then, the choice of definite and indefinite articles essentially plays out into the following rendition: No person shall decode any (indefinite) encrypted subscription programming signal unless, for *the* (definite) particular signal that is decoded, the person has received authorization from *the* (definite) lawful distributor. Thus, as might happen, if no lawful distributor exists to grant such authorization, the general prohibition must remain in effect.

42 Although I have already stated that the U.S. DTH distributors in the present case are not "lawful distributors" under the Act, I should discuss this term, because it is important to the interpretive process. Section 2 provides that a "lawful distributor" of an encrypted subscription programming signal is "a person who has the lawful right in Canada to transmit it and authorize its decoding". In this connection, the fact that a person is authorized to transmit programming in another country does not, by that fact alone, qualify as granting the lawful right to do so in Canada. Moreover, the phrase "lawful right" (« légitimement autorisée ») comprehends factors in addition to licences granted by the CRTC. In defining "lawful distributor", Parliament could have made specific reference to a person holding a CRTC licence (as it did in s.18(1)(c)) or a Minister's licence (s. 5(1)(a)). Instead, it deliberately chose broader language. I therefore agree with the opinion of Létourneau J.A. in the Federal Court of Appeal decision in *Norsat*, *supra*, at para. 4, that:

> [t]he concept of "lawful right" refers to the person who possesses the regulatory rights through proper licensing under the *Act*, the authorization of the Canadian Radio-television and Telecommunications Commission as well as the contractual and copyrights necessarily pertaining to the content involved in the transmission of the encrypted subscription programming signal or encrypted network feed.

As pointed out by the Attorney General of Canada, this interpretation means that even where the transmission of subscription programming signals falls outside of the definition of "broadcasting" under the *Broadcasting Act* (i.e., where the transmitted programming is "made solely for performance or display in a public place") and no broadcasting licence is therefore required, additional factors must still be considered before it can be determined whether the transmitter of the signals is a "lawful distributor" for the purposes of the *Radiocommunication Act*.

43 In the end, I conclude that when the words of s. 9(1)(c) are read in their grammatical and ordinary sense, taking into account the definitions provided in s. 2, the provision prohibits the decoding in Canada of any encrypted subscription programming signal, regardless of the signal's origin, unless authorization is received from the person holding the necessary lawful rights under Canadian law.

(b) Broader Context

44 Although the *Radiocommunication Act* is not, unfortunately, equipped with its own statement of purpose, it does not exist in a vacuum. TheAct's focus is upon the allocation of specified radio frequencies, the authorisation to possess and operate radio apparatuses, and the technical regulation of the radio spectrum. The Act also places restrictions on the reception of and interference with radiocommunication, which includes encrypted broadcast programming signals of the sort at issue. S. Handa et al., *Communications Law in Canada* (loose-leaf ed.), at p. 3.8, describe the *RadiocommunicationAct* as one "of the three statutory pillars governing carriage in Canada". These same authors note at p. 3.17 that:

> The *Radiocommunication Act* embraces all private and public use of the radio spectrum. The close relationship between this and the telecommunications and broadcasting Acts is determined by the fact that telecommunications and broadcasting are the two principal users of the radioelectric spectrum.

45 The *Broadcasting Act* came into force in 1991, in an omnibus statute that also brought substantial amendments to the *RadiocommunicationAct*, including the addition thereto of s. 9(1)(c). Its purpose, generally, is to regulate and supervise the transmission of programming to the Canadian public. Of note for the present appeal is that the definition of "broadcasting" in the *Broadcasting Act* captures the encrypted DTH programme transmissions at issue and that DTH broadcasters such as the appellant receive their licences under, and are subject to, that Act. The *Broadcasting Act* also enumerates 20 broad objectives of the broadcasting policy for Canada (in s. 3(1)(a) through (t)). The emphasis of the Act, however, is placed on *broadcasting* and not reception.

46 Ultimately, the Acts operate in tandem. On this point, I agree with the following passage from the judgment of LeGrandeur Prov. Ct. J. in Knibb, supra, at paras. 38-39, which was adopted by Gibson J. in the Federal Court Trial Division decision in Norsat, supra, at para. 35:

> The *Broadcasting Act* and the *Radiocommunication Act* must be seen as operating together as part of a single regulatory scheme. The provisions of each statute must accordingly be read in the context of the other and consideration must be given to each statute's roll [*sic*] in the overall scheme. [Cite to R. Sullivan, *Driedger on the Construction of Statutes* (3rd ed. 1994), at p. 286.]
>
> The addition of s. 9(1)(*c*), (*d*) and (*e*) and other sections to the *Radiocommunication Act* through the provisions of the *Broadcasting Act*, 1991 are supportive of that approach in my view. Subsections 9(1)(*c*), (*d*) and (*e*) of the *Radiocommunication Act* must be seen as part of the mechanism by which the stated policy of regulation of broadcasting in Canada is to be fulfilled.

47 Canada's broadcasting policy has a number of distinguishing features, and evinces a decidedly cultural orientation. It declares that the radio frequencies in Canada are public property, that Canadian ownership and control of the broadcasting system should be a base premise, and that the programming offered through the broadcasting system is "a public service essential to the maintenance and enhancement of national identity and cultural sovereignty". Sections 3(1)(d) and 3(1)(t) enumerate a number of specific developmental goals for, respectively, the broadcasting system as a whole and for distribution undertakings (including DTH distribution undertakings) in particular. Finally, s. 3(2) declares that "the Canadian broadcasting system constitutes a single system" best regulated and supervised "by a single independent public authority".

48 In this context, one finds little support for the restrictive interpretation of s. 9(1)(c). Indeed, as counsel for the Attorney General of Canada argued before us, after consideration of the Canadian broadcasting policy Parliament has chosen to adopt, one may legitimately wonder

> why would Parliament enact a provision like the restrictive interpretation? Why would Parliament provide for Canadian ownership, Canadian production, Canadian content in its broadcasting and then simply leave the door open for unregulated, foreign broadcasting to come in and sweep all of that aside? What purpose would have been served?

49 On the other hand, the interpretation of s. 9(1)(c) that I have determined to result from the grammatical and ordinary sense of the provision accords well with the objectives set out in the *Broadcasting Act*. The fact that DTH broadcasters encrypt their signals, making it possible to concentrate regulatory efforts on the reception/decryption side of the equation, actually assists with attempts to pursue the statutory broadcasting policy objectives and to regulate and supervise the Canadian broadcasting system as a single system. It makes sense in these circumstances that Parliament would seek to encourage broadcasters to go through the regulatory process by providing that they could only grant authorization to have their signal decoded, and thereby collect their subscription fees, after regulatory approval has been granted.

50 There is another contextual factor that, while not in any way determinative, is confirmatory of the interpretation of s. 9(1)(c) as an absolute prohibition with a limited exception. As I have noted above, the concept of "lawful right" in the definition of "lawful distributor" incorporates contractual and copyright issues. According to the evidence in the present record, the commercial agreements between the appellant and its various programme suppliers require the appellant to respect the rights that these suppliers are granted by the persons holding the copyright in the programming content. The rights so acquired by the programme suppliers permit the programmes to be broadcast in specific locations, being all or part of Canada. As such, the appellant would have no *lawful right* to authorise decoding of its programming signals in an area not included in its geographically limited contractual right to exhibit the programming.

51 In this way, the person holding the copyright in the programming can conclude separate licensing deals in different regions, or in different countries (e.g., Canada and the U.S.). Indeed, these arrangements appear typical of the industry: in the present appeal, the U.S. DTH broadcaster DIRECTV has advocated the same interpretation of s. 9(1)(c) as the appellant, in part because of the potential liability it faces towards both U.S. copyright holders and Canadian licencees due to the fact that its programming signals spill across the border and are being decoded in Canada.

52 I also believe that the reading of s. 9(1)(c) as an absolute prohibition with a limited exception complements the scheme of the *CopyrightAct*. Sections 21(1)(c) and 21(1)(d) of the CopyrightAct provide broadcasters with a copyright in the communication signals they transmit, granting them the sole right of retransmission (subject to the exceptions in s. 31(2)) and, in the case of a television communication signal, of performing it on payment of a fee. By reading s. 9(1)(c) as an absolute prohibition against decoding except where authorization is granted by the person with the *lawful right* to transmit and authorize decoding of the signal, the provision extends protection to the holders of the copyright in the programming itself, since it would proscribe the unauthorized reception of signals that violate copyright, even where no retransmission or reproduction occurs: see F. P. Eliadis and S. C. McCormack, "Vanquishing Wizards,Pirates and Musketeers: The Regulation of Encrypted Satellite TV Signals" (1993), 3 *M.C.L.R.* 211, at pp. 213-18. Finally, I note that the civil remedies provided for in ss. 18(1)(a) and 18(6) of the RadiocommunicationAct both illustrate that copyright concerns are of relevance to the scheme of the Act, thus supporting the finding that there is a connection between these two statutes.

(c) Section 9(1)(c) as a "Quasi-Criminal" Provision

53 I wish to comment regarding the respondents' argument regarding the penal effects that the "absolute prohibition" interpretation would bring to bear. Although the present case only arises in the context of a civil remedy the appellant is seeking under s. 18(1) of the Act (as a person who "has suffered loss or damage as a result of conduct that is contrary to paragraph9(1)(c)") and does not therefore directly engage the penal aspects of the *Radiocommunication Act*, the respondents direct our attention to ss. 10(1)(b) and 10(2.1). These provisions, respectively, create summary conviction offences for every person providing equipment for the purposes of contravening s. 9 and for every person who in fact contravenes s.9(1)(c). Respondents' counsel argued before us that, if s. 9(1)(c) is interpreted in the manner suggested by the appellant, "hundreds of thousands of Canadians can expect a knock on their door, because they will be in breach of the statute" and that "the effect of [the appellant's] submissions is to criminalise subscribers even if they pay every cent to which DIRECTV is entitled". The thrust of the respondents' submission is that the presence of ss. 10(1)(b) and 10(2.1) in the RadiocommunicationAct provides context that is important to the interpretation of s. 9(1)(c), and that this context militates in favour of the respondents' position.

54 Section 9(1)(c) does have a "dual aspect", in so far as it gives rise to both civil and criminal penalties. I am not, however, persuaded that this plays an important role in the interpretive process here. In any event, I do not think it correct to insinuate that the decision in this appeal will have the effect of automatically branding every Canadian resident who subscribes to and pays for U.S. DTH broadcasting services as a criminal. The penal offence in s. 10(1)(b) requires that circumstances "give rise to a reasonable inference that the equipment, device or component has been used, or is or was intended to be used, *for the purpose* of contravening section 9" (emphasis added), and allows for a "lawful excuse" defence. Section 10(2.5) further provides that "[n]o person shall be convicted of an offence under paragraph 9(1)(c) ... if the person exercised all due diligence to prevent the commission of the offence". Since it is neither necessary nor appropriate to pursue the meaning of these provisions absent the proper factual context, I refrain from doing so.

(d) Conclusion

55 After considering the entire context of s. 9(1)(c), and after reading its words in their grammatical and ordinary sense in harmony with the legislative framework in which the provision is found, I find no ambiguity. Rather, I can conclude only that Parliament intended to create an absolute bar on Canadian residents decoding encrypted programming signals. The only exception to this prohibition occurs where authorization is acquired from a distributor holding the necessary legal rights in Canada to transmit the signal and provide the required authorization. There is no need in this circumstance to resort to any of the subsidiary principles of statutory interpretation.

C. The Constitutional Questions

56 As I will discuss, I do not propose to answer the constitutional questions that have been stated in this appeal.

57 Rule 32 of the Rules of the Supreme Court of Canada, SOR/83-74 mandates that constitutional questions be stated in every appeal in which the constitutional validity or applicability of legislation is challenged, and sets out the procedural requirements to that end. As recognized by this Court, the purpose of Rule 32 is to ensure that the Attorney General of Canada, the attorneys general of the provinces, and the ministers of justice of the territories are alerted to constitutional challenges, in order that they may decide whether or not to intervene: Corbiere v. Canada (Minister of Indian& Northern Affairs)[1999] 2 S.C.R. 203(S.C.C.), at para. 49, *per* L'Heureux-Dubé J.; see also B.A. Crane and H.S. Brown, *Supreme Court of Canada Practice 2000* (1999), atp. 253. Rule 32 also serves to advise the parties and other potential interveners of the constitutional issues before the Court.

58 On the whole, the parties to an appeal are granted "wide latitude" by the Chief Justice or other judge of this Court in formulating the questions to be stated: Bisaillon c. Keable[1983] 2 S.C.R. 60(S.C.C.), at p. 71; *Corbiere*, *supra*, at para. 48. This wide latitude is especially appropriate in a case like the present, where the motion to state constitutional questions was brought by the respondents: generally, a respondent may advance any argument on appeal that would support the judgment below (Perka v. R.[1984] 2 S.C.R. 232(S.C.C.), at p. 240; Idziak v. Canada (Minister of Justice)[1992] 3 S.C.R. 631(S.C.C.), at pp. 643-44, *per* Cory J.). Like many general rules, however, this one is subject to an exception. A respondent, like any other party, cannot rely upon an entirely new argument that would have required additional evidence to be adduced at trial: Perka, supra; Idziak, supra; R. v. Gayle200154 O.R. (3d) 36(Ont. C.A.), at para. 69, leave to appeal refused January 24, 2002 [R. v. Gayle2002 CarswellOnt 159(S.C.C.)].

59 In like manner, even where constitutional questions are stated under Rule32, it may ultimately turn out that the factual record on appeal provides an insufficient basis for their resolution. The Court is not obliged in such cases to provide answers: Bisaillon, supra; Crane and Brown, supra, at p. 254. In fact, there are compelling reasons not to: while we will not deal with abstract questions in the ordinary course, "[t]his policy ... is of particular importance in constitutional matters" (Moysa v. Alberta (Labour Relations Board)[1989] 1 S.C.R. 1572(S.C.C.), at p. 1580; see also Danson v. Ontario (Attorney General)[1990] 2 S.C.R. 1086(S.C.C.), at p. 1099; Baron v. R.[1993] 1 S.C.R. 416(S.C.C.), at p. 452; R. v. Mills[1999] 3 S.C.R. 668(S.C.C.), at para. 38, *per* McLachlin and Iacobucci JJ.). Thus, as Sopinka J. stated for the Court in *Borowski v. Canada (Attorney General)*, [1989] 1 S.C.R. 342(S.C.C.), at p. 357: "The procedural requirements of Rule 32 of theSupreme Court Rules are not designed to introduce new issues but to define with precision the constitutional points in issue *which emerge from the record*". (Emphasis added.)

60 Respondents' counsel properly conceded during oral argument that there is noCharter record permitting this Court to address the stated questions. Rather, he argued that "*Charter* values" must inform the interpretation given to the *Radiocommunication Act*. This submission, inasmuch as it is presented as a stand alone proposition, must be rejected. Although I have already set out the preferred approach to statutory interpretation above, the manner in which the respondents would have this Court consider and apply the Charter warrants additional attention at this stage.

61 It has long been accepted that, where it will not upset the appropriate balance between judicial and legislative action, courts should apply and develop the rules of the common law in accordance with the values and principles enshrined in the Charter: Dolphin Delivery Ltd. v. R.W.D.S.U., Local 580[1986] 2 S.C.R. 573(S.C.C.), at p. 603, *per* McIntyre J.; Cloutier c.

Langlois[1990] 1 S.C.R. 158(S.C.C.), at p. 184; R. v. Salituro[1991] 3 S.C.R. 654(S.C.C.), at p. 675; R. v. Golden2001 SCC 83(S.C.C.), at para. 86, *per* Iacobucci and Arbour JJ.; *Pepsi-Cola Canada Beverages (West) Ltd. v. R.W.D.S.U., Local 558*, 2002 SCC 8(S.C.C.), at paras. 18-19. One must keep in mind, of course, that the common law is the province of the judiciary: the courts are responsible for its application, and for ensuring that it continues to reflect the basic values of society. The courts do not, however, occupy the same role *vis-à-vis* statute law.

62 Statutory enactments embody legislative will. They supplement, modify or supersede the common law. More pointedly, when a statute comes into play during judicial proceedings, the courts (absent any challenge on constitutional grounds) are charged with interpreting and applying it in accordance with the sovereign intent of the legislator. In this regard, although it is sometimes suggested that "it is appropriate for courts to prefer interpretations that tend to promote those [*Charter*] principles and values over interpretations that do not" (Sullivan, supra, at p. 325), it must be stressed that, to the extent this Court has recognized a "*Charter* values" interpretive principle, such principle can *only* receive application in circumstances of genuine ambiguity, i.e., where a statutory provision is subject to differing, but equally plausible, interpretations.

63 This Court has striven to make this point clear on many occasions: see, e.g., Hills v. Canada (Attorney General)[1988] 1 S.C.R. 513(S.C.C.), at p. 558, *per* L'Heureux-Dubé J.; Slaight Communications Inc. v. Davidson[1989] 1 S.C.R. 1038(S.C.C.), at p. 1078, *per* Lamer J. (as he then was); R. v. Zundel[1992] 2 S.C.R. 731(S.C.C.), at p. 771, *per* McLachlin J. (as she then was); Canada v. Pharmaceutical Society (Nova Scotia)[1992] 2 S.C.R. 606(S.C.C.), at p. 660; *Mossop*, supra, at pp. 581-82, *per* Lamer C.J.; R. v. Lucas[1998] 1 S.C.R. 439(S.C.C.), at para. 66, *per* Cory J.; Mills, supra, at paras. 22 and 56; *R. v. Sharpe*, *supra*, at para. 33.

64 These cases recognize that a blanket presumption of *Charter* consistency could sometimes frustrate true legislative intent, contrary to what is mandated by the preferred approach to statutory construction. Moreover, another rationale for restricting the "*Charter* values" rule was expressed in Symes v. R.[1993] 4 S.C.R. 695(S.C.C.), at p. 752:

> [T]o consult the *Charter* in the absence of such ambiguity is to deprive the *Charter* of a more powerful purpose, namely, the determination of a statute's constitutional validity. If statutory meanings must be made congruent with the *Charter* even in the absence of ambiguity, then it would never be possible to apply, rather than simply consult, the values of the *Charter*. Furthermore, it would never be possible for the government to justify infringements as reasonable limits under s. 1 of the *Charter*, since the interpretive process would preclude one from finding infringements in the first place. [Emphasis in original.]

(See also Willick v. Willick[1994] 3 S.C.R. 670(S.C.C.), at pp. 679-80, *per* Sopinka J.)

65 This last point touches, fundamentally, upon the proper function of the courts within the Canadian democracy. In Vriend v. Alberta[1998] 1 S.C.R. 493(S.C.C.), at paras. 136-42, the Court described the relationship among the legislative, executive, and judicial branches of governance as being one of dialogue and mutual respect. As was stated, judicial review on *Charter* grounds brings a certain measure of vitality to the democratic process, in that it fosters both dynamic interaction and accountability amongst the various branches. "The work of the legislature is reviewed by the courts and the work of the court in its decisions can be reacted to by the legislature in the passing of new legislation (or even overarching laws under s. 33 of the Charter)" (*Vriend*, *supra*, at para. 139).

66 To reiterate what was stated in *Symes* and Willick, supra, if courts were to interpret all statutes such that they conformed to the Charter, this would wrongly upset the dialogic balance. Every time the principle were applied, it would pre-empt judicial review on *Charter* grounds, where resort to the internal checks and balances of s. 1 may be had. In this fashion, the legislatures would be largely shorn of their constitutional power to enact reasonable limits on *Charter* rights and freedoms, which would in turn be inflated to near absolute status. Quite literally, in order to avoid this result a legislature would somehow have to set out its justification for qualifying the Charter right expressly in the statutory text, all without the benefit of judicial discussion regarding the limitations that are permissible in a free and democratic society. Before long, courts would be asked to interpret *this* sort of enactment in light of *Charter* principles. The patent unworkability of such a scheme highlights the importance of

retaining a forum for dialogue among the branches of governance. As such, where a statute is unambiguous, courts must give effect to the clearly expressed legislative intent and avoid using theCharter to achieve a different result.

67 It may well be that, when this matter returns to trial, the respondents' counsel will make an application to have s. 9(1)(c) of the RadiocommunicationAct declared unconstitutional for violating the Charter. At that time, it will be necessary to consider evidence regarding whose expressive rights are engaged, whether these rights are violated by s. 9(1)(c), and, if they are, whether they are justified under s. 1.

VII. Disposition

68 In the result, I would allow the appeal with costs throughout, set aside the judgment of the Court of Appeal for British Columbia, and declare that s. 9(1)(c)of the Radiocommunication Act creates a prohibition against all decoding of encrypted programming signals, followed by an exception where authorization is received from the person holding the lawful right in Canada to transmit and authorize decoding of the signal. No answer is given to the constitutional questions stated by order of the Chief Justice.

Appeal allowed.

Pourvoi accueilli.

Footnotes

* A corrigendum issued by the court on May 13, 2002 has been incorporated herein.

2004 SCC 68, 2004 CSC 68
Supreme Court of Canada

People's Department Stores Ltd. (1992) Inc., Re

2004 CarswellQue 2862, 2004 CarswellQue 2863, 2004 SCC 68, 2004 CSC 68, [2004] 3 S.C.R. 461, [2004] S.C.J. No. 64, 134 A.C.W.S. (3d) 548, 244 D.L.R. (4th) 564, 326 N.R. 267 (Eng.), 326 N.R. 267 (Fr.), 49 B.L.R. (3d) 165, 4 C.B.R. (5th) 215, J.E. 2004-2016, REJB 2004-72160

In the Matter of the Bankruptcy of Peoples Department Stores Inc./Magasins à rayons Peoples inc.

Caron Bélanger Ernst & Young Inc., in its capacity as Trustee to the bankruptcy of Peoples Department Stores Inc./Magasins à rayons Peoples inc. (Appellant) v. Lionel Wise, Ralph Wise and Harold Wise (Respondents) and Chubb Insurance Company of Canada/Compagnie d'assurance Chubb du Canada (Respondent)

Iacobucci, * Major, Bastarache, Binnie, LeBel, Deschamps, Fish JJ.

Heard: May 11, 2004
Judgment: October 29, 2004
Docket: 29682

Proceedings: affirming *People's Department Stores Ltd. (1992) Inc., Re* (2003), 2003 CarswellQue 145, (sub nom. *Peoples Department Stores Inc. (Trustees of) v. Wise)* 224 D.L.R. (4th) 509, [2003] R.J.Q. 796, 41 C.B.R. (4th) 225 (C.A. Que.); reversing *People's Department Stores Ltd. (1992) Inc., Re* (1998), (sub nom. *Peoples Department Stores Inc./Magasin à rayons Peoples inc. (Syndic de))* [1999] R.R.A. 178, 1998 CarswellQue 3442, 23 C.B.R. (4th) 200 (C.S. Que.)

Counsel: Gerald F. Kandestin, Gordon Kugler, Gordon Levine for Appellant
Éric Lalanne, Martin Tétreault for Respondents, Lionel Wise, Ralph Wise, Harold Wise
Ian Rose, Odette Jobin-Laberge for Respondent, Chubb Insurance Company of Canada

***Major, Deschamps JJ.*:**

I. Introduction

1 The principal question raised by this appeal is whether directors of a corporation owe a fiduciary duty to the corporation's creditors comparable to the statutory duty owed to the corporation. For the reasons that follow, we conclude that directors owe a duty of care to creditors, but that duty does not rise to a fiduciary duty. We agree with the disposition of the Quebec Court of Appeal. The appeal is therefore dismissed.

2 As a result of the demise in the mid-1990s of two major retail chains in eastern Canada, Wise Stores Inc. ("Wise") and its wholly-owned subsidiary, Peoples Department Stores Inc. ("Peoples"), the indebtedness of a number of Peoples' creditors went unsatisfied. In the wake of the failure of the two chains, Caron Bélanger Ernst & Young Inc., Peoples' trustee in bankruptcy (the "trustee"), brought an action against the directors of Peoples. To address the trustee's claims, the extent of the duties imposed by s. 122(1) of the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44 ("CBCA"), upon directors with respect to creditors must be determined; we must also identify the purpose and reach of s. 100 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("BIA").

3 In our view, it has not been established that the directors of Peoples violated either the fiduciary duty or the duty of care imposed by s. 122(1) of the CBCA. As for the trustee's submission regarding s. 100 of the BIA, we agree with the Court of

Appeal that the consideration received in the impugned transactions was not "conspicuously" less than fair market value. The BIA claim fails on that basis.

II. Background

4 Wise was founded by Alex Wise in 1930 as a small clothing store on St-Hubert Street in Montreal. By 1992, through expansion effected by a mix of internal growth and acquisitions, it had become an enterprise operating at 50 locations with annual sales of approximately $100 million, and it had been listed on the Montreal Stock Exchange in 1986. The stores were, for the most part, located in urban areas in Quebec. The founder's three sons, Lionel, Ralph and Harold Wise (the "Wise brothers"), were majority shareholders, officers, and directors of Wise. Together, they controlled 75 percent of the firm's equity.

5 In 1992, Peoples had been in business continuously in one form or another for 78 years. It had operated as an unincorporated division of Marks & Spencer Canada Inc. ("M & S") until 1991, when it was incorporated as a separate company. M & S itself was wholly owned by the large British firm, Marks & Spencer plc. ("M & S plc."). Peoples' 81 stores were generally located in rural areas, from Ontario to Newfoundland. Peoples had annual sales of about $160 million, but was struggling financially. Its annual losses were in the neighbourhood of $10 million.

6 Wise and Peoples competed with other chains such as Canadian Tire, Greenberg, Hart, K-Mart, M-Stores, Metropolitan Stores, Rossy, Woolco and Zellers. Retail competition in eastern Canada was intense in the early 1990s. In 1992, M-Stores went bankrupt. In 1994, Greenberg and Metropolitan Stores followed M-Stores into bankruptcy. The 1994 entry of Wal-Mart into the Canadian market, with its acquisition of over 100 Woolco stores from Woolworth Canada Inc., exerted significant additional competitive pressure on retail stores.

7 Lionel Wise, the eldest of the three brothers and Wise's executive vice-president, had expressed an interest in acquiring the ailing Peoples chain from M & S as early as 1988. Initially, M & S did not share Wise's interest for the sale, but by late 1991, M & S plc., the British parent company of M & S, had decided to divest itself of all its Canadian operations. At this point, M & S incorporated each of its three Canadian divisions to facilitate the anticipated divestiture thereof.

8 The new-found desire to sell coincided with Wise's previously expressed interest in acquiring its larger rival. Although M & S had initially hoped to sell Peoples for cash to a large firm in a solid financial condition, it was unable to do so. Consequently, negotiations got underway with representatives of Wise. A formal share purchase agreement was drawn up in early 1992 and executed in June 1992, with July 16, 1992 as its closing date.

9 Wise incorporated a company, 2798832 Canada Inc., for the purpose of acquiring all of the issued and outstanding shares of Peoples from M & S. The $27- million share acquisition proceeded as a fully leveraged buyout. The portion of the purchase price attributable to inventory was discounted by 30 percent. The discount was designed to inject equity into Peoples in the fiscal year following the sale and to make use of some of the tax losses that had accumulated in prior years.

10 The amount of the down payment due to M & S at closing, $5 million, was borrowed from the Toronto Dominion Bank (the "TD Bank"). According to the terms of the share purchase agreement, the $22-million balance of the purchase price would be carried by M & S and would be repaid over a period of eight years. Wise guaranteed all of 2798832 Canada Inc.'s obligations pursuant to the terms of the share purchase agreement.

11 To protect its interests, M & S took the assets of Peoples as security (subject to a priority in favour of the TD Bank) and negotiated strict covenants concerning the financial management and operation of the company. Among other requirements, 2798832 Canada Inc. and Wise were obligated to maintain specific financial ratios, and Peoples was not permitted to provide financial assistance to Wise. In addition, the agreement provided that Peoples could not be amalgamated with Wise until the purchase price had been paid. This prohibition was presumably intended to induce Wise to refinance and pay the remainder of the purchase price as early as possible in order to overcome the strict conditions imposed upon it under the share purchase agreement.

12 On January 31, 1993, 2798832 Canada Inc. was amalgamated with Peoples. The new entity retained Peoples' corporate name. Since 2798832 Canada Inc. had been a wholly-owned subsidiary of Wise, upon amalgamation the new Peoples became a subsidiary directly owned and controlled by Wise. The three Wise brothers were Peoples' only directors.

13 Following the acquisition, Wise had attempted to rationalize its operations by consolidating the overlapping corporate functions of Wise and Peoples, and operating as a group. The consolidation of the administration, accounting, advertising and purchasing departments of the two corporations was completed by the fall of 1993. As a consequence of the changes, many of Wise's employees worked for both firms but were paid solely by Wise. The evidence at trial was that because of the tax losses carried-forward by Peoples, it was advantageous for the group to have more expenses incurred by Wise, which, if the group was profitable as a whole, would increase its after-tax profits. Almost from the outset, the joint operation of Wise and Peoples did not function smoothly. Instead of the expected synergies, the consolidation resulted in dissonance.

14 After the acquisition, the total number of buyers for the two companies was nearly halved. The procurement policy at that point required buyers to deal simultaneously with suppliers on behalf of both Peoples and Wise. For the buyers, this nearly doubled their administrative work. Separate invoices were required for purchases made on behalf of Wise and Peoples. These invoices had to be separately entered into the system, tracked and paid.

15 Inventory, too, was separately recorded and tracked in the system. However, the inventory of each company was handled and stored, often unsegregated, in shared warehouse facilities. The main warehouse for Peoples, on Cousens Street in Ville St-Laurent, was maintained for and used by both firms. The Cousens warehouse saw considerable activity, as it was the central distribution hub for both chains. The facility was open 18 hours a day and employed 150 people on two shifts who handled a total of approximately 30,000 cartons daily through 20 loading docks. It was abuzz with activity.

16 Before long, the parallel bookkeeping combined with the shared warehousing arrangements caused serious problems for both Wise and Peoples. The actual situation in the warehouse often did not mirror the reported state of the inventory in the system. The goods of one company were often inextricably commingled and confused with the goods of the other. As a result, the inventory records of both companies were increasingly incorrect. A physical inventory count was conducted to try to rectify the situation, to little avail. Both Wise and Peoples stores experienced numerous shipping disruptions and delays. The situation, already unsustainable, was worsening.

17 In October 1993, Lionel Wise consulted David Clément, Wise's (and, after the acquisition, Peoples') vice-president of administration and finance, in an attempt to find a solution. In January 1994, Clément recommended and the three Wise brothers agreed that they would implement a joint inventory procurement policy (the "new policy") whereby the two firms would divide responsibility for purchasing. Peoples would make all purchases from North American suppliers and Wise would, in turn, make all purchases from overseas suppliers. Peoples would then transfer to Wise what it had purchased for Wise, charging Wise accordingly, and vice versa. The new policy was implemented on February 1, 1994. It was this arrangement that was later criticized by certain creditors and by the trial judge.

18 Approximately 82 percent of the total inventory of Wise and Peoples was purchased from North American suppliers, which inevitably meant that Peoples would be extending a significant trade credit to Wise. The new policy was known to the directors, but was neither formally implemented in writing nor approved by a board meeting or resolution.

19 On April 27, 1994, Lionel Wise outlined the details of the new policy at a meeting of Wise's audit committee. A partner of Coopers & Lybrand was M & S's representative on Wise's board of directors and a member of the audit committee. He attended the April 27th meeting and raised no objection to the new policy when it was introduced.

20 By June 1994, financial statements prepared to reflect the financial position of Peoples as of April 30, 1994 revealed that Wise owed more than $18 million to Peoples. Approximately $14 million of this amount resulted from a notional transfer of inventory that was cancelled following the period's end. M & S was concerned about the situation and started an investigation, as a result of which M & S insisted that the new procurement policy be rescinded. Wise agreed to M & S's demand but took the position that the former procurement policy could not be reinstated immediately. An agreement was executed on September 27,

1994, effective July 21, 1994, and it provided that the new policy would be abandoned as of January 31, 1995. The agreement also specified that the inventory and records of the two companies would be kept separate, and that the amount owed to Peoples by Wise would not exceed $3 million.

21 Another result of the negotiations was that M & S accepted an increase in the amount of the TD Bank's priority to $15 million and a new repayment schedule for the balance of the purchase price owed to M & S. The parties agreed to revise the schedule to provide for 37 monthly payments beginning in July 1995. Each of the Wise brothers also provided a personal guarantee of $500,000 in favour of M & S.

22 In September 1994, in light of the fragile financial condition of the companies and the competitiveness of the retail market, the TD Bank announced its intention to cease doing business with Wise and Peoples as of the end of December 1994. Following negotiations, however, the bank extended its financial support until the end of July 1995. The Wise brothers promised to extend personal guarantees in favour of the TD Bank, but this did not occur.

23 In December 1994, three days after the Wise brothers presented financial statements showing disappointing results for Peoples in its third fiscal quarter, M & S initiated bankruptcy proceedings against both Wise and Peoples. A notice of intention to make a proposal was filed on behalf of Peoples the same day. Nonetheless, Peoples later consented to the petition by M & S, and both Wise and Peoples were declared bankrupt on January 13, 1995, effective December 9, 1994. The same day, M & S released each of the Wise brothers from their personal guarantees. M & S apparently preferred to proceed with an uncontested petition in bankruptcy rather than attempting to collect on the personal guarantees.

24 The assets of Wise and Peoples were sufficient to cover in full the outstanding debt owed to the TD Bank, satisfy the entire balance of the purchase price owed to M & S, and discharge almost all the landlords' lease claims. The bulk of the unsatisfied claims were those of trade creditors.

25 Following the bankruptcy, Peoples' trustee filed a petition against the Wise brothers. In the petition, the trustee claimed that they had favoured the interests of Wise over Peoples to the detriment of Peoples' creditors, in breach of their duties as directors under s. 122(1) of the CBCA. The trustee also claimed that the Wise brothers had, in the year preceding the bankruptcy, been privy to transactions in which property had been transferred for conspicuously less than fair market value within the meaning of s. 100 of the BIA.

26 Pursuant to art. 2501 of the *Civil Code of Québec*, S.Q. 1991, c. 64 ("C.C.Q."), the trustee named Chubb Insurance Company of Canada ("Chubb"), which had provided directors' insurance to Wise and its subsidiaries, as a defendant in addition to the Wise brothers.

27 The trial judge, Greenberg J., relying on decisions from the United Kingdom, Australia and New Zealand, held that the fiduciary duty and the duty of care under s. 122 (1) of the CBCA extend to a company's creditors when a company is insolvent or in the vicinity of insolvency. Greenberg J. found that the implementation, by the Wise brothers qua directors of Peoples, of a corporate policy that affected both companies, had occurred while the corporation was in the vicinity of insolvency and was detrimental to the interests of the creditors of Peoples. The Wise brothers were therefore found liable and the trustee was awarded $4.44 million in damages. As Chubb had provided insurance coverage for directors, it was also held liable. Greenberg J. also considered the alternative grounds under the BIA advanced by the trustee and found the Wise brothers liable for the same $4.44 million amount on that ground as well. All the parties appealed.

28 The Quebec Court of Appeal, *per* Pelletier J.A., with Robert C.J.Q. and Nuss J.A. concurring, allowed the appeals by Chubb and the Wise brothers. The Court of Appeal expressed reluctance to follow Greenberg J. in equating the interests of creditors with the best interests of the corporation when the corporation was insolvent or in the vicinity of insolvency, stating that an innovation in the law such as this is a policy matter more appropriately dealt with by Parliament than the courts. In considering the trustee's claim under s. 100 of the BIA, Pelletier J.A. held that the trial judge had committed a palpable and overriding error in concluding that the amounts owed by Wise to Peoples in respect of inventory "were neither collected nor collectible". He found that the consideration received for the transactions had been approximately 94 percent of fair market

value, and he was not convinced that this disparity could be characterized as being "conspicuously" less than fair market value. Moreover, he did not accept the broad meaning the trial judge gave to the word "privy". Pelletier J.A. declined to exercise his discretion under s. 100(2) of the BIA to make an order in favour of the trustee. In view of his conclusion that the Wise brothers were not liable, Pelletier J.A. allowed the appeal with respect to Chubb.

III. Analysis

29 At the outset, it should be acknowledged that according to art. 300 of the C.C.Q. and s. 8.1 of the *Interpretation Act*, R.S.C. 1985, c. I-21, the civil law serves as a supplementary source of law to federal legislation such as the CBCA. Since the CBCA does not entitle creditors to sue directors directly for breach of their duties, it is appropriate to have recourse to the *Civil Code of Québec* to determine how rights grounded in a federal statute should be addressed in Quebec, and more specifically how s. 122(1) of the CBCA can be harmonized with the principles of civil liability: see R. Crête and S. Rousseau, *Droit des sociétés par actions: principes fondamentaux* (2002), at p. 58.

30 This case came before our Court on the issue of whether directors owe a duty to creditors. The creditors did not bring a derivative action or an oppression remedy application under the CBCA. Instead, the trustee, representing the interests of the creditors, sued the directors for an alleged breach of the duties imposed by s. 122(1) of the CBCA. The standing of the trustee to sue was not questioned.

31 The primary role of directors is described in s. 102(1) of the CBCA:

> **102.** (1) Subject to any unanimous shareholder agreement, the directors shall manage, or supervise the management of, the business and affairs of a corporation.

As for officers, s. 121 of the CBCA provides that their powers are delegated to them by the directors:

> **121.** Subject to the articles, the by-laws or any unanimous shareholder agreement,
>
> (a) the directors may designate the offices of the corporation, appoint as officers persons of full capacity, specify their duties and delegate to them powers to manage the business and affairs of the corporation, except powers to do anything referred to in subsection 115(3);
>
> (b) a director may be appointed to any office of the corporation; and
>
> (c) two or more offices of the corporation may be held by the same person.

Although the shareholders are commonly said to own the corporation, in the absence of a unanimous shareholder agreement to the contrary, s. 102 of the CBCA provides that it is not the shareholders, but the directors elected by the shareholders, who are responsible for managing it. This clear demarcation between the respective roles of shareholders and directors long predates the 1975 enactment of the CBCA: see *Automatic Self Cleansing Filter Syndicate Co. v. Cunninghame*, [1906] 2 Ch. 34 (Eng. Ch.); see also art. 311, C.C.Q.

32 Subsection 122(1) of the CBCA establishes two distinct duties to be discharged by directors and officers in managing, or supervising the management of, the corporation:

> **122.** (1) Every director and officer of a corporation in exercising their powers and discharging their duties shall
>
> (a) act honestly and in good faith with a view to the best interests of the corporation; and
>
> (b) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

The first duty has been referred to in this case as the "fiduciary duty". It is better described as the "duty of loyalty". We will use the expression "statutory fiduciary duty" for purposes of clarity when referring to the duty under the CBCA. This duty requires directors and officers to act honestly and in good faith with a view to the best interests of the corporation. The second duty is commonly referred to as the "duty of care". Generally speaking, it imposes a legal obligation upon directors and officers to be diligent in supervising and managing the corporation's affairs.

33 The trial judge did not apply or consider separately the two duties imposed on directors by s. 122(1). As the Court of Appeal observed, the trial judge appears to have confused the two duties. They are, in fact, distinct and are designed to secure different ends. For that reason, they will be addressed separately in these reasons.

A. The Statutory Fiduciary Duty: Section 122(1)(a) of the CBCA

34 Considerable power over the deployment and management of financial, human, and material resources is vested in the directors and officers of corporations. For the directors of CBCA corporations, this power originates in s. 102 of the Act. For officers, this power comes from the powers delegated to them by the directors. In deciding to invest in, lend to or otherwise deal with a corporation, shareholders and creditors transfer control over their assets to the corporation, and hence to the directors and officers, in the expectation that the directors and officers will use the corporation's resources to make reasonable business decisions that are to the corporation's advantage.

35 The statutory fiduciary duty requires directors and officers to act honestly and in good faith *vis-à-vis* the corporation. They must respect the trust and confidence that have been reposed in them to manage the assets of the corporation in pursuit of the realization of the objects of the corporation. They must avoid conflicts of interest with the corporation. They must avoid abusing their position to gain personal benefit. They must maintain the confidentiality of information they acquire by virtue of their position. Directors and officers must serve the corporation selflessly, honestly and loyally: see K.P. McGuinness, *The Law and Practice of Canadian Business Corporations* (1999), at p. 715.

36 The common law concept of fiduciary duty was considered in *B. (K.L.) v. British Columbia*, [2003] 2 S.C.R. 403, 2003 SCC 51 (S.C.C.). In that case, which involved the relationship between the government and foster children, a majority of this Court agreed with McLachlin C.J. who stated, at paras. 40-41 and 49:

> ...Fiduciary duties arise in a number of different contexts, including express trusts, relationships marked by discretionary power and trust, and the special responsibilities of the Crown in dealing with aboriginal interests....
>
> What ... might the content of the fiduciary duty be if it is understood ... as a private law duty arising simply from the relationship of discretionary power and trust between the Superintendent and the foster children? In *Lac Minerals Ltd. v. International Corona Resources Ltd.*, [1989] 2 S.C.R. 574, at pp. 646-47, La Forest J. noted that there are certain common threads running through fiduciary duties that arise from relationships marked by discretionary power and trust, such as loyalty and "the avoidance of a conflict of duty and interest and a duty not to profit at the expense of the beneficiary". <u>However, he also noted that "[t]he obligation imposed may vary in its specific substance depending on the relationship" (p. 646)</u>....
>
> ...concern for the best interests of the child informs the parental fiduciary relationship, as La Forest J. noted in *M. (K.) v. M. (H.), supra*, at p. 65. But the duty imposed is to act loyally, and not to put one's own or others' interests ahead of the child's in a manner that abuses the child's trust.... The parent who exercises undue influence over the child in economic matters for his own gain has put his own interests ahead of the child's, in a manner that abuses the child's trust in him. The same may be said of the parent who uses a child for his sexual gratification or a parent who, wanting to avoid trouble for herself and her household, turns a blind eye to the abuse of a child by her spouse. The parent need not, as the Court of Appeal suggested in the case at bar, be consciously motivated by a desire for profit or personal advantage; nor does it have to be her own interests, rather than those of a third party, that she puts ahead of the child's. It is rather a question of disloyalty -- of putting someone's interests ahead of the child's in a manner that abuses the child's trust. <u>Negligence, even aggravated negligence, will not ground parental fiduciary liability unless it is associated with breach of trust in this sense</u>. [Emphasis added.]

37 The issue to be considered here is the "specific substance" of the fiduciary duty based on the relationship of directors to corporations under the CBCA.

38 It is settled law that the fiduciary duty owed by directors and officers imposes strict obligations: see *Canadian Aero Service Ltd. v. O'Malley* (1973), [1974] S.C.R. 592 (S.C.C.), at pp. 609-10, *per* Laskin J. (as he then was), where it was decided that directors and officers may even have to account to the corporation for profits they make that do not come at the corporation's expense:

> The reaping of a profit by a person at a company's expense while a director thereof is, of course, an adequate ground upon which to hold the director accountable. Yet there may be situations where a profit must be disgorged, although not gained at the expense of the company, on the ground that a director must not be allowed to use his position as such to make a profit even if it was not open to the company, as for example, by reason of legal disability, to participate in the transaction. An analogous situation, albeit not involving a director, existed for all practical purposes in the case of *Phipps v. Boardman* [[1967] 2 A.C. 46], which also supports the view that liability to account does not depend on proof of an actual conflict of duty and self-interest. Another, quite recent, illustration of a liability to account where the company itself had failed to obtain a business contract and hence could not be regarded as having been deprived of a business opportunity is *Industrial Development Consultants Ltd. v. Cooley* [[1972] 2 All E.R. 162], a judgment of a Court of first instance. There, the managing director, who was allowed to resign his position on a false assertion of ill health, subsequently got the contract for himself. That case is thus also illustrative of the situation where a director's resignation is prompted by a decision to obtain for himself the business contract denied to his company and where he does obtain it without disclosing his intention. [Emphasis added.]

A compelling argument for making directors accountable for profits made as a result of their position, though not at the corporation's expense, is presented by J. Brock, "The Propriety of Profitmaking: Fiduciary Duty and Unjust Enrichment" (2000), 58 *U.T. Fac. L. Rev.* 185, at pp. 204-5.

39 However, it is not required that directors and officers in all cases avoid personal gain as a direct or indirect result of their honest and good faith supervision or management of the corporation. In many cases the interests of directors and officers will innocently and genuinely coincide with those of the corporation. If directors and officers are also shareholders, as is often the case, their lot will automatically improve as the corporation's financial condition improves. Another example is the compensation that directors and officers usually draw from the corporations they serve. This benefit, though paid by the corporation, does not, if reasonable, ordinarily place them in breach of their fiduciary duty. Therefore, all the circumstances may be scrutinized to determine whether the directors and officers have acted honestly and in good faith with a view to the best interests of the corporation.

40 In our opinion, the trial judge's determination that there was no fraud or dishonesty in the Wise brothers' attempts to solve the mounting inventory problems of Peoples and Wise stands in the way of a finding that they breached their fiduciary duty. Greenberg J. stated, at para. 180:

> We hasten to add that in the present case, the Wise Brothers derived no direct personal benefit from the new domestic inventory procurement policy, albeit that, as the controlling shareholders of Wise Stores, there was an indirect benefit to them. Moreover, as was conceded by the other parties herein, in deciding to implement the new domestic inventory procurement policy, there was no dishonesty or fraud on their part.

The Court of Appeal relied heavily on this finding by the trial judge, as do we. At para. 84, Pelletier J.A. stated that:

> [TRANSLATION] In regard to fiduciary duty, I would like to point out that the brothers were driven solely by the wish to resolve the problem of inventory procurement affecting both the operations of Peoples Inc. and those of Wise. [This is a] motivation that is in line with the pursuit of the interests of the corporation within the meaning of paragraph 122(1)(*a*) C.B.C.A. and that does not expose them to any justified criticism.

41 As explained above, there is no doubt that both Peoples and Wise were struggling with a serious inventory management problem. The Wise brothers considered the problem and implemented a policy they hoped would solve it. In the absence of evidence of a personal interest or improper purpose in the new policy, and in light of the evidence of a desire to make both Wise

and Peoples "better" corporations, we find that the directors did not breach their fiduciary duty under s. 122(1)(*a*) of the CBCA. See *820099 Ontario Inc. v. Harold E. Ballard Ltd.* (1991), 3 B.L.R. (2d) 123 (Ont. Gen. Div.) (aff'd (1991), 3 B.L.R. (2d) 113 (Ont. Div. Ct.)), in which Farley J., at p. 171, correctly observes that in resolving a conflict between majority and minority shareholders, it is safe for directors and officers to act to make the corporation a "better corporation".

42 This appeal does not relate to the non-statutory duty directors owe to shareholders. It is concerned only with the statutory duties owed under the CBCA. Insofar as the statutory fiduciary duty is concerned, it is clear that the phrase the "best interests of the corporation" should be read not simply as the "best interests of the shareholders". From an economic perspective, the "best interests of the corporation" means the maximization of the value of the corporation: see E.M. Iacobucci, "Directors' Duties in Insolvency: Clarifying What Is at Stake" (2003), 39(3) *Can. Bus. L.J.* 398, at pp. 400-1. However, the courts have long recognized that various other factors may be relevant in determining what directors should consider in soundly managing with a view to the best interests of the corporation. For example, in *Teck Corp. v. Millar* (1972), 33 D.L.R. (3d) 288 (B.C. S.C.), Berger J. stated, at p. 314:

> A classical theory that once was unchallengeable must yield to the facts of modern life. In fact, of course, it has. If today the directors of a company were to consider the interests of its employees no one would argue that in doing so they were not acting *bona fide* in the interests of the company itself. Similarly, if the directors were to consider the consequences to the community of any policy that the company intended to pursue, and were deflected in their commitment to that policy as a result, it could not be said that they had not considered bona fide the interests of the shareholders.
>
> I appreciate that it would be a breach of their duty for directors to disregard entirely the interests of a company's shareholders in order to confer a benefit on its employees: *Parke v. Daily News Ltd.*, [1962] Ch. 927. But if they observe a decent respect for other interests lying beyond those of the company's shareholders in the strict sense, that will not, in my view, leave directors open to the charge that they have failed in their fiduciary duty to the company.

The case of *Olympia & York Enterprises Ltd. v. Hiram Walker Resources Ltd.* (1986), 59 O.R. (2d) 254 (Ont. Div. Ct.), approved, at p. 271, the decision in *Teck, supra*. We accept as an accurate statement of law that in determining whether they are acting with a view to the best interests of the corporation it may be legitimate, given all the circumstances of a given case, for the board of directors to consider, inter alia, the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment.

43 The various shifts in interests that naturally occur as a corporation's fortunes rise and fall do not, however, affect the content of the fiduciary duty under s. 122(1)(*a*) of the CBCA. At all times, directors and officers owe their fiduciary obligation to the corporation. The interests of the corporation are not to be confused with the interests of the creditors or those of any other stakeholders.

44 The interests of shareholders, those of the creditors and those of the corporation may and will be consistent with each other if the corporation is profitable and well capitalized and has strong prospects. However, this can change if the corporation starts to struggle financially. The residual rights of the shareholders will generally become worthless if a corporation is declared bankrupt. Upon bankruptcy, the directors of the corporation transfer control to a trustee, who administers the corporation's assets for the benefit of creditors.

45 Short of bankruptcy, as the corporation approaches what has been described as the "vicinity of insolvency", the residual claims of shareholders will be nearly exhausted. While shareholders might well prefer that the directors pursue high-risk alternatives with a high potential payoff to maximize the shareholders' expected residual claim, creditors in the same circumstances might prefer that the directors steer a safer course so as to maximize the value of their claims against the assets of the corporation.

46 The directors' fiduciary duty does not change when a corporation is in the nebulous "vicinity of insolvency". That phrase has not been defined; moreover, it is incapable of definition and has no legal meaning. What it is obviously intended to convey is a deterioration in the corporation's financial stability. In assessing the actions of directors it is evident that any honest and good

faith attempt to redress the corporation's financial problems will, if successful, both retain value for shareholders and improve the position of creditors. If unsuccessful, it will not qualify as a breach of the statutory fiduciary duty.

47 For a discussion of the shifting interests and incentives of shareholders and creditors, see W.D. Gray, "*Peoples v. Wise* and *Dylex*: Identifying Stakeholder Interests upon or near Corporate Insolvency — Stasis or Pragmatism?" (2003), 39 *Can. Bus. L.J.* 242, at p. 257; E. M. Iacobucci & K.E. Davis, "Reconciling Derivative Claims and the Oppression Remedy" (2000), 12 *S.C.L.R.* (2d) 87, at p. 114. In resolving these competing interests, it is incumbent upon the directors to act honestly and in good faith with a view to the best interests of the corporation. In using their skills for the benefit of the corporation when it is in troubled waters financially, the directors must be careful to attempt to act in its best interests by creating a "better" corporation, and not to favour the interests of any one group of stakeholders. If the stakeholders cannot avail themselves of the statutory fiduciary duty (the duty of loyalty, *supra*) to sue the directors for failing to take care of their interests, they have other means at their disposal.

48 The Canadian legal landscape with respect to stakeholders is unique. Creditors are only one set of stakeholders, but their interests are protected in a number of ways. Some are specific, as in the case of amalgamation: s. 185 of the CBCA. Others cover a broad range of situations. The oppression remedy of s. 241(2)(*c*) of the CBCA and the similar provisions of provincial legislation regarding corporations grant the broadest rights to creditors of any common law jurisdiction: see D. Thomson, "Directors, Creditors and Insolvency: A Fiduciary Duty or a Duty Not to Oppress?" (2000), 58(1) *U.T. Fac. L. Rev.* 31, at p. 48. One commentator describes the oppression remedy as "the broadest, most comprehensive and most open-ended shareholder remedy in the common law world": S.M. Beck, "Minority Shareholders' Rights in the 1980s" in *Corporate Law in the 80s* (1982), 311, at p. 312. While Beck was concerned with shareholder remedies, his observation applies equally to those of creditors.

49 The fact that creditors' interests increase in relevancy as a corporation's finances deteriorate is apt to be relevant to, *inter alia*, the exercise of discretion by a court in granting standing to a party as a "complainant" under s. 238(*d*) of the CBCA as a "proper person" to bring a derivative action in the name of the corporation under ss. 239 and 240 of the CBCA, or to bring an oppression remedy claim under s. 241 of the CBCA.

50 Section 241(2)(*c*) authorizes a court to grant a remedy

> if the powers of the directors of the corporation or any of its affiliates are or have been exercised in a manner
>
> > that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder, creditor, director or officer...

A person applying for the oppression remedy must, in the court's opinion, fall within the definition of "complainant" found in s. 238 of the CBCA:

> (a) a registered holder or beneficial owner, and a former registered holder or beneficial owner, of a security of a corporation or any of its affiliates,
>
> (b) a director or an officer or a former director or officer of a corporation or any of its affiliates,
>
> (c) the Director, or
>
> (d) any other person who, in the discretion of a court, is a proper person to make an application under this Part.

Creditors, who are not security holders within the meaning of para. (*a*), may therefore apply for the oppression remedy under para. (*d*) by asking a court to exercise its discretion and grant them status as a "complainant".

51 Section 241 of the CBCA provides a possible mechanism for creditors to protect their interests from the prejudicial conduct of directors. In our view, the availability of such a broad oppression remedy undermines any perceived need to extend the fiduciary duty imposed on directors by s. 122(1)(*a*) of the CBCA to include creditors.

52 The Court of Appeal, at paras. 99-100, referred to *373409 Alberta Ltd. (Receiver of) v. Bank of Montreal*, [2002] 4 S.C.R. 312, 2002 SCC 81 (S.C.C.), as an indication by this Court that the interests of creditors do not have any bearing on the assessment of the conduct of directors. However, the receiver in that case was representing the corporation's rights and not the creditors' rights; therefore, the case has no application in this appeal. *373409 Alberta Ltd.* involved an action taken by the receiver on behalf of the corporation against a bank for the tort of conversion. The sole shareholder, director and officer of 373409 Alberta Ltd., who was also the sole shareholder, director and officer of another corporation, Legacy Holdings Ltd., had deposited a cheque payable to 373409 Alberta Ltd. into the account of Legacy. While it was recognized, at para. 22, that the diversion of money from 373409 Alberta Ltd. to Legacy "may very well have been wrongful vis-à-vis [373409 Alberta Ltd.]'s creditors" (none of whom were involved in the action), no fraud had been committed against the corporation itself and the bank, acting on proper authority, had not wrongfully interfered with the cheque by carrying out the deposit instructions. The statutory duties of the directors were not at issue, nor were they considered, and no assessment of the creditors' rights was made. With respect, Pelletier J.A.'s broad reading of *373409 Alberta Ltd.* was misplaced.

53 In light of the availability both of the oppression remedy and of an action based on the duty of care, which will be discussed below, stakeholders have viable remedies at their disposal. There is no need to read the interests of creditors into the duty set out in s. 122(1)(*a*) of the CBCA. Moreover, in the circumstances of this case, the Wise brothers did not breach the statutory fiduciary duty owed to the corporation.

B. The Statutory Duty of Care: Section 122(1)(b) of the CBCA

54 As mentioned above, the CBCA does not provide for a direct remedy for creditors against directors for breach of their duties and the C.C.Q. is used as suppletive law.

55 In Quebec, directors have been held liable to creditors in respect of either contractual or extra-contractual obligations. Contractual liability arises where the director personally guarantees a contractual obligation of the company. Liability also arises where the director personally acts in a manner that triggers his or her extra-contractual liability. See P. Martel, "Le 'voile corporatif' — l'attitude des tribunaux face à l'article 317 du Code civil du Québec" (1998), 58 R. du B. 95, at pp. 135-36; *Brasserie Labatt ltée c. Lanoue*, [1999] J.Q. No. 1108 (C.A. Que.), *per* Forget J.A., at para. 29. It is clear that the Wise brothers cannot be held contractually liable as they did not guarantee the debts at issue here. Extra-contractual liability is the remaining possibility.

56 To determine the applicability of extra-contractual liability in this appeal, it is necessary to refer to art. 1457 of the C.C.Q.:

> Every person has a duty to abide by the rules of conduct which lie upon him, according to the circumstances, usage or law, so as not to cause injury to another.
>
> Where he is endowed with reason and fails in this duty, he is responsible for any injury he causes to another person by such fault and is liable to reparation for the injury, whether it be bodily, moral or material in nature.
>
> He is also liable, in certain cases, to reparation for injury caused to another by the act or fault of another person or by the act of things in his custody. [Emphasis added]

Three elements of art. 1457 of the C.C.Q. are relevant to the integration of the director's duty of care into the principles of extra-contractual liability: who has the duty ("every person"), to whom is the duty owed ("another") and what breach will trigger liability ("rules of conduct"). It is clear that directors and officers come within the expression "every person". It is equally clear that the word "another" can include the creditors. The reach of art. 1457 of the C.C.Q. is broad and it has been given an open and inclusive meaning. See *Regent Taxi & Transport Co. v. Congrégation des petits frères de Marie*, [1929] S.C.R. 650 (S.C.C.), *per* Anglin C.J., at p. 655 (rev'd on other grounds, [1932] 2 D.L.R. 70 (Que. K.B.)):

> ...to narrow the prima facie scope of art. 1053 C.C. [now art. 1457] is highly dangerous and would necessarily result in most meritorious claims being rejected; many a wrong would be without a remedy.

This liberal interpretation was also affirmed and treated as settled by this Court in *Lister v. McAnulty*, [1944] S.C.R. 317 (S.C.C.), and *Hôpital Notre-Dame de l'Espérance c. Laurent* (1977), [1978] 1 S.C.R. 605 (S.C.C.).

57 This interpretation can be harmoniously integrated with the wording of the CBCA. Indeed, unlike the statement of the fiduciary duty in s. 122(1)(*a*) of the CBCA, which specifies that directors and officers must act with a view to the best interests of the corporation, the statement of the duty of care in s. 122(1)(*b*) of the CBCA does not specifically refer to an identifiable party as the beneficiary of the duty. Instead, it provides that "[e]very director and officer of a corporation in exercising his powers and discharging his duties shall ... exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances." Thus, the identity of the beneficiary of the duty of care is much more open-ended, and it appears obvious that it must include creditors. This result is clearly consistent with the civil law interpretation of the word "another". Therefore, if breach of the standard of care, causation and damages are established, creditors can resort to art. 1457 to have their rights vindicated. The only issue thus remaining is the determination of the "rules of conduct" likely to trigger extracontractual liability. On this issue, art. 1457 is explicit.

58 The first paragraph of art. 1457 does not set the standard of conduct. Instead, it incorporates by reference s. 122(1)(*b*) of the CBCA. The statutory duty of care is a "duty to abide by [a rule] of conduct which lie[s] upon [them], according to the ... law, so as not to cause injury to another". Thus, for the purpose of determining whether the Wise brothers can be held liable, only the CBCA is relevant. It is therefore necessary to outline the requirements of the duty of care embodied in s. 122(1)(*b*) of the CBCA.

59 That directors must satisfy a duty of care is a long-standing principle of the common law, although the duty of care has been reinforced by statute to become more demanding. Among the earliest English cases establishing the duty of care were *Dovey v. Cory*, [1901] A.C. 477 (Eng. H.L.); *Brazilian Rubber Plantation & Estates Ltd., Re*, [1911] 1 Ch. 425 (Eng. Ch. Div.); and *City Equitable Fire Insurance Co., Re* (1924), [1925] 1 Ch. 407 (Eng. C.A.). In substance, these cases held that the standard of care was a reasonably relaxed, subjective standard. The common law required directors to avoid being grossly negligent with respect to the affairs of the corporation and judged them according to their own personal skills, knowledge, abilities and capacities. See McGuinness, *supra*, at p. 776: "Given the history of case law in this area, and the prevailing standards of competence displayed in commerce generally, it is quite clear that directors were not expected at common law to have any particular business skill or judgment".

60 The 1971 report entitled *Proposals for a New Business Corporations Law for Canada* (1971) ("Dickerson Report") culminated the work of a committee headed by R.W. V. Dickerson which had been appointed by the federal government to study the need for new federal business corporations legislation. This report preceded the enactment of the CBCA by four years and influenced the eventual structure of the CBCA.

61 The standard recommended by the Dickerson Report was objective, requiring directors and officers to meet the standard of a "reasonably prudent person" (vol. II, at p. 74):

> **9.19**
>
> (1) Every director and officer of a corporation in exercising his powers and discharging his duties shall
>
> . . . . .
>
> (b) exercise the care, diligence and skill of a reasonably prudent person.

The report described how this proposed duty of care differed from the prevailing common law duty of care (vol. I, at p. 83):

> **242.** The formulation of the duty of care, diligence and skill owed by directors represents an attempt to upgrade the standard presently required of them. The principal change here is that whereas at present the law seems to be that a director is only required to demonstrate the degree of care, skill and diligence that could reasonably be expected from him, having regard to his knowledge and experience -- *Re City Equitable Fire Insurance Co.*, [1925] Ch. 425 -- under s. 9.19(1)(b) he is required to conform to the standard of a reasonably prudent man. Recent experience has demonstrated how low the prevailing legal standard of care for directors is, and we have sought to raise it significantly.

> We are aware of the argument that raising the standard of conduct for directors may deter people from accepting directorships. The truth of that argument has not been demonstrated and we think it is specious. The duty of care imposed by s. 9.19(1)(b) is exactly the same as that which the common law imposes on every professional person, for example, and there is no evidence that this has dried up the supply of lawyers, accountants, architects, surgeons or anyone else. It is in any event cold comfort to a shareholder to know that there is a steady supply of marginally competent people available under present law to manage his investment. [Emphasis added.]

62 The statutory duty of care in s. 122(1)(*b*) of the CBCA emulates but does not replicate the language proposed by the Dickerson Report. The main difference is that the enacted version includes the words "in comparable circumstances", which modifies the statutory standard by requiring the context in which a given decision was made to be taken into account. This is not the introduction of a subjective element relating to the competence of the director, but rather the introduction of a contextual element into the statutory standard of care. It is clear that s. 122(1)(*b*) requires more of directors and officers than the traditional common law duty of care outlined in, for example, *City Equitable Fire Insurance Co., Re*, *supra*.

63 The standard of care embodied in s. 122(1)(*b*) of the CBCA was described by Robertson J.A. of the Federal Court of Appeal in *Soper v. R.* (1997), [1998] 1 F.C. 124 (Fed. C.A.), at para. 41, as being "objective subjective". Although that case concerned the interpretation of a provision of the *Income Tax Act*, it is relevant here because the language of the provision establishing the standard of care was identical to that of s. 122(1)(*b*) of the CBCA. With respect, we feel that Robertson J.A.'s characterization of the standard as an "objective subjective" one could lead to confusion. We prefer to describe it as an objective standard. To say that the standard is objective makes it clear that the factual aspects of the circumstances surrounding the actions of the director or officer are important in the case of the s. 122(1)(*b*) duty of care, as opposed to the subjective motivation of the director or officer, which is the central focus of the statutory fiduciary duty of s. 122(1)(*a*) of the CBCA.

64 The contextual approach dictated by s.122(1)(*b*) of the CBCA not only emphasizes the primary facts but also permits prevailing socio-economic conditions to be taken into consideration. The emergence of stricter standards puts pressure on corporations to improve the quality of board decisions. The establishment of good corporate governance rules should be a shield that protects directors from allegations that they have breached their duty of care. However, even with good corporate governance rules, directors' decisions can still be open to criticism from outsiders. Canadian courts, like their counterparts in the United States, the United Kingdom, Australia and New Zealand, have tended to take an approach with respect to the enforcement of the duty of care that respects the fact that directors and officers often have business expertise that courts do not. Many decisions made in the course of business, although ultimately unsuccessful, are reasonable and defensible at the time they are made. Business decisions must sometimes be made, with high stakes and under considerable time pressure, in circumstances in which detailed information is not available. It might be tempting for some to see unsuccessful business decisions as unreasonable or imprudent in light of information that becomes available *ex post facto*. Because of this risk of hindsight bias, Canadian courts have developed a rule of deference to business decisions called the "business judgment rule", adopting the American name for the rule.

65 In *Pente Investment Management Ltd. v. Schneider Corp.* (1998), 42 O.R. (3d) 177 (Ont. C.A.), Weiler J.A. stated, at p. 192:

> The law as it has evolved in Ontario and Delaware has the common requirements that the court must be satisfied that the directors have acted reasonably and fairly. The court looks to see that the directors made a *reasonable* decision *not a perfect* decision. Provided the decision taken is within a range of reasonableness, the court ought not to substitute its opinion for that of the board even though subsequent events may have cast doubt on the board's determination. As long as the directors have selected one of several reasonable alternatives, deference is accorded to the board's decision [references omitted]. This formulation of deference to the decision of the Board is known as the "business judgment rule". The fact that alternative transactions were rejected by the directors is irrelevant unless it can be shown that a particular alternative was definitely available and clearly more beneficial to the company than the chosen transaction
>
> [reference omitted]. [Emphasis added; italics in original.]

66 In order for a plaintiff to succeed in challenging a business decision he or she has to establish that the directors acted (i) in breach of the duty of care and (ii) in a way that caused injury to the plaintiff: W.T. Allen, J.B. Jacobs, and L.E. Strine, Jr., "Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law" (2001), 26 *Del. J. Corp. L.* 859, at p. 892.

67 Directors and officers will not be held to be in breach of the duty of care under s. 122(1)(*b*) of the CBCA if they act prudently and on a reasonably informed basis. The decisions they make must be reasonable business decisions in light of all the circumstances about which the directors or officers knew or ought to have known. In determining whether directors have acted in a manner that breached the duty of care, it is worth repeating that perfection is not demanded. Courts are ill-suited and should be reluctant to second-guess the application of business expertise to the considerations that are involved in corporate decision making, but they are capable, on the facts of any case, of determining whether an appropriate degree of prudence and diligence was brought to bear in reaching what is claimed to be a reasonable business decision at the time it was made.

68 The trustee alleges that the Wise brothers breached their duty of care under s. 122(1)(*b*) of the CBCA by implementing the new procurement policy to the detriment of Peoples' creditors. After considering all the evidence, we agree with the Court of Appeal that the implementation of the new policy was a reasonable business decision that was made with a view to rectifying a serious and urgent business problem in circumstances in which no solution may have been possible. The trial judge's conclusion that the new policy led inexorably to Peoples' failure and bankruptcy was factually incorrect and constituted a palpable and overriding error.

69 In fact, as noted by Pelletier J.A., there were many factors other than the new policy that contributed more directly to Peoples' bankruptcy. Peoples had lost $10 million annually while being operated by M & S. Wise, which was only marginally profitable and solvent with annual sales of $100 million (versus $160 million for Peoples), had hoped to improve the performance of its new acquisition. Given that the transaction was a fully leveraged buyout, for Wise and Peoples to succeed, Peoples' performance needed to improve dramatically. Unfortunately for both Wise and Peoples, the retail market in eastern Canada had become very competitive in the early 1990s, and this trend continued with the arrival of Wal-Mart in 1994. At paras. 153 and 155, Pelletier J.A. stated:

> [TRANSLATION] In reality, it was that particularly unfavourable financial situation in which the two corporations found themselves that caused their downfall, and it was M. & S. that, to protect its own interests, sounded the charge in December, rightly or wrongly judging that Peoples Inc.'s situation would only worsen over time. It is crystal-clear that the bankruptcy occurred at the most propitious time for M. & S.'s interests, when inventories were high and suppliers were unpaid. In fact, M. & S. recovered the entire balance due on the selling price and almost all of the other debts it was owed.
>
> . . . . .
>
> ...the trial judge did not take into account the fact that the brothers derived no direct benefit from the transaction impugned, that they acted in good faith and that their true intention was to find a solution to the serious inventory management problem that each of the two corporations was facing. Because of an assessment error, he also ignored the fact that Peoples Inc. received a sizable [sic]consideration for the goods it delivered to Wise. Lastly, I note that the act for which the brothers were found liable, i.e. <u>the adoption of a new joint inventory procurement policy, is not as serious as the trial judge made it out to be and that, in opposition to his view, the act was also not the true cause of the bankruptcy of Peoples Inc.</u> [Emphasis added.]

70 The Wise brothers treated the implementation of the new policy as a decision made in the ordinary course of business and, while no formal agreement evidenced the arrangement, a monthly record was made of the inventory transfers. Although this may appear to be a loose business practice, by the autumn of 1993, Wise had already consolidated several aspects of the operations of the two companies. Legally they were two separate entities. However, the financial fate of the two companies had become intertwined. In these circumstances, there was little or no economic incentive for the Wise brothers to jeopardize the interests of Peoples in favour of the interests of Wise. In fact, given the tax losses that Peoples had carried forward, the companies had every incentive to keep Peoples profitable in order to reduce their combined tax liabilities.

71 Arguably, the Wise brothers could have been more precise in pursuing a resolution to the intractable inventory management problems, having regard to all the troublesome circumstances involved at the time the new policy was implemented. But we, like the Court of Appeal, are not satisfied that the adoption of the new policy breached the duty of care under s. 122(1)(*b*) of the CBCA. The directors cannot be held liable for a breach of their duty of care in respect of the creditors of Peoples.

72 The Court of Appeal relied on two additional provisions of the CBCA that in its view could rescue the Wise brothers from a finding that they breached the duty of care: ss. 44(2) and 123(4).

73 Section 44 of the CBCA, which was in force at the time of the impugned transactions but has since been repealed, permitted a wholly-owned subsidiary to give financial assistance to its holding body corporate:

> **44.**(1) Subject to subsection (2), a corporation or any corporation with which it is affiliated shall not, directly or indirectly, give financial assistance by means of a loan, guarantee or otherwise
>
> . . . . .
>
> (2) A corporation may give financial assistance by means of a loan, guarantee or otherwise
>
> . . . . .
>
> (c) to a holding body corporate if the corporation is a wholly-owned subsidiary of the holding body corporate;

74 While s. 44(2) as it then read qualified the prohibition under s. 44(1), it did not serve to supplant the duties of the directors under s. 122(1) of the CBCA. The Court of Appeal erred in concluding that s. 44(2) served as a blanket legitimization of financial assistance given by wholly-owned subsidiaries to parent corporations. In our opinion, it is incumbent upon directors and officers to exercise their powers in conformity with the duties of s. 122(1).

75 Although s. 44(2) authorized certain forms of financial assistance between corporations, this cannot exempt directors and officers from potential liability under s. 122(1) for any financial assistance given by subsidiaries to the parent corporation.

76 When faced with the serious inventory management problem, the Wise brothers sought the advice of the vice-president of finance, David Clément. The Wise brothers claimed as an additional argument that in adopting the solution proposed by Clément, they were relying in good faith on the judgment of a person whose profession lent credibility to his statement, in accordance with the defence provided for in s. 123(4)(*b*) (now s. 123(5)) of the CBCA. The Court of Appeal accepted the argument. We disagree.

77 The reality that directors cannot be experts in all aspects of the corporations they manage or supervise shows the relevancy of a provision such as s. 123(4)(*b*). At the relevant time, the text of s. 123(4) read:

> **123.** ...
>
> . . . . .
>
> (4) A director is not liable under section 118, 119 or 122 if he relies in good faith on
>
> (a) financial statements of the corporation represented to him by an officer of the corporation or in a written report of the auditor of the corporation fairly to reflect the financial condition of the corporation; or
>
> (b) a report of a lawyer, accountant, engineer, appraiser or other person whose profession lends credibility to a statement made by him.

78 Although Clément did have a bachelor's degree in commerce and 15 years of experience in administration and finance with Wise, this experience does not correspond to the level of professionalism required to allow the directors to rely on his advice as a bar to a suit under the duty of care. The named professional groups in s. 123(4)(*b*) were lawyers, accountants, engineers, and appraisers. Clément was not an accountant, was not subject to the regulatory overview of any professional organization and did not carry independent insurance coverage for professional negligence. The title of vice-president of finance should not automatically lead to a conclusion that Clément was a person "whose profession lends credibility to a statement made by

him." It is noteworthy that the word "profession" is used, not "position". Clément was simply a non-professional employee of Wise. His judgment on the appropriateness of the solution to the inventory management problem must be regarded in that light. Although we might accept for the sake of argument that Clément was better equipped and positioned than the Wise brothers to devise a plan to solve the inventory management problems, this is not enough. Therefore, in our opinion, the Wise brothers cannot successfully invoke the defence provided by s. 123(4)(*b*) of the CBCA but must rely on the other defences raised.

C. The Claim under Section 100 of the BIA

79 The trustee also claimed against the Wise brothers under s. 100 of the BIA. That section reads:

> **100.**(1) Where a bankrupt sold, purchased, leased, hired, supplied or received property or services in a reviewable transaction within the period beginning on the day that is one year before the date of the initial bankruptcy event and ending on the date of the bankruptcy, both dates included, the court may, on the application of the trustee, inquire into whether the bankrupt gave or received, as the case may be, fair market value in consideration for the property or services concerned in the transaction.
>
> (2) Where the court in proceedings under this section finds that the consideration given or received by the bankrupt in the reviewable transaction was conspicuously greater or less than the fair market value of the property or services concerned in the transaction, the court may give judgment to the trustee against the other party to the transaction, against any other person being privy to the transaction with the bankrupt or against all those persons for the difference between the actual consideration given or received by the bankrupt and the fair market value, as determined by the court, of the property or services concerned in the transaction.

80 The provision has two principal elements. First, subs. (1) requires the transaction to have been conducted within the year preceding the date of bankruptcy. Second, subs. (2) requires that the consideration given or received by the bankrupt be "conspicuously greater or less" than the fair market value of the property concerned.

81 The word "may" is found in both ss. 100(1) and 100(2) of the BIA with respect to the jurisdiction of the court. In *Standard Trustco Ltd. (Trustee of) v. Standard Trust Co.* (1995), 26 O.R. (3d) 1 (Ont. C.A.), a majority of the Ontario Court of Appeal held that, even if the necessary preconditions are present, the exercise of jurisdiction under s. 100(1) to inquire into the transaction, and under s. 100(2) to grant judgment, is discretionary. Equitable principles guide the exercise of discretion. We agree.

82 Referring to s. 100(2) of the BIA, in *Standard Trustco, supra*, at p. 23, Weiler J.A. explained that:

> When a contextual approach is adopted it is apparent that although the conditions of the section have been satisfied the court is not obliged to grant judgment. The court has a residual discretion to exercise. The contextual approach indicates that the good faith of the parties, the intention with which the transaction took place, and whether fair value was given and received in the transaction are important considerations as to whether that discretion should be exercised.

We agree with Weiler J.A. and adopt her position; however, this appeal does not turn on the discretion to ultimately impose liability. In our view, the Court of Appeal did not interfere with the trial judge's exercise of discretion in reviewing the facts and finding a palpable and overriding error.

83 Within the year preceding the date of bankruptcy, Peoples had transferred inventory to Wise for which the trustee claimed Peoples had not received fair market value in consideration. The relevant transactions involved, for the most part, transfers completed in anticipation of the busy holiday season. Given the non-arm's length relationship between Wise and its wholly-owned subsidiary Peoples, there is no question that these inventory transfers could have constituted reviewable transactions.

84 We share the view of the Court of Appeal that it is not only the final transfers that should be considered. In fairness, the inventory transactions should be considered over the entire period from February to December 1994, which was the period when the new policy was in effect.

85 In *Skalbania (Trustee of) v. Wedgewood Village Estates Ltd.* (1989), 37 B.C.L.R. (2d) 88 (B.C. C.A.), the test for determining whether the difference in consideration is "conspicuously greater or less" was held to be not whether it is conspicuous to the parties at the time of the transaction, but whether it is conspicuous to the court having regard to all the relevant factors. This is a sound approach. In that case, a difference of $1.18 million between fair market value and the consideration received by the bankrupt was seen as conspicuous, where the fair market value was $6.6 million, leaving a discrepancy of more than 17 percent. While there is no particular percentage that definitively sets the threshold for a conspicuous difference, the percentage difference is a factor.

86 As for the factors that would be relevant to this determination, the court might consider, inter alia: evidence of the margin of error in valuing the types of assets in question; any appraisals made of the assets in question and evidence of the parties' honestly held beliefs regarding the value of the assets in question; and other circumstances adduced in evidence by the parties to explain the difference between the consideration received and fair market value: see L.W. Houlden and G.B. Morawetz, *Bankruptcy and Insolvency Law of Canada* (3rd ed. (loose-leaf)), vol. 2, at p. 4-114.1.

87 Over the lifespan of the new policy, Peoples transferred to Wise inventory valued at $71.54 million. As of the date of bankruptcy, it had received $59.50 million in property or money from Wise. As explained earlier, the trial judge adjusted the outstanding difference down to a balance of $4.44 million after taking into account, *inter alia*, the reallocation of general and administrative expenses, and adjustments necessitated by imported inventory transferred from Wise to Peoples. Neither party disputed these figures before this Court. We agree with the Court of Appeal's observation that these findings directly conflict with the trial judge's assertion that Peoples had received no consideration for the inventory transfers on the basis that the outstanding accounts were "neither collected nor collectible" from Wise. Like Pelletier J.A., we conclude that the trial judge's finding in this regard was a palpable and overriding error, and we adopt the view of the Court of Appeal.

88 We are not satisfied that, with regard to all the circumstances of this case, a disparity of slightly more than six percent between fair market value and the consideration received constitutes a "conspicuous" difference within the meaning of s. 100(2) of the BIA. Accordingly, we hold that the trustee's claim under the BIA also fails.

89 In addition to permitting the court to give judgment against the other party to the transaction, s. 100(2) of the BIA also permits it to give judgment against someone who was not a party but was "privy" to the transaction. Given our finding that the consideration for the impugned transactions was not "conspicuously less" than fair market value, there is no need to consider whether the Wise brothers would have been "privy" to the transaction for the purpose of holding them liable under s. 100(2). Nonetheless, the disagreement between the trial judge and the Court of Appeal on the interpretation of "privy" in s. 100(2) of the BIA warrants the following observations.

90 The trial judge in this appeal had little difficulty finding that the Wise brothers were privy to the transaction within the meaning of s. 100(2). Pelletier J.A., however, preferred a narrow construction in finding that the Wise brothers were not privy to the transactions. He held, at para. 136, that:

> [TRANSLATION] ... the legislator wanted to provide for the case in which a person other than the co-contracting party of the bankrupt actually received all or part of the benefit resulting from the lack of equality between the respective considerations.

To support this direct benefit requirement, Pelletier J.A. also referred to the French version which uses the term *ayant intérêt*. While he conceded that the respondent brothers received an indirect benefit from the inventory transfers as shareholders of Wise, Pelletier J.A. found this too remote to be considered "privy" to the transactions (paras. 140-41).

91 The primary purpose of s. 100 of the BIA is to reverse the effects of a transaction that stripped value from the estate of a bankrupt person. It makes sense to adopt a more inclusive understanding of the word "privy" to prevent someone who might receive indirect benefits to the detriment of a bankrupt's unsatisfied creditors from frustrating the provision's remedial purpose. The word "privy" should be given a broad reading to include those who benefit directly or indirectly from and have

knowledge of a transaction occurring for less than fair market value. In our opinion, this rationale is particularly apt when those who benefit are the controlling minds behind the transaction.

92 A finding that a person was "privy" to a reviewable transaction does not of course necessarily mean that the court will exercise its discretion to make a remedial order against that person. For liability to be imposed, it must be established that the transaction occurred: (a) within the past year; (b) for consideration conspicuously greater or less than fair market value; (c) with the person's knowledge; and (d) in a way that directly or indirectly benefited the person. In addition, after having considered the context and all the above factors, the judge must conclude that the case is a proper one for holding the person liable. In light of these conditions and of the discretion exercised by the judge, we find that a broad reading of "privy" is appropriate.

IV. Disposition

93 For the foregoing reasons, we would dismiss the appeal with costs to the respondents.

Appeal dismissed.

Pourvoi rejeté.

Footnotes

* Iacobucci J. took no part in the judgment.

CT-2022-002

THE COMPETITION TRIBUNAL

IN THE MATTER OF the *Competition Act*, R.S.C. 1985, c.C-34;

AND IN THE MATTER OF the proposed acquisition by Rogers Communications Inc. of Shaw Communications Inc.;

AND IN THE MATTER OF an application by the Commissioner of Competition for an Order pursuant to section 92 of the *Competition Act*.

B E T W E E N:

COMMISSIONER OF COMPETITION

Applicant

and

ROGERS COMMUNICATIONS INC. AND SHAW COMMUNICATIONS INC.

Respondents

and

VIDEOTRON LTD.

Intervenor

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(For the Commissioner's Closing Argument)

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