PUBLIC

THE COMPETITION TRIBUNAL

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

IN THE MATTER OF an application by the Commissioner of Competition under section 92 of the *Competition Act*;

AND IN THE MATTER OF a joint venture between Saskatchewan Wheat Pool Inc. and James Richardson International Limited in respect of port terminal grain handling in the Port Vancouver.

BETWEEN:

THE COMMISSIONER OF COMPETITION

Applicant

- AND -

SASKATCHEWAN WHEAT POOL INC.,

JAMES RICHARDSON INTERNATIONAL LIMITED

6362681 CANADA LTD. AND 6362699 CANADA LTD.

Respondents

REPLY OF THE COMMISSIONER OF COMPETITION

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PART 1 - OVERVIEW

1. This is the Reply of the Commissioner of Competition (the "Commissioner") to the Response of the Respondents Saskatchewan Wheat Pool Inc.("SWP"), 6362681 Canada Ltd., and 6362699 Canada Ltd. (collectively the "SWP Response") and to the Response of the Respondent James Richardson International Limited ("JRI"). The two Responses will be collectively referred to as the "Responses". The Responses to the Application of the Commissioner pursuant to section 92 of the *Competition Act* R.S. 1985, c. C-34, as amended, (the "Act") seeking to prohibit the joint venture ("JV") between the parties were served and filed on February 3, 2006 .

2. The capitalized terms herein have the same meaning as those defined in paragraph 6 of the SGMF.

PART II - ADMISSIONS AND DENIALS

3. The Commissioner agrees with the grounds and material facts contained in paragraphs 9 through 13, 15, 20, 32, 34, 41, 42, 43, 46 through 50, 56, 61, 71, 88, 99, and 133 of SWP's Response and paragraphs 2, 13 through 20, 22, 23, 24, 27, 29, 31, 34, 35, 36, 38, 40, 43, 47, 49 through 54, 56 through 60, 64, 72, 73, 80, 104, 105, 112, 114, 125, 126,

127, 158, 159, 162, 184, 191, 197, 203, 207, 209, 222, 223, 224, and 238 of JRI's Response.

4. The Commissioner agrees in part with paragraph 45 of SWP's Response, but as is discussed in paragraph 12 below, the Commissioner states that section 69 of the *Canada Grain Act* ("*CGA*") is neither a timely nor effective remedy for Non-Integrated Graincos who may be refused port terminal services.

5. The Commissioner agrees with paragraph 67 of SWP's Response, but asserts that "direct hit" shipments are not a competitive alternative to port terminal grain handling facilities as discussed in more detail in paragraph 35 below.

6. With respect to the characterisation of the Canadian Wheat Board ("CWB") and its powers found in paragraphs 47, 48, 49 and 50 of SWP's Response and paragraphs 50 and 51 of JRI's Response, the Commissioner relies on the description of the CWB found in paragraphs 24 and 25 of the SGMF and the *Canadian Wheat Board Act,* R.S.C. 1985, C. c-24 and regulations thereunder.

7. The Commissioner denies each and every other ground and material fact contained in each of SWP's Response and JRI's Response.

PART III - ISSUES RAISED IN THE RESPONSES

8. Both SWP and JRI, in their respective Responses, challenge the Commissioner's position on relevant product and geographic market. As developed more fully in the paragraphs that follow, the Commissioner asserts that many of the arguments made by the Respondents are either incorrect or exaggerated. In a number of cases the Respondents refer to possibilities that are neither practicably feasible nor likely to be realized in the near term. This is also true of the Respondents' arguments with respect to barriers to entry, effective remaining competition and the effect of the regulatory environment.

A. Regulatory Environment

9. Prior to 1995, the CGC set maximum tariffs for services offered at port terminals but this practice ceased after the amendments of December 15th, 1994, to sections 50 and 51 of the *CGA*. Contrary to what the Respondents allege in paragraph 44 of the Response of SWP and paragraphs 59, 61 and 62 of the Response of JRI, the CGC does not regulate nor exercise effective regulatory control over the pricing of grain handling services at port terminals. There is an obligation for licencees under the *Canada Grain Act* ("*CGA*") to establish and file with the CGC a tariff schedule setting out the prices for various services offered by port grain handling terminals. While it is true that the rates charged by port terminal operators cannot exceed the rates filed, the level of the filed rates is not

controlled or constrained by the CGC and these tariffs can be amended at any time.

10. It is stated in paragraph 44 of SWP's Response that, upon written complaint and after a hearing, the Canadian Grain Commission ("CGC") may, by order, fix a maximum charge for services provided by licensees. This mechanism, however, was a transitional provision which ceased to be in force as of July 31, 1996 (subsection 51(5) of the *CGA*).

11. In respect of paragraph 44 of SWP's Response and paragraphs 61 to 63 of JRI's Response, the Commissioner states that no regulations have been enacted pursuant to section 116(m) of the *CGA* and there is no evidence that the CGC intends to adopt any such regulation in the future.

12. At paragraph 45 of SWP's Response and at paragraph 60 of JRI's Response, the Respondents submit that section 69 of the *CGA* obliges port terminal operators to receive into their facilities all grain delivered, without discrimination, and in the order in which it arrives, subject to available storage space. Furthermore, the Respondents submit that the CGC has the authority to make specific orders to enforce this section. The Commissioner states that section 69 of the *CGA* is neither a timely nor effective remedy for Non-Integrated Graincos who may be refused port terminal services.

B. Product Market

13. The Commissioner stated in paragraphs 27 and 28 of the SGMF, and continues to assert, that the relevant product market is port grain terminal handling services. The Respondents allege in paragraph 53 of SWP's Response and paragraph 76 of JRI's Response that port terminal grain handling services "are not, collectively, a unique service for which there are no practical substitutes." In addition, the Respondents allege in paragraphs 53 to 64 of SWP's Response and paragraphs 78 to 87 of JRI's Response that each port terminal grain handling service provided by the JV is within a separate and distinct product market.

Bundling of Port Terminal Grain Handling Services

14. Without the bundling of elevation, grain loading, storage, segregation and blending services provided at a port terminal, there is simply no practical alternative means of delivering grain to a vessel. As a result, a hypothetical monopolist of port grain handling services in Canadian west coast ports would likely be able to impose and sustain a significant and non-transitory increase in price.

15. The loading and elevation services provided at a port terminal are a critical link between

the ultimate customer and sellers of grain such as the CWB and, in the case of non-CWB grain, grain companies or farmers. The fact that elevation services are provided at primary grain elevators does not at all affect the need to have grain elevation done again at the port. Elevation at primary terminals is therefore not a substitute to elevation at port terminals for any grain shipments.

16. Other than in limited cases of direct-hit shipments, which are discussed at paragraphs 34 and 35 below, all bulk grain shipments that arrive at ports for export require storage services. Most shipments do not arrive at the port terminal at the same time as the vessel that receives them. Once a grain shipment is unloaded from a rail car, it must remain in a licensed facility until it is loaded onto a vessel. Accordingly, the availability of storage services at primary elevators is of no help in solving this timing problem. The only alternative for shippers would be to hold the grain in rail cars until the vessel arrives, which is costly. While JRI concedes in paragraph 89 of its Response that storage in-country is not a perfect substitute for storage at the port terminal, it is apparent from the Respondents' Responses that storage in-country is not a close substitute. At paragraph 22 of SWP's Response and paragraph 44 of JRI's Response, the Respondents argue that one of the factors that necessitate the JV is the limited storage capacity at JRI's port facility. If JRI could readily substitute in-country storage for port storage, the limited storage capacity at JRI's facility would not be problematic. The Respondents' own arguments, in short, assume that port storage and country storage are not close substitutes.

17. Segregation and blending services are key to providing customers with grain that best fits their needs at minimum cost. Unless a port terminal provides segregation services, an "average" mixture of all the grades and protein levels received by a port terminal would result, and the ability of the CWB or of other sellers of grains to adequately serve customers who require specific quality characteristics would be diminished. Without the ability to segregate, a terminal could only ship one quality of one grain at a time. Similarly, unless a port terminal offers blending services, the CWB and other sellers would not be able to adequately serve a customer that requires a particular grade and/or protein level. The ability to serve individual customers' needs in a cost-effective way is a key element of the CWB and other sellers' marketing efforts.

18. Cleaning services make up only a small fraction of the total revenue received by port terminals from Non-Integrated Graincos for port terminal grain handling services since a significant percentage of cleaning is already being done at primary grain elevators. Currently, all Non-Integrated Graincos clean all of the volume they can in-country to export specifications.

19. Once grain is unloaded at a port terminal, it would be prohibitively expensive to purchase the services of elevation, storage, segregation, blending or vessel loading from either another port terminal or primary grain elevators. Thus, a port terminal customer buys a

"bundle" of services from that particular port terminal. Accordingly, a single provider of all port grain handling services would have the ability to impose and sustain a significant and non-transitory increase in the sum of the charges for all of these services.

Alleged Separate Product Markets

20. Through paragraphs 54 to 64 of SWP's Response and paragraphs 76 and 79 to 87 of JRI's Response, the Respondents assert that port grain handling services consist of a number of discrete services, each of which must be considered in its own separate relevant market, and that "[t]here are a number of competitive alternatives for each of the various grain handling services supplied by port terminals."

21. With the possible exception of cleaning, none of the above noted port terminal services has an acceptable substitute. The Commissioner also notes that for CWB grains, the Non-Integrated Graincos pay for cleaning at port, but the CWB pays for the other port terminal handling services. However, while Non-Integrated Graincos can clean grain at their primary elevators, rather than purchasing cleaning services from port grain handling terminals, an increase in the price of cleaning at port would not significantly affect their behaviour when purchasing the bundle of port handling services. This is because, as discussed in paragraph 18, Non-Integrated Graincos already clean all of the volume that they can in-country to export specifications. Even if cleaning is seen as a separate

market, it does not diminish the market power of the port grain handling terminal as it has market power in respect of the remaining bundle of port terminal grain handling services.

Alleged Grain Transportation Alternatives

22. The Respondents further allege in paragraphs 65 to 69 of SWP's Response and in paragraphs 88 to 117 of JRI's Response that there are alternatives to transporting grain so as to entirely bypass port terminal grain handling facilities. Such alleged alternatives include a) containerized shipping, b) direct-hit shipments, c) shipping through Vancouver Wharves, and d) direct rail shipments to customers.

23. For the reasons stated in paragraphs 29, 30 and 31 of the SGMF and more fully developed in the following paragraphs of the Reply, the Commissioner continues to assert that containerized shipping, direct-hit shipments, shipping through Vancouver Wharves and direct rail shipments are not competitive alternatives to the port terminal grain handling services provided by the JV. Each of the Commissioner's positions with respect to these matters are discussed in detail below.

a) Containerized Shipments of Grain

24. The Commissioner stated in paragraph 28 of the SGMF that port terminal grain handling

services are a distinct product market without practical substitutes for shipment of grain to international customers. The Respondents contest that assertion.

25. In paragraph 68 of SWP's Response and paragraphs 4, 76, 77, 94 and 96 of JRI's Response, the Respondents have argued that containerized shipment of grain is a viable alternative to the bulk handling of grain and is therefore another means by which shippers can bypass the bulk handling facilities of port terminals. In paragraph 69 of SWP's Response and in paragraphs 100, 101 and 117 of JRI's Response, the Respondents have concluded that the relevant product market should include alternative means of grain transportation in general, and containerized shipments in particular. The Commissioner disagrees with these conclusions.

26. Containers have historically been used mainly for shipping certain specialty grains (e.g. peas, lentils, beans, mustard seed, canary seed, etc.) and malt barley. Because the volume of specialty crops in Western Canada is much smaller than that of major grains, it is more amenable to ship such specialty grains in smaller quantities (i.e. by container). It is important to note that these specialty grains represented less than 4.3 % of all the grain shipped through the Port of Vancouver in 2005[1]. As well, since segregation and blending are not required when handling specialty grains, thus eliminating the need to store large

[1] Port of Vancouver, Cargo Statistics Report, January to December 2005 / 2004

volumes at port facilities, containerized shipping is a possible alternative. Accordingly, while major grains are almost exclusively shipped in bulk, specialty grains have characteristics that make them more amenable to containerized shipping.

27. As acknowledged in paragraph 65 of SWP's Response, unlike specialty grains, only a very small percentage of major grains are shipped by containers through the Port of Vancouver. In fact, in 2004, only 0.27% of all the canola and 0.34% of all the wheat exported through the Port of Vancouver was shipped by containers. It is noteworthy that the combined volume of wheat and canola represented 91% of all the grain that went through the Port of Vancouver during the last two years.

28. In paragraph 103 of its Response, JRI states that increasingly large quantities of grain are being exported from Canada through containerized shipments, but then provides statistics on the volume of containerized shipments of grain from the United States. The fact remains that containers are largely used to ship smaller quantities of specialty grains, malt barley and identity preserved grains[2]. There are significant administrative burden of shipping grain via containers which is another disincentive to using containers for large shipments. For instance, each container needs a set of Customs documents whereas there

[2] "Identity Preserved" or "IP grain" is grain that is segregated from other parcels of grain from farm to ultimate destination. Movement of IP grain through the handling and transportation system should be accompanied by a paper trail.

will only be one set of documents for a bulk shipment. Thus, 25,000 tonnes shipped by container will require more than 1,000 containers, each with a set of Customs documents. Therefore, a significant and non-transitory price increase of port terminal grain handling charges at Canadian west coast grain handling ports is not likely to induce grain shipments away from bulk handling to containers.

29. For all of the reasons stated in paragraphs 28 and 29 of the SGMF and in paragraphs 26 to 28 above, the Commissioner maintains that the containerized shipment of grain is not a competitive alternative to the bulk shipment of grain and thus should not be included in the relevant product market.

Fairview NewContainer Terminal in Prince Rupert

30. The Respondents, having argued that containerized shipments of grain should be included in the relevant product market, which is denied by the Commissioner, go on to state in paragraphs 68 and 86 of SWP's Response and in paragraphs 7, 110 and 111 of JRI's Response that a new container shipping facility will become operational in 2007 at the Port of Prince Rupert. In paragraph 115 of JRI's Response, the Respondent states that this facility will have the capacity to be a viable and effective competitor to the Joint Venture with respect to the supply of the relevant grain handling services. The Commissioner denies this assertion.

31. In paragraph 110 of JRI's Response, the Respondent advanced that this new container terminal is being promoted as a significant supplier of containerized shipments of grain from Western Canada to Asia and other export markets. In fact, this new container terminal called "Fairview" has been promoted by CN and the Prince Rupert Port Authority as an opportunity to move a number of products between Asia and North American mid-western markets. Such products include forest products, paper, pulp, plastics, modular home manufacturing, window/door frames, processed food products, specialty agricultural products, and other commodities.

32. It is important to note that the promoters of the Fairview facility have advertised their facility as being able to ship many types of non-agricultural products and specialty grains. Specialty grains include buckwheat, canary seed, lentils, rye, chickpeas, mustard seeds and sunflower. This is consistent with the current trends in the types of grains that are shipped by container, as discussed in paragraphs 26 to 28 above. Furthermore, as indicated in paragraph 26 above, these grains account for a small proportion of all the grain exported through the Port of Vancouver.

33. For all the reasons stated above, containerized shipments of grain in general and containerized shipments of grain through the Fairview terminal in particular, will not effectively compete with bulk grain handling facilities and will not constrain the pricing of the JV terminals.

b) Direct-Hit Shipments

34. "Direct-hit" shipping is the operation by which grain shipments from primary elevators are directly unloaded from railcars onto ocean-going vessels at the port. In paragraphs 67 and 69 of the Response of SWP and paragraph 101 of the Response of JRI, the Respondents argue that direct-hit shipments are a competitive alternative to the services supplied by the JV, as they permit shippers of grain to bypass port terminal facilities. Hence, the Respondents submit that direct-hit shipments should be included in the relevant product market. The Commissioner denies this allegation.

35. As stated in paragraph 30 of the SGMF, direct-hit shipments are not an acceptable substitute to port terminal grain handling services because of the extremely precise logistics that are required. The operation of matching train arrivals to a vessel is difficult and very risky, and direct-hit shipments entail a host of other logistical problems. Rail demurrage can impose significant additional costs to shippers. Furthermore, neither segregation nor blending is possible at the port through this method of shipping grain.

c) Vancouver Wharves

36. The Commissioner is of the view that Vancouver Wharves is not part of the product market relevant to this matter for the reasons stated in paragraph 31 of the SGMF. The

Respondents contest that assertion.

37. Vancouver Wharves handles various bulk commodities including mineral concentrates, pulp & paper, sulphur, fertilizers and agriproducts. With respect to grain handling, it has equipment specially designed for the soft handling of grain and this part of Vancouver Wharves' business has focussed on the handling of specialty grains such as peas, lentils, canary and mustard seeds, identity-preserved grains etc.

38. Vancouver Wharves has limited licensed grain storage capacity of 25,000 tonnes. The lack of storage capacity is a severe constraint on the ability to handle significant volume of conventional grain. As a consequence the grain must arrive "just-in-time" with vessel arrivals. With the lack of storage capacity, grain cannot be segregated at this port facility. The importance and necessity of segregating grain at the port terminal is highlighted by the Respondents' Responses in paragraphs 17, 18, 21, 24, 121 and 123 of SWP's Response and paragraphs 57, 66, 67, 68, 222, 223, 224, and 225 of JRI's Response.

39. In reply to paragraphs 187 and 188 of JRI's Response and paragraphs 85 and 93 of SWP's Response, the Commissioner states that neither Vancouver Wharves nor Neptune Bulk Terminals (Canada) Ltd. are likely to expand their grain handling services.

d) Direct Shipments to Continental Markets

40. In paragraph 69 of the Response of SWP and in paragraphs 101 and 117 of the Response of JRI, the Respondents assert that truck and rail shipments to continental customers must be included in the relevant product market. The Commissioner denies this assertion. In direct shipments from the Prairies to continental customers, trucking and rail transportation modes are not used as a replacement or substitute to port terminal grain handling services. They do not access the same end-customers as port grain terminals. The issue of direct truck and rail shipments as it relates to geographic market is discussed in paragraphs 60 and 61 below.

C. Geographic Market

Primary Elevators Are Not Part of the Relevant Market

41. In paragraph 70 of SWP's Response and paragraph 118 of JRI's Response, the Respondents submit that the relevant geographic market in the provision of services such as blending, cleaning and elevation should include all of Western Canada because, in the Respondents' view, the JV competes with primary grain elevators in the supply of such services. The Commissioner asserts that since primary grain elevators are not close substitutes to port grain terminals in the provision of this set of services (see paragraphs 14 to 21 pertaining to the relevant product market), they are therefore not part of the

relevant geographic market.

Ports in the Relevant Geographic Market

42. The Respondents assert that the ports of Churchill, Thunder Bay and the St. Lawrence Seaway ports, as well as U.S. ports, are competitive alternatives to Canadian west coast ports and should be included in the relevant geographic market. The Commissioner denies this assertion. As indicated by the Respondent in paragraph 71 of the Response of SWP, the fees charged by port terminal operators are a small component of the total cost of handling and transporting grain from the farmer to its destination. As a result, a significant and non-transitory increase in port terminal fees would not likely induce a change of the export corridor used to effect the sale of the grain. The Commissioner asserts that grain shippers' port selection is based on the destination of grain shipments rather than relative port terminal charges between ports located in different export corridors, as illustrated in the following paragraphs.

<u>**Other Canadian Ports**</u>

a) Export Markets Served by various Canadian Ports

43. As indicated in paragraph 32 of the SGMF, in recent years, approximately 95% of all the bulk grain from Western Canada destined for Asia has passed through the ports of

Vancouver and Prince Rupert. In fact, during the 2003-2004 crop year, 100% of the canola, 98% of the barley, and 95 % of the wheat originating in Western Canada and shipped to Asia passed through Canadian west coast grain handling port terminals. The Commissioner asserts that this is strong evidence that other ports have not been competitive alternatives to Canadian west coast ports for grain shipments from Canada to Asian markets. Furthermore, approximately three-quarters of the volume of grain exported off-shore from the Canadian west coast ports during the last five years were shipped to Asia.

44. Shipments of grain from Canadian west coast ports have been destined to various export markets in the following proportions:

TABLE - A - **Export Markets served by Canadian west coast ports**

Destination of grain shipments through Canadian west coast ports (percentage of total grain volume shipped)

Markets \ Crop Years	**2003-04**	**2002-03**	**2001-02**	**2000-01**
Asia	75.6 %	77.2 %	71.4 %	74.3 %
South America	14.5 %	15.1 %	15.3 %	13.1 %
Mexico	4.9 %	6.5 %	8.6 %	9.2 %
Western Europe	2.8 %	0	2.0 %	1.9 %
Africa	1.7 %	0.6 %	1.8 % %	1.2 %
All other markets	0.5 %	0.6 %	0.9 %	0.3 %

45. Ports located in Churchill, Thunder Bay and on the St. Lawrence Seaway serve different export markets than the Canadian west coast ports. In addition, the port at Thunder Bay is closed 3 months of the year during the winter and the port at Churchill is only open approximately 4 months of the year. As pointed out in paragraph 126 of JRI's Response and illustrated in the following table, Europe and Africa are the two primary grain markets for these ports:

TABLE - B - **<u>Export Markets served by Churchill, Thunder Bay and the St. Lawrence Seaway</u> - Destination of grain shipments through the ports of Churchill, Thunder Bay and the St. Lawrence Seaway (percentage of total grain volume shipped)**

Markets \ Crop Years	2003-04	2002-03	2001-02	2000-01
Western Europe	47.9 %	34.8 %	27.8 %	27.8 %
Africa	26.4 %	43.2 %	42.0 %	40.4 %
South America	9.1 %	11.3 %	16.6 %	14.4 %
United States	5.3 %	2.9 %	3.7 %	4.9 %
Eastern Europe	4.2 %	0.1 %	0.5 %	0.7 %
Asia	3.7 %	2.8 %	5.8 %	6.8 %
Mexico	3.4 %	5.0 %	3.6 %	5.1 %

46. The major markets served by Canadian west coast ports are located across the Pacific while the primary markets served by the ports of Churchill, Thunder Bay and those on the St. Lawrence Seaway are located across the Atlantic. Churchill, Thunder Bay and the St. Lawrence Seaway ports are clearly not competitive alternatives to Canadian west coast

ports for grain movements from Western Canada to Asian markets.

47. Canadian west coast ports have also dominated shipments to South American markets. Grain shipments from Canadian west coast ports have accounted for more than 60% of the total volume of grain shipped from Canada to South America during the 2003-2004 crop year.

b) Redirection of Grain Volumes between Export Corridors and other Markets

48. In paragraphs 71 to 76 of SWP's Response and paragraphs 120 to 134 of JRI's Response, the Respondents assert that an increase in costs in one market or along one export corridor will, at the margin, redirect volumes to other export corridors and other markets. The Respondents claim that port terminal facilities at both the Port of Vancouver and Prince Rupert are disciplined by port facilities located in Thunder Bay, Churchill, Sorel, Quebec City and Montreal. To this end, the Respondents submit that these ports must be included in the relevant geographic market. The Commissioner denies these assertions.

49. The lock-out in Vancouver provides an example of a very substantial increase in costs in one port market, which can be used to test the Respondents' assertions. A review of the proportion of annual grain volumes exported through the various Canadian ports and other gateways (i.e. direct shipments to continental markets) since the 1999/2000 crop year indicates that the vast majority of the volume lost by the Port of Vancouver during

the four-month lock-out in the Fall of 2002 went to the Port of Prince Rupert. Thus, faced with a complete inability to ship grain through Vancouver, the majority of exporters did not turn to other markets, but rather diverted the routing of their shipments to Prince Rupert. It is important to note that for many of these shippers, particularly those located on CP lines, the redirection of their shipments to Prince Rupert increased the costs of shipping their grain to off-shore markets significantly. Nevertheless, these shippers used Prince Rupert rather than redirecting their shipments to other export markets. Under these circumstances, it is doubtful that any significant redirection of grain shipments to other export markets would occur if there were a significant and non-transitory increase in the prices of port terminal grain handling services at Canadian west coast ports.

50. Furthermore, it is also important to note that during the Vancouver lock-out, other Canadian ports were not used to any greater extent to serve the major markets served by the Canadian west coast ports. Rather than decreasing during the lock-out period, the share of all the grain shipments to Asia accounted for by the west coast ports actually increased from 95.23 % the previous year to 97.08 % during the lock-out. Canadian west coast ports' share of grain export shipments to South America decreased only marginally from 55.4 % to 54 % during these same years.

51. For the reasons stated in paragraphs 42 to 50 above, other Canadian ports are not close competitive alternatives to Canadian west coast ports.

U.S. Ports

52. The Commissioner states in paragraph 56 of the SGMF that US port terminals in the Pacific North-West are not a close substitute for port grain terminals services at Canadian west coast ports. The Respondents contest that assertion.

a) Rail rates to access U.S. ports

53. The Commissioner stated in paragraph 56 of the SGMF that rail rates are approximately \$12 per tonne, or 37%, higher from Western Canada to Portland or Seattle, as compared to Vancouver. This statement was based on a review of CN's published rates in 2005 for transporting grain in covered hopper cars from a sample of 14 origination points in Western Canada to Vancouver versus Seattle and Portland. In paragraph 94 of SWP's Response and paragraph 198 of JRI's Response, the Respondents indicated that rail costs are variable depending upon the point of origin thus implying that U.S. ports are a close substitute to Vancouver port terminal grain handling services .

54. In paragraph 198 of its Response, JRI added that, depending on the origin of the grain, transportation to a port located within the United States may be achieved at the same or lower rail cost than Vancouver. The Commissioner denies this allegation. CN's current published rail rates for moving grain from as many as 200 different locations in Western Canada to Vancouver versus Seattle and Portland indicate that in all cases, the rail costs

to Seattle and Portland are higher and, in most cases, much higher than rail costs to Vancouver. In fact, the average differential in rail rates, weighted by grain shipment volumes by province to Vancouver, are more than $13 per tonne, or 40%, higher from Western Canada to Portland or Seattle, as compared to Vancouver.

55. With respect to the allegations set out in paragraphs 75 and 94 of SWP's Response and in paragraph 196 of JRI's Response, the Commissioner points out that whether the grain may be shipped from Western Canada to these U.S. ports in order to reach the Carribean or other export markets located closer to these ports, is not relevant to the question of determining whether these ports could be competitive alternatives. That is, Canadian west coast ports are used primarily for shipping grain to Asian markets as stated in paragraph 32 of the SGMF. Ports located in the Gulf of Mexico would be a much more circuitous route to ship grain from Western Canada to Asia, thus adding considerable costs and time as compared to using the ports of Vancouver or Prince Rupert. Moreover, published rail rates from Saskatchewan to ports in Louisiana are, on average, 47% higher than to Vancouver. In addition, there would be extra time and costs involved in the ocean shipping segment of such routing.

b) Handling costs at U.S. ports

56. The Commissioner denies that lower rates at U.S. ports offset any additional rail costs required to access these ports as suggested in paragraphs 75 and 94 of SWP's Response

and paragraphs 128 and 199 of JRI's Response. The question is not whether U.S. ports provide services at lower rates, but whether such savings, if they exist, offset additional rail and other costs. They do not. Major grain shippers in Western Canada have indicated that they have never shipped any significant volume of grain to U.S. ports as an alternative to shipping through Canadian west coast ports. In fact, these shippers did not even use U.S. ports as an alternative to Vancouver during the 2002-2003 lock-out at the port of Vancouver.

c) Other complications in using U.S. Ports

57. The Commissioner notes that Canadian grain moving through the U.S. must be segregated from U.S. grain through the handling system so as to preserve the Canadian quality and grading specifications.

58. In addition, complexities may arise when shipping through the CGC due to the necessity of grading by the CGC.

59. Given the fact that Canadian grain shippers have not used U.S. ports as alternatives to Canadian west coast ports, and that there being noevidence that such will change in the near to medium term, it cannot be said that U.S. Ports are a substitute for Canadian west coast grain handling port terminals.

Direct Truck and Rail Shipments to North American Continental Markets

60. In paragraph 136 of the JRI's Response, the Respondent submits that the relevant geographic market must include alternative transportation systems or corridors, such as direct rail shipments. The Commissioner denies this assertion.

61. These direct truck and rail shipments serve customers located in different markets than those passing through the Canadian west coast grain handling port terminals. Furthermore, contrary to what is implied in paragraph 72 of SWP's Response and in paragraph 121 of JRI's Response, the Commissioner affirms that these direct shipments would not exercise an effective constraint on the prices of port terminal grain handling facilities at facilities located on the Canadian west coast. During the lock-out at the Port of Vancouver, no significant volume was diverted from the Canadian west coast gateway to continental markets. As a matter of fact, the proportion of Canadian grain exports accounted for by these direct export shipments from Prairie elevators, far from increasing during the crop year of the Vancouver lock-out, actually decreased to less than 12% of all grain exports from 15% during the previous year. Faced with a complete inability to ship grain through the Port of Vancouver, grain exporters did not switch to direct shipments of grain to continental customers. Clearly, these direct grain shipments are not a substitute for shipping grain through Canadian west coast grain handling port terminals.

D. Market Shares

62. In paragraphs 83 of the Response of SWP and paragraph 145 of the Response of JRI, the Respondents allege that even if the relevant market is limited to Vancouver and Prince Rupert, the Commissioner has omitted to include the capacity and receipts of Prince Rupert Grain Ltd. ("PRG") from the table at paragraph 37 of the SGMF which would have brought the combined market share of the JV well below the 35% threshold set out in the Merger Enforcement Guidelines of the Competition Bureau. The Commissioner restates that PRG is not an independent competitor as it is jointly controlled by all the current owners of the Vancouver port grain terminals, as pointed in paragraph 39 of the SGMF and in paragraph 66 below. As a result, one cannot include all the capacity or receipts of PRG as if it were an independent competitor for the purpose of market share calculations.

63. The shareholding interests held by each co-tenant of PRG are adjusted from time to time based on the respective volumes that each bring to the PRG terminal. As noted in paragraph 39 of the SGMF, the Respondents had a combined ownership interest in PRG of 38.9%, a level almost equivalent to their combined share of the overall capacity of Vancouver port grain terminals. Once PRG's capacity and volume throughputs for the 2004-2005 crop year are allocated based on the respective shareholding interest of each of its co-tenants, the Respondents have a combined share of the Canadian west coast ports grain handling services market of 38.1% based on licensed storage capacity and of 44.2%

based on volume througputs. Thus, the inclusion of PRG does not change significantly the market concentration structure shown by the table contained in paragraph 37 of the SGMF.

64. In paragraph 81 of the Response of SWP and paragraphs 148, 149 and 150 of the Response of JRI, the Respondents argue that the market shares found in paragraph 37 of the SGMF are overstated as they include both internal transfers of grain and the supply of grain handling services to third parties. The Commissioner denies this allegation. The proper indicators of the market power and the market presence of each competitor in the market are its total capacity and volume handles. The Commissioner also points out that port terminal grain handling fees are charged for grain handling services provided on all CWB grain volume handled by the terminal including on the volume originated from its own primary elevators.

E. Prince Rupert Grain Ltd. (“PRG”)

65. The Commissioner stated in paragraphs 50 to 55 of the SGMF that, even if PRG is in the relevant geographic market, it is not an effective independent competitor to the Vancouver port terminals. The Respondents contest that assertion.

a) PRG: not a vigorous competitor because of its ownership structure

66. The Commissioner denies the allegations found in paragraph 91 and 92 of SWP's Response and paragraph 160 of JRI's Response that PRG operates independently from its shareholders who are also owners of "competing" grain terminals at Vancouver. While day-to-day operational decisions may be left to PRG's management, important strategic decisions affecting PRG are approved by its Co-Tenants' Committee on which all PRG shareholders are represented.

b) PRG lack of connection to the CP rail network

67. In paragraph 92 of SWP's Response and paragraph 163 of JRI's Response, the Respondents argue that although PRG is not directly connected to the CP rail network, PRG is in the same position as the Respondent's two terminals on the North Shore of Burrard Inlet in Vancouver.

68. PRG is clearly more isolated from the CP rail network relative to the two Vancouver terminals of the Respondents. The CP-CN interchange closest to Prince Rupert is in either Edmonton or Kamloops. However, as the CP line goes to the South Shore of Burrard Inlet in Vancouver, the CP-CN interchange point is located only a few kilometres away from the SWP and JRI terminals in Vancouver. As discussed below, by virtue of the rail regulatory framework in Canada, CP-originated grain shipments have competitive

access to the JV terminals. This is not the case for the PRG terminal because the various points of interchange are all located too far away from the point of destination of the rail movements for the relevant rail regulation to apply.

69. For all rail movements where the point of interchange is located within 30 km from the point of delivery, the rate from this point to the point of delivery is set by regulation pursuant to the rail interswitching provisions of the *Canada Transportation Act*. Under the current rail interswitching regulated rate structure, the rates applicable to the interchange of CP cars with CN at Vancouver for delivery to either of the two JV terminals is \$185 per single car or \$50 per car for interswitching a car block of 60 cars or more. This provides CP and grain shippers located on its line competitive access to the JV terminals. Importantly, however, this supportive regulatory mechanism is not available to CP for any rail interchange movements to PRG. The rates and conditions under which CP cars can be interchanged with CN for furtherance to PRG are not regulated but rather set through confidential negotiations between the two railways. Given that CP's published rates to PRG are 12% higher than CN's published rates for same originations, as indicated in paragraph 53 of the SGMF, this implies that CP-originated grain shipments do not have cost competitive access to PRG.

70. Furthermore, in paragraphs 92 of SWP's Response and paragraph 163 of JRI's Response, the Respondents state that CP-originated grain shipments have moved to PRG through an interchange between CP and CN. The Commissioner notes, that on the contrary, no

significant volume of CP originated grain has ever been delivered to PRG except during the Vancouver lock-out. In fact, for all years since the 1996-97 crop year, the movement of grain from CP lines to PRG has accounted for only a very small percentage of the total volume of grain moved to Prince Rupert (i.e. varying between 0 and 3.4 %). Moreover, whenever grain has moved from CP lines to PRG, it has been at CWB's request for the purpose of addressing a particular problem. Such problems include helping to clear a backlog on CP lines created by severe weather conditions and the need to move disease-damaged wheat.

71. SWP claims, in paragraph 92 of its Response, that the cost of rail transportation to Prince Rupert is the same as to Vancouver from most locations in Western Canada. In fact, it is only with respect to CN grain traffic that the cost of rail transportation to Prince Rupert is the same as to Vancouver. As stated at paragraph 53 of the SGMF, CP's published rates to Prince Rupert are 15% higher than its rates to Vancouver, and 12% higher than CN's published rates to Prince Rupert for same originations.

72. The Commissioner also points out that CP's insignificant volume of grain shipments to Prince Rupert is in stark contrast to its large share of the total volume sent to the SWP terminal in Vancouver. Importantly, even though the SWP and JRI terminals are not directly connected to the CP line, as pointed out by both the Respondents in paragraph 92 of SWP'S Response and paragraph 163 of JRI's Response, CP-originated grain accounts for a large proportion of their grain receipts at their terminals. For example, CP-originated

grain has accounted for between 45% and 55% of all the grain that has moved to SWP's terminal during the 3-year period between 2001 and 2004.

73. Over the past three crop years, approximately half of all the grain grown in Western Canada has originated on the CP line. The fact that PRG has not been a competitive gateway for CP-originating grain is a key factor in PRG not being an effective competitor to the JV.

c) PRG's limited handlings of non-Board grains

74. In paragraph 92 of SWP's Response and paragraph 164 of JRI's Response, the Respondents indicate that PRG could be configured to clean canola with minimal sunk costs. However, PRG has not handled any significant tonnage of canola over the last 20 years. The Commissioner notes that the Port of Vancouver has an active canola export market such that shippers are less likely to send canola through Prince Rupert. The Commissioner has no evidence to indicate that this pattern is likely to change.

75. For all of the reasons stated in the SGMF and in paragraphs 66 to 74 above, the Commissioner submits that the effectiveness of PRG as an independent competitor to the JV is limited even when PRG is included in the relevant market.

F. Buyers' Alleged Countervailing Power

76. In paragraphs 174 to 178 of the JRI's Response and paragraphs 117 and 118 of SWP's Response, the Respondents assert that the CWB and Third Party Graincos have a countervailing ability to constrain any exercise of market power by the JV.

77. Admittedly, the CWB has more bargaining power than individual farmers. Indeed, this is one of the principal reasons for its existence. However, the CWB has not been able to constrain steady price increases for port terminal services over time, even in periods of low demand for such services. Furthermore, the ability of both the CWB and Non-Integrated Graincos to switch to other suppliers of port terminal grain handling services is very limited as explained in the various paragraphs above dealing with the relevant product and geographic market.

78. In paragraph 118 of the Response of SWP, the Respondent alleges that the CWB can direct shipments to Prince Rupert without incurring additional costs. This assumes wrongly that PRG is an independent competitor to whom the CWB can turn to if faced with increased prices at Vancouver. In fact, the CWB incurred significant additional costs when it had to redirect CP-originated shipments to PRG during the lock-out at Vancouver as CP published rail rates to PRG are 12% higher than its published rail rates to Vancouver, as stated in paragraphs 69 and 71 above.

G. Alleged Efficiencies

79. The Respondents allege in paragraphs 223 of JRI's Response and 119 of SWP's Response that the proposed JV will lead to efficiency gains that are greater than and offset the anti-competitive effects. Neither JRI's nor SWP's Response provide any quantitative estimates or other information on the magnitude or likelihood of the efficiency gains that they assert the proposed JV is likely to bring about.

80. The Respondents allege in paragraph 234 of JRI's Response and 119 of SWP's Response that the efficiency gains will be lost if the Commissioner is granted the relief requested in the Application. The Respondents have not explained why the alleged efficiency gains could not be made through arms length commercial agreements as opposed to a JV.

PART IV - CONCLUSION

81. If the Respondents are permitted to enter into their proposed JV, this will substantially lessen the competitive options available to Non-Integrated Graincos and to the CWB, thus negatively impacting Canadian grain farmers.

82. Specifically, the proposed JV will likely result in a substantial lessening or prevention of competition in the Canadian west coast port terminal grain handling services market by causing or allowing: 1) grain handling service tariffs charged to both the CWB and Non-Integrated Graincos to increase; 2) diversion premiums paid to Non-Integrated Graincos

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to be reduced or eliminated; and, greater difficulties in obtaining terminal authorization and ready access by Non-Integrated Graincos. Furthermore, because of the vertical integration between port terminal grain handling markets and primary grain elevator markets, the proposed JV will cause or allow similar anti-competitive effects within many local primary grain handling markets.

Mr. Jonathan Chaplan
Mr. André Brantz
Ms. Valérie Chénard
Department of Justice
Competition Law Division
50 Victoria Street
Place du Portage, Phase I, 22nd Floor
Hull, Quebec KIA 0C9
Telephone (819) 953-3895
Facsimile (819) 953-9267

And;

Mr. Andrew J.F. Lenz
Perley-Robertson, Hill & McDougall LLP
90 Sparks Street, 4th floor
Ottawa, Ontario
K1P 1E2
Telephone (613) 566-2842
Facsimile (613) 238-8775

Counsel for the Commissioner of Competition

DATED at Hull, Quebec this 3rd day of March, 2006

Sheridan Scott Q, .C.
Commissioner of Competition
Place du Portage, Phase 1
21st Floor - 50 Victoria Street
Hull, Quebec
KIA OC9

TO: **BALFOUR MOSS LLP**
7th Floor, Bank of Montreal Building
2103 11th Avenue
Regina, Saskatchewan
S4P 4G1

Mr. Peter T. Bergbusch
Tel: 306-347-8328
Fax: 306-347-8351

Solicitors for the Respondent,
Saskatchewan Wheat Pool Inc., 6362681 Canada Ltd.
and 6362699 Canada Ltd.

AND TO: BORDEN LADNER GERVAIS LLP
Robert S. Russell
Adam Fanaki
Scotia Plaza,
40 King Street West
Toronto, Ontario
M5H 3Y4
Solicitors for the Respondent, James Richardson International Limited.

INTERVENORS

Mr. Darin J. Hannaford ant
Miller Thomson LLP
2700, 10155-102 Street
Edmonton, Alberta
T5J 4G8
Telephone: (780) 429 1751
Fax: (780) 424-5866

Counsel to Canadian National Railway Company

Mr. Marc Shannon
Senior Counsel
Gulf Canada Square
401-9th Avenue S.W.
Suite 2000
Calgary, Alberta
T2P 4Z4

Counsel to Canadian Pacific Railway

Mr. Robert W. Grant
Heenan Blaikie LLP
2200-1055 West Hastings Street
Vancouver, British Columbia
V6E 2E9
Telephone: (604) 669-0011
Fax: (604) 669-5101

Counsel to Vancouver Port Authority

Mr.Donald B. Houston
Fraser Milner Casgrain LLP
1 First Canadian Place
P.O. Box 100
100 King Street West
Toronto, ON M5X 1B2
Direct Line: (416) 863-4620
Fax: 416-863-4592

Counsel to the Canadian Wheat Board

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Mr. Jonathan Chaplan
Mr. André Brantz
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Department of Justice
Competition Law Division
50 Victoria Street
Place du Portage, Phase I, 22nd Floor
Hull, Quebec KIA 0C9
Telephone (819) 953-3895
Facsimile (819) 953-9267

And;

Mr. Andrew J.F. Lenz
Perley-Robertson, Hill & McDougall LLP
90 Sparks Street, 4th floor
Ottawa, Ontario
K1P 1E2
Telephone (613) 566-2842
Facsimile (613) 238-8775

Counsel for the Commissioner of Competition

DATED at Hull, Quebec this 3rd day of March, 2006

Sheridan Scott Q, .C.
Commissioner of Competition
Place du Portage, Phase 1
21st Floor - 50 Victoria Street
Hull, Quebec
KIA OC9

PUBLIC

TO: **BALFOUR MOSS LLP**
7th Floor, Bank of Montreal Building
2103 11th Avenue
Regina, Saskatchewan
S4P 4G1

Mr. Peter T. Bergbusch
Tel: 306-347-8328
Fax: 306-347-8351

Solicitors for the Respondent,
Saskatchewan Wheat Pool Inc., 6362681 Canada Ltd.
and 6362699 Canada Ltd.

AND TO: BORDEN LADNER GERVAIS LLP
Robert S. Russell
Adam Fanaki
Scotia Plaza,
40 King Street West
Toronto, Ontario
M5H 3Y4
Solicitors for the Respondent, James Richardson International Limited.

INTERVENORS

Mr. Darin J. Hannaford ant
Miller Thomson LLP
2700, 10155-102 Street
Edmonton, Alberta
T5J 4G8
Telephone: (780) 429 1751
Fax: (780) 424-5866

Counsel to Canadian National Railway Company

Mr. Marc Shannon
Senior Counsel
Gulf Canada Square
401-9th Avenue S.W.
Suite 2000
Calgary, Alberta
T2P 4Z4

Counsel to Canadian Pacific Railway

Mr. Robert W. Grant
Heenan Blaikie LLP
2200-1055 West Hastings Street
Vancouver, British Columbia
V6E 2E9
Telephone: (604) 669-0011
Fax: (604) 669-5101

Counsel to Vancouver Port Authority

Mr.Donald B. Houston
Fraser Milner Casgrain LLP
1 First Canadian Place
P.O. Box 100
100 King Street West
Toronto, ON M5X 1B2
Direct Line: (416) 863-4620
Fax: 416-863-4592

Counsel to the Canadian Wheat Board