

# **Using the Competitive Edge for Consumers**

**Submission**

**of the**

**Public Interest Advocacy Centre (PIAC)**

**to the**

**Competition Policy Review Panel Consultation**

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## **Introduction**

The Public Interest Advocacy (PIAC) is an Ottawa-based non-profit organization that has provided legal services, research and public advocacy on behalf of ordinary and vulnerable consumers since 1976. The work of the Centre concerns the public or consumer interest in the delivery of important public services such as telecommunications, energy, broadcasting, transportation and financial services. In addition, and partially as a result of its involvement with such industries, PIAC has developed a measure of expertise in the fields of competition law, privacy, e-commerce and general consumer protection.

PIAC has long championed the proposition that effective consumer protection and maintenance of markets free of anti-competitive conduct, will result in productive successful domestic industries capable of success in the global economy. PIAC is thus well positioned to respond to the issues within the Panel's mandate, namely the examination of Canadian competition policy with a view to ensuring such policies promote an innovative and productive economy able to face the challenges of a global marketplace.

## **Role of Competition Law and Consumer Protection in Sharpening Canada's Competitive Edge**

The consultation paper identifies the importance of competition as a driver for productivity:

“Competition is a key driver of productivity. The benefits of competition are well known: lower prices and more product choice for consumers, and more efficient, dynamic and innovative firms. Competition promotes quality, efficiency and consistent improvement, and it disciplines firms to the challenges of the marketplace.”

Section 1.1 of the *Competition Act* (also the “Act”) takes a slightly different approach and sees competition as a means of achieving the more fundamental goals of efficiency, expansion of world markets, protection of the opportunity for small businesses to compete, and protection of competitive prices and product choices.<sup>1</sup> There can arise different policy choices where it may be difficult to achieve all of the fundamental goals as these may be in conflict with each other. We will discuss an example of such conflict in relation to mergers.

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<sup>1</sup> Trebilcock et al, *The Law and Economics of Canadian Competition Policy*, University of Toronto Press,(2002), p.39

It is important to note that the Competition Act also contains prohibitions against seller conduct in the marketplace that distorts the manner in which consumers make decisions in the marketplace. These prohibitions, for the most part, attempt to control deceptions that strike at the core of the utility of competitive markets.

As a former FTC chairman, Timothy Muris has noted, a salutary effect of competition is that it provides incentives for sellers to provide information about their products and services to differentiate them from the competition. This effect can be negated by the practices of dishonest sellers, particularly those selling products infrequently purchased.<sup>2</sup> Former Chairman Muris considers the core of modern consumer protection policy as preventing sellers from lying about their products and preventing unfair practices such as unilateral breach of contract or unauthorized billing. He links such policing activities with the maintenance of consumer trust in the market and promoting efficient transactions:

“By striving to keep sellers honest, therefore, consumer protection policy does more than safeguard the interests of the individual consumer – it serves the interest of consumers generally and facilitates competition.”<sup>3</sup>

In his same address, Mr. Muris stresses the importance of rigorous standards of consumer protection in a global economy with digital commerce:

‘Therefore if fraudulent marketers are based in the country that has weakest laws or enforcement structures, and can avoid effective punishment in other jurisdictions in which they do business, the least restrictive jurisdiction could dictate the level of fraud that will be allowed.’

The concept of protecting the transactional interests of consumers as a necessary adjunct to competition has been accepted in other jurisdictions. In Australia, the Productivity Commission issued a draft report in 2007 that attempted to address the necessity of informed choice by consumers in markets and the necessity, in certain circumstances, to intervene to correct market failure or to achieve social justice goals.<sup>4</sup> The relationship between consumer protection and competition was elaborated as follows:

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<sup>2</sup> Prepared Remarks of Timothy J. Muris, The Interface of Competition and Consumer Protection Chairman, Federal Trade Commission At The Fordham Corporate Law Institute’s Twenty-Ninth Annual Conference on International Antitrust Law and Policy New York City October 31, 2002

<sup>3</sup> Ibid at p. 5

<sup>4</sup> *Review of Australia’s Consumer Policy Framework*, Productivity Commission Draft Report, p.29

The role of consumers in facilitating competition, and promoting well-functioning markets, has long been recognized. In seeking the ‘best’ value (the good or service and price/quality combination most appropriate for them) consumers not only advance their own self-interest, but also provide signals to suppliers on the product characteristics they require. Competition between suppliers, who respond to these signals, can variously lead to lower costs, improved product quality, greater innovation and higher productivity.<sup>5</sup>

PIAC’s submission to this Panel could easily be subsumed simply with the topic of the relationship between such consumer protection and the advancement of competition. Similarly a cataloguing of the different elements of the consumer protection matrix, including federal, provincial and common law remedies and the effect of their reform or enhancement on competition, as well as the general efficiency and productivity of Canadian industry would also be germane, but beyond the scope of this submission.

## **PIAC’s Priorities for Panel Action**

As a result of the necessity to focus our comments to meet the limitations herein, PIAC has chosen to direct its submissions in two principal areas: merger remedies enforcement, and new compliance mechanisms. Our priorities reflect both the importance of the suggested reform in the market to the position of our constituent consumers and the fact that they have been policy options studied and recommended for consideration by the OECD.<sup>6</sup> In addition, the new remedies for compliance discussed herein have been recommended and put forward by the Competition Commissioner in the form of Bill C-19, that was introduced but not approved, in the 38<sup>th</sup> Parliament. In PIAC’s view, because of the public processes that have already transpired, the reforms in each of these areas are ripe for consideration by this Panel as measures that can play an important role in ensuring open and honest competition for global commerce by Canadian firms, as well as providing rigorous policing of anti-competitive conduct within Canadian borders.

## **Merger Enforcement**

### **Background**

The present *Competition Act* was enacted in 1986. Any review of the effectiveness of the Canadian competition regime must comprehend the significant differences

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<sup>5</sup> Ibid at p. 28

<sup>6</sup> Canada- Report on Competition Law and Institutions (2004), Organization for Economic Cooperation and Development

between the Canadian economy of 1986 and that of today. There has been an acceleration of the transition from an economy that was primarily resource-based to one that contains a much more broadly diversified mix skewed towards services and which is significantly more integrated into the global economy and global supply chains.

The fear of being overwhelmed by foreign firms was a driver for policy as far back as the introduction of the *Combines Investigations Act* in 1910.<sup>7</sup> Other national economies were larger, and tariff barriers to exports were high, as were transport and communications costs. Policymakers had concluded that Canadian firms could only succeed on a domestic basis and thus, were challenged by economies of scale. The tradition of “national champions” effectively narrowed the focus of even big Canadian players and arguably kept Canadian companies uncompetitive on the world stage with attendant results on the domestic economy.

The “efficiencies defense” in s. 96 of the Act was, in large part, a residue of the approach that was tailored to overcome the perceived disadvantage of Canadian firms. If mergers would likely bring about gains in efficiency that would be greater than, and would offset, anti-competitive effects brought about by the merger, they would be allowed. This meant that the defense became a key measure to help the firms in the Canadian economy achieve economies of scale.

Sec. 96(2) of the Act refers to the ability to meet the foreign competition as a significant factor influencing the merger approval process by referring to efficiency gains that would result in a significant increase in exports or a significant substitution of domestic products for imports as an important consideration when approving a merger. The key question for this Panel is whether the balancing of costs and benefits implicit in the efficiencies defense makes sense in a modern competition policy for Canada. With lower transport and communications costs, are geographic markets the same as they were 22 years ago? Haven’t decreases in tariffs and non-tariff trade barriers, through bilateral agreements such as NAFTA and multilateral agreements such as the Uruguay Round, changed the ambit of markets from local and national, to continental and global in scope?

Clearly in product markets such as telecommunications and financial services, the answer is yes. The international movement of goods of data and services through international broadband traffic has broadened markets with important economic transactions taking place frequently only in the digital sphere. At the same time, the technology itself has created both a convergence in markets by, for example, eliminating distinctions between television, cable and Internet broadcasting.

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<sup>7</sup> S.C. 1910, c.9

As a result, it is questionable, at this juncture, whether Canadian consumers must absorb potential anti-competitive effects in order to allow Canadian firms, to obtain economies of scale and scope. Restricting the level of competition in the Canadian economy is an unlikely solution for encouraging exports and import substitution.

PIAC submits that, in the context of the discussion of merger review, it is useful to first review the objectives of the Act set out in S. 1.1. These objectives are not prioritized, nor is there an effort to relate one to the other. The purpose of the Act is “to maintain and encourage competition in Canada”, in order to

- promote the efficiency and adaptability of the Canadian economy
- expand export opportunities while at the same time recognizing the role of foreign competition in Canada
- ensure that small and medium-sized enterprises “have an equitable opportunity to participate in the Canadian economy”
- provide consumers with competitive prices and product choices.

The first objective, promoting the efficiency and adaptability of the Canadian economy is, itself, a means to an end. Efficiency is desirable because it allows for a greater consumer surplus with attendant affects on parameters such as consumption, leisure, social investment and employment., “Efficiency” must be read in conjunction with the other objectives, and as a means of better attaining them.

As we have noted above in our discussion of sec. 96(2) of the Act that the second objective, directed to improving Canada’s trade balance, is likely obsolete.<sup>8</sup> In fact, in PIAC’s view, the large changes that have been effected in the Canadian economy over the last two decades and the current access by Canadian firms to global markets make any tolerance of reduced competition as a palliative for perceived national handicaps a dubious policy option. It is PIAC’s understanding that, in practice, the provisions of s. 96(2) do not guide the Competition Bureau or the Competition Tribunal’s review of a merger. This should continue.

The third objective of the Act is ostensibly to give small and medium-size businesses “an equitable opportunity to participate in the Canadian economy”. This objective would seem to be grounded in a historic desire to preserve small independent firms, for political and social reasons, and to protect them from

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<sup>8 8</sup> In addition, it is not clear whether or not s. 96(2) runs counter to Canada’s obligations under the WTO

“trusts” and large companies.<sup>9</sup> The objective’s application in practice is somewhat difficult to define. In PIAC’s view, the objective should amplify the overall concepts that vigorous competition in size and numbers is the preferable policy choice for product and service markets, rather than the idea that corporate organization options may be ruled out of or in bounds on the basis of size alone.

The fourth objective, to provide consumers with competitive prices and product choices, targets the achievement of a higher standard of living and a better quality of life.<sup>10</sup> This objective captures the concept that the purpose of efficiency gains, a better balance of trade, and higher employment levels, is to create consumer surplus, that can be used for increased consumption, leisure, or ensuring healthy communities with worthwhile social investment. Lower prices and greater variety should be the first priority of the *Competition Act* in today’s economy. Increasing efficiency should be seen as a means of attaining this priority objective.<sup>11</sup> In PIAC’s view this objective should be the driver for change particularly in the evolution of a competition law regime that must evolve from protection of national champions to one that produces competition that benefits consumers and business.<sup>12</sup>

## **Merger Efficiencies Defense**

As mergers may prevent or substantially lessen competition in a market, sec. 92 of the *Act* gives the Competition Tribunal a variety of tools to prevent such harm from occurring. However, where there are efficiency gains arising as a result of the merger, S. 96(1) provides that a merger will be allowed if the efficiency gains will be greater than, and will offset, the effects of any prevention or lessening of competition that is likely to result.

Efficiency gains may include allocative, productive, and dynamic efficiency gains. In practice, efficiency gains from a merger may include productive efficiency gains, which can come about as a result of reduced costs or greater output.

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<sup>9</sup> This thrust was especially strong in the United States. See for example Richard A. Posner, *Antitrust Law*, 2<sup>nd</sup> Ed. (Chicago: University of Chicago Press, 2001) at 25. Protection of smaller firms seems to have played a much lesser role, if any, in enforcement of competition laws in Canada, which is as it should be.

<sup>10</sup> “price” in PIAC’s submission includes non-price attributes of a product, such as quality.

<sup>11</sup> Many economists hold that increasing efficiency should be the only goal of competition policy. Other goals, according to them, should be pursued through other policy instruments. See for example Michael Trebilcock et. al., *The Law and Economics of Canadian Competition Policy* (Toronto: University of Toronto Press, 2002) at 39. However, these other policy instruments are not always available, or may be very costly to use. In a second-best world, it is important that competition policy, even if it should not be the primary tool to resolve problems such as income redistribution, at least should not aggravate them.

<sup>12</sup> The OECD has been critical of special arrangements either in relation to preference for Canadian small firms or in the approach to quantifying efficiencies in a merger review which may allocate greater weight to shareholder rather than consumer interest. *The Role of Competition Policy in Regulatory Reform in Canada*, 2002

Dynamic efficiency gains from a merger, such as innovation and improved use of technologies and information, may be significant, but are hard to quantify.<sup>13</sup> Finally, as to allocative effects, a substantial lessening of competition would be expected to lead to a reduction of efficiency as output is reduced below competitive levels. The use of a “total surplus standard” in merger review, advises netting out of such allocative efficiency losses against productive and dynamic efficiency gains to come to a conclusive result.

But the total surplus standard ignores income redistribution consequences of the merger. A substantial lessening of competition is normally accompanied by a significant non-transitory price increase: indeed, this is an important observation made by the Competition Bureau and many others. This lessening redistributes income from consumers of the merged firm’s products to the firm itself.<sup>14</sup> The total surplus standard assumes that, if efficiency gains are positive, the “winners” of the redistribution could compensate the “losers” and still be better off.<sup>15</sup>

This standard is consistent with the view that the only objective of competition policy should be maximization of efficiency. However, it is not necessarily consistent with the objectives in the *Competition Act*.<sup>16</sup>

Some observers suggest that the focus of the merger provisions should be limited to efficiency objectives, leaving to other policy instruments the task of correcting any unwanted side effects such as redistribution of income:

The use of competition policy to achieve not merely efficiency but an equitable distribution of wealth would result in an excessively complex and non-transparent set of legal rules that would be both uncertain and arbitrary – being determined by the opinions or values of whoever was sitting on the tribunal in a particular case. Government instruments such as taxes and social insurance are much better suited for the goal of distributing income equitably.<sup>17</sup>

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<sup>13</sup> All of the efficiency gains expected from a merger are very hard to quantify. Indeed, some observers believe that the uncertainty in measuring efficiency gains and losses is so massive that “there should be no general defense of efficiency”: Posner, *op. cit.*, at 133

<sup>14</sup> In turn, the increased revenues will be passed on, in part to employees through higher salaries and benefits, and in part to shareholders through an increase in earnings that is translated into increased share prices. The magnitude of the final incidence is an empirical matter. To simplify the discussion, we refer to shareholder effects and do not discuss employee effects. This has no impact on the arguments advanced.

<sup>15</sup> This is the well-known Kaldor-Hicks criterion for welfare maximization. See Richard A. Posner, *op. cit.*, at 23.

<sup>16</sup> “The purely legal arguments for total surplus as a criterion to be read directly in section 96 of the *Competition Act* are not persuasive... Section 96 of the Act is ambiguous.” Trebilcock et. al., *op. cit.*, at 149.

<sup>17</sup> Trebilcock et. al., *op. cit.*, at 40.

However, these other instruments may be very costly, and often may not be politically feasible. As a result, the negative non-efficiency impacts of a merger may never be corrected through taxation, social insurance, and other such measures.<sup>18</sup> Indeed, there is a long tradition in the economics literature that claims that adjusting relative prices is one of the more effective means of income redistribution.<sup>19</sup> It is also unclear why the arbitrariness of tolerating allocative efficiency losses and rising prices accruing to certain stakeholders is preferable to a merger enforcement process that attempts to prevent such phenomena.

In any event, s. 96(1) says that efficiency gains are to be greater than, and offset, “the effects of any prevention or lessening of competition”. While these effects include efficiency losses (typically allocative efficiency losses), the wording does not limit “effects” to these. In particular, a merged firm with increased market power would generally be expected to raise its prices, inter alia redistributing income from purchasers of its products to the merged firm. It is PIAC’s view that this redistribution is an effect of the substantial lessening of competition, and should be included when balancing efficiency gains against anti-competitive effects.

Indeed, it is not possible to separate the efficiency effects of a merger from the redistributive effects, without making strong assumptions as to interpersonal comparisons of individuals’ income utility. For example, the total surplus approach implicitly assumes that redistribution does not affect overall utility, i.e. that one person’s losses can simply be netted out against another’s gains. But that is true only if their marginal utilities of income are equal. This is a questionable assumption.

As an illustration, consider a merger that results in a net efficiency gain of \$1 million, accompanied by an increase in prices that transfers \$100 million from consumers to the merged firm. While the final incidence of that \$100 million may be different from the initial incidence, for simplicity assume that the entire \$100 million goes to the firm’s shareholders.<sup>20</sup> The net result is that shareholders as a group are better off by \$101 million, being the beneficiaries of \$100 million in price hikes resulting from a lessening of competition brought about by the merger plus the efficiency gain of 1 million. Consumers, on the other hand, are worse off by the \$100 million price increase. With any weighting that accorded with the

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<sup>18</sup> For example, it is difficult to imagine a tax limited to producers of propane, and tax credits or subsidies targeted just to consumers of propane.

<sup>19</sup> For example, see J de V. Graaff, *Theoretical Welfare Economics* (Cambridge: Cambridge University Press, 1957) at 155 and 171: “By far the simplest way of securing the distribution of wealth we desire is through the price system... [T]inkering with the price system is one of the more feasible and generally satisfactory ways of securing whatever division of wealth is desired.”

<sup>20</sup> As pointed out above, some of the \$100 million will likely also be captured by employees, depending on various elasticities of substitution and the demand for and supply of the kind of labour used by the firm.

valuation placed upon the loss by consumers themselves, say \$1.02 or more, society as a whole would be worse off. The “total surplus” test may thus not be an ideal leveling instrument for measurement.

In fact, most competition authorities use a “consumer surplus standard” in merger reviews including: the United States, European Union, United Kingdom, and Australia.<sup>21</sup> What this means is that reviewing authority must be satisfied that there is an actual improvement in the consumer surplus for merger approval (i.e. the difference between what consumers are *willing to pay* and what they *actually pay*, aggregated across all consumers who purchase the good in question). Under this standard, if improving consumer surplus reduces profits, those lost profits are not taken into account.<sup>22</sup> Thus the efficiency strategies of merging companies may only be pursued up to the point where consumers are not harmed.

The standard assumption in the economics literature is that an extra dollar has more value to a person with a lower level of income. It is reasonable to suppose that, on average, shareholders are better off financially than consumers.<sup>23</sup> If so, evaluation of any measure, that redistributes income from consumers to shareholders, must take into account the loss in aggregate welfare it causes. The “total surplus” test in mergers analysis does not and as such it is incomplete and should not be used.

There may be other reasons to contend that that the “total surplus” standard may be welfare-reducing in practice . In the typical mergers case, a firm has many more consumers than shareholders. Thus, where the merger results in a non-transient

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<sup>21</sup> According to Massimo Motta, *Competition Policy: Theory and Practice* (New York: Cambridge University Press, 2004) at 274: “So far, the EC in its decisions has not explicitly ruled out the possibility of using an efficiency defense, but it has not showed much sympathy for this argument either. Whenever cost reductions have been claimed by the merging parties, the EC has dismissed those claims on various grounds.”

<sup>22</sup> “The Role of the Consumer Harm Test in Competition Policy”, Adrian Majumdar, [http://www.luc.edu/law/academics/special/center/antitrust/pdfs/consumer\\_harm.pdf](http://www.luc.edu/law/academics/special/center/antitrust/pdfs/consumer_harm.pdf)

<sup>23</sup> Some economists question this assumption. They point to the increasingly broad ownership of common stock, both directly and through mutual funds and pension plans (Posner, *op. cit.*, at 24). In cases of luxury goods , such as the Whistler Mountain ski resort, the consumers may be wealthier than the shareholders (Trebilcock et. al., *op. cit.*, at 150). However, recent statistics show that dividend income is heavily concentrated in the upper income levels of Canadians. Thus, for returns reporting income of less than \$20,000, 9.6% reported receiving dividends, while for returns reporting income of more than \$100,000, 52.3% reported receiving dividends. Put another way, grossed-up dividends made up 0.6% of the income of those with income below \$20,000, but 6.8% of the income of those with income above \$100,000. Put yet a third way, of the total amount of dividends reported, 0.9% were reported by taxpayers with incomes of less than \$20,000, while 56.8% were reported by taxpayers with income of more than \$100,000. (Calculated from Canada Revenue Agency, *Income Statistics 2002 – 2000 tax year*, Final Basic Table 2). This calculation does not reflect dividends received within RRSPs or pension plans. Nevertheless, using receipt of dividends as a proxy for share ownership, clearly share ownership is concentrated at upper income levels, where the marginal utility of money is less.

price increase which is smaller than the shareholder profit from greater output or revenue, the redistribution concentrates wealth, inflicting a (smaller) loss on the many, and a (larger) gain on the few. Even if consumers and shareholders started at identical income levels, this redistribution would lead to a loss in welfare (due to declining marginal utility of income).

Currently, the Canadian approach to the efficiencies defense in mergers uses “balancing weights”, as required by the Federal Court of Appeal.<sup>24</sup> Essentially, income redistribution effects will be considered in the efficiencies defense. The weight to be given to a dollar of income distribution, relative to a dollar of efficiency gain, is to be determined on the circumstances of the situation, and may depend on the different socio-economic status of customers and shareholders. Indeed, it is possible that different weights should apply to different classes of customers.

Attempts to attach different weights to impacts on different socio-economic groups have a long history. For example, the issue has long been debated in performing developmental project appraisals in developing countries.<sup>25</sup> In theory, this approach is attractive, allowing the flexibility and discretion to take into consideration the circumstances of each case. In practice, however, this very flexibility and discretion leads to significant disadvantages.<sup>26</sup>

First, how are the different classes of affected customers and shareholders to be determined? If weights are to vary according to income levels or socio-economic status, how many categories should there be, and what are the cut-off levels? Should other factors, such as geographic location, be important, e.g. if the losses are to customers in Canada but the gains largely to shareholders in another country? To the degree that some of the costs or benefits flow to employees, rather than to customers or shareholders, should these be identified and weighted separately?

Second, should losses and gains be weighted differently? This suggestion follows from the finding in behavioural economics that on average people are more concerned by a loss than by a gain of equal magnitude.<sup>27</sup>

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<sup>24</sup> *Commissioner of Competition v. Superior Propane Inc.* (2001), 11 C.P.R. (4<sup>th</sup>) 289 (April 4, 2001)

<sup>25</sup> “The use of variable weights on gains and losses to different income groups has been the most controversial issue in cost-benefit analysis in recent years. Many considerations have been raised in discussions of this issue, ranging from practical and procedural questions to moral values and political process.” Anandarup Ray, *Cost-Benefit Analysis: Issues and Methodologies* (Baltimore: Johns Hopkins Press for the World Bank, 1984) at 22.

<sup>26</sup> Trebilcock et. al., *op. cit.*, at 150; Posner, *op. cit.*, at 24

<sup>27</sup> <sup>27</sup> Tversky, A. and D. Kahneman (1992), “Advances in prospect theory: cumulative representation of uncertainty”, 5 *J. Risk and Uncertainty* 297. See also Barberis, N. and R. Thaler, “A Survey of Behavioral

Third, once the categories are chosen, how are the weights to be selected? Should benefits to one category receive one and a half times the weight of those to another category? twice the weight? three times the weight? Is there a risk that the process to choose weights would become highly politicized?

Fourth, before the weights can be applied, gains and losses must be measured by category. Presumably it is the final incidence of these gains and losses that is important. But such measurements require large quantities of information that might be very difficult to obtain.

These considerations lead PIAC to conclude that, while the balancing weights approach has many attractive features in theory, in practice it is extremely difficult and controversial to implement. Further, it can cause considerable uncertainty among parties contemplating a merger. Since the weights might vary from case to case, the case law would be of limited use in reducing this uncertainty.<sup>28</sup>

Over and above the practical difficulties of implementation, PIAC has some reservations about the public policy justification for the balancing weights approach. Essentially, the underpinning of the approach is a utilitarian one, whereby it is acceptable for certain members of society to lose, as long as others gain enough to be able to more than make them whole.<sup>29</sup> Note, however, that the approach does not require the winners to actually compensate the losers, only to have the potential to do so. The losers remain losers.

It is thus not clear to PIAC why, in the context of a merger that prevents or substantially lessens competition, it is acceptable for shareholders to obtain benefits that exceed the magnitude of the efficiency gains generated, where the surplus comes at the expense of losses to customers. There are also practical considerations. A consumer standard is administratively less cumbersome. As one analyst has noted:

“While measuring *whether* consumers have been harmed is by no means easy, measuring consumer harm *accurately* and then trading off gains in profits is even harder”<sup>30</sup>

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Finance”, Chapter 18 in Constantinides, G.M., M. Harris and R. Stultz, eds., *Handbook of the Economics of Finance* (Elsevier Science, 2003) at 1080.

<sup>28</sup> Note the critical comments of the OECD in the 2004 Report at footnote # supra

<sup>29</sup> This is the Hicks-Kaldor criterion for welfare-enhancing changes.

<sup>30</sup> Majumdar at p.2

PIAC concludes that if the efficiency defense found in s. 96 is retained, efficiency gains should satisfy the “consumer surplus” standard; i.e. they must not result, or be likely to result, in significantly higher prices to customers. Adoption of a consumer surplus standard by Canada would be a step toward harmonization with some of our major trading nation partners.

The retention of the current formulation subverts the objectives of competition and open markets by simply saddling some stakeholders with the burdens of a merger arrangement and giving others the benefits of the same .

## **New Operational Tools for Compliance**

### **Administrative Monetary Penalties**

Today, Canadian and global regulators face conflicting demands to attempt to minimize state interference in commerce, and yet, at the same time take responsibility for meeting statutory objectives. As a result of these pressures, regulators are increasingly seeking to expand their regulatory regime by attempting to obtain compliance in the most efficient way possible. This is primarily done by adding new tools to their enforcement toolkit such as performance-based ratemaking , benchmarking and the like.

Enforcement is an essential component in any regulatory system for the simple fact that an inability to enforce rules and regulations effectively removes the regulator from influencing market conduct. There are, of course , two important aspects of enforcement - identification of misconduct and the rectification of the same. The rectification response of the regulator must not only deal effectively with the particular breach, but also send a message to others in the regulated community that such violations will not be tolerated.

It is in this context that the practice of levying Administrative Monetary Penalties (AMPs) has attracted the attention of Canadian and international regulators. AMPs are civil penalties in the form of large monetary charges that are imposed upon individuals and business entities usually in a summary fashion by regulatory tribunal. They are not considered punitive in nature or amounting to criminal or quasi-criminal sanctioning of the misconduct. Their purpose is to deter repetition of the conduct by the offender and other regulated entities by virtue of the size of the penalty and the swiftness of its imposition.

AMPs have been widely heralded as providing a more flexible and responsive regulatory structure that balances the competing interests of stakeholders. They are increasingly used to engender compliance and cooperation from the ‘regulated

community', to secure environmental or consumer protection and timely rectification of market problems.<sup>31</sup>

Bill C-19 introduced in 2005 attempted to deploy the potential of AMPs in the anti-trust/consumer protection setting. Administrative remedies can be applied by the Competition Tribunal, or by a court of competent jurisdiction when necessary.<sup>32</sup> Bill C-19 would have allowed the Competition Tribunal to impose an Administrative Monetary Penalty (AMP) if it found that a person or company abused its dominant position, in contravention of s.79 of the Act. Under the provisions of s.79 of the Act, in deciding whether a violation exists or not, the Competition Tribunal must consider three criteria, whether:

- one or more persons substantially or completely controls, throughout Canada or any area thereof, a class or species of business,
- those people have engaged in a practice of anti-competitive acts, and
- that the practice prevents or lessens competition substantially in a market,

Bill C-19, would have allowed the Competition Tribunal to impose AMPs on any person or corporation in order to prevent the repetition of such anti-competitive acts. The amount of the penalty was \$10 million or less for the first offence, and \$15 million or less for subsequent offences. Additionally, three factors, gross revenue, actual or anticipated profits generated through the abuse of dominance, and the financial position of the person against whom the order is made, were added as factors in the making of an AMP.

Bill C-19 also proposed amendments regarding AMPs levied against deceptive marketing violations set out in Part VII.1 of the Act in 3, 5 and 6. Under the current Act, AMPs imposed to address deceptive marketing are limited to \$50,000 or less for a first offence and \$100,000 or less for subsequent offences<sup>33</sup>. In the case of corporations, AMPs are restricted to \$100,000 for a first offence and \$200,000 for subsequent offences.

Bill C-19 also increased monetary penalties for individuals and corporations that use deceptive marketing practices. Individuals may pay as much as \$750,000 for a first offence and \$1,000,000 for a subsequent offence (an increase of \$700,000 and \$900,000 respectively). Corporations would have paid as much as \$10,000,000

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<sup>31</sup> Austl., Commonwealth, Australian Law Reform Commission, *Pamphlet 3 – Civil and Administrative Penalties* (December 2000) [ALRC Pamphlet 3]. Online: ALRC <<http://138.25.65.50/au/other/alrc/publications/intro/3/index.html>>.

<sup>32</sup> Recall that deceptive marketing offences can be either criminal or civilly reviewable and thus adjudicated by either a criminal court or the Competition Tribunal as the case may be. See note 15, *supra*.

<sup>33</sup> S. 74.1(1)(c)

for a first offence and \$15,000,000 for a subsequent offence (an increase of \$9.9 Million and \$14.8 Million respectively).<sup>34</sup>

The AMP provisions in the former Bill C-19 recognized that misleading advertising not only is financially damaging to those consumers that are induced to buy or act as a result of misrepresentation, but corrosive to the other businesses that are unable to compete with the misleading offer and whose reputation may be affected by the shoddy practice.

Abuse of dominant position can be enormously beneficial to the dominant player if it forces competitors to exit the market. This is particularly the case in markets involving new entrant competitors with high costs of entry. The elimination of choice can be a precursor to uncompetitive pricing and quality for consumers.

As well, Canada is a country with high levels of concentration in many markets, particularly when compared to the United States- a phenomenon that is likely to be a difficult match for any innovation agenda. The competitiveness of Canadian markets cannot be lamented on the one hand while the other denies the Competition Commissioner the tools to help alleviate the problem.

PIAC strongly supports the introduction of Administrative Monetary Penalties (AMPs) as a remedy available to the Competition Tribunal in cases of abuse of dominance. This will give enforcement of the *Competition Act* some much-needed “teeth”. At present, the only remedies are forward-oriented injunction-like orders to “cease and desist” from anti-competitive conduct, or, in rare circumstances, to take positive action.

The present scheme leaves it open to firms to engage in conduct that may well be anti-competitive, aggressively exploring the bounds of what the Competition Bureau and Competition Tribunal will accept. If the conduct turns out to be abusive, the only real consequence is that the firm will be ordered not to do it any more. As a result, as a firm weighs the benefits and costs of potentially anti-competitive conduct, at present the balance is tilted toward the benefits.

The possibility of a meaningful level of AMPs restores the balance between the benefits and costs of such conduct, and will discourage firms from courses of action that are clearly anti-competitive and against consumers’ interests.

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<sup>34</sup> The Act currently makes it a criminal offence to contravene an order made under Parts VII.1 and VIII of the Act. Clause 3 of Bill C-19 makes an exception for the new AMPs that could be imposed under section 74.1(1)(c). Violation of an AMP order made under this section will not attract criminal sanctions. Legislative summary, *supra* note 26, at pp.6.

Some commentators oppose the introduction of AMPs in cases of abusive conduct, saying that the current regime provides a sufficient deterrent effect.<sup>35</sup> In particular, they point to “the significant costs” of being investigated by the Competition Bureau.<sup>36</sup> But this argument amounts to saying that there already is an administrative monetary penalty, imposed by the Competition Bureau in the form of costs of compliance with an investigation. Unfortunately, these costs may not be proportionate to the gravity of the situation, given the nature of the practice, the injury to competition, profits from the practice, and the other factors listed in proposed s. 79(3.2). Such administrative costs can be controlled in large part by the firm being investigated, depending on its responses. Indeed, a firm that has acted in an obviously anti-competitive way may be willing to settle much more quickly, and incur much lower investigation costs, than a firm whose conduct is marginal and who is determined to defend its actions.

In any case, it is important that the Competition Tribunal have the discretion, within the framework of the proposed provisions, to levy AMPs at a level sufficient to discourage anti-competitive conduct in the future. Administrative costs incurred during an investigation are unlikely sufficient to deter anti-competitive conduct in many situations.

Opponents of AMPs also invoke the effects on firms’ reputations of being investigated and being found to have abused a dominant position. They claim that these reputational effects are a sufficient disincentive to firms contemplating conduct that could be anti-competitive.

While some firms no doubt value their reputations highly, and use them as marketing tools, others clearly do not. Anyone who has been exposed to the torrent of consumer complaints that have not been satisfactorily addressed by various companies quickly develops a jaundiced view of the importance of reputation to some.<sup>37</sup> Media reports of findings of anti-competitive conduct are generally buried in the business pages of the newspapers, and may never register with the typical customer.

Some opponents of AMPs argue that their imposition would be unfair because they are, in a sense, retroactive: the conduct complained of had not yet been ruled anti-competitive at the time it occurred. But that is exactly the point, in PIAC’s

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<sup>35</sup> See e.g. Canadian Bar Association, National Competition Law Section, Submission on Bill C-19: Competition Law Amendments (December 2004) at 5.

<sup>36</sup> In a complex society such as ours, firms bear administrative costs of all kinds, for example tax audits. Penalties are still assessed when proper taxes have not been paid, despite associated administrative costs.

<sup>37</sup> If damage to reputation were a sufficient deterrent to misconduct, criminal acts could be punished by prominently publicizing the names and pictures of the guilty, and society could be spared the costs of jails and prisons.

view. Statutes and Competition Bureau guidelines cannot provide for all of the schemes that human ingenuity can dream up, nor should they try to preempt all conduct that might be anti-competitive. Firms must be allowed discretion to design business strategies and otherwise operate their businesses. However, it is important for proper incentives to be in place so that firms, in exercising their discretion, be mindful of the potential anti-competitive aspects and the ensuing consequences. Such experiments in “pushing the envelope” must not be without consequences.

PIAC submits that AMPs are important to correct the imbalance between the costs and benefits of potentially anti-competitive conduct, and to give firms the appropriate incentives.

### **Restitution**

PIAC also strongly supports the clauses in Bill C-19 that provided for restitution in cases of deceptive marketing. Customers are harmed by such conduct, and it is only fair that they be made whole, to the degree possible. While it is true that AMPs are already available as a remedy for deceptive marketing, AMPs will not help consumers who have suffered losses. They are meant to deter future misconduct. Restitution is the only practical way to help consumers.

Some observers are concerned that having both AMPs and restitution is duplicative, and may lead to excessive payments. However, the amount of AMPs is within the discretion of the Competition Tribunal, and can be tailored to the specific circumstances of the case.

Other observers argue that providing for restitution is an inappropriate shift to consumer protection. They go on to state that the focus of the Competition Bureau’s work should be on the protection of the competitive process as a whole and not on individual consumers.<sup>38</sup>

PIAC notes that the objectives of the *Competition Act*, as set out at s. 1.1, read in part:

“...and in order to provide consumers with competitive prices and product choices.”

Product choices require informed consumers, and deceptive marketing practices are intended to defeat informed choices by consumers. The result is harm to consumers. It is this harm that restitution is intended to remedy.

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<sup>38</sup> Public Policy Forum, *National Consultation on the Competition Act: Final Report* (April 8, 2004) at 28

More generally, the invitation to the Competition Bureau to focus on the competitive process as a whole, and not on individual consumers, misses the very purpose of the Act. Competition is not an end in itself. Rather, it is a means to an end – increased social welfare, and ultimately consumers who are better off. To try to make the consumer disappear from the equation is to defeat the very purpose of the Act.

## **Market Studies**

After Bill C-19 was introduced, the Government proposed amendments to that included the controversial suggestion to permit market studies in the *Competition Act*. While this proposed amendment did not advance beyond the Committee stage before the Bill died, it was the centre of considerable debate.

The *Competition Act* does not currently allow for market studies with formal powers to compel production of information into a specific industry. At present, the Act provides powers to investigate a business or individual who is suspected to have contravened the Act. Supporters of the market studies proposal felt that it was an additional tool that could be useful to enable a proactive approach to maintenance of competition. A complaint or prosecutorial driven approach has inherent limitations. Therefore, it is of critical importance that governments have more information on the operation of important industry sectors and markets. At the same time, a review of international respondents disclosed that their competition authorities are vested with similar powers and that they have proven to be valuable assets.<sup>39</sup> For example, the U.S. Federal Trade Commission (FTC) can conduct "research and policy" reports that are not limited in scope. While these tend to be non-adversarial in nature, the FTC does possess subpoena power to get the requisite information.

Conversely, those stakeholders opposed (largely substantial business interests) to a market studies power, have submitted that the Competition Commissioner already has the necessary tools to enforce the *Competition Act* and that the Commissioner could carry out studies by hiring consultants or experts. Furthermore, they have raised concerns about the considerable time and potentially significant costs for both the government and businesses to comply with requests for information. They were also concerned about procedural safeguards against self-incrimination and whether such a power could be used as an inappropriate means of diverting political pressure on the Competition Bureau.<sup>40</sup>

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<sup>39</sup> *Market Studies: A Review by the Competition Bureau*, October 6, 2005 [**Market Studies**] <http://www.competitionbureau.gc.ca/epic/site/cb-bc.nsf/en/01988e.html>.

<sup>40</sup> *Ibid.*

During the Committee hearings on Bill C-19, the Commissioner indicated that the Bureau was still analyzing the viability of market studies and would look at related Charter implications as well as consider in detail how other jurisdictions handle market studies. On this point, the Bureau has found that:

If such market studies are conducted for a legitimate purpose to assess the state of competition in various sectors of the economy, i.e. that they are not a disguised enforcement inquiry, and provided that such a power contains protections against self-incrimination, it could be possible to integrate such a power into the *Competition Act*.<sup>41</sup>

PIAC would support the suggestion to create Commissioner inquiries into the state of competition in a market. Too often there is a reactive, rather than a proactive, approach taken to market regulation. As the arrangements made domestically in any industry may spill over into international markets and vice versa, it is essential to have the national competition authority ahead of the curve, and not simply acting to put out fires on an ex post basis.

PIAC also notes there are few resources that could enable independent market studies if not conducted by the Bureau. Resource constraints impede consumer and public interest groups from undertaking such studies. CITT may have the expertise to undertake such studies. However, there should also be an informed resourced consumer brief on the issue. PIAC strongly supports funded participation by non-commercial public interests in these studies where appropriate.

## **Competition Resources**

For the purposes of this submission, PIAC performed a high level, if somewhat cursory, comparison of the personnel and budgeted resources allocated to competition authorities in various jurisdictions including the United States, Canada, and the EU. No definitive conclusions can be presented herein as to the appropriateness of current Canadian resources for enforcement of competition law. This is principally because it is difficult to control all variables of function for the purpose of making a conclusion. Anecdotally, it would appear that Canadian resources are more concentrated in economic analysis rather than legal and adjudicative review and enforcement.<sup>42</sup> The OECD has also recommended that the Bureau be granted a permanent budget increase to better carry out its mandate.<sup>43</sup>

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<sup>41</sup> *Ibid.*

<sup>42</sup> The Competition Bureau for example has 87 lawyers and 168 economists and professional staff; the two branches of the FTC have 514 lawyers and over 160 paralegals on their 2005 staff component of 1063.

<sup>43</sup> OECD 2004 Report p. 33

PIAC is aware of the fact the Bureau has the resources to pursue only a relative handful of the deceptive marketing complaints made to authorities, and the Competition Tribunal has been asked to review relatively few mergers contested by the Bureau<sup>44</sup>. It would be helpful if there was more transparency concerning the management of competition enforcement resources, particularly why choices have been made to prioritize some misconduct over others, or to accept the lessening of competition in other circumstances. As well, there seems little reason to simply pour AMPs into the entire government's consolidated revenue without enhancing the Bureau's own system of competition and consumer protection.

Finally, it should also be noted that Canada's has been asked by the OECD<sup>45</sup> to consider providing a wider right of private action to enforce the *Competition Act*. Such a measure could increase the likelihood that anticompetitive conduct, which, as we have described, can be destructive of efficiency in markets and consumer welfare, will be challenged and an appropriate remedy applied.

## Recommendations

1. The objectives of the *Competition Act* should be reviewed to ensure that they remain valid in the current Canadian economy. Any restrictions on competition should be rigorously justified to assess whether such measures are necessary and effective in accomplishing an objective which could not otherwise be achieved without the restriction. The effects of such restriction should be equitably distributed among stakeholders.
2. The merger efficiency defense should be operable only in the event that the merger achieves a consumer surplus standard.
3. The *Competition Act* should be amended to provide stronger civil sanctions in the form of administrative monetary penalties (AMPs) to deter anti-competitive behavior in accordance with the former Bill C-19.
4. *The Competition Act* should be amended to provide for restitution to consumers in cases of deceptive marketing.
5. *The Competition Act* should be amended to allow the Commissioner of Competition to conduct market studies with the power to compel the production of information if necessary.

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<sup>44</sup> Trebilcock et. al. note that as of 2002, the Tribunal had been asked to review only 4 mergers since the *Act* was passed in 1986

<sup>45</sup> OECD 2004 Report p. 33

6. The Government should respond swiftly to the need for greater resources for the Competition Commissioner. This should include expansion of private party access to the Competition Tribunal.

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