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Introduction to the *CPI Antitrust Chronicle* Canada Issue—2014

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Introduction to the *CPI Antitrust Chronicle* Canada Issue—2014

Mark Katz[1]

It is once again a great pleasure to serve as guest editor for *CPI Antitrust Chronicle's* special issue devoted to Canadian competition law and policy.

The past year was a very busy one for Canadian competition law developments, the effects of which will continue to be felt in 2014 and beyond.

From an enforcement perspective, the key development was the appointment of John Pecman as Commissioner of Competition, the head of Canada's Competition Bureau. Mr. Pecman's appointment is notable for three reasons: he is a seasoned Bureau veteran (30 years at the Bureau with a wide range of experience and responsibilities); he is the first Commissioner to be appointed from the Bureau's career civil service; and he is an economist, not a lawyer (thankfully).

Since the new Commissioner's appointment in June 2013, he has moved assiduously and with determination to put his own stamp on the Bureau and competition enforcement in Canada. Mr. Pecman has launched a variety of initiatives in this regard, perhaps none more important than placing a renewed emphasis on competition "advocacy," particularly as it relates to the regulated sectors of the Canadian economy. This marks a welcome recognition that the Bureau's impact on promoting competition in Canada can and should extend beyond standard enforcement and litigation.

That said, 2013 was also a very important year for case law developments affecting key areas of Canadian competition law. The Supreme Court of Canada issued a decision upholding the right of indirect plaintiffs to sue for damages in follow-on competition litigation; the Federal Court of Appeal decided cases affecting the *Competition Act's* merger review (*Tervita*) and abuse of dominance provisions (*TREB*); the Competition Tribunal held that the *Competition Act's* price-maintenance provision was **not** broad enough to curtail alleged anticompetitive conduct by Visa and MasterCard affecting merchant fees; and the Ontario Superior Court largely dismissed the Bureau's allegation that one of the country's leading communications companies had made misleading claims in relation to cell phone performance.

In this issue, our authors examine several of these key case law developments. Niki Iatrou & Bronwyn Roe, for example, discuss the implications of the *Tervita* case (now on appeal to the Supreme Court of Canada), which will address the analytical framework to be applied when a merger is alleged to "prevent" competition substantially in a relevant market. For their part,

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Debbie Salzberger & David Rosner assess the impact of the *TREB* and *Visa/MasterCard* cases on the rules governing unilateral conduct in Canada.

Two of our articles then deal with potential developments that could alter and expand the future scope of competition law enforcement in Canada. In their contribution, George Addy & Erika Douglas assess the Competition Bureau's recent foray into a case involving "product hopping" in the pharmaceutical industry and explore what this could mean for future enforcement in the (still) cutting edge intersection of intellectual property and competition law. Marissa Ginn & Marc Van Audenrode then appraise from an economist's perspective the Canadian government's recent proposal to use competition law to combat what many Canadians perceive to be "unjustified" cross-border price discrimination. (Debbie Salzberger & David Rosner also touch on this issue in their article on unilateral conduct.)

Finally, one of the interesting aspects of Canadian competition law is the extent to which it interacts with our rules governing foreign investment. From a certain perspective, Canadian foreign investment law can be seen as competition law's evil alter ego, working at protectionist cross-purposes to competition law's promotion of free and open markets. And yet, sometimes the issues faced by both legal regimes are quite similar. As Sandy Walker points out in her treatment of the issue, one such common question is how to deal with state-owned enterprises ("SOEs"), a subject that has presented unique challenges to both Canadian competition and foreign investment law.

I would like to close by thanking all of our authors for their contributions to this special Canadian colloquium in the *CPI Antitrust Chronicle*. I hope that you find their articles informative and instructive, as I did. I would also like to offer special thanks to Lindsay McSweeney for once again giving me the opportunity to expose CPI readers to a sampling of the varied and interesting developments shaping competition law and policy in Canada.

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Landfill Case Makes It to the Top of the Heap: Canada’s Highest Court to Rule on “Prevention” of Competition Framework In *Tervita*

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Landfill Case Makes It to the Top of the Heap: Canada's Highest Court to Rule on "Prevention" of Competition Framework In *Tervita*

Nikiforos Iatrou & Bronwyn Roe [1]

I. INTRODUCTION

For the first time in nearly 20 years, a contested merger case is before the Supreme Court of Canada ("SCC").[2] The SCC is scheduled to hear an appeal from the Federal Court of Appeal's ("FCA") decision in *Tervita Corp. v. Canada (Commissioner of Competition)* ("*Tervita*") on March 27, 2014 which will address the framework to be applied in a challenge of a merger on the basis that it is likely to prevent competition substantially in the relevant market.

As the Competition Tribunal ("Tribunal") and FCA both noted in their decisions, prevention of competition cases have been rare.[3] The "prevention" branch of s. 92 of the *Competition Act* ("Act") was raised in only three previous Tribunal cases,[4] and since each of those cases was primarily concerned with allegations involving a substantial *lessening* of competition, the Tribunal did not address in any detail the analytical framework applicable to the assessment of an alleged substantial *prevention* of competition.[5] *Tervita* is the first case in which the Commissioner has challenged a merger based solely on a theory of prevention of competition, and the SCC's decision will mark the first time the SCC has weighed in on the appropriate framework for a "prevention" case under s. 92.

The SCC will consider two main issues on the appeal: (1) the proper legal test to determine when a merger gives rise to a substantial prevention of competition under s. 92 of the Act, and (2) the proper approach to the efficiencies defense under s. 96 of the Act.

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[2] The last contested merger case the SCC heard was *Canada (Director of Investigation & Research, Competition Act) v. Southam Inc.*, [1996] 1 S.C.R. 748.

[3] *Tervita Corp. v. Canada (Commissioner of Competition)*, 2013 FCA 28 at ¶23 (hereinafter "FCA Decision").

[4] *Canada (Director of Investigation and Research) v. Southam Inc.* (1992), 43 C.P.R. (3d) 161 (Comp. Trib.), rev'd on other grounds (1995), 63 C.P.R. (3d) 1 (FCA), rev'd, [1997] 1 S.C.R. 748; *Canada (Commissioner of Competition) v. Superior Propane*, 2000 Comp Trib 15, 7 C.P.R. (4th) 385; and *Canada (Commissioner of Competition) v. Canadian Waste Services Holdings Inc.*, 2001 Comp Trib 3, 11 C.P.R. (4th) 425, aff'd 2003 FCA 131.

[5] (*Canada (Commissioner of Competition) v CCS Corp*, 2012 Comp Trib 14 at ¶121 (hereinafter "Tribunal Decision")).

II. BACKGROUND FACTS

In 2010, Tervita Corporation ("Tervita," formerly CCS Corporation), which owns the only two operating secure landfills in Notheastern British Columbia ("NEBC") entered into an agreement to acquire Complete Environmental Inc. ("Complete"), including certain lands known as the Babkirk Site. Complete's vendors had intended to operate the Babkirk Site as a bioremediation facility. Of critical importance to the Commissioner's case was the fact that the vendors also held a permit to operate a secure landfill at the site. Secure landfills in NEBC are designed to securely and permanently dispose of hazardous waste generated by oil and gas operations. In contrast, bioremediation is a method for treating contaminated soil by using microorganisms to reduce contamination.[6]

The Commissioner of Competition ("Commissioner") had informed the parties that she opposed the transaction on the ground that it was likely to prevent competition substantially in the market for secure landfill services in NEBC, as it would maintain Tervita's monopoly for hazardous waste disposal services in the area.[7]

The transaction closed in January 2011 over the Commissioner's objection; the Commissioner brought her case challenging the merger pursuant to s. 92 of the Act three weeks after the deal closed. Section 92 grants jurisdiction to the Tribunal to intervene where "a merger or proposed merger prevents or lessens, or is likely to prevent or lessen, competition substantially."[8]

III. THE COMPETITION TRIBUNAL'S DECISION

Before the Tribunal, the Commissioner argued that the acquisition had substantially prevented competition that would have arisen if a competitor, rather than Tervita, had acquired the Babkirk Site and built and operated a landfill at the site. In response, Tervita and Complete took the position that if Tervita had not purchased Complete, Complete's owners would not have operated a secure landfill at the site, but instead would have operated a bioremediation business that would not compete with Tervita's landfilling operations.[9] Therefore, they argued, there would have been no competition or likelihood of competition absent the merger.

The Tribunal accepted the Commissioner's position that the merger was likely to lessen competition substantially and ordered Tervita to divest itself of the assets relating to the Babkirk Site, including the landfill operations permit.

A. Section 92 Prevention of Competition Analysis

The Tribunal developed an analytical framework for prevention of competition merger reviews, finding that, in determining whether a merger is likely to prevent competition under s. 92 of the Act, the Tribunal must assess:

1. whether a merger is more likely than not to maintain the ability of the merged entity to exercise greater market power than in the absence of the merger;

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[6] *Id.* at ¶¶42-46; FCA Decision, *supra* note 3 at ¶12.
[7] FCA Decision, *Id.* at ¶16.
[8] *Competition Act*, R.S.C., 1985, c. C-34, s. 92.
[9] Tribunal Decision, *supra* note 5 at ¶23.

2. whether it is likely the new entry or increased competition from within the relevant market that the Commissioner alleges was, or would be, prevented by the merger would be sufficiently timely (within a "reasonable period of time"), and occur on a sufficient scale, to result in (i) a material reduction of prices or a material increase in non-price competition, (ii) in a significant part of the relevant market, and (iii) for a period of approximately two years; and
3. whether other firms would be likely to enter or expand on a scale similar to that which was prevented or forestalled by the merger, and in a similar timeframe.[10]

In applying this framework, the Tribunal accepted that, absent the merger, the vendors would have developed the Babkirk Site as a bioremediation facility for hazardous waste, with a small incidental half-cell secure landfill in which to move the soil that was not successfully treated.[11]

Then, extending its analysis further into the future, the Tribunal held that, within a year, the bioremediation business would have failed for want of customers and due to the technical limitations of bioremediating hazardous waste. After this failure, the Tribunal found that the vendors would have either begun operating the facility as a secure landfill themselves, or would have sold the site to another party that would have operated it as a secure landfill. In either scenario, the result would be a full service secure landfill at the Babkirk Site by no later than the spring of 2013.[12]

In considering the possibility of competition from new entrants, the Tribunal found that there were no other proposed new entrants in NEBC, and that the barriers to entry in the secure landfill business in NEBC were such that it would take a new entrant at least 30 months to complete the process of selecting a new site, obtaining the necessary regulatory authorizations, and constructing a new secure landfill.[13]

The Tribunal concluded that the operation of a secure landfill at the site by the spring of 2013 would have resulted in substantial competition for the supply of secure landfill services[14] and that, absent the merger, prices for secure landfilling surfaces would have been at least 10 percent lower. Further, the merger was likely to maintain Tervita's ability to exercise materially greater market power.[15]

B. Section 96 Efficiencies Defense Analysis

As the FCA found that the Tribunal had committed certain errors in its analysis of Tervita's efficiencies defense, we will address the efficiencies defense analysis under the FCA's decision, below.

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[10] Tribunal Decision, *id.* at ¶¶121-26; FCA Decision, *supra* note 3 at ¶85.
[11] Tribunal Decision, *id.* at ¶197; FCA Decision, *id.* at ¶25.
[12] Tribunal Decision, *id.* at ¶199-209.
[13] *Id.* at ¶222.
[14] *Id.* at ¶215.
[15] *Id.* at ¶229.

IV. THE FEDERAL COURT OF APPEAL'S DECISION

Tervita appealed the Tribunal's decision to the FCA on both factual and legal grounds, arguing that the Tribunal had erred in a number of ways in its analyses under ss. 92 and 96.[16]

Chiefly, Tervita argued that the Tribunal had erred in its s. 92 analysis by extending its analysis beyond the date of the merger and engaging in "unbridled speculation" regarding possible future events.[17] Under the s. 96 analysis, Tervita argued that the Tribunal had erred in its quantification of anticompetitive effects, in its consideration of "order implementation efficiencies," and in its s. 96 offset methodology.

The FCA unanimously dismissed Tervita's appeal, endorsing the Tribunal's forward-looking analytical framework for prevention of competition merger reviews under s. 92 of the *Competition Act*; providing guidelines to follow in ascertaining an appropriate temporal framework for poised entry in any given prevention case; and rejecting Tervita's assertion that the Tribunal's findings were unsupported by the evidence. While the FCA found that the Tribunal had erred in some respects in its s. 96 efficiencies analysis, the FCA engaged in the analysis itself and decided that the merger's marginal efficiencies did not outweigh its anticompetitive effects.

A. Section 92 Prevention of Competition Analysis

1. The Tribunal's Section 92 Analysis in a Prevention Case Is Forward-Looking

Tervita argued that the Tribunal's analysis in determining whether the new entry alleged to have been prevented by the merger should be confined to the time the merger occurred, rather than to "within a reasonable period of time," as the Tribunal had determined.[18] The FCA rejected this argument, finding that, not only is the Tribunal's analysis in a prevention of competition case "necessarily forward-looking,"[19]—requiring it to look into the future to determine whether the new entry would have occurred within a reasonable period of time,[20]— but, also, that its findings in this regard deserve particular deference.

2. Ascertaining the Appropriate Temporal Framework for Poised Entry in a Prevention Case

The FCA found that, while the meaning of "reasonable period of time" in respect of when entry would have likely occurred absent the merger will necessarily vary from case to case and will depend on the business under consideration, certain guidelines should be followed to ascertain the appropriate temporal framework for "poised entry" in any given prevention case:[21]

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[16] FCA Decision, *supra* note 3 at ¶¶49-51.
[17] *Id.* at ¶¶50, 95.
[18] *Id.* at ¶86.
[19] *Id.* at ¶87.
[20] *Id.* at ¶88.
[21] *Id.* at ¶89.

First, the timeframe must be discernable.[22] Second, the timeframe for thwarted competition should fall within the temporal dimension of the barriers to entry into the market at issue.[23]

In *Tervita,* the evidence established that it would take a new entrant at least 30 months to open a secure landfill.[24] Absent the merger, the Tribunal held, there would have been competition within about two years. This was within the timeframe of the barriers to entry, and thus met this branch of the test.[25] *Tervita* therefore clarifies that poised entry means entry within the timeframe relating to barriers to entry.

In approaching the timeframe issue in this fashion, the FCA cited the decision in *BOC International Ltd. v. Federal Trade Commission*[26] where the Court of Appeals for the Second Circuit found that:

> It seems necessary … that the finding of probable entry at least contain some reasonable temporal estimate related to the near future, with 'near' defined in terms of entry barriers and lead time necessary for entry in the particular industry, and that the finding be supported by substantial evidence in the record.[27]

The FCA in *Tervita* agreed with the sentiment of this passage, and found that using the barriers to entry in the market in question would be a helpful guidepost for future prevention cases in determining whether the entrant under consideration was "poised" to enter the market. The FCA stressed that it was not establishing a hard and fast rule and that, in some cases, it might be appropriate to expand the temporal analysis beyond the temporal dimension of the barriers to market entry.[28]

Applying this framework, the FCA rejected the submission that the Tribunal had engaged in "unbridled speculation." On the contrary, it recounted the evidence that was before the Tribunal in support of the conclusion that the bioremediation business of the vendors would have failed.[29] The FCA found that it was reasonable for the Tribunal to conclude that the bioremediation business would have failed and that the vendors would have switched course, operating the secure landfill themselves or selling it to a third party that would have done so.[30]

B. Section 96 Efficiencies Defense Analysis

Section 96 of the Act provides for a defense to a merger challenge where the merger brings about, or is likely to bring about, gains in efficiency that will be greater than, and will offset, the merger's anticompetitive effects.[31] The Tribunal thus engages in a balancing test, considering whether the gains in efficiency that have been proven by the party relying on the

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[22] *Id.* at ¶90.
[23] *Id.* at ¶91.
[24] Tribunal Decision, *supra* note 5 at ¶222.
[25] FCA Decision, *supra* note 3 at ¶¶92-94.
[26] *BOC International Ltd. v. Federal Trade Commission*, 557 F.2d 24 (2d Cir. 1997).
[27] *Id.* at 29.
[28] FCA Decision, *supra* note 3 at ¶91.
[29] *Id.* at ¶¶95-103.
[30] *Id.* at ¶¶104.
[31] *Competition Act*, *supra* note 8, s. 96.

defense are greater than, and offset, the anticompetitive effects that have been proven by the Commissioner.[32]

The FCA agreed with Tervita's submissions that the Tribunal had erred in certain aspects of its s. 96 analysis. However, the FCA upheld the Tribunal's rejection of Tervita's efficiencies. The FCA then laid out what it considered to be the correct approach to the offset analysis and applied it to the facts, finding that Tervita's minimal efficiencies did not offset the merger's anticompetitive effects.

1. Rejecting Quantified Efficiencies

Tervita claimed as gains in efficiency resulting from the merger (i) one year of transportation cost savings and (ii) one year of market expansion gains which could have been realized since Tervita could have operated a secure landfill at the Babkirk Site by the spring of 2012, one year earlier than a third-party purchaser could have.[33] The Tribunal, however, found that these one-year gains in efficiency would have resulted from delays in the implementation of its order, and concluded that it would be contrary to the purposes of the Act to recognize them.[34]

The FCA agreed that it would be contrary to the overall scheme of the Act to consider these "order implementation" gains in efficiency.[35] Further, the FCA found that, since the one-year transportation and market expansion gains in efficiency had not in fact been realized by Tervita, and would now never be realized, they should not be considered in the s. 96 balancing exercise: Pursuant to s. 96(1) of the Act, gains in efficiency claimed for the period *preceding* the merger review decision must have been *in fact* achieved in order to be recognized; gains in efficiency claimed for the period *subsequent* to the merger review decision must be *likely* to be achieved.[36]

2. The Offset Analysis

The FCA found that the Tribunal's offset methodology had been overly subjective and clarified the correct methodology. The offset analysis under s. 96 requires the Tribunal to balance both quantitative and qualitative gains in efficiency against both the quantitative and qualitative anticompetitive effects resulting or likely to result from the merger. The gains in efficiency must be of a larger magnitude than the anticompetitive effects and must compensate for the overall anticompetitive effects.[37] The offset analysis must be as objective as is reasonably possible, and where an objective determination cannot be made, it must be reasonable.[38]

The FCA went on to apply the methodology, finding that the efficiencies did not offset the anticompetitive effects. The FCA explained that the fact that the quantitative anticompetitive effects of the merger had not been quantified meant that the weight to be afforded to these effects

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[32] FCA Decision, *supra* note 3 at ¶113; *Canada (Commissioner of Competition) v. Superior Propane Inc.*, 2001 FCA 104, [2002] 3 F.C. 185 at ¶75.

[33] FCA Decision, *id* at ¶131-32.

[34] *Id.* at ¶133.

[35] *Id.* at ¶135.

[36] *Id.* at ¶137-38.

[37] *Ibid* at ¶146.

[38] *Id.* at ¶¶147-48.

was undetermined; Tervita still bore the burden of demonstrating that the gains in efficiency offset the anticompetitive effects.[39] The efficiencies were "marginal to the point of being negligible,"[40] and therefore could not offset the known anticompetitive effects, even where the weight to be afforded to such effects was undetermined.[41] Further, the FCA observed that a pre-existing monopoly, as was the case in *Tervita*, would usually magnify the anticompetitive effects of a merger.[42]

V. THE FINAL ARBITER: THE SUPREME COURT OF CANADA

Tervita sought and was granted leave to appeal to the SCC, Canada's final court of appeal. The appeal, scheduled to be heard March 27, 2014, will address two issues:

1. What is the proper legal test to determine when a merger gives rise to a substantial prevention of competition under s. 92 of the Act and to what extent, if any, is the Tribunal permitted to consider possible future events when it finds that there is no present competitive constraint being removed from the market?
2. What is the proper approach to the efficiencies defense under s. 96 of the Act and, in this respect:
   a) On what basis can real, quantified efficiencies be rejected?
   b) What is the proper approach to the offset analysis?[43]

VI. GUIDANCE FOR OTHER JURISDICTIONS? THE TRIBUNAL'S PREVENTION FRAMEWORK AND THE U.S. DOCTRINE OF "ACTUAL POTENTIAL ENTRY"

Other jurisdictions, and in particular the United States, may find that *Tervita* can offer guidance in approaching "actual potential entry" cases.

The analysis adopted by the Tribunal is consistent with U.S. jurisprudence and the forward-looking doctrine of "actual potential entry," which holds that a merger violates s. 7 of the U.S. *Clayton Act* if, absent the merger, a party would probably have entered a market and that this entry would probably have increased competition.[44]

The U.S. test for proving actual potential entry as summarized in *Yamaha Motor Co. Ltd. v. Federal Trade Commission* requires the government to meet three preconditions: (1) show that the potential entrant had "available feasible means" for entering the relevant market; (2) provide some indication that entry would have been expected to occur in the near future; and (3) show that entry offers "a substantial likelihood of ultimately producing deconcentration of that market or other significant pro-competitive effects."[45] As was the case in *Tervita*, *Yamaha Motor Co. Ltd.*

[39] *Id.* at ¶167.
[40] *Id.* at ¶169.
[41] *Id.* at ¶174.
[42] *Id.* at ¶173.
[43] Notice of Application for Leave to Appeal (Tervita Corporation, Complete Environmental Inc. and Babkirk Land Services Inc., Applicants) dated 11 August 2013 at ¶4.
[44] *Yamaha Motor Co. Ltd. v. Federal Trade Commission*, 657 F.2d 971 (8th Cir. 1981); *BOC International Ltd. v. Federal Trade Commission*, *supra* note 25.
[45] *Yamaha Motor Co. Ltd. v. Federal Trade Commission*, *id.*

v. Federal Trade Commission suggests that objective evidence of market conditions can be relied upon to engage in this forward-looking exercise.[46]

The analytical framework in *Tervita*, and its successful application in finding a prevention of competition, may offer guidance to U.S. "actual potential entry" cases, which have heretofore not succeeded.

The Canadian competition bar will be closely following *Tervita*'s appeal at the SCC, and the decision may prove to be a valuable one for antitrust enforcers in other jurisdictions.

[46] *Id.* at 9-10.

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New Clouds on the Legality of Unilateral Conduct in Canada

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New Clouds on the Legality of Unilateral Conduct in Canada

Deborah Salzberger & David Rosner [1]

I. INTRODUCTION

The provisions of the Canadian *Competition Act* ("Act"), as interpreted by relatively few cases, created clear demarcations around permissible unilateral conduct in Canada. Recent developments have, however, clouded the picture. Concurrent shifts in proposed legislation, judicial decisions, and enforcement collectively signal new and broader interpretations of the scope of the Act's unilateral conduct provisions. In turn, these developments create uncertainty for businesses operating in Canada, highlighting the need for meaningful transparency and reasoned guidance from the Competition Bureau, the courts, and the legislature. In this regard, the experiences of competition law jurisdictions that have grappled with exploitative pricing, price discrimination, and broader concepts of unilateral conduct than were previously actionable in Canada provide a natural frame of reference.

This note (II) describes the previously understood application of the Act to unilateral conduct; (III) discusses recent enforcement developments that portend unclear changes in the application of unilateral conduct rules in Canada; and (IV) considers ways that clarity could be re-established for unilateral conduct in Canada, including by reference to the experiences of the United States and the European Union.

II. UNILATERAL CONDUCT UNDER THE CANADIAN COMPETITION ACT

Sections 75 to 79 of the Act govern unilateral conduct. Notably:[2]

- Section 76 permits the Competition Tribunal to make an order where resale price maintenance results in an adverse effect on competition (among other requirements).[3]
- Section 79 permits the Competition Tribunal to make an order and impose administrative monetary penalties of up to CAD $10 million where a dominant firm engages in an "anti-competitive act" that prevents or lessens competition substantially (among other requirements). Section 78 contains a non-exhaustive list of types of conduct that can constitute an anti-competitive act under section 79.

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[2] In addition to sections 76, 78, and 79, discussed above, sections 75 and 77 permit the prohibition of refusals to deal and certain distribution practices, respectively. There have not been significant developments in respect of these sections recently.

[3] The Competition Tribunal is a specialized court that has jurisdiction over all the provisions of the Act that concern unilateral conduct.

The language of these sections of the Act is specific, which is one of the features that distinguishes the Act from the competition laws of other jurisdictions.[4] Arguably, on account of this degree of specificity the handful of cases that have considered the Act's unilateral conduct provisions have produced decisions that (i) made careful reference to the Act's text for the purposes of identifying the scope of its provisions, (ii) interpreted the language of the Act narrowly, and (iii) adopted relatively bright-line interpretations regarding the scope of permissible conduct.

The best example of such a case may be *Commissioner of Competition v. Canada Pipe,*[5] where the Federal Court of Appeal considered, among other things, the meaning of the term "anti-competitive act" in section 79. It held that:

> [w]hile clearly non-exhaustive, the illustrative list [of acts] in section 78 provides direction as to the type of conduct that is intended to be captured [as an anti-competitive act] … reasoning by analogy, a non-enumerated anti-competitive act will exhibit the shared essential characteristics of the examples listed in section 78.[6]

With reference to an earlier case, the court held that, "the purpose common to all acts [listed in section 78], save that found in paragraph 78(1)(f), is an intended negative effect on a competitor…"[7] The court further held that: "an anti-competitive act is defined by reference to its purpose" and that the inquiry is:

> focused upon the intended effects of the act **on a competitor**." As a result, some types of effects on **competition** in the market might be irrelevant [and would not constitute an anti-competitive act], if these effects do not manifest through a negative effect on a competitor. It is important to recognize that "anti-competitive" therefore has a restricted meaning within the context of [section 79], for the Act as a whole, "competition" has many facets as enumerated in section 1.1, for the particular purposes of [section 79], "anti-competitive" refers to an act whose purpose is a negative effect on a **competito**r."[8]

Canada Pipe therefore defined the meaning of an anti-competitive act by careful reference to the text of the Act itself. The decision interpreted the meaning of anti-competitive act narrowly, limiting the meaning of anti-competitive conduct to that which has as its overriding purpose the exclusion of competitors. In reaching this conclusion, *Canada Pipe* acknowledged that there may be gaps in the Act (since some types of conduct that affect competition would not be actionable if not manifested through a negative effect on a competitor) and virtually ignored paragraph 78(1)(f), which identifies "buying up of products to prevent the erosion of existing price levels" as an anti-competitive act.

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[4] The language of §1 or §2 of the *Sherman Act* and Articles 101 and 102 of the Treaty on the Functioning of the European Union are far more general than the detailed language of the Act.

[5] *Canada (Commissioner of Competition) v. Canada Pipe Co.*, 2006 FCA 233.

[6] *Id.*, ¶63.

[7] *Id.*, ¶64, with reference to *Canada (Director of Investigation and Research) v. NutraSweet Co.*, (1990), 32 C.P.R. (3d) 1 (Comp. Trib.) at 34.

[8] *Id.*, ¶68 (emphasis included in the original).

This decision resulted in the creation of a bright line for companies operating in Canada—so long as the overriding purpose of a business practice was something other than the exclusion of a competitor, the business practice could not constitute an abuse of dominance.

III. RECENT DEVELOPMENTS INTRODUCE UNCERTAINTY AND BUSINESS RISK

There have been three recent developments in Canadian competition law that cloud the question of whether the delimiters of permissible unilateral conduct under the Act are still certain. As a result, conduct that was previously considered legitimate competitive strategy may, in the current environment, raise the risk of enforcement action.

A. Visa/MasterCard—Tribunal Highlights Overreaching Interpretation of the Act

In 2010, the Commissioner applied to the Tribunal for an order prohibiting Visa and MasterCard from enforcing certain of their rules (e.g., the "honour all cards" and the "no surcharge" rule), alleging that the rules had the effect of influencing upwards or discouraging the reduction of card acceptance fees, contrary to the section 76 price maintenance provision. This represented an aggressive attempt by the Commissioner to fit the credit card companies' rules into the framework of a section the Act that made an "upward influence" on resale prices actionable in certain circumstances.

The Tribunal rejected the Commissioner's application on the basis that, among other reasons, section 76 requires a resale of a product.[9] In so doing, the Tribunal also rejected the Commissioner's "overreaching interpretation of section 76."[10]

B. Federal Government's 2014 Budget—A De Facto Price Discrimination Provision?

Despite the deep integration of their economies, prices for consumer goods sold in Canada are often higher than in the United States. This so-called "price gap" is often attributed to circumstances such as the relatively small size of the Canadian economy, the volatility of the Canadian exchange rate, the cost of compliance with Canadian product safety standards, and the cost of transportation and distribution in Canada. The price gap is occasionally the subject of political discussion.[11]

The federal government's February 2014 budget promised that it would introduce "legislation to prohibit unjustified cross-border price discrimination to reduce the gap between consumer prices in Canada and the United States."[12] The Commissioner of Competition would

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[9] *The Commissioner of Competition v. Visa Canada Corporation and MasterCard International Incorporated*, 2013 Comp. Trib. 10, at ¶ 137.

[10] *Id.*, at ¶139.

[11] For example, in February 2013 the Standing Senate Committee on National Finance published a report entitled *The Canada-USA Price Gap*; *available at*: http://www.parl.gc.ca/content/sen/committee/411/nffn/rep/rep16feb13-e.pdf.

[12] *The Road To Balance: Creating Jobs and Opportunities*, tabled in the House of Commons by the Honourable James M. Flaherty, P.C., M.P., Minister of Finance, February 11, 2014, at page 171, *available at* http://www.budget.gc.ca/2014/docs/plan/pdf/budget2014-eng.pdf.

be empowered to enforce these new laws, the details of which would only be "announced in the coming months."[13]

The government's proposal seems contrary, in principle, to Parliament's decision in the 2009 reforms of the Act that, among other things, abolished the *per se* (criminal) offense of price discrimination. The government's proposal to have the Commissioner enforce the new laws may also contradict recent statements by Bureau officials that the Bureau is:

> not a price regulator and Canadian businesses are free to set their own prices at whatever levels the market will bear, provided that these high prices are not the result of anti-competitive conduct such as price-fixing or abuse of a dominant position.[14]

Apart from a suggestion in the budget document that market power will be necessary to engage the envisaged price discrimination provision,[15] the lack of specificity in the federal government's announcement leaves many unanswered questions around the scope of a new price discrimination law. Will the proposed legislation restrict only cross-border disparities, or also intra-Canadian price discrimination? Will it effectively create an "exploitative pricing" prohibition? Must the conduct have competitive effects before it can be actionable, or are we moving back to a *per se* offense? What "justifications" for price disparities are valid? Absent clear answers, the scope for enforcement against unilateral conduct will be further clouded.

C. Toronto Real Estate Board—Is Abuse of Dominance Expanding in Canada?

In 2011, the Commissioner applied for an order against the Toronto Real Estate Board ("TREB"), a trade association of realtors. The Commissioner alleged TREB's rules restricted the ability of realtors to pursue innovative internet-based business models, which constituted an abuse of dominance. The Commissioner admitted that the TREB did not compete with realtors, such that its conduct did not constitute direct action against a competitor (per the standard in *Canada Pipe*).

The Commissioner asked that the Tribunal revisit the decision in *Canada Pipe* on the basis that (i) the list of anti-competitive acts in section 78 is not exhaustive, and (ii) paragraph 78(1)(f) (discussed above, which concerns buying up of product) does not require that a competitor be harmed. The Tribunal rejected this request, instead finding that section 78 "is a powerful indicator that the Canada Pipe Rule is the correct approach."[16] The Commissioner's application therefore failed.

In concluding *obiter* remarks, the Tribunal noted that "[t]he Tribunal observes that, although section 79 does not apply, section 90.1 of the Act might give the Commissioner a means

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[13] *Id.*, ¶182.

[14] *See, The Canada-USA Price Gap*, *supra* note 11, at 56. More recently, however, the Commissioner of Competition has made comments that suggest his approval of the government's "action to protect consumers and end price disparity." *See* Remarks by John Pecman, Commissioner of Competition, delivered November 14, 2013 in Toronto; *available at* http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03629.html.

[15] *The Road To Balance*, *supra* note 12 at 182, provides that the legislation will be applicable to situations where "companies use their market power to charge higher prices in Canada that are not reflective of legitimate higher costs… Higher prices brought on by excessive market power hurt Canadian consumers."

[16] *Commissioner of Competition v. The Toronto Real Estate Board*, 2013 Comp. Trib. 9, ¶15.

to apply to the Tribunal."[17] Section 90.1 is a civil provision that prohibits anti-competitive agreements among persons, two or more of whom are competitors. The Tribunal's remarks once again suggest that the Commissioner was attempting to bridge perceived gaps between different sections of the Act and advocate for an arguably overreaching interpretation of one of the unilateral conduct provisions in the Act.

The Commissioner appealed. In brief reasons, the Federal Court of Appeal reversed the decision of the Tribunal, holding that:

> I do not interpret *Canada Pipe* to mean that as a matter of law, a person who does not compete in a particular market can never be found to have committed an anti-competitive act against competitors in that market, or that a subsection 79(1) order can never be made against a person who controls a market otherwise than as a competitor.[18]

The Federal Court of Appeal then conducted further statutory interpretation, but seemingly reached the opposite conclusion as it did in *Canada Pipe*. Instead of ignoring paragraph 78(1)(f), which is unusual as a matter of antitrust and has never been tested in Canadian courts, it held that:

> paragraph 78(1)(f) is an indication that Parliament did not intend the scope of subsection 79(1) to be limited in such a way that it cannot possibly apply to the Board in this case. If the Court in Canada Pipe intended to narrow the scope of subsection 79(1) as the Tribunal held, then I would be compelled to find that aspect of Canada Pipe to be manifestly wrong because it is based on flawed reasoning (specifically, the unexplained inconsistency in the reasons).[19]

The Federal Court of Appeal sent the case back to the Tribunal for consideration on the merits.

The Federal Court of Appeal's decision does not contain any discussion as to how the concept of an anti-competitive act might be limited post-*Canada Pipe*, or how general antitrust principles might support or otherwise relate to the outcome of its decision. Given the open-ended definition of an anti-competitive act in *TREB*, there are questions as to whether exploitative pricing by dominant firms could potentially now be subject to section 79 of the Act.

IV. TRANSPARENCY AND BRIGHT LINES NEEDED IN CANADA

These recent developments, considered collectively, suggest a tension in interpretation that clouds the previously bright line between permissible and impermissible unilateral conduct. This leaves unanswerable questions about the legality of aggressive commercial conduct for companies operating in Canada, and raises real risks for business.

If companies operating in Canada are to continue to compete aggressively, then more transparency and new bright lines are needed. The experiences of the United States and the European Union, which have long grappled with price discrimination and broader concepts of abuse of dominance than were previously actionable in Canada (including exploitative abuse), provide relevant direction in developing a Canadian road map.

[17] *Id.*, at ¶26.

[18] *Commissioner of Competition v. Toronto Real Estate Board*, 2014 FCA 29, at ¶14.

[19] *Id.*, at ¶20.

- If the Commissioner is of the view that section 79 is broad enough to capture conduct by a dominant firm other than that which is manifested through a negative effect on a competitor, as was previously the common understanding in Canada, then clear guidance as to the reach of section 79 is critical. The European Commission, which administers a broadly scoped abuse of dominance provision, has attempted to provide such guidance in significant detail through an articulation of its enforcement priorities and the application of its abuse of dominance provision in those areas of priority.[20] In the United States, there are calls in many quarters for the Federal Trade Commission to publish clear guidance surrounding how it intends to enforce §5 of the *Federal Trade Act*, which is also broadly scoped (indeed, proposed guidelines have already been published).[21] Either of these approaches, if adopted in Canada, could create the transparency businesses require.
- If exploitative pricing and price discrimination are to be actionable under competition laws, new legislation may be in order. This approach is far preferable—from a democratic, legal, and economic perspective—to stretching the existing, narrowly drafted unilateral conduct provisions. The government has taken the first step in this regard by promising new legislation concerning price discrimination; for its part, the Bureau has recently issued draft guidelines for public comment concerning the enforcement of section 76 (the price maintenance provision).[22]
- Where new legislation is required, widely accepted economic principles should be its basis, and the experiences of other leading competition law jurisdictions considered. For example:
    - Any new legislation should only be capable of applying to conduct that harms competition; that is, any new legislation should apply a *rule of reason*, rather than a *per se*, standard. This approach has the advantage of being consistent with the scheme of the Act, which the Supreme Court of Canada has described as economic regulation designed to address conduct that reduces competition,[23] and precluding the consideration of non-economic factors. It would also be consistent with the degree of caution and objectivity that courts have adopted for price discrimination and exploitative pricing cases in other jurisdictions. For example, in the United States price discrimination can only be established if it results in an injury to competition.[24] By further example, in the European Union courts have found that proving exploitative pricing requires more than simply proving the existence of a large profit margin—in addition, the unfairness of the

[20] *See*, *Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings*, OJ C 45 (February 24, 2009).

[21] *See*, for example, William Kovacic & Marc Winnerman, *Competition Policy and the Application of Section 5 of the Federal Trade Commission Act*, 76 ANTITRUST L.J, 929 (2010; *infra)*, note 26.

[22] *See*, Competition Bureau, *Price Maintenance (Section 76 of the Competition Act) Enforcement Guidelines*, draft for public consultation (March 20, 2014), *available at*: http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03687.html.

[23] *See, General Motors v. City National Leasing*, [1989] 1 S.C.R. 641 at 676.

[24] *See* the discussion of injury to competition in *Volvo Trucks North America, Inc. v. Reeder-Simco GMC Inc.*, 546 U.S. 164 (2006).

impugned price relative to the price of other products must also be established (thereby importing a concern with competition generally into the analysis).[25]

- Any new legislation should shield conduct that results in some cognizable efficiencies (which approach is being advocated for in the United States)[26] or otherwise permit the harm from the impugned conduct to be measured against the efficiencies that it also creates, such that no order could be made unless the conduct results in deadweight loss.[27]
- Any new legislation should adopt bright lines and well-recognized exceptions and defenses, so that companies operating in Canada can have certainty as to when their business practices will be free from scrutiny. For example, new legislation should only apply to firms with a dominant position;[28] this would be consistent with the limited scenarios in which exploitative pricing can be pursued by the European Commission. By further example, new price discrimination legislation should not apply where customers do not receive products of like quality or quantity (i.e., volume discounts should be permitted), and there should be an exception for meeting competitors' prices; these exceptions are available in the United States and in the European Union.

[25] *See* Case 27/76*, United Brands Company v. Commission,* [1978] ECR 207.

[26] This standard, which certain people are advocating for in respect of §5 of the *Federal Trade Act*, recognizes the inherent risk associated with prohibiting conduct that results in efficiencies to the economy. *See* the Statement of Federal Trade Commissioner Joshua D. Wright, *Proposed Policy Statement Regarding Unfair Methods of Competition Under Section 5 of the Federal Trade Commission Act*, published June 19, 2013, at section III, *available at* http://www.ftc.gov/sites/default/files/documents/public_statements/statement-commissioner-joshua-d.wright/130619umcpolicystatement.pdf.

[27] The examination of the efficiencies created by impugned conduct is required by other sections of the Act (*see*, in particular, subsection 90.1(4) and section 93).

[28] *See*, *supra,* note 15.

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Canada Considers Hopping on Board with a Product-Hopping Case

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Canada Considers Hopping on Board with a Product-Hopping Case

George Addy & Erika Douglas[1]

I. INTRODUCTION

The Canadian Competition Bureau (the "Bureau") has been signaling a renewed interest in competition enforcement in the pharmaceuticals industry, and more broadly, issues at the forefront of intellectual property and competition law. While enforcement in this space has seen significant attention from other major antitrust regulators, this marks a shift for the Bureau. Most significantly, the Bureau has commenced an inquiry into whether alleged product-hopping conduct amounts to an abuse of dominance under the *Competition Act*. This article explains product hopping, surveys the major U.S. arguments as to why it may raise competition concerns, and then considers the Bureau's potential case.

In contemplating a product-hopping case, the Bureau joins a crop of recent antitrust enforcement efforts around the globe directed at variations of product hopping conduct. In November 2012, the U.S. Federal Trade Commission ("FTC") filed a brief as *amicus curiae* in the private product hopping case *Mylan Pharmaceuticals, Inc v Warner Chilcott Public Limited Co.* (*"Mylan Pharmaceuticals"*),[2] which recently settled. In July 2010, the European Union General Court upheld the European Commission's finding in a seminal product-hopping case against AstraZeneca. Enforcers in less prominent jurisdictions have also been getting in on the action; in February 2014 the Australian Competition and Consumer Commission announced a product-hopping case against Pfizer, and the U.K. Office of Fair Trading issued a decision against Reckitt Benckiser in April 2011.

II. WHAT IS PRODUCT HOPPING AND WHY IS IT ATTRACTING ANTITRUST ATTENTION?

As the FTC explains, "product hopping" or "product switching" generally involves branded manufacturers introducing new formulations of patented drugs shortly before the patent protection on the older version of the drug expires, then withdrawing from the market the older drug that faces imminent generic competition.[3] The conduct often involves allegedly steering physicians or pharmacists to "hop" demand over to the new branded drug formulation, which is protected by a long-term patent. Because generic drugs tend to rely on substitution rules that allow pharmacies to swap-in the generic equivalent for a branded drug, when physicians stop writing prescriptions for the older drug, this eliminates the possibility of substitution and thus (the FTC argues) the possibility of meaningful generic competition. In its *Mylan*

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[2] 2014 U.S. Dist. LEXIS 21504 (E.D. Pa. Feb. 18, 2014).

[3] The FTC observes the same result as a product withdrawal can be indirectly achieved through the branded company raising price or creating supply shortages of the older product.

Pharmaceuticals amicus brief, the FTC argued such pharmaceutical product redesigns, where the old product is withdrawn, could constitute exclusionary conduct in violation of section 2 of the *Sherman Act*.

Branded pharmaceutical companies maintain that the introduction of a new product formulation and withdrawal of an old one is a business decision based on innovation and profit maximization, and does not constitute anticompetitive conduct. The companies point to jurisprudence outside of the product-hopping context which held "the process of invention and innovation is clearly tolerated by the antitrust laws" and push for an approach where the court is "very skeptical" about claims that competition has been harmed by product improvements.[4] The argument is that courts should be cautious about sanctioning product design changes, lest they dampen the incentives for branded pharmaceutical companies to further innovate.

The FTC counters that although the general rule is judicial deference to product innovation, pharmaceutical product design changes should not be considered *per se* lawful. The FTC is not suggesting that such conduct is *per se* unlawful but rather that it may be subject to challenge in particular circumstances where the anticompetitive effects outweigh the benefits. If anticompetitive harm is shown from the formulation switchover, the harm is then weighed against benefits of the change.[5]

The FTC characterizes the product hop in *Mylan Pharmaceuticals* as being forced by the removal of the old product from the market "preventing consumers from weighing the relative merits of competing products."[6] This absence of consumer choice is seen by the FTC as the essential difference between product switching in the pharmaceutical industry and product switching in other contexts, where U.S. courts have expressed caution over questioning the innovation value of new products on the premise that the switch merely reflects consumer choice. Private cases to date in the United States have similarly focused on whether there was an elimination of consumer choice arising from the branded company's withdrawal of its older product formulation. The FTC has yet to test this theory in a case of its own, and the case in which the FTC filed its *amicus* brief recently settled.

The FTC's approach tasks the court or antitrust enforcers with balancing pro-competitive and anticompetitive effects of a drug formulation change. The harm hinges on skepticism over whether the new drug formulation, which may involve a dosage or formula change, offers a sufficiently improved therapeutic benefit over the older drug formulation. If there is some marginal benefit, the question then becomes whether that benefit is sufficient to make up for the foregone cost savings arising from less generic competition.

In terms of effect on competition, Warner Chilcott argued in filings for *Mylan Pharmaceuticals* that the new drug formulation is either an improvement, and thus enhances competition or, at worst, it has a neutral effect because one formulation replaces another. Product-hopping cases can thus present a thorny proposition of determining whether the

[4] *Berkey Photo, Inc v Eastman Kodak Co* 603 F.2d 263, 281 (2nd Cir. 1979).

[5] *Mylan Pharmaceuticals, supra note 2,* FTC Brief as *Amicus Curiae* at 13, referring to *Abbott Labs v Teva Pharms USA, Inc* 432 F Supp. 2d 408, 422 (D Del. 2006) and the analytical approach applied in *United States v Microsoft Corp* 253 F 3d 34 (DC Cir. 2001) (en banc).

[6] *Id.* at 13.

innovation is credible from an antitrust perspective, in the context of an already complex regulatory regime where false positives create the risk of chilling innovation among branded pharmaceutical companies.

III. THE CANADIAN COMPETITION BUREAU INQUIRY INTO PRODUCT HOPPING

The Bureau is currently investigating whether Alcon Canada Inc. ("Alcon") abused a dominant position in the supply of prescription drugs for the treatment of allergic conjunctivitis through product-hopping conduct.[7] Alcon Canada Inc. sells two prescription eye-drop products for the treatment of allergic conjunctivitis in Canada. One, Patanol, is nearing the end of its patent protection. Apotex Inc., a generic drug company, received approval to market a generic version of Patanol (which was challenged by Alcon in separate proceedings). The other product, Pataday, is newer, and at the beginning of its patent protection period in Canada. Although the products have the same active ingredient, the older product requires use twice a day while the new product requires use only once a day.

The Bureau argues Alcon withdrew the supply of its older drug, Patanol, in advance of the imminent entry of a generic substitute. The Bureau's theory of abuse seems to be based on this withdrawing supply of the older drug and switching of physician demand to the new drug, in order to prevent effective generic entry. The Commissioner of Competition ("Commissioner") obtained a court order for the production of records and a written information return from Alcon in order to advance his inquiry. Alcon argued against the issuance of the order, claiming that its decision to cease marketing the older drug was not an anticompetitive act constituting an abuse of dominance. It argued further, if there was an abuse of dominance, the inquiry was premature or the issues had been resolved, because Alcon had agreed to recommence supplying Patanol in Canada.

The Bureau's case as currently framed could raise difficult questions on the assessment of pro-competitive benefits and any anticompetitive harm arising from incremental innovation, as seen in U.S. cases. It appears that Apotex remained free to compete on the basis of its generic version of the older drug, which may make the anticompetitive harm more difficult to establish. This is in contrast to product-hopping cases in jurisdictions such as the European Union and the United Kingdom, where seminal cases involved additional action by the branded pharmaceutical company beyond the mere discontinuance of sales of the branded version, such as withdrawing market authorizations for the old branded drug in order to block even the possibility of competition from the generic version of that older drug.

The decision to issue the production order in the Alcon investigation is not an endorsement by the court of the Commissioner's theory of the case. However, if the case proceeds, it would be a rare example of the Commissioner adopting an argument of more than "mere exercise" of patent rights. Alcon was required to produce records and written returns within 60 days of the order issued on December 21, 2012. Although such deadlines may be extended on consent of the Commissioner, it seems that, a year later, there has been plenty of time for production and review of the records. The status of the case is thus somewhat unclear, but it is understood to be ongoing.

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[7] *See, Commissioner of Competition v Alcon Canada Inc, Federal Court of Canada*, Court File No T-2223-12.

The Alcon investigation comes alongside developments that signal a new willingness of the Bureau to wrestle with the often-complex intersection of intellectual property law and competition law. In November 2013, the Bureau held a workshop on competition issues in the pharmaceutical sector, which included sessions on reverse payment settlements, international perspectives on antitrust in pharmaceuticals, and pharmaceutical life-cycle management strategies.

New guidance on intellectual property law and competition enforcement is also anticipated. The current Intellectual Property Enforcement Guidelines ("IPEGs") date to 2000, long before issues like product hopping were at the forefront of competition enforcement. The Bureau's newfound enthusiasm is in contrast to a historically restrained approach, at least compared to agencies in other jurisdictions, to issues in the pharmaceutical industry and, in particular, cases that raise questions over the reconciliation of patent law and competition law. Even if the Alcon case does not ultimately proceed, the Bureau seems newly poised to delve into enforcement in this area.

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Canada's Proposed Legislation to Prohibit Cross-Border Price Differentials

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Canada's Proposed Legislation to Prohibit Cross-Border Price Differentials

Marissa Ginn & Marc Van Audenrode[1]

I. INTRODUCTION

In its most recent budget released on February 11, 2014, the Government of Canada announced its intent to introduce new legislation guarding against what it terms "unjustified cross-border price discrimination" resulting from "country pricing strategies—that is, when companies use their market power to charge higher prices in Canada that are not reflective of legitimate higher costs."[2] Some evidence exists that Canadians pay more than Americans for identical goods: recent estimates from various sources of the Canada-U.S. price gap range from 10 to 25 percent, after adjusting for sales tax differentials.[3]

In this article, we discuss the potential economic factors driving such price differentials, and provide our views, as economists, on the implications of this proposed amendment to the *Competition Act* on consumers and on the Canadian economy.[4]

II. WHAT IS PRICE DISCRIMINATION?

Price discrimination is a term used by economists to describe a firm's practice of charging different prices to customers for the same good or service. Airline tickets for a given flight are a commonly cited example, whereby the prices paid by different passengers typically vary widely, depending mainly on when a ticket was purchased and for what fare class. Other examples occur in homogeneous goods industries with high relative transportation costs and economies of scale, such as cement or fertilizer. In such industries, firms generally compete on the delivered price to each customer, so customers located close to the factory will pay more for the good net of transportation costs than customers located farther away with more alternative sources of supply. This form of price discrimination, despite being frequently perceived as proof of the firm in question unjustly exercising market power, can in fact be a more competitive and more efficient market outcome than if all customers were charged the same net price.

The potential efficiency of price discrimination and the possibility that it does not constitute evidence of anticompetitive behaviour were previously recognized by the Canadian

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[2] Minister of Finance of the Government of Canada, "The Road to Balance: Creating Jobs and Opportunities," February *11, 2014 (*henceforth referred to as the "Federal Budget"*).*

[3] *Id.*, Chart 3.4.1 at 181.

[4] We note that it is not clear from the Federal Budget whether this proposed legislation would be applied only to price discrimination between Canada and the United States. For simplicity, we focus on the Canada-U.S. price differential in this article.

Government when it repealed the criminal pricing provisions concerning price discrimination in its 2009 amendments to the *Competition Act*. In addition, the view that higher prices in Canada relative to the United States are not necessarily indicative of a lack of competition was echoed by the Canadian Competition Bureau in a recent report by the Standing Senate Committee on National Finance entitled "The Canada-USA Price Gap."[5] This same report notes that officials from the Competition Bureau said that "the Competition Bureau is not a price regulator and that Canadian businesses are free to set their own prices at whatever levels the market will bear, provided that these high prices are not the result of anti-competitive conduct such as price-fixing or abuse of a dominant position."[6]

Current provisions in the *Competition Act* already address issues of excessive market power from explicit coordination and abuse of dominance. The Canadian Government's proposed new legislation is thus fundamentally at odds with the Competition Bureau's past positions, as well as with developments in competition laws in other jurisdictions.[7]

III. POSSIBLE CAUSES OF CROSS-BORDER PRICE DIFFERENTIALS

Aside from border costs, which are the traditional transaction costs associated with selling goods across borders (*e.g.*, import tariffs), there are two types of non-border costs that can lead to cross-border price differentials: local transaction costs and differences in local market conditions. The latter include factors such as dissimilarities in supply conditions like the availability of substitute products.

We are not aware of any research that has pinpointed a single explanation for the differential in average prices of retail goods between Canada and the United States. Some of the key reasons that have been identified as contributing to the Canada-U.S. price gap—and are explained in more detail below—are: exchange rates, population and demographics, operating costs, and country pricing strategies.

A. Exchange Rates

In a recent article published in the *American Economic Review*, the premier journal in economics, its authors find that differences in prices between Canada and the United States for identical goods sold at retail outlets operated by the same grocery store chain could in part be explained by exchange rate differentials. Specifically, their research found that average prices (and costs) in Canada were comparably higher than those in the United States in 2007, after the appreciation of the Canadian dollar relative to 2004.[8]

This result would seem counter-intuitive, as a higher relative value of the Canadian dollar could be expected to bring Canadian prices closer to U.S. prices once adjusted for the exchange rate, not farther away. Moreover, as the Canadian dollar continued to appreciate toward parity with the American greenback, the number of Canadian shoppers travelling across the border

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[5] Senate Canada, "The Canada-USA Price Gap: Report of the Standing Senate Committee on National Finance," February 2013 (henceforth referred to as the "Senate Committee Report"), p. 56.

[6] *Id.* at 56.

[7] COMPETITION BUREAU CANADA, A GUIDE TO AMENDMENTS TO THE COMPETITION ACT (April 22, 2009).

[8] G. Gopinath, et al., *International Prices, Costs, and Markup Differences*, 101(6) AMER. ECON. REV. Fig. 3 and p. 2458 (October 2011).

increased.[9] This increase in cross-border shopping could be expected to put downward pressure on prices in Canada. But recent measures of the Canada-U.S. price gap indicate that parity between the Canadian and American dollars did not lead to price equalization, at least on average and for some categories of goods.[10]

The recent changes in the value of the Canadian/U.S. dollar exchange rate have been accompanied by greater volatility in exchange rate fluctuations. This creates added uncertainty and could therefore explain part of the price gap from the risk premium associated with this increased volatility. In other words, the uncertainty surrounding the future value of the Canadian dollar may lead companies to price their goods at a higher level in order to compensate them for the risk of losing money on imported products and the costs of frequently changing their prices to adjust to all exchange rate movements.

The risk with pricing in a fluctuating exchange rate environment is especially relevant given the historical context, where the value of the Canadian dollar was substantially lower than its U.S. counterpart in the not-so-distant past. Thus, manufacturers may be reluctant to price goods at equivalent values when the two dollars are at par, especially when there are non-negligible costs to changing prices (*e.g.*, prices printed on books), as there is substantial risk that such prices will imply a considerable discount in Canada when the value of the Canadian dollar depreciates. For example, over the period of about a year from the beginning of 2013 to the beginning of 2014, the Canadian dollar fell from approximately par to below U.S. $0.90, implying a 10 percent discount on any prices that are listed as equivalent in Canadian and U.S. dollars.[11] Changes in the exchange rate and exchange rate volatility may therefore explain at least some of the Canada-U.S. price gap.

B. Population and Demographics

Customers that buy in larger quantities generally benefit from lower per unit prices, a concept known in economics as buyer power. Given that the population of Canada is approximately one-tenth of the population of the United States, the relative size of the Canadian market may contribute to lower levels of competition and explain at least part of the Canada-U.S. price gap.[12] For imported goods, it could be expected that per unit prices are higher in Canada as compared with the United States due to smaller volumes being purchased from foreign manufacturers. For domestically produced goods, perhaps American manufacturers are better able to profit from economies of scale and cost efficiencies due to the larger pool of proximate buyers at their disposal.

Other than differences in the size of each market, there are a number of differences in the characteristics of the population. In particular, as compared to the United States, Canada has, among others, (i) substantially more foreign-born people, (ii) lower personal disposable income per capita, (iii) lower per capita retail spending, (iv) a relatively older population, and (v) a

[9] *See* Figure 3 of the Senate Committee Report, *supra* note 5.

[10] *Id.*, Ch. 4, *supra* note 5.

[11] Bank of Canada, Noon Exchange Rates, *available at* http://www.bankofcanada.ca/rates/exchange/ (accessed March 9, 2014).

[12] World Bank, Population by Country, 2012*, available at* http://data.worldbank.org/indicator/SP.POP.TOTL (accessed March 9, 2014).

greater percentage of the population living in the country's largest cities.[13] These distinctions may contribute to differences in demand for certain products.

The differences in demand may also manifest themselves through dissimilarities between versions of a given type of product to cater to consumer preferences in the given market, such that many products may not be considered "the same."[14] Such differences in population, demographics and versions of a given product type may thus be factors in explaining the Canada-U.S. price gap.

C. Operating Costs

Although the Canadian Government has not yet provided details on the framework it is proposing to introduce,[15] it appears as though firms would be required to justify charging higher prices in Canada than in the United States on the basis of their operating costs.[16] Higher taxes, higher labor costs (potentially resulting from higher minimum wages), and the higher cost of distribution (distances between major population centers are generally larger in Canada and the price of fuel is substantially higher) are a few factors that are likely to provide some basis for firms' higher operating costs in Canada.

However, some costs likely stem from differences that cannot be easily quantified, such as cross-country productivity differences. More fundamentally, prices need not be directly tied to operating costs in a market that is not perfectly competitive, but this does not imply that firms are behaving anticompetitively. Such differences in local transaction costs are likely to explain at least part of the Canada-U.S. price gap.

D. Country Pricing Strategies

Certain factors prevent price arbitrage by consumers and retailers who would purchase cheaper goods in one market to resell them in another market. Such market segmentation factors include differences in commercial practices, corporate agreements requiring that retail stores purchase only from own-country distributors (*i.e.*, supply chain segmentation), and government regulations (*e.g.*, safety standards and language labelling requirements). As a result of market segmentation, profit-maximizing firms may be able to price discriminate by selling products at different prices in different markets in response to differences in supply and demand conditions across the segmented markets. Market segmentation factors may therefore inhibit prices from converging until price differentials can be eliminated.

This is the reason for the Canada-U.S. price gap that is being targeted by the Canadian Government in its proposed amendment to the *Competition Act*. However, the government appears only to be addressing goods for which prices are *higher* in Canada relative to the United

[13] Statistics Canada, Canadian Demographics at a Glance, 2008, Catalogue no. 91-003-X; TD Economics, "Comparing and Contrasting Canadian and American Consumers – Some Stylized Facts," December 18, 2013; OECD.

[14] Indeed, Gopinath and co-authors found a very small percentage of all products offered across the grocery store chain were sold both in Canada and the United States, where identical products were matched on the basis of unique product (UPC) codes. Gopinath, et al., *supra* note 8 at 2455.

[15] As noted in the Federal Budget, "details will be announced in the coming months." *Supra* note 2 at 182.

[16] *Id.* at 182.

States. But some goods' prices may indeed be *lower* in Canada as a result of firms' pricing-to-market strategies. For example, although most cars' list prices are higher in Canada, including for vehicles manufactured in Canada, some cars are listed at lower prices.[17, 18]

The fact that price differentials are lower or even reversed for certain products or product types is likely due to differences in supply and demand across the two markets, which affects the prices that firms can charge in that given market. Indeed, competition for the sale of compact and subcompact vehicles, which are in higher demand in Canada relative to the United States, has kept relative price differentials for these types of cars lower as compared with luxury vehicles.[19]

In the same *American Economic Review* article mentioned above, the authors found that the price gap they detected was due to wholesale price differences, not differences in retail markups or non-traded retail costs.[20] This finding of pricing-to-market at the wholesale level is consistent with what the Retail Counsel of Canada reported to the Standing Senate Committee on National Finance, namely that the majority of products sold by Canadian retailers are purchased in Canadian dollars through Canadian wholesalers, distributors, and multinationals with subsidiaries in Canada—thus retailers were not to blame for the lack of adjustment of retail prices to the exchange rate.[21] Higher wholesale prices (and, consequently, higher retail prices) may in part result from import tariffs, which the Canadian Government is currently exploring through a program to provide tariff relief on certain categories of consumer goods.[22]

Another market segmentation factor that inhibits arbitrage, and therefore cross-border price convergence, is the *de minimis* threshold on the value of goods that can be shipped into Canada without being subject to import duties or taxes. This threshold is currently set at $20 in Canada, but other countries have substantially higher thresholds. For example, the United States' threshold is U.S. $200.[23]

The lower *de minimis* threshold in Canada may reduce competition and may also increase costs for companies that import low value input components, thereby contributing to the Canada-U.S. price gap. Similarly, an increase in the allowable exemption limits for travellers, including allowing an exemption for travel under 24 hours, may also contribute to reducing the Canada-U.S. price gap by enhancing competition.

IV. CONCLUSION

In sum, companies will charge whatever prices the market will bear, which is likely not reflective of anticompetitive behavior on their part as the highest possible price a firm can charge will be reflective of the level of competition in the market. If there are relatively few substitutes for a good and buyers are not very sensitive to the price, then manufacturers can sell at relatively

[17] Senate Committee Report, *supra* note 5 at 33-35.

[18] Car prices in 2002, when the Canadian dollar was only worth about U.S. $0.64, were *lower*, after adjusting for exchange rate differentials. (*Id.* at 38.)

[19] *Id.* at 39.

[20] Gopinath et al., *supra* note 8 at 2475.

[21] Senate Committee Report, *supra* note 5 at 8.

[22] Federal Budget, *supra* note 2 at 182; Senate Committee Report, *supra* note 5 at 13-19.

[23] Senate Committee Report, *supra* note 5 at 28.

higher prices. This is not against the current *Competition Act*. Most firms operate in markets that are not perfectly competitive, as perfect competition is rare, thus some degree of market power should not be a concern. Furthermore, increases in internet purchases and awareness of cross-border prices from web-based price comparisons will likely lead to enhanced price competition, thereby decreasing the Canada-U.S. price gap for many identical consumer goods.

Finally, the implications of the Canadian Government's new proposed legislation may not have the intended benefit on Canadian consumers. This legislation would entail an additional burden on companies operating in Canada or selling into the Canadian market, where firms may be required to provide details of a complex price and cost analysis, which could ultimately have the undesired effect of further reducing competition by driving out (or failing to attract) competitors.[24]

Indeed, the "insufficient competition in the retail market" that was noted as being one potential factor for the Canada-U.S. price gap in the Federal Budget may be further exacerbated by the Government's latest proposed amendment to the *Competition Act*.[25] Particularly since the bulk of the Canadian population lives in close proximity to the American border, the simplest way to decrease the Canada-U.S. price gap for identical consumer goods would be to allow consumers to freely purchase goods in the United States without any exemption limits, thereby requiring prices in Canada to gravitate toward those across the border in response to competition. But this would likely not have a favorable impact on Canadian businesses, and would not address perhaps more fundamental issues driving the price gap, such as productivity differentials. Thus, the Canadian Government should carefully consider how its pro-consumer stance backed by this proposed legislation may adversely affect the Canadian economy as a whole.

[24] Such a price and cost analysis would likely be complex as it may require data over a sufficiently long period of time to explain how input costs purchased at a given price in one period affect output prices in another period, and how contracts may affect prices and costs.

[25] Federal Budget, *supra* note 2 at 181.

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"Special" Treatment:
State-Owned Enterprises Under Canada's Foreign Investment and Competition Laws

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"Special" Treatment: State-Owned Enterprises Under Canada's Foreign Investment and Competition Laws

Sandy Walker[1]

I. INTRODUCTION

Canada, like the United Kingdom and the United States, has witnessed a sharp decline in state ownership in the past few decades. However, investment by foreign state investors in Canada in recent years—in effect a foreign "nationalization"—has represented an interesting and significant deviation from this trend, particularly in the natural resources sector. Such investment has not gone unnoticed: the acquisition of Canadian resource companies by foreign state-owned enterprises ("SOEs") and sovereign wealth funds ("SWFs") has become the subject of heated political debate and extensive press attention in Canada over the last few years including the acquisition by Chinese SOE, CNOOC, of Canadian oil company, Nexen in 2013. (For convenience, SOEs and SWFs will be referred to collectively in this paper as "SOEs.")

This wave of foreign state ownership has been remarkable not only because of the state status of the acquirers but also because the sources of foreign direct investment in Canada are no longer limited to Western countries (particularly the United States) but include a growing number of emerging economies such as China, Malaysia, Korea, Russia, Singapore and the Middle Eastern oil states.[2]. As illustrated in Table 1, which lists recent SOE investments in Canada (see Appendix A), investment by SOEs in Canada has focused primarily on natural resources and, in particular, oil and gas.

Also of note is that Chinese investment has expanded dramatically: cumulative foreign direct investment into Canada from China (both state and non-state) was U.S. $10.7 billion at the end of 2011, an increase of 3500 percent in the last decade.[3] From 2011 to 2012, Chinese investment in Canada doubled to reach U.S. $21.3 billion, $15.2 billion of which can be attributed to the CNOOC-Nexen deal.[4]

SOEs are also investing in related industries, moving up the energy sector's "value chain;"[5] for example, PetroChina had expressed interest in building Enbridge's Northern

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[2] *See*, *The Visible Hand, Special Report on State Capitalism*, 402 (8768) THE ECONOMIST (January 21, 2012) ("The Economist 2012 SOE Report") which notes that "the 13 biggest oil firms, which between them have a grip on more than three-quarters of the world's oil reserves, are all state-backed." In addition, "three Chinese state-owned companies rank among the world's ten biggest companies by revenue, against only two European ones."

[3] Foreign Affairs and International Trade Canada, "Canada-China Economic Complementarities Study," http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/china-chine/study-comp-etude.aspx?view=d#exec.

[4] *See* KPMG, *The Dream Goes On: Rethinking China's Globalization* (May 2013).

[5] *See* Nathan Vanderklippe, *China Moving Up Canada's energy value chain*, GLOBE AND MAIL (June 18, 2012), *available at* http://www.theglobeandmail.com/report-on-business/industry-news/energy-and-resources/china-moving-up-canadas-energy-value-chain/article4106346/

Gateway pipeline to transport Canadian oil to the west coast of Canada. It is also noteworthy that Chinese companies have increasingly invested in Canadian companies with assets in Canada rather than Canadian companies with assets outside of Canada (e.g., China National Petroleum Corporation's acquisition of PetroKazakhstan in 2005).

The sometimes nationalist response by Canadians[6] to SOE investments is in part a response to already existing concerns about foreign investment. These concerns rose to a fevered pitch in the wake of a spate of foreign (non-SOE) takeovers of Canadian icons beginning in the mid 2000s with the acquisitions of companies such as mining company Inco, aluminum producer Alcan, natural resources giant Falconbridge, and retailer Hudson's Bay Company (founded in 1670 in Canada). The loss of head office jobs (the so-called "hollowing out" of corporate Canada) and the elimination of Canadian companies as national champions were key themes of critics of these investments.

II. MERGER CONTROL AUTHORITIES—COMPETITION BUREAU AND INDUSTRY CANADA

The two main regulatory authorities that review SOE acquisitions in Canada are the Competition Bureau which enforces merger control under the Competition Act (the "CA") and the federal Department of Industry ("Industry Canada")—more specifically, the Investment Review Division—which administers and enforces Canada's foreign investment review legislation, the Investment Canada Act (the "ICA").[7] With the increase in SOE investments over the past several years, both authorities have scrambled to develop responses to some of the specific issues raised by such investments. As discussed in greater detail below, the Competition Bureau has recently formulated a provisional response while the Canadian Government has articulated a more restrictive SOE policy and buttressed this with amendments to the ICA.

III. BRIEF BACKGROUND ON SOES

While SOEs have been around for many decades, they became the focus of public discourse beginning in the mid 2000s as they shifted a proportion of their investments from lower return bonds and treasury bills of Western countries to higher yielding equity investments and strategic assets. Moreover, SOEs have increasingly been from emerging economies that have accumulated foreign exchange reserves through trade surpluses (*e.g.* countries such as China).

SOEs may be distinguished from private companies on several dimensions from their governance structure and objectives to their operating principles. In 2005, the OECD recognized the special factors that characterize state owners and create unique challenges for them and for the countries in which they make investments:

> A major challenge is to find a balance between the state's responsibility for actively exercising its ownership functions, such as the nomination and election of the board, while at the same time refraining from imposing undue political interference in the management of the company. Another important challenge is to ensure that there is a level-playing field in markets where private sector

[6] A poll by Abacus Data in September 2012 showed that 69 percent of Canadians were opposed to the proposed acquisition of Nexen by CNOOC. *See* abacusdata.ca/2012/09/20/energy-politics-nexen-cnooc-and-china/.

[7] The Department of Canadian Heritage is responsible for the administration of the ICA in respect of cultural businesses.

companies can compete with enterprises and that governments do not distort competition in the way they use their regulatory or supervisory powers.[8]

Not surprisingly, SOEs are not a homogeneous group. Some, such as the Norwegian fund, will not buy more than 5 percent of any one company while others are willing to take bigger stakes in companies and expect to import expertise through their investments. Moreover, as is apparent from Table 1, SOEs are often from non-OECD countries (*i.e.*, more recently developed or developing countries) where state ownership is a dominant feature of the economy, particularly in critical sectors such as energy, transport and telecom.[9]

In addition, some SOEs may not necessarily operate according to the commercial principles and dictates of private-sector companies, and the home countries in question may not be democratic or capitalist. In other words, the home countries of the SOEs may have different political, cultural, and economic institutions and SOEs, accordingly, represent a heterogeneous group.

IV. MERGER CONTROL OF SOE TRANSACTIONS UNDER THE COMPETITION ACT

A. Background on the Competition Act

Under the CA, parties to a transaction involving the acquisition of assets of an operating business; of the voting shares of a corporation; or of interests in a combination, an amalgamation, or the formation of a combination may be subject to the CA's premerger notification regime. In addition, the Commissioner of Competition (the "Commissioner"), who is the head of the Competition Bureau (the "Bureau"), may review and challenge any "merger" before the Competition Tribunal. A "merger" is defined to include not only acquisitions of control but also acquisitions of a significant interest in a business.[10] The following section provides a brief overview of the CA's premerger notification process as well as the substantive merger review process.

B. Premerger Notification and Merger Review

Premerger notification is required under Part IX of the CA when certain monetary thresholds are exceeded. There are three notification thresholds[11] applicable to an acquisition of voting shares of a corporation under the CA, all of which must be exceeded for the transaction to be notifiable:

- Size of the Parties: The parties to the transaction (who are the buyer and the target corporation in a share acquisition), together with the affiliates of each of them,

[8] *OECD Guidelines on Corporate Governance of State-Owned Enterprises*, OECD 2005 at 3 [*OECD Governance*].

[9] The Economist 2012 SOE Report, *supra* note 2 at 4, notes that at June 2011, the highest shares of national/state-controlled companies in the emerging market by industry sector are, in descending order, energy, utilities, telecommunication services, financials, and industrials.

[10] Section 91 of the CA defines a "merger" as "the acquisition or establishment, direct or indirect, by one or more persons, whether by purchase or lease of shares or assets, by amalgamation or by combination or otherwise, of control over or significant interest in the whole or a part of a business of a competitor, supplier, customer or other person."

[11] All thresholds in the CA are determined with reference to the most recent audited financial statements of the target company, adjusted, as necessary, to reflect subsequent significant non-ordinary course events or transactions.

collectively have assets (book value) in Canada or annual gross revenues from sales in, from, or into Canada that exceed CDN $400 million.

- Size of the Transaction: The aggregate book value of the assets in Canada owned directly or indirectly by the target corporation **or** the annual gross revenues from sales in or from Canada generated from those assets in Canada must exceed CDN $82 million.
- Shareholding Threshold: As a result of the proposed acquisition, the purchaser will hold more than 20 percent of the voting shares of a publicly traded corporation (or more than 35 percent of a privately held company) or if the purchaser already holds more than 20 percent of the voting shares of a public company (35 percent of a private corporation), it would hold more than 50 percent of the voting shares as a result of the proposed acquisition.

Where a proposed transaction meets the notification thresholds under the CA, each of the parties is required to file a notification with the Commissioner. This filing commences a 30-day statutory waiting period within which the parties are prohibited from closing the transaction, unless the requirement to notify is waived or the waiting period is terminated by the issuance of an Advance Ruling Certificate (an "ARC") or a no-action letter. The Commissioner may within the initial 30-day waiting period issue a "supplemental information request" ("SIR") for additional information and documents, in which case a new 30-day waiting period will commence following compliance with the SIR. SIRs are requested only where a matter raises significant competition concerns.

In addition to, or in lieu of, compliance with the CA's premerger notification provisions, the parties have the option of requesting **positive clearance** in the form of an ARC or a no-action letter, and do make such requests in almost all notifiable transactions (to shape the Bureau's assessment of a transaction). The request for an ARC or no-action letter is in the form of a letter to the Commissioner and contains a competitive impact analysis of the transaction. If granted, an ARC exempts the parties from any premerger notification obligation or terminates the statutory waiting period if a premerger notification has been filed and the waiting period is still running. An ARC also precludes the Commissioner from challenging a completed transaction provided the parties have disclosed all material facts and the transaction is completed within one year of the date on which the ARC is issued.

An ARC will only be issued in the clearest of circumstances where the Commissioner is of the view that the transaction is not likely to substantially prevent or lessen competition (*e.g.*, where there is no, or only minimal, overlap in the businesses of the buyer and the target). Even if an ARC request is denied, the Commissioner may issue a no-action letter stating that he does not at that time intend to challenge the transaction.

The differences between an ARC and a no-action letter are that a no-action letter (i) preserves the Commissioner's right to challenge the transaction within one year of closing, and (ii) absent an explicit waiver of the obligation to notify (which waiver is routinely granted), does not exempt parties from the premerger notification obligation. It is highly unusual for a transaction to be challenged post-closing following issuance of an unqualified no-action letter, and parties regularly close their transactions with comfort on the basis of such clearance.

Whether or not a transaction is notifiable, it may be subject to challenge by the Commissioner before the Competition Tribunal on the grounds that it will likely cause a substantial lessening or prevention of competition. In making this determination, the Commissioner will consider a number of factors, including the extent of any competitive overlap between the businesses of the parties and, with respect to products that overlap, the presence of effective competitors, the parties' and competitors' market shares, and any barriers to entry (among other things).

C. Application of the Competition Act to SOE Acquisitions

The nationality of the parties to a transaction is not a relevant factor in merger control under the CA. Nor is a party's state-owned status. Nevertheless, the Competition Bureau has reviewed a number of SOE transactions, many in the natural resources sector, over the past several years. The Bureau has not issued definitive guidance on SOE-related issues with the result that its views may well continue to evolve. Nevertheless, the following section summarizes the Bureau's current, provisional approach to the substantive review of SOE transactions as well as premerger notification.

D. Substantive Review of SOE Transactions

The Competition Bureau has reviewed numerous SOE transactions. As many of these have occurred in the oil and gas sector—often production assets—none has raised serious substantive competition issues as of yet. Nevertheless, as SOE investments grow in natural resource sectors and expand beyond such sectors, future SOE transactions may generate significant competition issues.

Such an outcome is much more likely if the Competition Bureau were to regard all SOEs owned by the same foreign government as under common control for purposes of its substantive competition analysis. In fact, the Competition Bureau has likened its treatment of SOEs to how it treats private equity funds that are controlled by a common management firm. As a result, the Bureau has taken the position that it may not provide positive clearance in the form of an ARC or a no-action letter if it does not receive detailed information regarding all of the foreign government's (including its affiliates) investments in Canada (down to a 10 percent interest).[12] Not surprisingly, this could create difficulties for certain SOEs that do not have access to detailed information about the businesses of entities that they may regard as competitors.

The concern raised by the Bureau's demand for extensive information (on 10 percent and greater investments of other SOEs owned by the same home state as the acquiring party SOE) is mitigated somewhat by the fact that the Bureau is only interested in the holdings of other SOEs in industries related to the target business. For example, if the business to be acquired is engaged in the oil and gas sector, the Bureau will not be interested SOEs operating in an unrelated sector (*e.g.* air transportation), although the Bureau might find investments in vertically related sectors such as pipelines to be relevant.

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[12] If the SOE believes there are impediments to obtaining the relevant information, the SOE must advise if there exist alternative means for the Bureau to obtain the information.

Where the SOE is unable to provide sufficient information about other SOEs' holdings in Canada, the transaction may have to proceed to closing without receiving positive clearance (*i.e.*, an Advance Ruling Certificate or a no-action letter) unless the Bureau accepts that such information is not relevant. In such instances, the parties will have to take comfort from the Bureau's failure to bring an injunction prohibiting closing of the transaction and the parties' own assessment of the likelihood for any challenge to the transaction.

A more appropriate response from the Bureau would be to issue a no-action letter if it does not intend to challenge the transaction (the Bureau remains free under the CA to oppose the transaction within one year). Such an approach would permit the acquiring SOE to obtain some reassurance and would also ensure that a standard closing condition (an ARC or a no-action letter) in a purchase and sale agreement could be fulfilled.

E. Premerger Notification Issues Arising for SOEs

The sovereign status of the investor may also be relevant in respect of premerger notification. In particular, a significant issue is whether other SOEs owned by the same home state are technically "affiliates" for premerger notification purposes under the CA.

The Competition Bureau has provisionally (for the past few years) adopted the position that the term "person" for the purposes of premerger notification section of the CA does not include a foreign government.[13] As a result, SOEs owned by the foreign government that are not within the party SOE's corporate chain of control below the parent state are not currently considered "affiliates" for purposes of premerger notification.

The Bureau's position is significant and advantageous for SOE acquirers for two reasons. First, all parties to notifiable transactions must submit certain required information regarding all affiliates in the same or related (vertically or horizontally) businesses. This requirement could be very difficult for SOE parties to meet given that other SOEs may be unwilling to share such competitively sensitive information (e.g., customer information) with entities they regard as competitors. If information about such SOEs were required, the merging parties would not be able to trigger the 30-day statutory waiting period. If the parties have also not received positive clearance from the Commissioner in the form of an Advance Ruling Certificate or a "no-action" letter (see above discussion), then they would not be in a legal position to close.

Fortunately, because the Competition Bureau's interpretation of "affiliate" does not include affiliates who are in different chains of control under the foreign government, the likelihood of an SOE party being unable to provide information relating to affiliates with assets in the same business in Canada may be reduced. This assessment is predicated on the assumption that SOEs that compete with the SOE party are less likely to be held within the same corporate grouping below the foreign government. Where this assumption does not hold, the SOE party may try to convince the Bureau that the SOEs about which information is sought are marketplace rivals, and that the SOE party has complied with CA requirements on the basis that information

[13] Note that the CA specifically addresses this issue for corporations controlled by the Canadian sovereign, whether at the federal or provincial level, stating, "one corporation is not affiliated with another corporation by reason only of the fact that both corporations are controlled by Her Majesty in right of Canada or a province, as the case may be."

regarding its "affiliates" is not "reasonably obtainable" by the SOE party (a ground for failing to supply certain information that must be set out in a declaration under oath or solemn affirmation attached to the notification filing). However, the Commissioner might well not accept this position.

SOEs that might otherwise be considered "affiliates" may also be omitted from the filing if they could not reasonably be considered relevant to the Commissioner's assessment of whether the proposed transaction would be likely to prevent or lessen competition substantially. As a result, no information would need to be included in a premerger notification relating to SOEs engaged in a sector that is unrelated vertically or horizontally to the acquiring SOE's overlapping business with the target. This "relevancy" screen is a standard exemption and may be helpful for SOE parties .

Second, the Bureau's provisional approach regarding SOE affiliates means that fewer SOEs must be included when calculating the size of parties' threshold ($400 million).[14] This is advantageous for SOEs that have limited assets in Canada because the transaction may not, as a result, be notifiable.

V. REVIEW OF SOE TRANSACTIONS UNDER THE INVESTMENT CANADA ACT

As with all investments by foreigners, SOE investments may be subject to review under the *Investment Canada Act* (the "ICA"). SOEs are currently subject to the same review threshold as non-SOEs (although they will not be once amendments to the ICA are implemented—see discussion below); but, since 2007, reviewable investments have been assessed on the basis of two additional criteria not applicable to non-SOE investors—commercial orientation and corporate governance—under the "net benefit to Canada" test.

In the past year, the Canadian Government announced that it will scrutinize SOE investments more closely and in June 2013 amended the ICA to permit the review of SOE acquisitions that might otherwise not be reviewable under the general ICA rules and to broaden the definition of an SOE to include "influence," not just ownership, by a foreign government. In addition, although it approved CNOOC's acquisition of Nexen in December 2012, the Government indicated it would prohibit further acquisitions of control of Canadian oil sands businesses by SOEs save on an exceptional basis.[15] The Government has also revised its guidelines on how it will review investments by SOEs, although its 2007 guidelines remain largely intact.

[14] Even if the Bureau took the position that all entities owned by the same foreign state are affiliates, not all SOEs would be equally affected. In particular, some SOEs might not be considered to be controlled by a foreign state under the CA "control" rules and therefore might not be affiliated with other SOEs owned by that state. For example, unlike for Canadian government entities, the CA does not recognize that an SOE might not have share capital. Accordingly, SOEs without share capital or otherwise not meeting the definition of control in the CA might not be considered to be controlled by the home state and therefore affiliated with other SOEs owned by that state.

[15] Note that only reviewable transactions are subject to this prohibition.

A. Background on the ICA

1. The ICA Review Process

Subject to certain exemptions, every acquisition of control by a non-Canadian of a Canadian business requires either notification (essentially a post-closing administrative formality) or detailed review and pre-closing ministerial approval under the ICA. The test for approval is whether the transaction will be of "net benefit to Canada."

Direct acquisitions[16] of control by World Trade Organization ("WTO") investors trigger a pre-closing approval requirement if the review threshold is exceeded. (Indirect acquisitions, *i.e.*, the purchase of a foreign corporation that owns a Canadian entity, are generally not reviewable, subject to exceptions for the purchase of a cultural business or non-WTO transactions.) The current review threshold is a book value of assets of the target of CD $354 million or more (as reflected in the audited financial statements for the most recently completed fiscal year prior to closing). A WTO investor is a purchaser that is controlled ultimately by nationals of a WTO member country.[17]

The review threshold will be changed following issuance of a regulation implementing a new review threshold (established in 2009 amendments to the ICA) of $600 million in "enterprise value" ("EV") of the target Canadian business; this threshold will rise to $800 million within two years and to $1 billion within four years. Based on previous drafts of the regulation, EV for a public company will likely be defined in relation to its market capitalization over a defined period plus liabilities minus cash; for share acquisitions of private companies or asset purchases, EV will likely be defined in relation to the purchase price plus liabilities minus cash. (As will be discussed in greater detail below, the EV threshold will not apply where the acquirer is an SOE investor as a result of amendments to the ICA in June 2013.)

If a transaction is reviewable, it must be approved by the Minister of Industry prior to closing. An application for review triggers a 45-day initial review period which can be unilaterally extended by Industry Canada for a further 30 days. Any further extensions must be made with the consent of the acquirer. (Such consent is generally forthcoming as Ministerial approval may otherwise be withheld.)

The determination of whether a transaction meets the "net benefit to Canada" test is largely based on economic factors relating to the impact of the investment on the following, among others: the level of employment, capital expenditures, the locus of head office functions, participation of Canadians in senior management, innovation, technology transfer, and the level of exports. However, the statutory factors include "the compatibility of the investment with

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[16] Direct acquisitions may be by way of acquisition of the shares of a Canadian corporation or of interests in a Canadian partnership or through the acquisition of substantially all the assets of a business in Canada.

[17] A corporation is WTO-controlled if the corporation is not controlled in fact through share ownership (*i.e.*, a widely held company) and at least two-thirds of the board of directors are WTO citizens. Note that even if the purchaser is not a WTO investor, the higher review threshold of $354 million also applies if the Canadian target business is currently controlled by a WTO investor; for this purpose, however, Canada is not considered a "WTO" country. That is, if a non-WTO investor acquires a Canadian-controlled corporation, the current review threshold is $5 million in book value of assets. (However, there are very few non-WTO investors given the inclusiveness of the WTO membership roster.)

national industrial, economic and cultural policies, taking into consideration industrial, economic and cultural policy objectives enunciated by the government or legislature of any province likely to be significantly affected by the investment." The open-ended nature of this factor gives the Government broad latitude to invoke unspecified policies to justify the "net benefit" decision and accordingly permits decisions that may be politically motivated.

Investors typically are required to make certain commitments (called "undertakings") to the Canadian government in order to obtain ministerial approval. These undertakings are generally for a three-year duration but may be five years for very large transactions and, in certain instances, will operate indefinitely.

2. National Security Review Process

In 2009, the Canadian Government introduced a national security screening process into the ICA. The federal Cabinet may prohibit or attach conditions to a foreign investment in an existing Canadian business, or the establishment of a new Canadian business, if such investment would be "injurious" to Canada's "national security." If the investment has already been completed, the Cabinet may order a divestiture.

The scope of "national security" is not defined nor has the government issued any guidance. Without any criteria identified under the act, the federal Cabinet has wide discretion to determine the relevant risk factors. Note that guidance issued in respect of the U.S. national security review process (undertaken by the Committee on Foreign Investment in the United States or CFIUS) identifies targets in sectors such as critical infrastructure, critical technology, and energy as meriting closer scrutiny.

In addition, national security review applies to a much broader scope of transactions than the general "net benefit" review process. For example, there is no safe harbor for transactions that fall below the "net benefit" review threshold noted above, and minority investments are subject to review whether or not they constitute an acquisition of "control."

While there is no formal mechanism to obtain pre-clearance of these transactions on national security grounds, early submission of a filing (either an application for review or a notification) under the general ICA provisions (*i.e.*, those not related to national security) will trigger a 45-day period following which the Minister must send a notice of an order for national security review or during which the Minister must send a notice of possible review. Parties to a transaction would be well-advised to provide for leeway of several days (*e.g.*, five days) in addition to the 45-day period to provide for the receipt of such notice. If such a notice has not been received, the parties can close, reassured that the transaction will not be challenged.[18] The exception is minority investments that do not represent an acquisition of control, in which case the Minister has 45 days from closing to give notice of a review or possible review. If a national security review is invoked, investors can expect potentially significant delays, adding as much as

[18] Note, however, that with the new rules on SOE investments, it is possible that the Government might determine that an investor is an SOE post closing and could then require the filing of an application for review on the basis that control in fact was acquired even if no such control would be found under the generally applied (to non-SOEs) presumptions and rules. The characterization of the investor as an SOE could also potentially trigger a national security review.

130 days (and possibly more, once all of the 2013 amendments are in force) if the maximum prescribed periods are fully utilized.

The national security review process generated some anxiety among foreign investors at its introduction but it was only in October 2013 that the Government first (at least publicly) prohibited a transaction on national security grounds.[19] With that said, as noted below, Canadian politicians and interested "stakeholders" have over the past few years become more aware of the potential to use the ICA to political advantage. As a result, it is possible that "national security" concerns could be used to justify the review of a transaction that is unpopular and not otherwise reviewable under the "net benefit" approval process.

In addition, while a national security review is not likely to apply in most circumstances, foreign investors need to include on their checklists consideration of whether there is any potential for national security issues to arise. Concerns could relate to the target's sector (*e.g.*, critical technology or infrastructure, defense industry and inputs to the defense industry), and/or to the investor (*e.g.*, is it associated with organized crime?).

3. BHP Billton's Bid for Potash Corp. of Saskatchewan in 2010

Most "net benefit" reviews under the ICA are relatively routine processes that pose no threat to transaction completion (although they may extend deal timelines). However, the Government's rejection of the proposed acquisition by BHP Billiton ("BHP") of Potash Corp. of Saskatchewan ("PotashCorp") (the "Potash decision") in 2010 signaled that the review process can become highly politicized and result in unpredictable and adverse outcomes for transactions.[20]

[19] On October 7, the Industry Minister announced that he was not approving Egyptian-controlled Accelero Capital Holding's purchase of MTS' Allstream Division—the wireline enterprise services division of Manitoba Telecom Services Inc.—on national security grounds. The reasons for the Minister's decision in the Accelero/Allstream case were only hinted at. In his press release, the Minister noted that "MTS Allstream operates a national fibre optic network that provides critical telecommunications services to businesses and governments, including the Government of Canada."

Allstream's press release underlines the significant degree to which the parties made efforts to meet the "net benefit to Canada" test—offering commitments including a plan to invest $300 million over the next three years—and Accelero reportedly sought to assuage government concerns about national security, including offering not to supply the Canadian government and committing not to buy from Chinese manufacturer, Huawei. The press release also makes it clear that the parties were taken by surprise and puzzled by the rejection on national security grounds, underlining the lack of communication by the government as to the nature of the threat it identified.

Industry Canada also issued a notice of review on national security grounds in a proposed transaction in 2009 involving the purchase by a Belgian company (George Forrest International Afrique SPRL) of a Canadian company, Forsys Metals Corp., whose only asset was a uranium project in Namibia. The parties ultimately abandoned the transaction. There have been a few other transactions that have been reviewed on national security grounds (including (reportedly) the acquisition of control of wireless carrier Wind Mobile) but relatively little information is available about these.

[20] Note that the Canadian Government did not issue a final rejection of BHP's proposed acquisition of potashcorp as BHP withdrew its bid, stating "the minister of industry would have required additional undertakings beyond those BHP billiton had already offered which would have conflicted with bhp billiton's business strategy and been counter to creating shareholder value." *See* Helia Ebrahimi, *BHP Billiton blasts Canadian government as it pulls $38bn potashcorp bid*, THE TELEGRAPH (November 15, 2010), *available at*

The Potash decision was only the second time in the history of the ICA that a foreign investment outside of the cultural sector was turned down, and resulted in the parties abandoning the transaction.[21] While the government issued no decision, from statements made publicly, the Minister of Industry was apparently not satisfied that BHP was prepared to make sufficient commitments in respect of capital expenditures or PotashCorp's membership in Canpotex.[22] At the time, the Minister of Agriculture also referred to potash as a "strategic resource," raising the question whether Canada viewed certain industries as "strategic" and too important to Canada's national interests to be owned by foreigners.

Despite these apparent concerns, the most widely accepted explanation for the Government's rejection of the bid was the political and populist reaction against the deal led by the Premier of Saskatchewan (the province in which most of PotashCorp's assets are located). The Premier's objections included concerns over a significant reduction in tax revenues and foreign ownership of a "strategic" resource. Significantly, the bid was hostile and the minority status of the reigning Conservative government made it vulnerable to a potential loss of Parliamentary seats in Saskatchewan and elsewhere in Canada.

The absence of official reasons for the Potash decision fostered a sense of anxiety and concern about Canada's openness to foreign investment.[23] It also offered several lessons to foreign investors including SOEs prospecting for Canadian investments:

1. It underlined the importance of early consultation with various influential stakeholders, including the governments of the provinces in which the target business is located, to communicate a coherent and credible story about the positive impact of the investment in Canada.
2. It demonstrated that the timing of an acquisition is critical: launching a bid at a time when the federal government or the relevant provincial governments are politically vulnerable (just prior to an election or when the government is in a minority position) increases the risk of a rejection.
3. Pursuing a hostile takeover adds uncertainty given that a Canadian target corporation generally will have stronger relationships with the Government than the foreign acquirer.

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http://www.telegraph.co.uk/finance/newsbysector/industry/mining/8133214/bhp-billiton-blasts-canadian-government-as-it-pulls-38bn-potashcorp-bid.html.

[21] In the first, Alliant TechSystems' proposed acquisition of the geospatial business of MacDonald Dettwiler and Associates was rejected under the "net benefit" test in 2008 partly on the basis of apparent national security concerns (no official reasons for the decision were given by the government). The national security review process was not yet in place.

[22] *See* Cassandra Kyle, *BHP Billiton withdraws potash bid, citing 'net-benefit' bar*, POSTMEDIA NEWS (Nov. 15, 2010), *available at* www.canada.com/news/Billiton+withdraws+potash+citing+benefit/3827505/story.html.

[23] BHP offered commitments that were significant and in some respects, unprecedented, including foregoing tax benefits to which it was entitled in Saskatchewan, remaining a member of the Canpotex potash export consortium for five years, and establishing its global headquarters in Saskatoon. BHP also offered a U.S. $250 million performance bond to the government to backstop its undertakings, likely to allay public concerns about compliance with undertakings.

4. Wary foreign investors may wish to avoid the ICA "net benefit" review process altogether by considering alternatives to acquiring a controlling stake in a Canadian target such as "off-take agreements" in the resource sector.[24]

The Potash decision did not reflect a sea-change in Canada's openness to foreign investment. Indeed, in the more than three years since the decision, there has been no final rejection of a foreign investment under the "net benefit to Canada" test. Nevertheless, while most recognize that a review under the ICA will not constitute a roadblock to completion of a transaction, in those few deals involving Canadian icons or sensitive sectors (the category for which is neither defined nor closed), the ability to close cannot be absolutely guaranteed. In the case of an SOE acquirer, such concerns may well be heightened as illustrated by the public reaction to the recent CNOOC/Nexen deal and the Canadian Government's articulation of a new policy towards SOEs in 2012 and amendments to the ICA in 2013 (discussed below).

B. ICA Review of SOE Transactions—Background

1. 2007 SOE Guidelines

In 2007, Industry Canada issued guidelines on how it would review investments by state-owned investors (the "2007 SOE Guidelines") that exceed the review thresholds.[25] The release of the guidelines followed a tide of takeovers of Canadian marquee companies by non-SOEs as well as an increasing recognition that SOEs were becoming significant players in Canadian investments (beginning with Chinese SOE Minmetals' aborted attempt to take over Noranda Inc. in the fall of 2004). There were a number of concerns expressed about SOEs, including the opaque nature of their organizations, unfair advantages in acquiring businesses (having deep pockets and access to non-commercial credit terms), and the possibility of SOEs pursuing non-business objectives of the home state such as the strategic hoarding of resources (rather than development) and funneling resources to the home country of the SOE.

The 2007 SOE Guidelines defined an SOE as an enterprise that is owned or controlled directly or indirectly by a foreign government.[26] In addition, the guidelines set out two factors (beyond the typical "net benefit" factors) that the Government would consider in reviewing SOE investments: corporate governance and commercial orientation.

a. Corporate Governance

The 2007 SOE Guidelines state that the Government will examine whether the non-Canadian investor adheres to Canadian standards of corporate governance (including, for example, commitments to transparency and disclosure, independent members of the board of directors, independent audit committees, and equitable treatment of shareholders), and to Canadian laws and practices. The examination will also cover how and the extent to which the non-Canadian is owned or controlled by a state.

The requirement for Canadian standards of corporate governance merits some comment. The rationale for requiring independent directors is likely an attempt to ensure that the Canadian

[24] Off-take agreements entitle the investor to a share of production.

[25] The guidelines do not apply to transactions under the review threshold.

[26] As noted below, "SOE" is more broadly defined now to include "influence."

business is governed by an entity with directors at arm's length from the SOE's home country. With respect to how the state controls the investing entity, the actual mechanisms of control may be opaque to an outsider or the formal mechanisms may not reflect how control is actually held.

One way to address corporate governance concerns is a public listing of the company on an exchange with significant transparency requirements, such as the New York Stock Exchange. Indeed, a requirement to maintain an exchange listing may be requested as a way to meet corporate governance standards. Absent such a public listing, the Government may demand detailed commitments relating to transparency.

b. Commercial Orientation

In assessing the commercial orientation of the SOE, the 2007 SOE Guidelines stated that the Minister will assess whether the target Canadian business will continue to have the ability to operate on a commercial basis regarding:

- where to export;
- where to process;
- the participation of Canadians in its operations in Canada and elsewhere;
- support of on-going innovation, research, and development; and
- the appropriate level of capital expenditures to maintain the Canadian business in a globally competitive position.

The first factor highlights a potential concern that the SOE might simply wish to funnel Canadian natural resources to its home state, rather than supplying market-based customers. With respect to processing, the concern is that processing would be moved offshore to increase employment and economic activity in the home state of the SOE, rather than processing in Canada.

As with corporate governance, the concern that the target Canadian business will be operated according to non-market dictates could be allayed significantly if the SOE is listed on a recognized stock exchange given the transparency and accountability requirements of certain stock exchange rules. (Note that not all stock exchanges would meet this requirement.)

c. Undertakings

Finally, the 2007 SOE Guidelines outline the types of binding commitments or undertakings that may be required to ensure that SOE investments result in a net benefit to Canada. These include:

- commitments to appoint Canadians as independent directors,
- the employment of Canadians in senior management,
- the incorporation of the target business in Canada, and
- the listing of shares of the acquiring company or the target Canadian business on a Canadian stock exchange.

It is significant to note that certain undertakings by SOEs may well exceed the normal three to five year commitments given by non-state foreign investors.

2. Summary of SOE Reviews to Date

The Canadian government has reviewed and approved numerous transactions involving an SOE.[27] These include: the acquisition of Chinese SOE, CNOOC, of Nexen (2013); the acquisition of Progress Energy by Malaysian SOE Petronas (2012); Sinopec's acquisition of Daylight Energy (2011); the acquisition of Opti-Canada acquisition by CNOOC (2011); Sinopec's acquisition from ConocoPhillips Co. of a company holding a 9 percent interest in oil sands producer, Syncrude Canada Ltd. (2010); PetroChina's acquisition of interests in two oil sands projects owned by Athabasca Oil Sands Corp. (2010); the acquisition of Nova Chemicals by International Petroleum Investment Company (owned by the Abu Dhabi government) (2009); Korea National Oil Corp.'s acquisition of Harvest Energy (2009); China Investment Corp.'s acquisition of a 45 percent stake in an oil sands joint venture with PennWest (2009); and the acquisition by a subsidiary of publicly listed Abu Dhabi National Energy Company PJSC (TAQA), of PrimeWest Energy Trust (2008).[28]

The Ministerial approvals noted above have demonstrated that SOE transactions have in the past been seen as beneficial to Canada. This is not surprising given that Canada is a small country with vast natural resources and needs foreign capital to develop its resources. The recent prominence of Chinese SOEs as investors in Canada is also noteworthy and reflects the warming of relations between Canada and China that began with Prime Minister Harper's 2009 visit to China and has continued through numerous meetings between the Prime Minister and other Cabinet ministers and their Chinese counterparts.

The approvals are also significant in that SOE investments do not appear to have raised national security concerns (although such concerns have no doubt been canvassed). Nevertheless, at the same time as the CNOOC/Nexen transaction was approved, the Canadian Government announced its new policy towards SOEs, including a prohibition of reviewable acquisitions of control of Canadian businesses in the oil sands and a heightened level of scrutiny of SOE investments in the Canadian economy generally.

C. The CNOOC/Nexen Deal—A Pivotal Transaction

The ICA approval process for CNOOC's acquisition of Nexen illustrates the significant degree of politicization that may accompany the review of a high profile acquisition by an SOE in the resource sector. A key theme is the extent to which the net benefit review process morphed into a much broader economic and political debate about the Canada-China relationship, a challenge that would not be faced by a private sector foreign investor.

As noted above, while the statutory factors the Industry Minister must consider in making the "net benefit to Canada" generally relate to economic, objective factors such as employment, level of capital expenditures, and the locus of head office functions, the Minister may also take into account "national industrial, economic and cultural policies," as well as

[27] The minority (17 percent) investment by China Investment Corp. in Teck Resources in July 2009 was not subject to "net benefit" review because it did not constitute an acquisition of control.

[28] *See* http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aUazXOsVZ1GM.

provincial policies in those same areas. This category represents a very large "black box" of unspecified policies that can be used to justify a range of diverse outcomes for a proposed transaction. As the discussion of the CNOOC/Nexen transaction below illustrates, the Canadian Government struggled to balance its concern to maintain Canada's open investment climate, while at the same time responding to the larger political dynamics at play.

During the review period for the transaction, there was a steady torrent of press reports covering every angle of the CNOOC/Nexen acquisition and the highest level of government officials, including Prime Minister Harper, were involved in approving the deal. Prior to granting approval, Prime Minister Harper noted that the Government would determine whether the deal was not just of "net benefit" to Canada but also whether it was in the "long term interest" of Canada.[29] Although there had been suggestions that national security would be a consideration, it does not appear that there was a national security review. The parties also made a filing under the U.S. national security legislation (the *Foreign Investment and National Security Act* of 2007) enforced by the Committee on Foreign Investment in the United States.

One of the major criticisms of the transaction was that China would not allow a comparable transaction by a Canadian investor in China.[30] This concern for reciprocity was repeatedly noted by critics of the deal who argued that the ICA test of "net benefit to Canada" should require a condition that China open its door to Canadian investment in the same sector. Others opposed such conditionality. According to liberal economic orthodoxy, even unilateral action to eliminate obstacles is considered beneficial for the liberalizing country. In addition, some commentators noted that Nexen had been "for sale" for a long time and that no Canadian company had been willing to buy it.[31] Nevertheless, the "reciprocity" argument had some traction with the public and the Canadian government undoubtedly felt the pressure to obtain significant commitments (falling short of reciprocal access) from CNOOC.

Another criticism of the CNOOC/Nexen transaction alleged that the net benefit to Canada was questionable because state-owned investors do not historically run companies in the most efficient way. Indeed, as noted above, Canada had in the past few decades privatized a number of crown corporations (including PetroCanada) in recognition of this view. Canadian economist Jack Mintz argued: "Unless a government wishes its state-owned enterprises to operate strictly according to commercial criteria, a takeover of a private company by an SOE could result in the target performing less efficiently since other criteria besides value maximization undermine profitability and productivity." Moreover, Mintz noted that the playing field for bidders was not level as SOE acquirers have advantages (including tax exempt status and cheap credit) that mean that the winning bid is not based on economics and is, therefore, not the

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[29] *See* James *Waterman, How to Buy a Canadian Oil Company, CNOOC's bid to acquire Nexen gets political,* PIPELINE NEWS NORTH, *available at* http://www.pipelinenewsnorth.ca/article/20120912/PIPELINE0118/309129999/-1/pipeline/how-to-buy-a-canadian-oil-company

[30] *See* Jeffrey Simpson, *What if Nexen coveted CNOOC?*, GLOBE AND MAIL (September 29, 2012), *available at* http://www.theglobeandmail.com/commentary/what-if-nexen-coveted-cnooc/article4575332/.

[31] *See* Sophie Cousineau, *The price that China must pay to win Nexen*, GLOBE AND MAIL (September 29, 2012) *available at* http://www.theglobeandmail.com/report-on-business/industry-news/energy-and-resources/the-price-china-must-pay-to-win-nexen/article4576200/.

bid that maximizes the economic advantages to the target company (including replacing existing management with better management). Accordingly, he proposed addressing this issue by limiting state ownership to 30 percent of voting shares as is done with pension plans.[32]

Despite these public criticisms of the CNOOC bid, a number of factors militated in favor of government approval of the transaction. First, CNOOC positioned the transaction in a favorable light by communicating publicly its willingness to make significant commitments, including:

- Establishing Calgary as CNOOC's North and Central American headquarters, which will manage Nexen's global operations and CNOOC's existing operations in the region (comprising approximately U.S. $8 billion of CNOOC's existing assets);
- Intending to retain Nexen's current management team and employees;
- Enhancing capital expenditures on Nexen's assets;
- Intending to list CNOOC Limited shares on the TSX; and
- Enhancing community and social commitments.[33]

These commitments corresponded closely to the 2007 SOE Guidelines described above, and their communication at the time of announcing the transaction reflected CNOOC's appreciation of the political nature of the Investment Canada approval process.

Second, the Canadian Government had been making considerable efforts to promote trade and investment with China as witnessed by Prime Minister Harper's visits to China in December 2009 and February 2012 as well as the conclusion of the Foreign Investment Promotion and Protection Agreement ("FIPA") with China in September 2012.[34] A rejection of CNOOC's bid would have seriously undermined the rapprochement Canada has sought with China and jeopardize future trade and investment between the countries.

Moreover, Prime Minister Harper indicated that Canada must accept the differences between the two countries' economies: "We can't make it a prerequisite of doing business that they've got to become just like us. We do have to factor in our differences and factor in those differences in pursuing ultimately what our best interests are within a relationship that has to be mutually beneficial."[35]

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[32] Jack Mintz, *Jack Mintz: Limit State Takeovers*, *available at* http://opinion.financialpost.com/2012/07/24/jack-mintz-limit-state-takeovers/.

[33] *See* the CNOOC press release, *CNOOC Limited Enters into Definitive Agreement to Acquire Nexen Inc.*, July 23, 2012, *available at* http://www.cnoocltd.com/encnoocltd/newszx/news/2012/2062.shtml.

[34] *See* Bill Curry & Shawn McCarthy, *Tories quietly table Canada-China investment treaty*, GLOBE AND MAIL, (September 28, 2012) at p. A11, *available at* http://www.theglobeandmail.com/news/politics/tories-quietly-table-canada-china-investment-treaty/article4573635/.

[35] *See* Shawn McCarthy & Andy Hoffman, *Harper promises playbook for foreign takeovers*, GLOBE AND MAIL, (September 7, 2012), *available at* http://www.theglobeandmail.com/report-on-business/industry-news/energy-and-resources/harper-promises-playbook-for-foreign-takeovers/article4525220/

D. Approval of CNOOC/Nexen and Revised SOE Policy (2012)

Canada ultimately approved the CNOOC/Nexen deal in December 2012—more than four months after it was announced. At the same time, the Prime Minister announced a new and more stringent policy framework for the review of SOE investments in Canada. The new policy reflects limits to the Government's tolerance for significant foreign government ownership in the Canadian economy and in the oil sands. The highlights of the Government's December 2012 announcement are:

- Further acquisitions of control of a Canadian oil sands business would be prohibited under the "net benefit to Canada" test absent "exceptional circumstances." (Note that this only applies to reviewable transactions.) Apart from the obvious impact of decreasing investment in the oil sands, the prohibition casts doubt on whether certain provisions in existing SOE joint ventures in the oil sands can be implemented. For example, could an SOE's right of first refusal in a joint venture agreement be exercised if this resulted in the SOE acquiring control? Such an issue would have repercussions on oil sands joint ventures formed after the prohibition; an SOE taking a minority position in an oil sands joint venture would need to have minority partner protections but the range of such protections would be constrained by the prohibition on acquisitions of control. As a consequence, SOEs may be unwilling to make even a minority investment in the oil sands or may only be willing to buy at a discount.
- Scrutiny of SOE investments would be intensified, especially in sectors where SOE influence in a particular industry is deemed significant.
- Revisions to the SOE guidelines would underscore that SOEs are expected to be transparent, constrain state influence, and operate according to free market principles. (See the revised guidelines in Appendix B.) Note that the main criteria in the guidelines continue to be the SOE's commercial orientation and whether it meets Canadian standards of corporate governance.[36]
- The definition of SOEs would be broadened to include companies that were influenced by foreign governments. (See discussion below.)

E. June 2013 SOE Amendments to the ICA

In June 2013, the Canadian Government passed amendments to the ICA implementing its new approach towards SOEs and lengthening the maximum amount of time for a national security review. (Not all of these amendments are yet in force.)

For the following reasons the amendments to the ICA will almost certainly result in more SOE investments being subject to pre-closing Ministerial approval on the basis of "net benefit to Canada:"

[36] The 2012 SOE guidelines add that adherence to Canadian laws includes adherence to free market principles and that in examining the extent to which the non-Canadian is owned or controlled by a state, the influence of the state on the conduct and operations of the SOE will be examined. In addition, the impact of the investment on productivity and industrial efficiency in Canada is an additional consideration in determining the SOE satisfies the commercial orientation requirement.

- While the ICA review requirement only applies to acquisitions of control of Canadian businesses, and the rules for determining whether an acquisition of control has occurred are set out in the ICA, the amendments enable the Minister to make SOE investments subject to review if he finds "control in fact"—even if the application of the ICA's general rules would lead to the conclusion that no acquisition of control has occurred.
- The uncertainty generated by this Ministerial discretion is exacerbated by the potentially very broad scope of the term "SOE" which has been expanded beyond entities that are controlled by foreign governments to include those that are "influenced" by such governments.
- SOEs will not benefit from the increase in the generally applicable review threshold, which is set to rise dramatically over the next few years. The likely result is that SOE investments will be subject to more reviews than would otherwise be the case.

1. Broader Ministerial Discretion to Subject SOE Transactions to Review

The amendments may significantly increase the number of SOE investments requiring Ministerial approval by permitting the responsible Minister to avoid the general ICA rules and presumptions:

- **Defining when an acquisition of control occurs**. The ICA general rules establish presumptions regarding when control is acquired. For example, they state that the acquisition of less than one-third of the voting shares of a corporation, or of less than a majority of the economic interests of a partnership, is deemed not to be an acquisition of control. If there is no acquisition of control, there is no requirement for a "net benefit" review under the ICA. For an SOE, these rules need not be applied if the Minister concludes based on "any information and evidence" made available to him that the SOE will acquire control in fact.
- **Determining whether one entity is controlled by another**. The ICA sets out general rules and presumptions regarding when control exists. However, the amendment would permit the Minister to go beyond those rules in assessing whether an SOE controls another entity in fact, thus creating some uncertainty about whether such an entity would be considered an SOE when it made an acquisition.
- **Determining whether an investor is Canadian or not**. The ICA establishes rules to determine the Canadian status of an investor. As a result of the amendment, an entity that would otherwise be considered Canadian-controlled may be judged to be an SOE if the Minister concludes that it is controlled in fact by an SOE. The consequence is that if such an entity pursued an acquisition of a Canadian business, it would be subject to the SOE review threshold and Ministerial discretion on whether it was acquiring control in fact.

The repercussions of bypassing the normal presumptions and rules on these points could be significant for an SOE investor. As an assessment of "control in fact" can be relatively subjective and depend on a detailed analysis of the terms of the investment, it may be unclear—especially early in the deal process—whether the SOE investment is an acquisition of control in fact under the ICA and therefore potentially reviewable. Moreover, the Government has no plans

to issue guidance on how it will apply a "control in fact" test, although this phrase has been interpreted in the context of cultural business reviews under the ICA and in other legislation including transportation, telecommunications, and tax laws.

Finally, a determination that the investor is an SOE, or that an SOE controls or has acquired control of a Canadian business can be made retroactive to April 29, 2013. This retroactivity raises the risk that an investor will have to seek Ministerial approval under the "net benefit" test or be subject to national security review post-closing where the parties concluded pre-closing that there was no acquisition of control by an SOE (*e.g.,* because the investment involved a minority interest) or that the investor was not an SOE. To address this uncertainty, an investor may, in the appropriate circumstances, wish to consult early on with the Government. However, it should be noted that the Minister is not required under s. 37 of the ICA to provide a formal, written opinion on this issue but may choose to do so.

2. Expanded Scope of an SOE

The definition of an SOE has been amended to include not only the government of a foreign state or agency of such government and an entity that is controlled, directly or indirectly, by such a government, but also an entity that is influenced, directly or indirectly, by a foreign government. The definition of an SOE has also been expanded to capture individuals acting under the direction of a foreign government or under the direct or indirect influence of a foreign government.

The Government has indicated there is no plan for guidance on the term "influence." It is possible that the Government will feel constrained not to interpret this phrase too broadly as there may be a risk of a backlash against Canadian pension funds and other quasi-public Canadian entities in foreign countries. Nevertheless, it is unclear in any given situation where the Government will choose to draw the line with respect to, for example, the degree of foreign government representation on boards or senior management links to government officials when determining whether an entity is "influenced" by a foreign government.

It is also worth noting that the Government may be in a better position to identify state involvement once it has finalized a draft regulation establishing new information requirements for notification filings and applications for review. The draft regulation would require information from investors respecting any level of direct or indirect state ownership (including the nature and extent of the state's interest in the investor), sources of funding for the investment, and the names of the members of the investors' board of directors and the five highest paid officers.[37]

3. SOE Review Threshold

SOEs will not benefit from the planned increase to the current review threshold. At present, the review threshold for direct acquisitions of Canadian businesses by foreign investors controlled by nationals of WTO countries is CD $354 million in the book value of the target Canadian business. Non-SOEs will in the future face a review threshold based on the target's

[37] *See* draft *Regulations Amending the Investment Canada Regulations* at http://www.gazette.gc.ca/rp-pr/p1/2012/2012-06-02/html/reg1-eng.html.

enterprise value; the threshold will be $600 million when implemented, rising to $800,000 in two years and then to $1 billion four years later. As noted above, the meaning of "enterprise value" will be defined by regulation; draft regulations to date have defined EV for public companies as market capitalization plus liabilities minus cash, while EV for private companies relates to purchase price plus liabilities minus cash.

The likely outcome of differentiating between SOEs and non-SOEs in the review threshold is that more SOE transactions will be subject to review relative to non-SOE transactions, although this is not necessarily the case. For example, for Canadian businesses that are engaged in industries where book values may be lower relative to EV (*e.g.,* information technology companies), it is possible that an SOE investment might be below the book value review threshold while a non-SOE investment would exceed the enterprise value threshold for the same target. This would advantage the SOE investor relative to the non-SOE in a bidding process for the Canadian target business—a curious result that is at odds with the Government's objective to require more scrutiny of SOE investments.

4. Longer Timelines for National Security

The amendments also extend the maximum timelines for national security review (though these amendments are not in force at the time of writing) and extend the date following the conclusion of a national security review by which the Minister has to provide the "net benefit" ruling. The implications of these extensions are unlikely to be serious for most transactions given that in the four years since national security has been introduced, there have been very few reviews. Nevertheless, for those that are subject to national security review, deal timelines could be extended significantly.

VI. CONCLUSION

Given its own relatively small pool of domestic capital, Canada relies on foreign investment. SOEs are major players in global business and capital markets and have the financial resources and appetite to invest (especially in natural resources but also in other sectors). In this context, it is important that the rules for SOE investment in Canada are clear and predictable in their application. Both the Competition Bureau and Industry Canada have taken steps in this direction over the past few years, although the Bureau has characterized its approach as provisional and the Government's revised foreign investment review policy has generated uncertainties for SOE investments.

The Competition Bureau's recently articulated approach to premerger notification for SOEs makes it easier for SOEs to file a complete notification, although potential pitfalls still exist for some SOEs. However, the Bureau's approach to substantive reviews of SOE transactions (requiring information relating to any SOE of a foreign government in a similar or vertically related business to the party SOE) does not take into account that some SOEs may legitimately be unable to provide information about such entities. In such scenarios, where the Competition Bureau has sufficient information to conclude that it will close its file on a matter, there is a strong argument that it should be willing to provide SOE investors with the comfort of a "no-action" letter indicating that it has no current intention to challenge the proposed transaction.

The Canadian Government has articulated a revised approach to SOEs over the past year by announcing its (restrictive) policy towards oil sands investments by SOEs and by

underscoring its intention to scrutinize SOE investments closely. In this environment, significant uncertainties remain for SOE investors. The CNOOC/Nexen transaction demonstrated the particular susceptibility of SOE transactions to generate political controversy and therefore be more unpredictable in their outcome than a similar investment by a foreign non-state acquirer (where the focus of concern would be largely on the target investment and not the nature of the investor). In addition, while the Canadian Government has given notice that acquisitions of control of Canadian oil sands businesses will in general be prohibited, it has not addressed the circumstances which would lead it to grant exemptions from this policy.

Finally, the broadened discretion of the Minister to determine the reviewability of an investment and to define an SOE more expansively also generates anxiety for SOEs (or would-be SOEs) looking to invest in Canada and even for SOEs (or would-be SOEs) who already have made investments in Canada.

A number of commentators are of the view that Canada's restrictive policy on SOEs investing in the oil sands has deterred SOE investors and hurt the Canadian economy.[38] While it is likely that the lower rate of investment by SOEs relates to a number of factors including lower commodity prices, the Canadian Government could take steps to blunt the negative repercussions. First, it could offer guidance on when it might provide exemptions from the prohibition on SOEs acquiring control of oil sands assets and on how broadly it will interpret "SOEs." Second, the Government should convincingly telegraph the message that while the Canadian Government will review SOE investments to ensure net benefit to Canada, SOE investors are welcome in all other sectors of the Canadian economy.

[38] *Foreign takeover limits scaring away investors, says Prentice*, CBC (October 1, 2013) at http://www.cbc.ca/news/business/foreign-takeover-limits-scaring-away-investors-says-prentice-1.1874507. *See also* Rebecca Penty & Andrew Mayeda, *Oil Sands Deals Dive as State Firms Scrutinized*, BLOOMBERG (September 30, 2013), *available at* http://www.bloomberg.com/news/2013-09-30/oil-sands-deals-dive-as-state-firms-scrutinized.html.

APPENDIX A.

TABLE 1: Selected Recent SOE Investments in Canada

SOE/SWF	Canadian Target	Year of Investment
China National Offshore Oil Company ("CNOOC")	Nexen Inc. ("Nexen")	2013
Petronas (Malaysia)	Progress Energy Resources Corp.	2012
Sinopec (China)	Daylight Energy	2011
CNOOC (China)	Opti-Canada	2011
Sinopec (China)	9% stake in Syncrude Canada Ltd. (vendor = ConocoPhillips Co.)	2010
PetroChina (China)	Athabasca Oil Sands Corp.	2010
China Investment Corp. (China)	45% stake in PennWest	2009
Korea National Oil Corp. (Korea)	Harvest Energy	2009
International Petroleum Investment Company (Abu Dhabi)	Nova Chemicals	2009
Abu Dhabi National Energy Company PJSC ("TAQA") (Abu Dhabi)	PrimeWest Energy Trust	2008

APPENDIX B

REVISED SOE GUIDELINES

Guidelines—Investment by state-owned enterprises—Net benefit assessment[39]

The following guidelines are issued by the Minister responsible for the administration of the *Investment Canada Act* (the "Act"), under the authority of section 38 of the Act, to inform investors of certain procedures that will be followed in the administration of the review and monitoring provisions of the Act where the investors are state-owned enterprises (SOEs).

Recognizing that increased capital and technology would benefit Canada, the purpose of the Act is "to encourage investment in Canada by Canadians and non-Canadians that contributes to economic growth and employment opportunities and to provide for the review of significant investments in Canada by non-Canadians in order to ensure such benefit to Canada."

For the purposes of these guidelines, an SOE is an enterprise that is owned, controlled or influenced, directly or indirectly by a foreign government.

As currently required by the *Investment Canada Regulations*, in their applications for review, non-Canadian investors, including SOEs, are required to identify their controller, including any direct or indirect state ownership or control.

It is the policy of the Government of Canada to ensure that the governance and commercial orientation of SOEs are considered in determining whether reviewable acquisitions of control in Canada by the SOE are of net benefit to Canada. In doing so, investors will be expected to address in their plans and undertakings, the inherent characteristics of SOEs, specifically that they are susceptible to state influence. Investors will also need to demonstrate their strong commitment to transparent and commercial operations.

The Minister will apply the principles already embedded in the Act to determine whether a reviewable acquisition of control by a non-Canadian who is an SOE is of net benefit to Canada. Under the Act, the burden of proof is on foreign investors to demonstrate to the satisfaction of the Minister that proposed investments are likely to be of net benefit to Canada.

When assessing whether such acquisitions of control are of net benefit to Canada, the Minister will examine, as part of the assessment of the factors enumerated in section 20 of the Act, the corporate governance and reporting structure of the non-Canadian. This examination will include whether the non-Canadian adheres to Canadian standards of corporate governance (including, for example, commitments to transparency and disclosure, independent members of the board of directors, independent audit committees and equitable treatment of shareholders), and to Canadian laws and practices, including adherence to free market principles. The Minister will assess the effect of the investment on the level and nature of economic activity in Canada, including the effect on employment, production and capital levels in Canada. The examination will also cover how and the extent to which the non-Canadian is owned, controlled by a state or its conduct and operations are influenced by a state.

[39] *Available at* http://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/lk00064.html#state-owned.

Furthermore, the Minister will assess whether a Canadian business to be acquired by a non-Canadian that is an SOE will likely operate on a commercial basis, including with regard to:

- where to export;
- where to process;
- the participation of Canadians in its operations in Canada and elsewhere;
- the impact of the investment on productivity and industrial efficiency in Canada;
- support of on-going innovation, research and development in Canada; and
- the appropriate level of capital expenditures to maintain the Canadian business in a globally competitive position.

Specific undertakings related to these issues may assist to supplement a non-Canadian's plans for the Canadian business. Examples of undertakings that have been used in the past and could be used in the future, include, among other undertakings, the appointment of Canadians as independent directors on the board of directors, the employment of Canadians in senior management positions, the incorporation of the business in Canada, and the listing of shares of the acquiring company or the Canadian business being acquired on a Canadian stock exchange. Appropriate monitoring will be conducted in accordance with the ICA.

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The Proposed Damages Directive: The Real Lessons from the United States

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The Proposed Damages Directive: The Real Lessons from the United States

Robert H. Lande[1]

I. INTRODUCTION

Europeans should be doubly cautious when they study the U.S. experience with private antitrust enforcement. Nevertheless, there are ten specific lessons they can learn. None, however, is consistent with the conventional wisdom in the international competition community that U.S.-style private enforcement has been a disaster.[2] Each should help Europe objectively consider the Commission's proposed Directive concerning private enforcement of Competition Law.[3]

II. TWO IMPORTANT REASONS FOR CAUTION

Europeans should not trust anyone from the United States who gives advice on the subject of private enforcement of competition law without carefully and skeptically considering the source. When someone says, "I'm from the U.S. and I'm here to help you," remember that everyone has a bias and an agenda. All of my assertions should be discounted accordingly[4] and heavily in light of the following more general caution:

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[1] Venable Professor of Law, University of Baltimore School of Law, and a Director of the American Antitrust Institute. I would like to thank Neil Averitt, John Connor, Joshua Davis, and Albert Foer for valuable comments, and Timothy Hart for excellent research assistance. A version of this article will appear in SHAPING PRIVATE ANTITRUST ENFORCEMENT IN EUROPE (Mel Marquis & Giorgio Monti, eds. forthcoming).

[2] Although not saying he agreed with it, former FTC Chair William Kovacic succinctly summarized the conventional wisdom as follows: "private rights of actions U.S. style are poison." *See* FTC:WATCH No. 708, FTC WATCH 4 (Nov. 19, 2007), http://www.ftcwatch.com/series/708/ (quoting William E. Kovacic speaking at an American Bar Association panel on Exemptions and Immunities). For an extensive compilation of additional criticisms of U.S. private cases *see* Joshua P. Davis & Robert H. Lande, *Toward an Empirical and Theoretical Assessment of Private Antitrust Enforcement*, 36 SEATTLE UNIV. L. REV 1269, 1269-70, *available at* http://papers.ssrn.com/sol3/papers.cfm?Abstract_id=2132981&download=yes [hereafter "Toward Assessment"].

[3] When some critics suggest the proposed Directive will move Europe closer towards a U.S.-style of private antitrust enforcement, they speak in almost apocalyptic terms. Because an extremely negative view of U.S. private enforcement is the accepted wisdom in the international competition community, proponents of expanded private rights in Europe are forced to go to great lengths to demonstrate they are not proposing a U.S.-style system. In fact, critics of private enforcement tend to make two (largely inconsistent) claims: that it does too little—it fails to provide meaningful recovery to victims—and that it does too much—it forces defendants to settle even groundless claims. Neither assertion has empirical support. For an extended analysis of these issues *see* Joshua P. Davis & Robert H. Lande, *Defying Conventional Wisdom: The Case For Private Antitrust Enforcement*, 48 GEORGIA L. REV. 1, 17 (2013), *available at* http://papers.ssrn.com/sol3/papers.cfm?Abstract_id=2217051 [hereafter "Defying Conventional Wisdom"].

[4] In the interest of full disclosure, my own background includes employment as an enforcer at the U.S. Federal Trade Commission, as a lawyer at Jones Day where I represented defendants more often than I represented plaintiffs, and as a professor. I also have worked as a consultant to law firms from time to time and am a co-founding Director of the American Antitrust Institute.

Don't trust anyone giving advice about private enforcement policy unless his or her recommendations are based upon reliable empirical evidence. This especially includes the conventional wisdom that private antitrust enforcement in the United States has been a mistake Europe should avoid. A careful examination of the underpinnings of this criticism actually demonstrates that this consensus is not based upon reliable evidence.[5] Rather, this conclusion derives only from opinions, anecdotes, and hypotheticals.[6]

It is essential, moreover, that you do not require proponents of private enforcement to persuade you beyond a reasonable doubt that the critics' opinions are wrong. Rather, a proper assessment should begin from a position of neutrality, and the proper analysis and resolution of the issues should involve neutrally weighing which side has presented better evidence supporting their assertions.[7]

III. TEN SPECIFIC LESSONS FROM THE UNITED STATES

There is a significant amount of empirical evidence concerning the U.S. experience with private enforcement that can be useful for Europeans considering expanding private rights of action. The following lessons are based upon evidence that, while not perfect, is the best that is available. None of these lessons are consistent with the conventional wisdom in the competition law field.

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[5] *See* Defying Conventional Wisdom, *supra* note 3, at 3-8.

[6] As you scrutinize the conclusions of critics of U.S. private enforcement please do so with skepticism because:

1. Critics' hypotheticals or anecdotes do not count as reliable empirical evidence. Almost everything involving private enforcement—good and bad—has happened on occasion. The crucial issue for policy purposes is how often or how frequently they occur. When a critic asserts that something has happened a couple of times this is not proof that it is a typical or common outcome. It may well be anomalous.
2. An anecdote should count even less when it involves the person alleging it because these anecdotes might be self-serving. Often, a defense lawyer will recount a private litigation horror story without any opportunity being given for a response from other side. Please insist on listening to all sides before you reach a judgment.
3. A lawyer giving advice based upon their 30 years of experience, especially 30 years mostly spent doing defense work, is not presenting neutral evidence. We're all advocates and effective advocates first convince themselves that their positions are correct. Although every one of us believes we're neutral, it's very difficult to be neutral after you've spent most of a 30-year career representing one side of a controversy.
4. The older the evidence, the more it should be discounted. Private enforcement in the United States today is very different from the cases that were brought a generation or two ago. Many of the older private cases were substantively weak or resulted in questionable relief. Further, some longstanding critics of U.S. private enforcement formed their initial views when they were young, and it can be difficult for anyone to change their first impression, despite the changes in the field that have arisen during the last 30 years.

[7] Beware of critics giving advice that explicitly or implicitly places the burden of persuasion on the other side. In the foggy world of competition policy, whichever side has the burden of proof will be at a significant disadvantage. Some critics of U.S. private enforcement say in effect, "Here's what I believe, and although I don't have any empirical evidence for my positions you can trust me because it's based upon my 30 years of experience. Make the other side prove beyond a reasonable doubt that my assertions are false." This is especially unfair if the critics offer only hypotheticals or self-serving anecdotes to support their views.

A. Private Enforcement Has Provided Substantial Compensation to U.S. Victims of Anticompetitive Activity

This fundamental point often gets lost during the heated and wide-ranging debates. It is so significant that it warrants being placed as the first substantive lesson for the European Union.

Professor Joshua Davis and I recently studied 60 large and relatively recent private U.S. antitrust cases.[8] These cases returned a total of $33.8-$35.8 billion in cash to victims of anticompetitive behavior.[9] These figures do not include products, discounts, coupons, or the value of injunctive relief or precedent—only cash. Consequently, these totals significantly understate the actual benefits to the victims.[10] And, of course, we studied only 60 cases (albeit 60 of the largest private U.S. cases) out of the many hundreds of private cases filed in the United States in recent years.

The proposed Directive has as its primary goal to compensate European victims of anticompetitive behavior.[11] The U.S. experience shows that private enforcement has the potential to do this. Moreover, there is no other practical way to achieve this goal.

B. The Assertion that Remedies Secured by Private Cases Usually are Valueless is Contradicted by the Empirical Evidence

Critics of U.S. private antitrust actions frequently assert that the remedies typically secured by U.S. private actions are at best dubious and often are completely worthless. Their contention is that the most common remedies consist solely of worthless coupons, meaningless discounts, and obsolete products, or cash recoveries that were subsequently consumed by private attorney fees and claims administration expenses. According to many critics, the only ones to benefit from private enforcement are attorneys.[12]

None of the critics who make these charges, however, offer evidence beyond opinions, hypotheticals, and occasional anecdotes.[13] Indeed, for the 60 cases Professor Davis and I recently studied, our best estimate (based on empirical evidence) is that, overall, only 20 percent of the

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[8] For an analysis of these 60 cases *see* Defying Conventional Wisdom, *supra* note 3.

[9] *Id.* at 17.

[10] *Id.* at 16. For a large number of methodological issues and caveats associated with this study *see Id.* and Robert H. Lande & Joshua P. Davis, *Benefits From Private Antitrust Enforcement: An Analysis of Forty Cases*, 42 U. SAN FRANCISCO L. REV 879, 889-91, *available at* http://papers.ssrn.com/sol3/papers.cfm?Abstract_id=1090661 [hereafter "Benefits"]. As an example of the complications involved, we counted multiple cases involving the same or closely related cartels as a single case. Thus, even though a huge number of private cases were filed against the international vitamins cartel (and this "cartel," moreover, easily could be considered to be multiple cartels) we counted all these cases as one.

[11] *See* Commission Proposal for a Directive of the European Parliament and of the Council on certain rules governing actions for damages under National Law for infringements of the Competition Law Provisions of the European Union, at 30-31, COM (2013) 404 (Oct. 6, 2013).

[12] Of course, the private lawyers deserve compensation. This is especially true because plaintiff attorneys bear the risk of no recovery, cost of lost time, and usually discovery expenses as well.

[13] For example, Professor Daniel Crane asserted that "issuing [class members] a check is often so expensive that administrative costs swallow the entire recovery." Daniel Crane, *Optimizing Private Enforcement*, 63 VANDERBILT L. REV. 675, 683 (2010). To support his statement, Professor Crane cited a 41 year-old article by Judge Posner that made a similar claim but contained no empirical support. *See* Toward Assessment, *supra* note 2, at 1305 (discussing the lack of foundation for Professor Crane's assertion).

recoveries went for attorney fees and claims administration expenses.[14] The rest was returned to the victims.

Nor have the critics who claim that private U.S. antitrust cases typically have returned only worthless coupons, meaningless discounts, or obsolete products to victims ever supported their conclusions with systematic evidence. They give opinions, make assertions, and provide anecdotes and hypotheticals. They also sometimes examine what happened in other areas of law and simply assert that these outcomes also occur as a consequence of contemporary U.S. private antitrust cases.[15] But they never offer systematic evidence from antitrust cases to support their opinions. (Interestingly, only one of the cases Professor Davis and I examined involved a coupon remedy—the Auction Houses cases. However, those coupons were fully redeemable for cash if they were not used for 5 years and, again, we did not take the coupons into account in assessing the benefits of the litigation; we considered only the cash recovery.)[16]

Abuses naturally occur from time to time in private antitrust cases, as they do almost everywhere in the legal system. However, a majority of the most egregious examples are from other areas of law or are quite old. No one has ever presented reliable evidence showing that examples are common today or typical of contemporary private antitrust cases brought in the United States.

C. Most Successful U.S. Cases are Likely to Have Involved Anticompetitive Conduct

Almost every U.S. private case that results in a remedy does so through a settlement,[17] so their underlying merits have not been definitively reviewed by a judge. Critics often use the fact that most of these cases settled to assert that they were meritless. They sometimes claim that U.S. plaintiffs often receive huge sums from meritless cases and that private antitrust actions often amount to blackmail or extortion.[18]

Since almost anything can happen, there is no doubt that some U.S. settlements did not involve anticompetitive conduct, and because almost all of the cases Professor Davis and I studied settled, one reasonably might ask whether they involved anticompetitive conduct. Of course, opinions about specific cases will vary, and very few conclusions can fairly be made about the merits of settlements.

Nevertheless, there are good reasons to think the cases we studied involved legitimate claims. The same underlying conduct supporting the settlements gave rise to criminal penalties in 17 of the 60 cases; to civil relief by the government in 17 cases; to a trial that defendants lost in 15 cases; and to plaintiffs surviving or prevailing at summary judgment or judgment as a matter of law in 14 cases.[19] Overall, 88 percent of the cases exhibited at least one form of validation as to

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[14] *See* Defying Conventional Wisdom, *supra* note 3, at 46-48.

[15] *Id.* For a summary of additional criticisms of private antitrust enforcement, *see* Benefits, *supra* note 10, at 884–89.

[16] *Id.* at 901 n. 81. To be conservative, however, we did not count these coupons in our cash totals.

[17] *See*, for example, Toward Assessment, *supra* note 2, passim.

[18] *See* Benefits, *supra* note 10, at 884-88.

[19] Some cases have more than one indicia of merit. *See* Defying Conventional Wisdom, *supra* note 3, at 18-19.

their merits.[20] (Only 7 of 60 cases did not have at least one of these indicia of validation; these 7 cases settled too early for a substantive evaluation of their merits).[21]

Although this does not prove that these cases involved anticompetitive conduct, to be fair one should compare these indicia of validity to the evidence underlying critics' charges that these and other cases constituted meritless, legalized blackmail. What evidence do critics provide to back up their assertions? Essentially…they offer nothing. Only anecdotes, hypotheticals, and opinions—no studies, statistics, or reliable evidence. There is no indication that any of the cases Professor Davis and I studied lacked merit, except of course for the self-serving assertions of the defendants involved. It is ironic that the conventional wisdom about the lack of merit of U.S. private antitrust enforcement itself lacks merit.

D. Most Large U.S. Private Recoveries are Opt-Out Class Action Contingent Fee Cases

Of the 60 large private U.S. cases Professor Davis and I studied, 47 were opt-out[22] class action suits brought by attorneys who were working for a contingency fee.[23] These cases recovered approximately two-thirds of the $33.8-$35.8 billion recovered by private antitrust plaintiffs in our study.[24]

Even though some European nations allow opt-out class action cases,[25] the European Union only permits opt-in class action cases,[26] and these cases typically recover damages for only a tiny percentage of victims.[27] Nor does the European Union allow lawyers to receive contingency fees,[28] and this limitation severely restricts the ability of most consumer-plaintiffs to recover. Although some business victims will be able to sue successfully if the proposed Directive is enacted, the vast majority of consumer-victims and small business-victims will continue to be uncompensated.

The 60 cases Professor Davis and I studied were among the largest private actions ever brought in the United States and therefore might not be representative of either U.S. private cases as a whole or the majority of cases likely to be filed in Europe under the proposed Directive. Nevertheless, the European lack of opt-out class action cases and contingent fee arrangements suggests that even if the proposed Directive is enacted, most European victims of anticompetitive behavior will remain uncompensated.

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[20] *Id.*

[21] *Id.*

[22] "Opt-out" cases can include every class member unless they decide not to participate in the class.

[23] *See* Toward Assessment, *supra* note 2, at 1286-87.

[24] *Id.* at 1287.

[25] *See* ALBERT A. FOER & JONATHAN W. CUNEO, THE INTERNATIONAL HANDBOOK OF PRIVATE ENFORCEMENT OF COMPETITION LAW 277-414 (Albert A. Foer & Jonathan W. Cuneo, eds. 2010).

[26] *See* proposed Directive at Commission Recommendation of 11 June 2013 on common principles for injunctive and compensatory collective redress mechanisms in the Member States concerning violations of rights granted under Union Law 2013 O.J. (L 201) 60, 64 (EU).

[27] *See* Albert A. Foer & Jonathan W. Cuneo, *supra* note 24, at 296-315.

[28] *Id.*

E. Indirect Purchasers Usually Recover Much Less than Direct Purchasers

In the United States, there were almost always extra proof problems and other complications involving indirect purchaser cases.[29] These issues have tended to make indirect purchaser recoveries much smaller than those in direct purchaser cases.[30] For example, of the 60 large cases Professor Davis and I studied, only 11 involved indirect purchasers, and the indirect purchasers recovered only $2.2 billion, compared to the recovery of $13.1-$14.6 billion by direct purchasers in those 44 cases.[31]

Apparently, in Europe there are unclear standards involving such direct/indirect purchaser issues as the pass-on defense.[32] Nevertheless, if the U.S. experience is a guide, the relatively modest payments that will be made to indirect victims won't cause the sum of payments to direct and indirect purchasers to exceed 100 percent of the overcharges.

F. Victims in the United States Rarely Were Overcompensated

Even though U.S. law theoretically awards "treble damages," U.S. victims rarely have been overcompensated. Taking the actual U.S. experience into account, there is no reason to expect that overcompensation will be a problem in Europe.

This, of course, means that defendants rarely will pay more than the inflated profits they obtained through anticompetitive conduct.[33] This is so, despite the possibility victims will receive seemingly "duplicative" recoveries under the laws of E.U. Member States in addition to facing liability to both direct and indirect purchasers.

The U.S. antitrust laws theoretically award "treble damages" plus attorney fees to successful plaintiffs.[34] However, almost every successful U.S. case settles, and the median settlement was less than 50 percent of single damages.[35] Thus, even though the $33.8-$35.8

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[29] *See* Robert H. Lande, *New Options for State Indirect Purchaser Legislation: Protecting the Real Victims of Antitrust Violations*, 61 ALABAMA L. REV. 447, 456 (2010), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1267202.

[30] In addition, many states do not allow indirect purchaser suits.

[31] *See* Towards Assessment, *supra* note 2, at 1286.

[32] *See* proposed Directive, *supra* note 11, at 17-18.

[33] However, under the standard optimal deterrence model, defendants should pay more than their illegal gains because the probability that their activity will be discovered and sanctioned is less than 100 percent. *See* John M. Connor & Robert H. Lande, *Cartels as Rational Business Strategy: Crime Pays*, 34 CARDOZO L. REV. 427, 431-35 (2012), *available at* http://papers.ssrn.com/sol3/papers.cfm?Abstract_id=1917657&download=yes [hereinafter "Cartels as a Business Strategy"].

[34] *See* 15 U.S.C. Section 15(a)(i) (2000).

[35] Defendants should not be expected to settle for their maximum possible exposure. Indeed, for a variety of complex reasons even settlements as high as single damages are unusual. Professor John Connor and I are studying a group of 66 cartel cases where a neutral scholar calculated the cartel's overcharges in the U.S. market. We compared these results to the damages secured in private antitrust cases filed against these cartels in the United States. Despite the entitlement to treble damages, our tentative findings are that the victims of only 14 cartels received more than 100% of their damages. The rest—52 cases—yielded less than actual damages. In fact, half settled for less than 50 percent of actual damages and the median of the settlements was only 45 percent of single damages. These figures are preliminary and are subject to a large number of caveats. They also omit consideration of the value of products, coupons, and discounts. For these reasons the actual median settlement could be greater—perhaps as high as 75 percent of single damages.

billion Professor Davis and I calculated as being returned to victims in recent U.S. cases is a lot of money, it probably was not nearly enough to fully compensate all the victims in these cases.[36]

By contrast, the proposed Directive provides for single damages, defined to include pre-judgment interest and lost profit.[37] Pre-judgment interest and lost profit are not features found in U.S. antitrust, and they often can be quite significant. Nevertheless, as noted above, the U.S. "treble damages" remedy usually yields settlements of less than 50 percent of actual damages. If this ratio were to apply to European private cases under the proposed Directive, European victims would be expected to recover on average significantly less than 50 percent of actual damages. Even in the cases where some victims additionally recover under the laws of individual European nations, their total compensation is likely to be far less than the actual harm they suffered.

Moreover, if the proposed Directive is enacted, there are at least two additional important reasons why most victims will continue to be uncompensated. First, recall that most large private U.S. antitrust recoveries are opt-out class action cases. By contrast, the proposed Directive allows only opt-in class action cases, which typically recover far less. Second, most private U.S. recoveries come in contingent fee cases. These are rarely if ever permitted in Europe, even though without them, consumers and small businesses seldom will be able to bring competition cases.

For the above reasons, the proposed Directive is unlikely to come close to achieving its goal of fully compensating European victims of anticompetitive behavior, and European victims will rarely be overcompensated.

G. The U.S. Private Cases Have Helped Deter Anticompetitive Conduct Significantly

The purpose of the proposed Directive is, of course, to compensate victims of anticompetitive behavior.[38] Cases arising under the Directive also will help deter anticompetitive conduct, and this should be considered a welcomed side-benefit.

Deterrence of anticompetitive behavior is often believed to be the concern only of government enforcement. Nevertheless, a study I performed with Professor Davis shows that private enforcement in the United States likely deters a substantial amount of anticompetitive activity. In fact, it probably deters more anticompetitive behavior than even the highly acclaimed anti-cartel program of the U.S. Department of Justice.[39] This is true even though the Antitrust Division's cases often result in prison sentences for cartel participants![40] We hope that this

[36] This is especially likely to be true because roughly 20 percent of the U.S. recoveries were consumed by the victims' attorneys' fees and claims administration expenses. *See* Defying Conventional Wisdom, *supra* note 3, at 46-47.

[37] *See* proposed Directive, *supra* note 11, at 2.

[38] *See id.* at 4.

[39] Robert H. Lande & Joshua P. Davis, *Comparative Deterrence From Private Enforcement and Criminal Enforcement of the U.S. Antitrust Laws*, 2011 BRIGHAM YOUNG UNIV. L. REV. 315, 317 (2011), *available at* http://papers.ssrn.com/sol3/papers.cfm?Abstract_id=1565693.

[40] We use $6 million as having approximately the equivalent deterrent effect of a year in prison. *Id.*

finding will cause many in both the United States and in Europe to reevaluate their views as to the overall efficacy of private antitrust enforcement.

Of course, recent fines for violations of competition law have been much higher in Europe than in the United States. In 2013 the total U.S. antitrust fines were $1.88 billion,[41] while for the European Union they were $2.50 billion.[42] Similarly, for the last five years the United States and European Union total fines were, respectively, $4.19 billion[43] and $11.92 billion[44] and for the last ten years the totals were, respectively, $6.74 billion[45] and $23.21 billion.[46] As impressive as these European totals have been, however, they are smaller than the recoveries in just the 60 private U.S. cases that Professor Davis and I studied. Surely in Europe—like in the United States—private actions have the potential to significantly deter anticompetitive conduct.

The proposed Directive's private actions are not likely to have such dramatic deterrence effects for the reasons given in Section F, *supra*. Nevertheless, the Directive’s deterrence effects have the potential to be important. These should be considered a welcomed side-benefit of the Directive, especially because these cases will cost European governments and taxpayers very little in enforcement costs.

H. Despite the Combination of U.S. Private Actions and Government Enforcement, There Has Been No Evidence of Over-deterrence

If the proposed Directive is enacted, firms might well pay both a fine to the European Union and damages in private cases. The U.S. experience strongly suggests, however, that this combination will not result in over-deterrence.

A recent study I co-authored with Professor John Connor analyzed the optimal deterrence issue in the cartel context. We analyzed whether existing U.S. cartel sanctions are optimal in achieving deterrence.[47]

The United States imposes a diverse array of sanctions against collusion: criminal fines and restitution payments for firms in addition to prison, house arrest, and fines for corporate officials. Both direct and indirect victims can sue for mandatory treble damages and attorney's

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[41] *See* Melissa Lipman, *EU eclipses DOJ with 2.5B in antitrust fines in 2013*, Law360.com (January 8, 2014 7:02PM), http://www.law360.com/articles/499516/eu-eclipses-doj-with-2-5b-in-antitrust-fines-in-2013.

[42] *Id.* at 1.

[43] *See* Toward Assessment, *supra* note 2, at 1329-30, app. Tbl. 13,14 (2013), (for years 2003-2011); Department of Justice, Antitrust Division, *Division Update Spring 2013*, (last visited January 10, 2013), http://www.justice.gov/atr/public/division-update/2013/criminal-program.html (for year 2012); Lipman, *supra* note 40, at 1 (for year 2013).

[44] *See id.* (for year 2013); European Commission, Competition: Cartel statistics, 1 (Dec. 2013), http://ec.europa.eu/competition/cartels/statistics/statistics.pdf.l (for year 2012); Slaughter & May, *The EU Competition Rules on Cartels*, app. 1 at 26 (May 2012), *available at* http://files.teneoevents.eu/media/emailings/pdf/the-eu-competition-rules-on-cartels.pdf (for years 2003-2011).

[45] *See* Toward Assessment, *supra* note 2, at 1329-30, app. Tbl. 13,14 (2013), (for years 2003-2011); Department of Justice, *supra* note 42 (for year 2012); Lipman, *supra* note 40, at 1 (for year 2013).

[46] *See* Lipman, *supra* note 40, at 1 (for year 2013); European Commission, *supra* note 43 (for year 2009-2012); Slaughter & May, *supra* note 43, at 26 (for years 2003-2009).

[47] *See* Cartels as a Business Strategy, *supra* note 32.

fees.[48] The multiplicity of sanctions has helped give rise to the strongly held—but until recently never seriously examined—conventional wisdom in the antitrust field that these sanctions are not just adequate, but they are likely excessive.

We analyzed the issue using the standard optimal deterrence approach.[49] The model is predicated upon the belief that corporations and/or individuals contemplating illegal collusion will be deterred only if expected rewards are less than expected costs, adjusted by the probability the illegal activity will be detected and sanctioned. To undertake this analysis, we first calculated the expected rewards from cartelization using a new and unique database containing information concerning 75 cartel cases.[50] We surveyed the literature to ascertain the probability that cartels are detected and that detected cartels are sanctioned. We calculated the size of the sanctions involved for each case in our sample. These included corporate fines, individual fines, payouts in private damage actions, and the equivalent value (or disvalue) of imprisonment or house arrest for the individuals convicted.[51]

Our analysis showed that, overall, the combined U.S. cartel sanctions are only 9-21 percent as large as they should be to protect potential victims of cartelization optimally. This means that despite the existing sanctions, collusion remains a rational business strategy. Cartelization is a crime that, on average, pays. In fact, it pays very well. There is currently no cartel over-deterrence in the United States. Nor is the proposed Directive likely to cause over-deterrence in Europe.

I. Many Private Cases Were Not Follow-ups to Government Litigation

Not all of the private actions brought in the United States were follow-ups to government enforcement. The Davis/Lande study, for example, found that more than one-third of the 60 cases it studied were not follow-ups to government actions, and an additional 12 were significantly broader than the original government cases.[52] $8.4-$10.2 billion was recovered from the cases that did not follow U.S. federal, U.S. state, or E.U. government enforcement actions. In these cases, private plaintiffs uncovered the violations, initiated, and pursued the litigation with the government following the private plaintiffs' lead or playing no role at all. Another $11 billion came from cases with a mixed private/public origin or from cases that were significantly broader than the government's original case.[53]

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[48] In theory victims also can sue for the allocative inefficiency effects of market power or the "umbrella" effects of market power. In the United States there has never been an award for the allocative inefficiency effects of market power, and awards for the "umbrella effects" of market power are rare or non-existent. *Id.* at 457-62. Don't expect too many of these awards in European cases.

[49] We also incorporated a number of behavioral insights into our analysis, but they only changed our proposed remedies. *Id.*, passim.

[50] *Id.*

[51] For example, we use $6 million as having approximately the equivalent deterrent effect of either a year in prison or a year of house arrest. *Id.*

[52] *See* Defying Conventional Wisdom, *supra* note 3, at 30. The private cases often were broader in terms of time or geography or included more defendants or alleged violations. They often involved more defendants than the government cases, more causes of action, and greater relief (in some instances the only relief).

[53] *Id.*

It is doubtful, however, that the proposed Directive will result in nearly as many private cases that are not follow-ups to government enforcement. In fact, because the European Union has very different discovery procedures,[54] and allows neither opt-out class action cases nor contingent fee cases, the number of private actions that do not follow government enforcement may be rare.

J. U.S. Victims Received Billions of Dollars from Foreign Violators of U.S. Antitrust Law

The final point might be called a "balance of payments" or a "fairness to Europeans" consideration. A study by Dr. Connor found that, since 1999, foreign violators of U.S. antitrust laws returned more than $13 billion to U.S. victims of foreign cartels and monopolies. Indeed, in just the 60 cases Professor Davis and I studied, at least $6-$8 billion was recovered from non-U.S. companies, including more than $3 billion in cases against members of the vitamins cartels.[55] These totals do not include recoveries of products, discounts, coupons, or the value of injunctive relief or legal precedent.

For political and other purposes, it could be highly significant that a substantial portion of these recoveries came from foreign lawbreakers. Without private enforcement, these foreign actors could have preyed on participants in the U.S. economy while retaining almost all of their spoils.

As you know, many E.U. law violators are from the United States or Asia. A vigorous European private enforcement system surely would return a considerable number of Euros to European consumers and corporations from U.S. and other foreign actors.

IV. CONCLUSIONS

The Commission's proposed Directive concerning the private enforcement of Competition Law certainly would be beneficial for victims of anticompetitive conduct because it would allow some of them to obtain some compensation. It does not, however, go nearly far enough. Primarily, because it does not allow opt-out class action cases or contingent fees, it will leave most victims uncompensated.

It is certainly possible the proposed Directive has flaws and will result in some unintended or undesirable consequences. But today, there is a much greater flaw in E.U. competition law. Because of its lack of effective private enforcement, most victims are uncompensated. The injustice from not compensating these victims is more important than any injustices that might happen to companies that violate E.U. law.

If the proposed Directive is enacted, it should be assessed after it has been in effect for 3 to 5 years. The U.S. experience suggests this examination will produce a number of important findings: (i) most of the private cases will be found to be meritorious; (ii) despite possible suits under Member State as well as E.U. law, and by both direct and indirect victims, most victims will still be uncompensated or undercompensated; (iii) deterrence of anticompetitive activity will

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[54] For an extensive discussion on these issues *see* Albert A. Foer & Jonathan W. Cuneo, *supra* note 24 (comparing and contrasting the United States and European approaches in detail).

[55] *See* Defying Conventional Wisdom, *supra* note 3, at 17.

improve; and (iv) E.U. victims will recover a considerable number of Euros from non-E.U. violators. Further, the total amounts paid by violators in suits filed Europe-wide as a result of the new Directive, and also under the laws of individual European nations, by both direct and indirect purchasers, will rarely if ever exceed 100 percent of the actual damages.

After this retrospective is complete, the Commission should consider ways to further improve its private enforcement system. Perhaps at that time, the European Union will reconsider allowing opt-out class action cases or contingent fees. If the Commission does reevaluate these issues, it should, of course, do so only on the basis of objective, reliable empirical information, and not on the basis of rumor, unsupported conventional wisdom, opinions, hypotheticals, or anecdotes.

In the meantime, individual Member States are free to do more than the minimum, set out by the proposed Directive. This short article suggests only a few of the ways[56] they could enact laws that are extremely likely to help victims of anticompetitive behavior.

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[56] As another possibility, the proposed directive contains a presumption that cartels overcharge, but the presumption does not specify an overcharge amount. *See* proposed directive, *supra* note 11, at 39. Perhaps a revised directive should contain a presumption that cartels overcharge by 10 percent, the amount specified by the United States sentencing commission in its antitrust guidelines. A more realistic alternative would be to adopt a 20 percent presumption, which would still be less than the typical amount of cartel overcharges found in a study I performed together with Professor Connor. *See* John M. Connor & Robert H. Lande, *How High Do Cartels Raise Prices? Implications for Reform of the Antitrust Sentencing Guidelines*, 80 TULANE LAW. R. 513 (2005), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=787907.

This study identified about 200 serious social science studies of cartels, and these studies contained 674 observations of average overcharges. Our primary finding is that the median cartel overcharge for all types of cartels over all time periods has been 25 percent; 17-19 percent for domestic U.S. cartels, and 30-33 percent for international cartels. Thus, in general, international cartels have been about 75 percent more effective in raising prices than domestic cartels. Since the United States has had, historically, by far the toughest system of anticartel sanctions, this could imply that these sanctions have been having significant effects.

We also performed a survey of every final verdict we could find in decided U.S. collusion cases. Only 3 of the 25 cases we found were international cartels. This survey produced an average median overcharge of 21.6 percent and an average mean overcharge of 30.0 percent. Thus, the 25 U.S. cartel decisions produced average overcharges that were quite comparable to the results of the much larger set of economic estimates. *Id.*

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Mexico's Proposed Reform of Competition Law: A Critique from Europe

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Mexico's Proposed Reform of Competition Law: A Critique from Europe

Anne Perrot & Assimakis Komninos[1]

I. INTRODUCTION

Legislative innovations in the competition law area may be based on good intentions but it is always a good idea to run a sanity check and refer back to fundamental principles of sound competition policy. On February 19, 2014, the Secretaría de Economía within the Federal Executive Branch proposed rather sweeping amendments to the Mexican Competition Act (the "Law Proposal"), which include a number of problematic elements. Most alarmingly, the Law Proposal refers to a newly introduced concept of "barriers to competition" and would make it a violation of competition law to create a "barrier to competition."

In our short article, we draw on our academic and professional expertise in the area of competition law, economics, and policy and on our experience as former enforcers. We also draw on experience from our participation in international forums of competition law enforcement agencies, such as the Competition Committee of the Organisation for Economic Cooperation and Development ("OECD"), the International Competition Network ("ICN"), and the United Nations Conference on Trade and Development ("UNCTAD").

We believe that merger control and standard antitrust rules give competition authorities a set of efficient and secure tools to guarantee the well-functioning of markets for which competition is the normal way to operate. The implementation of these policy interventions relies on a set of definitions, methods, and tools shared by most competition authorities around the world. This framework allows, on the one hand, for a full understanding by firms of the risks associated with anticompetitive behavior and, on the other hand, limits both the risks of "false negatives" and "false positives" by competition authorities. It also ensures that firms understand the level-playing field in which they operate and guarantees that their investments will not be confiscated.

A legal framework that would introduce a new and vague additional source of intervention by competition authorities would destroy this legal framework and lead to a high degree of uncertainty. In particular, the risk of divestiture of assets resulting from so-called "barriers to competition" would place a high burden on firms and would hamper their willingness to innovate and invest, leading finally to a less competitive economy.

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II. THE MEXICAN LEGISLATIVE PROPOSALS ON THE CONCEPT OF "BARRIERS TO COMPETITION"

We understand that a new Competition Bill is currently pending before the Mexican legislature. The proposed text includes a number of provisions that are rather familiar to competition law experts. In particular, there are provisions on anticompetitive agreements (Article 53 on "Absolute Monopolistic Practices"), unilateral conduct of dominant companies (Article 54 on "Relative Monopolistic Practices"), and merger control (Article 61 *et seq*. on "Concentrations").

However, the Law Proposal also includes a number of alarmingly novel provisions, concepts, and procedures, which seriously depart from mainstream competition law and economics and which go as far as being incompatible with the most fundamental notions of competition law enforcement. These provisions center on the introduction of a nebulous concept of "barriers to competition," which, as such, is not met in any other mainstream competition law enforcement system, to the best of our knowledge.

In particular, the following provisions of the Law Proposal are most relevant:

- Article 52 of the Law Proposal stipulates that "barriers that, according to this law, limit, damage or prevent free participation or economic competition in the production, processing, distribution or commercialization of goods or services are prohibited."
- According to Article 55, practices associated with such "barriers to competition" "shall be considered unlawful and be punished."
- According to Article 57 of the Law Proposal, "the Commission shall establish what is essential in order to prevent and eliminate any barriers to free participation and economic competition using the procedures set forth by this law."
- Article 94 of the Law Proposal appears to provide authority to determine whether "there are elements which determine the existence of barriers for free competition" and, if so, to order "corrective measures deemed necessary" for the purpose of "eliminating restrictions for the efficient operation of the market in question."
- According to the Law Proposal, "the measures may include the elimination of barriers to free competition, regulation of essential inputs or divestiture of assets, rights, partnership interests or shares of the Economic Agents in the proportion required to eliminate anti-competitive practices detected by the Commission. The measures concerning the existence of an Essential Input shall include mode of access to it, price or tariff controls, technical and quality conditions and time schedules."

III. ANALYSIS OF THE PROPOSED PROVISIONS IN LIGHT OF BASIC COMPETITION LAW PRINCIPLES

Based on our review of the proposed legislation, we believe that the novel concept of "barriers to competition" could be used by the competition authority in two distinct but also interlinked ways:

First, it appears from Articles 52, 55, and 57 of the Law Proposal that a new kind of competition law violation is introduced, not recognized in competition regimes elsewhere, the

erection of "barriers to competition." The text is not particularly clear as to whether this constitutes a self-standing third basic violation of competition law, apart from anticompetitive agreements (Article 53) and monopolization or abuse of market power (Article 54), or whether it is a specific practice that the law would consider as an example of an anticompetitive agreement (if pursued in an agreement put in effect by a number of firms) or of monopolization (if pursued unilaterally by a firm or firms holding market power).

However this concept functions, it would give rise to a competition law violation that would be unlawful and punishable by the authority through monetary sanctions and through the imposition of injunctive measures. In this sense, to the best of our knowledge, this would be a unique violation of competition law that is not present in other mainstream competition law systems. It is certainly not recognized in U.S. antitrust law or EU competition law, and we believe no similar provision exists in the national competition laws of the EU Member States or in the competition statutes of other major countries. This should not come as a surprise, since, as we explain below, there are valid legal, economic, and policy arguments against this flawed concept.

Second, it seems that Article 94 of the Law Proposal aspires to introduce into Mexican competition law a system of market investigation, where there has been no unlawful conduct by firms (in the form of anticompetitive agreement or monopolization). Yet, the authority would intervene to deal with what it perceives as "existence of barriers for free competition or of essential inputs which require to be regulated because they affect the process of free competition."

Such an enforcement mechanism is again unique. There are maybe a handful of jurisdictions, most notably the United Kingdom, Greece, and Israel, which include the market investigation mechanism in their competition law enforcement systems (which one of the authors of this paper is intimately familiar as a former Commissioner). Such market investigations, in other words, can be undertaken when there is a competition problem that is not caused by a competition law violation. The authority may intervene against a certain market structure or sometimes a "market failure" and this may, indeed, lead to regulatory measures. However, the Mexican proposals are different in nature from these models and are built around the nebulous concept of "barriers to competition," contrary to the above models.

The market investigation tool, as we know it from the above three jurisdictions, is a rather controversial way to intervene in a market and there are valid criticisms that can be launched against it, as we develop below. However, it is important to note that Article 94 of the Law Proposal is far more deserving of criticism, because it differs fundamentally even from the U.K., Greek, and Israeli systems and likely would lead to flawed outcomes that are detrimental to competition and consumer welfare.

A. "Barriers to Competition" as a Violation of Competition Law

In their current form, Articles 52, 55, and 57 of the Law Proposal appear to introduce a new kind of competition law violation, the erection of "barriers to competition." This is an unfortunate and flawed concept.

The very notion of "barriers to competition" is not a term or concept that is met in recognized competition theory, legislation, or case law elsewhere. It is a descriptive term that may have a very generic and imprecise meaning. Anticompetitive practices may result in creating

"barriers to competition," but a "barrier to competition" by itself does not indicate there in fact exists any anticompetitive behavior. Besides, there are already means to fight barriers to entry when these barriers result either from unilateral monopolistic conduct or from collusive behavior. Mexican law currently in force, like other competition laws, has such means readily available. In addition, merger control allows competition authorities to assess the dangers of more concentrated market structures that can result from external growth. Indeed, in the context of merger control, competition authorities can impose structural remedies in order to correct the potential anticompetitive effects of a contemplated merger.

Various competition laws, following basic economic principles, refer to "barriers to entry," which is a different and precise concept. Entry barriers are factors that prevent or hinder companies from entering a specific market. They may result, for instance, from a particular market structure (for example, sunk cost industry, brand loyalty of consumers to existing products, the need for distribution systems, the costly establishment of a reputation) or the behavior of incumbent firms. Government policies can also be a source of entry barriers (such as through licensing requirements and other regulations).[2]

However, these factors are seen neutrally by competition laws. Their existence is only useful to define the product and geographic market or to assess market power or dominance on a properly defined market; the identification of entry barriers is not used to establish an infringement of competition rules. Indeed, the existence or erection of barriers to entry, as such, is not considered unlawful by the laws of other countries.

We understand that the concept "barriers to competition" is not meant as "barriers to entry" by the Law Proposal; nevertheless, the use of the former term creates confusion because it resembles the latter term. Certainly, any theory which would make the existence or even erection of barriers to entry a violation of competition law would be fundamentally flawed and at variance with mainstream competition laws and basic economic principles. Barriers to entry cannot by themselves constitute an abuse of dominance or market power.

The apparent introduction of the concept of infringement based upon the existence of "barriers to competition" in Article 52, especially when combined with the other related provisions recited above, raises a related concern that efficient companies may be penalized for striving and succeeding in growing their market share through perfectly acceptable and desired conduct. More generally, a company's possession of a high market share is not unlawful in either the United States or the European Union or, indeed, in other competition law systems. Competition law encourages companies to grow their market shares through more efficient operations, investment, and innovation, and other pro-competitive behavior. Under EU competition law, other European competition laws, U.S. law and other leading economies' competition laws, a firm's dominant position is not, in itself, prohibited and cannot constitute a competition law violation. Instead, an abuse of dominance can only be established through evidence of exclusionary or exploitative conduct.

[2] European Commission, Directorate-General for Competition, *Glossary of Terms Used in EU Competition Policy*, *Antitrust and Control of Concentrations*, Brussels, p. 17 (July 2002).

Thus, to punish a firm and force divestitures, the authorities must prove more: A company's status and its conduct are not unlawful if there is no finding that the company engaged in some kind of exclusionary, exploitative, or otherwise harmful conduct that is punishable under competition rules. A finding of high market shares, high concentration, barriers to entry, or, indeed, "barriers to competition" is not enough. High market shares as such do not even themselves indicate whether a firm has market power.[3]

A recent judgment of the Grand Chamber of the European Court of Justice makes some important general pronouncements on the role of dominance and on the intervention of competition law, which, we believe, deserve the attention of the Mexican law makers:

> It is settled case-law that **a finding that an undertaking has such a dominant position is not in itself a ground of criticism of the undertaking concerned** (Case 322/81 Nederlandsche Banden-Industrie-Michelin v Commission [1983] ECR 3461, paragraph 57, and Joined Cases C-395/96 P and C-396/96 P Compagnie maritime belge transports and Others v Commission [2000] ECR I-1365, paragraph 37). **It is in no way the purpose of Article [102] to prevent an undertaking from acquiring, on its own merits, the dominant position on a market** (see, inter alia, TeliaSonera Sverige, paragraph 24). **Nor does that provision seek to ensure that competitors less efficient than the undertaking with the dominant position should remain on the market.**
>
> Thus, **not every exclusionary effect is necessarily detrimental to competition** (see, by analogy, TeliaSonera Sverige, paragraph 43). **Competition on the merits may, by definition, lead to the departure from the market or the marginalisation of competitors that are less efficient and so less attractive to consumers from the point of view of, among other things, price, choice, quality or innovation.**
>
> According to equally settled case-law, a dominant undertaking has a special responsibility not to allow its behaviour to impair genuine, undistorted competition on the internal market (Case C-202/07 P France Telecom v Commission [2009] ECR I-2369, paragraph 105 and case-law cited). When the existence of a dominant position has its origins in a former legal monopoly, that fact has to be taken into account.
>
> In that regard, it is also to be borne in mind that Article [102] applies, in particular, to the conduct of a dominant undertaking that, **through recourse to methods different from those governing normal competition on the basis of the performance of commercial operators**, has the effect, **to the detriment of consumers**, of hindering the maintenance of the degree of competition existing in the market or the growth of that competition (see, to that effect, AKZO v Commission, paragraph 69; France Télécom v Commission, paragraphs 104 and 105; and Case C-280/08 P Deutsche Telekom v Commission [2010] ECR I-9555, paragraphs 174, 176 and 180 and case-law cited)."[4]

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[3] *See* Louis Kaplow, *Market Share Thresholds: On the Conflation of Empirical Assessments and Legal Policy Judgments*, Harvard John M. Olin Center for Law, Economics, and Business, Discussion Paper No. 692 pp. 9-10 (May 2011).

[4] Case C-209/10, *Post Danmark A/S v Konkurrencerådet*, Judgment of 27 March 2012, ¶¶ 21-24 (emphasis added).

As a general principle, competition laws and competition law enforcement should always strive to protect competition and consumer welfare, not individual competitors who do not deliver to consumers. Rivals may be less successful for other reasons, as well; for example, they may not invest in their companies or in innovation to the same extent, or they may simply be less efficient. Competition law should not encourage such firms. Legal rules and provisions that facilitate a redistribution of assets (such as in a divestiture order) or that force access to inputs developed by a dominant competitor are likely to encourage economic free-riding and discourage the very investment Mexican policy makers should want to foster.

Also, dominant companies should be free to compete aggressively as long as this competition is ultimately for the benefit of consumers.[5] So-called "competition on the merits" has beneficial effects for consumers and should therefore be promoted. Competition does not only allow consumers to obtain a broader supply and lower prices, it also leads to a selection of efficient firms by market mechanisms: this mechanism drives out of the market only those firms that are not efficient enough to sustain competition on the merits. Therefore, an inadequate intervention in this natural mechanism, like the divestiture of firms who gained market share due to their higher efficiency, would deprive consumers of the main and long-term benefits of competition.

This means that a company that competes successfully on the market may acquire a number of advantages vis-à-vis its competitors, such as a more efficient distribution network, a paramount brand, access to a technology that was developed with considerable effort and investment, and other assets or inputs that its competitors would desire or envy. However, it would be flawed if a law that prohibits "barriers to competition" (which is a very vague concept itself) gave the competition authority the power to order firms to divest assets or technology. This would give adverse incentives to firms to engage in a vigorous competition on the merits, since the benefits of a growing activity would be confiscated.

In addition, the simple threat of being subject to such a divesture makes investment more risky and should further discourage investment, competition on the merits, and innovation. It would ultimately be also a factor dissuading potential investors to enter the Mexican market.

These detrimental effects to consumer welfare, competition, and the economy were aptly described by Advocate General Jacobs, one of the most eminent Advocates General at the European Court of Justice, in his celebrated Opinion in *Bronner*:

> First, it is apparent that the **right to choose one's trading partners and freely to dispose of one's property** are generally recognised principles in the laws of the Member States, in some cases with constitutional status. Incursions on those rights require careful justification.
>
> Secondly, the justification in terms of competition policy for interfering with a dominant undertaking's freedom to contract often requires a careful balancing of conflicting considerations. In the long term **it is generally pro-competitive and in the interest of consumers to allow a company to retain for its own use facilities which it has developed for the purpose of its business. For example, if**

[5] *See, e.g.*, European Commission, Directorate-General for Competition, MEMO/08/761, Brussels, 3 December 2008.

> **access to a production, purchasing or distribution facility were allowed too easily there would be no incentive for a competitor to develop competing facilities. Thus while competition was increased in the short term it would be reduced in the long term. Moreover, the incentive for a dominant undertaking to invest in efficient facilities would be reduced if its competitors were, upon request, able to share the benefits. Thus the mere fact that by retaining a facility for its own use a dominant undertaking retains an advantage over a competitor cannot justify requiring access to it.**
>
> Thirdly, in assessing this issue it is important not to lose sight of the fact that the primary purpose of Article [102] is to prevent distortion of competition—and in particular to safeguard the interests of consumers—**rather than to protect the position of particular competitors.** It may therefore, for example, be **unsatisfactory**, in a case in which a competitor demands access to a raw material in order to be able to compete with the dominant undertaking on a downstream market in a final product, to focus solely on the latter's market power on the upstream market and conclude that its conduct in reserving to itself the downstream market is automatically an abuse. Such conduct will not have an adverse impact on consumers unless the dominant undertaking's final product is sufficiently insulated from competition to give it market power.[6]

In conclusion, with reference to Articles 52, 55, and 57 of the Law Proposal, for a company to be found liable in a manner consistent with competition theory, practice, and enforcement in modern market-based economies, there must be a predicate finding that the market power held was acquired through recognized exclusionary or exploitative conduct. A dominant market position or a concentrated market cannot, in themselves, amount to a violation of competition law based on the vague concept of "barriers to competition," and cannot lead to structural measures and price regulation. That would be bad law and would also be at variance with the most fundamental principles in effect in mainstream competition law systems globally. It would also harm both competition and consumers, apart from the specific companies concerned.

B. "Barriers To Competition" As a Trigger for a Market Investigation Leading to Behavioral and Structural Measures

The second way in which the Law Proposal employs the concept of "barriers to competition" is as a trigger for the conduct of a market investigation. This can potentially lead to the imposition of behavioral and structural measures on a number of market players, even though the companies concerned did not engage in any violation of the competition rules.

We understand that the Mexican Competition Act currently in force allows the conduct of market studies, which are issued as non-compulsory "opinions" by the chairman of the Commission.[7] Indeed, a number of market studies have been conducted and most of them concerned regulated sectors: technological convergence (2005), content provision in telecommunications (2006), competition in the provision of individual retirement accounts (2006), retail banking services (2007), competition in airport services (2007), and foreign trade (2008).

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[6] Case C-7/97, *Oscar Bronner GmbH & Co. KG v Mediaprint Zeitungs- und Zeitschriftenverlag GmbH & Co. KG and Others*, [1998] ECR I-7791, Opinion of AG Jacobs, ¶¶ 56-58 (emphasis added).

[7] OECD Policy Roundtable, Market Studies, DAF/COMP(2008)34, p. 75.

Such market studies are in-depth opinions that elaborate on a particular industry's structure and its existing regulation and contain detailed analyses of competition conditions in specific goods or services in these regulated markets. They include a set of recommendations for the government or the legislature and observations on the industry's structure and behavior, but they do not and cannot lead to behavioral or structural measures that the competition authority can impose. In other words, such investigations are seen as a tool of competition **advocacy** (and potentially also legislative advocacy), and not as competition **enforcement**.[8]

Market studies that are disconnected from the imposition of behavioral or structural measures are a useful tool in the hands of competition authorities[9] A number of competition laws, including EU competition law, are familiar with this tool currently in force as a component of the existing Mexican Competition Act.[10]

However, the Law Proposal goes much further and introduces for the first time a very different model, that of **market investigations leading to the adoption of regulatory measures of a behavioral or structural nature**. This is not a model that finds favor with competition law systems internationally. We are familiar only with the U.K., Greek, and Israeli systems that have adopted this rather controversial model. We understand that the Law Proposal, indeed, purports to introduce the U.K. model into Mexican law.

The U.K. model of market investigation is aimed at assessing whether competition in a market is working effectively and where it is desirable to focus to answer this question, e.g. on the functioning of the market as a whole rather than on a single aspect of it, or the conduct of particular firms within it. A market investigation aims only to see if competition within the particular market under review is working well or can be improved and is not seeking to establish general rules and obligations for firms.[11]

A market investigation's overarching framework allows the investigation to tackle "adverse effects on competition" from any source. As well as being able to look into the conduct of firms, the competition authority can probe for other causes of possible "adverse effects on competition," such as structural aspects of the market (including barriers to entry and expansion) or the conduct of customers. Having established a competition problem, and identified its causes, the competition authority is then able to impose a wide range of legally enforceable remedies, including behavioral and structural measures, extending even to divestitures of assets, and make recommendations for remedial action by other public bodies.

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[8] *Id*. p. 80.

[9] OECD Policy Roundtable, Market Studies, DAF/COMP(2008)34; ICN Advocacy Working Group, Market Studies Project Report, June 2009.

[10] Jurisdictions that recognize this tool include the European Union, the United States, Romania, South Africa, Italy, and Mexico. *See generally* Tamar Indig & Michal S. Gal, *New Powers-New Vulnerabilities? A Critical Analysis of Market Inquiries Performed by Competition Authorities*, COMPETITION LAW AS REGULATION (Di Porto & Drexl, eds. forthcoming, 2014), *available at* SSRN: http://ssrn.com/abstract=2333068. *See also* ICN Advocacy Working Group, Market Studies Project Report, June 2009.

[11] UK Competition Commission, CC3 (Revised) - Guidelines for Market Investigations: Their Role, Procedures, Assessment and Remedies, pp. 8-9 (April 2013).

The identification of anticompetitive features in a market investigation, or the imposition of remedies, does not mean that market participants have infringed the law.[12] Nevertheless, it certainly impinges on the economic freedoms of market participants, especially if they are the addressees of behavioral or structural measures. The Greek and Israeli systems are broadly modeled on the U.K. system.

There are a number of reasons why Mexico is well-advised to exercise caution before uncritically adopting this model. Certainly, some drawbacks of that system must be given proper consideration. Below we mention a number of such drawbacks:

1. A market investigation that leads to the imposition of regulatory measures of a behavioral or structural nature represents a rather extreme intervention in the core of economic freedom. Competition law, of course, may intervene to regulate conduct on the market. This is not objectionable when the company or companies concerned have acted through an anticompetitive agreement or by abusing their market power. On the other hand, when no such specific anticompetitive conduct has taken place, it is not obvious why a company should be subject to regulation and to measures restricting its freedom, merely because of the existence of a market structure that is considered simply undesirable. Such an intervention that, in the end, punishes a company for the status of the market on which it is present, departs from the general principle of imputation of antitrust liability that is applicable to competition law enforcement.

2. Even if there is an important public interest at stake, it is not clear why the existing orthodox legal standards and tools available to Mexico's competition authorities do not allow them to efficiently fight against anticompetitive conduct. On the one hand, merger control allows them to assess *ex ante* the risks of lessening of competition that an excessive increase of market power could create. On the other hand, the detection and punishment of anticompetitive practices allow competition authorities to restore *ex post* the competitive functioning of the market. They also give *ex ante* incentives to firms to behave in a pro-competitive way. The action of competition authorities in these two fields relies on a precise standard of proof, and intervention is based on the implementation of a set of approved methods and tests that guarantee legal certainty and a level-playing field on the market.

3. When the competition authorities are given the additional task positively to increase competition in a market, this increases uncertainty in the market. It is not clear which degree of intervention is warranted and which tools for achieving it are preferable. Thus, this represents a paradigm shift from the certainty (or from an acceptable degree of uncertainty) of the standard anticompetitive practices (agreements and abuse of market power) to the uncertainty of "increasing competition." This, in turn, might negatively affect firms' conduct, especially investment decisions.[13]

4. An argument that is used in favor of the market investigation tool is that it allows the competition authorities to deal with cases of "market failures." However, it is not certain that such "market failures" should always be remedied within the confines of competition law, particularly if the orthodox tools of competition law cannot remedy the absence of effective

[12] *Id*. p. 9.

[13] Indig & Gal, *supra* note 10.

competition in a specific market. The source of the problem may not lie in competition itself, but rather in other factors, such as regulation, network effects, customer inertia, or imperfect information flows between market participants. A good example is often the case of regulated markets or of oligopolistic markets that were recently liberalized. In most cases, the answer to the problem of "market failures" lies in regulation itself and not competition. For example, in the only final market investigation conducted in Greece by the Hellenic Competition Commission, it transpired that the real problem lay in State regulatory measures that were restricting competition.

5. The introduction of a full-fledged market investigation system entails a dramatic departure from the basic philosophy of competition law, as it breaks some of the traditional lines between *ex post* and *ex ante* regulation and broadens the competition authorities' powers significantly to include "market engineering."[14] Indeed, it is not guaranteed that competition authorities can recreate conditions of free competition as if they were the product of a "laboratory."

6. Competition authorities themselves sometimes are reluctant to be given such regulatory powers by legislation and may consider the market investigation tool a "poisonous chalice." This is because it may result in diluting the resources designated to traditional tasks, leading to inferior performance and inferior deterrence. For example, the indicative timescale of the U.K. Competition Commission for the carrying out and finalization of a market investigation is 18 to 24 months. To that timescale, one must add the proceeding before the Office of Fair Trading ("OFT"), which makes the decision to "refer" the case to the Competition Commission. In short, this is a terribly time- and resource-consuming exercise. In the United Kingdom, it consumes the resources of two well-endowed and sophisticated authorities. It is not clear how smaller competition authorities could cope with it, bearing in mind that they have to prioritize their other antitrust cases. In Greece, the Hellenic Competition Commission has not been eager to open this proceeding, precisely for lack of resources. In sum, the market investigation tool may be described as a "luxury tool" that has to be handled with care.

7. The introduction of the market investigation tool, particularly when the law gives the Executive the initiative for its deployment, creates a certain politicization of competition law enforcement and may ultimately harm the competition authority's independence. This, of course, depends on the circumstances of each country. It may also provide an excuse to governments that fail to proceed with desirable structural reform, because they can pretend that it is the role of the competition authority to proceed to structural reform via the market investigation tool. This is an idea that we consider extremely dangerous.

As a result, while we certainly consider interesting the U.K. experiences with the market investigation tool, particularly with regard to existing or former State monopolies, we caution against its uncritical introduction into other economies that do not share the same economic, political, and institutional features. Mexico should proceed with caution even if it is satisfied that its institutions share a substantial degree of empirical expertise attained from "normal" competition enforcement.

[14] *Id.*

C. The Flawed Test of "Barriers to Competition" in Mexico's Proposed Market Investigation System

In any event, even if Mexico is firmly resolved to introduce into its Competition Act a system of market investigation leading to the imposition of behavioral or structural measures, we consider imperative that the current text of the Law Proposal which refers to the totally nebulous concept of "barriers to competition" be revisited. Article 94 of the Law Proposal provides that "[t]he Commission shall initiate ex officio or by request of the Federal Executive Branch, on its own motion or through the Secretary General's Office, the proceeding of market investigation to determine the existence of barriers to competition or of essential inputs."

This text is at variance with the test used in the other known systems that include such a market investigation tool. For example, U.K. law refers generally to any "feature, or combination of features, of a market in the United Kingdom for goods or services" that "prevents, restricts or distorts competition," and, more specifically, to "the structure of the market concerned or any aspect of that structure" and to the conduct of the market participants and their customers.[15]

Greek competition law, for its part, gives powers to the Hellenic Competition Commission to conduct market investigations in sectors of the Greek economy where "there are no conditions of effective competition" and where it considers that its existing enforcement powers "do not suffice for the creation of conditions of effective competition."[16]

Finally, in Israel, the law in force empowers the competition authority to actively change market conditions in markets characterized by a high degree of oligopolistic coordination.

As seen from these examples, none of the existing full-fledged market investigation systems relies on the notion of "barriers to competition" and none singles out "essential inputs." Indeed, the relevant text of the Law Proposal suffers from a number of flaws:

1. As explained above, the concept of "barriers to competition" is confusing and not customary in competition law and economics.[17]

2. The linkage of "barriers to competition" with the existence of so-called "essential inputs" is equally confusing and dangerous. If by "essential inputs" the text refers to the doctrine of "essential facilities," then this raises serious concerns. Competition laws exceptionally consider a dominant company's refusal to grant access to "essential facilities" as an abuse of market power if there is an exclusionary incentive to restrict competition on a downstream market. But in order to do so, competition authorities carefully examine to what extent the facility should indeed be considered as essential. This is a crucial step since otherwise, forcing access would deprive the owner of his property right and therefore, of any incentives to invest in the production of the input.

Outside the area of market power and of exclusionary abuses, there can be no application of the doctrine of "essential facilities." Particularly in the area of market investigations, if that

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[15] UK Enterprise Act 2002, s. 131 *et seq*. *See also* recent amendments by Enterprise and Regulatory Reform Act 2013, s. 33 *et seq*.

[16] Article 11(1) of the Greek Competition Act.

[17] *Supra*.

doctrine were to be put in effect, it would amount to a serious blow to competition on the merits and to consumer welfare.

3. Introducing a new and vague concept of "barriers to competition," especially in combination with the reference to "essential inputs" would certainly send a clear signal to firms to be reluctant to engage in investments in the absence of a clear legal context regarding their assets. That would be in particular detrimental to innovation.

4. A policy mandating divestitures for companies that attain specific market-share thresholds, or have invested in what may be considered as "essential inputs," may also have perverse consequences on their incentives to invest and innovate over the longer term. For instance, a firm may refrain from making significant investments for fear of triggering mandatory divestitures if these investments may lead to substantial growth in the firm's share. Likewise, it may refrain from investing in and developing an innovative technology for fear of that technology being considered an "essential input."

5. The proposed price regulation provisions, which are linked with the mandating of access to "essential inputs," are problematic and would bring the authority into the shaky ground of a cross-sector regulator, when it has no such expertise. The proposed legislation also begs the question of "what is the correct price" of access, especially in the case where there has been no prior access. Moreover, competition authorities are not well equipped to define what the access price of an "essential input" should be. Usually, they only define principles these prices should obey, like that according to which prices should be "cost oriented," but are unable to compute the adequate **level** of prices that should prevail for the access to a facility.

6. The envisioned change in the legislation carries thus the risks of "false positives;" that is, the likelihood that pro-competitive behavior will be punished. This in turn would lead to perverse incentives to firms. In order to adequately invest in R&D, new projects, and production tools—which are all ingredients of competition on the merits—firms need to be secured in the legal environment in which they operate. Legal certainty regarding the assessment of anticompetitive behavior is a crucial part of this environment and competition authorities should only base their interventions on methods and concepts that leave limited scope for vague interpretations.

IV. CONCLUSIONS

Our analysis of the Law Proposal leads us to the following conclusions:

- The introduction of a *sui generis* violation of competition law centered around the notion of "barriers to competition" (per the proposed Articles 52, 55, and 57) is flawed and runs counter to the most fundamental principles of competition law and economics. It would create an intolerable degree of legal uncertainty for enterprises and would be detrimental to competition, consumer welfare, and to the Mexican economy as a whole.
- The adoption of a system of market investigation leading potentially to behavioral and/or structural measures should be viewed with caution because of a number of drawbacks. A more developed cost-benefit analysis is called for, building on past experiences in those few systems that have adopted this model. In addition, the applicable test for regulatory

intervention should be clearly structured around a consumer welfare standard and not around nebulous concepts.

- In any event, the introduction of market investigations to deal specifically with "barriers to competition" and perceived problems associated with "essential inputs" is flawed and at variance with the other few existing models, which the Law Proposal in effect purports to follow. It should be avoided because it creates a severe risk that pro-competitive behavior will be blocked, thus harming the public interest that competition law aspires to protect in the first place.

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Abuse of Dominance Under the Competition Act, 2002: Developments and Trends

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Abuse of Dominance Under the Competition Act, 2002: Developments and Trends

Kalyani Singh[1]

I. INTRODUCTION

On December 9, 2013, the Competition Commission of India ("CCI") imposed a penalty of approximately INR 17 billion on Coal India Limited for abusing its dominance under the Competition Act, 2002 ("Competition Act");[2] this is the maximum penalty as yet imposed on a company. This case was yet another instance of the increasing rigor with which competition law is being enforced in India.

Since coming into force in 2009, CCI—the antitrust regulatory body in India—has effectively asserted the importance of the Competition Act in the Indian economy. The architecture of the Competition Act is premised on standard antitrust legislation prevalent in most jurisdictions: it regulates anticompetitive agreements, abuse of dominance, and combinations. Notwithstanding this similarity in legislative text, as can be expected in developing jurisdictions India has substantially diverged in the enforcement of competition law. Particular to this divergence is its enforcement of abuse of dominance. As revealed through the CCI's decisions, a unique position regarding abuse of dominance has evolved in India.

This article attempts to shed some light on the law and subsequent developments and trends relating to abuse of dominance under the Competition Act.

II. ABUSE OF DOMINANCE UNDER THE COMPETITION ACT

Section 4 of the Competition Act proscribes any enterprise or group from abusing its dominant position. The language of Section 4 of the Competition Act is very similar to Article 102 of the Treaty for European Union ("TFEU") with one major difference—this provision does not cover the concept of collective dominance.

Assessment of a conduct, as an abuse of dominance, hinges upon three basic components:

1. definition of a relevant market;
2. establishing dominance of the enterprise or the group in the relevant market; and
3. determination of abusive conduct in the relevant market.

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[2] *M/s Maharashtra State Power Generation Company Ltd. v. M/s Mahanadi Coalfields Ltd. & Ors.*, 03/2012; *M/s Maharashtra State Power Generation Company Ltd. v. M/s Western Coalfields Ltd. & Ors.*, 11/2012; and *M/s Gujarat State Electricity Corporation Limited v. M/s South Eastern Coalfields Ltd. & Ors,* 59/2012, December 9, 2013.

A. Relevant Market

"Relevant market" under the Competition Act is defined as either the relevant product market or the relevant geographic market or both.[3] The Competition Act also provides for an illustrative list of factors to be taken into consideration when delineating the relevant product and the relevant geographic markets.[4] The CCI has construed the term "relevant market" to mean both a relevant product and a relevant geographic market.[5]

Like most jurisdictions, the CCI has primarily concentrated on the *end-use* of the product in its delineation of the relevant product market.[6] By contrast, CCI's take on the relevant geographic market seems to be surprisingly circumscribed. While the Competition Act gives extraterritorial jurisdiction to the CCI—therefore empowering it to look at a landscape beyond India—it invariably seems to limit its assessment to be within India.[7] The primary reason for this emanates from the definition of dominance under Section 4 of the Competition Act, which requires a dominant position to be established in India. Within India, however, the CCI has adhered to the general principle of delineating the relevant geographical market as the area within which the conditions of competition are homogenous.[8]

Specific to the definition of relevant market is the CCI's reluctance to use economic tools. Specifically, the CCI has so far avoided the use of economic tools such as the generally accepted hypothetical monopolist test SSNIP test ("SSNIP") in relation to the delineation of the relevant product market. For instance, in the *NSE* case[9] the CCI categorically rejected the SSNIP. In most of its current decisions, the CCI seems to have maintained this stance; however, in the *BCCI* case[10] it did fleetingly refer to the SSNIP test when determining the relevant market. This line of thought, unfortunately, does not seem have been carried over to CCI's general conceptualization of the relevant market. [11]

B. Establishing Dominance

Predictably, determination of dominance is another necessary precursor to any assessment of a conduct as an abuse of dominance. The definition of dominance under the Competition Act is fairly universal: it is defined as the ability to act independently of competitive forces, or to affect competitors or consumers in one's favor.[12]

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[3] Section 2(r) of the Competition Act

[4] Section 19(6) and 19(7) of the Competition Act.

[5] *Belaire Owners' Association v. DLF Limited, HUDA & Ors.*, 19/2010, August 12, 2011.

[6] Section 2(t) of the Competition Act.

[7] *See,* Coal India case, *supra* n. 2.

[8] *See,* DLF case, *supra* n. 5.

[9] *MCX Stock Exchange Ltd. & Ors. v. National Stock Exchange of India Ltd. & Ors.*, 13/2009, June 23, 2011.

[10] *Sh. Surinder Singh Barmi v. Board for Control of Cricket in India (BCCI),* 61/2010, February 8, 2013.

[11] For instance *see, M/s ESYS Information Technologies Pvt. Ltd .v. Intel Corporation (Intel Inc.) & Ors.,* 48/2011, January 16, 2014; *South City Group Housing Apartment Owners Association v. Larsen &Tuobro (L&T) & Ors.*, 49/2011, October 23, 2013; *M/s HNG Float Glass Ltd v. M/s Saint Gobain Glass India Ltd.,* 51/2011, October 24, 2014, etc. The CCI refrained from using the SSNIP test in these cases.

[12] Explanation to Section 4 of the Competition Act.

The Competition Act also provides for a detailed list of factors to be considered when determining dominance.[13] In this range of factors, the most important—at least for a preliminary assessment—seems to be the market share of an enterprise. However, the CCI has, of late, steered away from relying on market share as the primary indicator of dominance,[14] indicating a desire for a more comprehensive assessment of the market position.

C. Determining Abuse of Dominance—A Form-based Approach

Section 4(2) of the Competition Act provides an exhaustive list of conducts that are considered abusive. Incidentally, the legislative text of Section 4 is very similar to Article 102 of TFEU. Notwithstanding this similarity in the language, the CCI's recent actions indicate a preference for a form-based approach—as opposed to the effects-based assessment prevailing in the European Union ("EU").

CCI's approach to date suggests that, in the event the conduct of the dominant enterprise falls within the list of conducts provided by way of Section 4(2), that conduct amounts to an abuse of dominance—the CCI is not likely to look go into the assessment of subsequent competitive impact.[15] Further, abuse of dominance, as prohibited under the Competition Act, includes both exploitative and exclusionary abuses.[16]

D. Penalties and Consequences

Since the Competition Act belongs to the civil enforcement regime, the primary consequence for infringing the provisions of the Competition Act is a monetary penalty. In the event the CCI concludes an enterprise to have abused its dominance, the maximum penalty that can be imposed is up to 10 percent of the average turnover for the preceding three years.[17] Further, if the defaulting enterprise belongs to a group, the entire group is culpable under the Competition Act and the CCI is empowered to take an action against the entire group.[18]

In addition to imposing fines, the CCI can also pass an order imposing any or all of the following behavioral remedies on an enterprise abusing its dominance:

a) an order to cease and desist the anticompetitive conduct;[19]

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[13] Section 19(4) of the Competition Act.

[14] *See,* HNG Float Glass case, *supra* n. 11.

[15] *See,* NSE case, *supra* n. 9.

[16] In DLF case, *supra* n. 5, the CCI held that monopolization by the developer—by imposing unfair terms and conditions on the consumers—illegal under Section 4. The conduct considered anticompetitive in this case was an exploitative conduct.

On the other hand, in *Kapoor Glass Private Limited v. Schott Glass India Private Limited*, 22/2010, March 29, 2012, the CCI was of the view that the conduct by the dominant firm (Schott Group)—of favoring its own subsidiary to the exclusion of the latter's competitors—amounted to abuse of dominance.

[17] Section 27 (b) of the Competition Act. In the DLF case, *supra* n. 5, DLF—for abusing its dominance—was fined with a penalty of approximately INR 6300 Million—7 percent of the average of the turnover for the last three preceding financial years.

[18] Proviso to Section 27 of the Competition Act. *Also see,* Coal India case, *supra* n. 2, the CCI imposed a fine on the entire group, *viz.,* Coal India Limited.

[19] Section 27 (a) of the Competition Act. *Also see* DLF case, *supra* n. 5, the CCI ordered DLF to cease and desist its anticompetitive practices.

b) an order to modify agreements to the manner specified by the CCI;[20]

c) an order to divide a dominant enterprise to ensure that it does not abuse its dominance in the future;[21]and

d) any other order it deems fit.[22]

III. JURISPRUDENTIAL DEVELOPMENTS

Central to understanding the CCI's approach to abuse of dominance are these recent developments:

A. The Role of Plausible Business Justification—The Inverted Assessment

Notwithstanding the form-based approach discussed above, the CCI has recently recognized the concept of plausible business justifications in its assessment of a conduct, looking into the objectives and the rationale of a conduct.

For instance, in *Dhanraj Pillay and Others v. Hockey India*,[23] the CCI, when assessing abuse of dominance allegations by Hockey India, applied the inherent proportionality test. After applying this test, the CCI held that the conduct of Hockey India did not amount to any of the conducts enumerated in Section 4(2) of the Competition Act and was therefore not abusive.

Again, in *All Odisha Steel Federation v. Odisha Mining Corporation Limited*,[24] a case relating to excessive and differential pricing, the CCI took into account the market conditions and the nature of supply and demand in the relevant market. Subsequently, the CCI held that the pricing, though not determined by the market forces, was neither unfair nor excessive and therefore did not violate Section 4(2) of the Competition Act.

Interestingly, this plausible business justification defense is used to preclude the conduct from falling within the ambit of Section 4(2) rather than amounting to a justification to show a lack of harm to competition in the market—formulating an inverse assessment of the conduct.

Also, it should be noted that the CCI has expressly observed the exceptional nature of these justifications[25]—indicating a rather limited tolerance towards such defenses.

B. Role of an Enterprise—Differentiated Treatment

Another peculiar development is recognizing the importance of the role of an enterprise in the Indian economy. The CCI has taken a rather cautionary approach when assessing the conduct of a public sector undertaking as opposed to a profit-making enterprise.

This approach is reflected not only in CCI's decisional practices, but also in the legislative provisions. For instance, one of the factors for assessing dominance is social obligations

[20] Section 27(d) of the Competition Act. *Also see,* DLF case, *supra* n. 5; and Coal India, *supra* n. 2, the CCI ordered the agreements to be modified in order to comply with the provisions of the Competition Act.

[21] Section 28 of the Competition Act.

[22] Section 27 of the Competition Act

[23] 73/2011, May 31, 2013.

[24] 12/2012, September 19, 2013.

[25] *See supra* n. 23, ¶ 10.6.5.

undertaken by the enterprise.[26] Interestingly, this factor has played an important role in assessing the conduct of a public sector undertaking when establishing dominance of such an enterprise. In numerous cases, the CCI has held various public sector undertakings to be dominant; however, its decisions regarding the conduct of these undertakings suggests a comparatively lenient treatment—[27]a contradiction with its assessment in cases where the enterprise under scrutiny is one with profit maximization as its primary objective.

Nevertheless, in a recent case the CCI took a contrary view. In the case against Coal India Limited[28]—a public sector undertaking—the CCI held that the company had abused its dominance in the market by imposing unfair conditions in fuel supply agreements. It observed that social obligations and social costs are no longer a primary consideration for the CCI when assessing a conduct.[29] Nevertheless, the CCI did take into account the company's objectives and functions as a mitigating factor when arriving at a penalty of 3 percent of the average turnover.[30] This indicates a gradual but definitive shift in CCI's approach towards such differentiated treatment.

C. Importance of Consumers

As discussed above, the CCI regards abusive conduct as including both exploitative and exclusionary conducts. Arguably, the main reason can be attributed to the consumer-centric priorities of the CCI. In a plethora of cases, the CCI has categorically acknowledged protection of consumer interest as one of the primary objectives of the Competition Act.[31]

Interestingly, while these priorities resonate of the Chicago School, the approach taken by the CCI seems to concentrate on directly protecting consumer interest—as opposed to consumer interests being a necessary corollary of unbridled competition in the market. Consequently, this consumer-centric approach has produced numerous complaints filed by consumers, rather than competitors, in abuse of dominance cases.[32]

D. Competition Law in an Indian Context—The Divergence In Enforcement

Arguably, the most striking feature illustrated from recent case law developments is the manner of enforcement by the CCI.

Competition law in India seems to rely heavily on EU law, particularly in abuse of dominance cases. This reliance is evident in the replication of the legislative provisions relating to abuse of dominance. Additionally, the CCI—in numerous cases—has relied on EU jurisprudence

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[26] Section 19(4)(k) of the Competition Act.

[27] For instance, in the Odisha steel case, *supra* n. 24, the CCI acknowledged that since the dominant enterprise operates independent of the market forces, the practices cannot be looked assessed through the perspective of market forces, ¶ 13.9.

[28] *See,* Coal India case, *supra* n. 2.

[29] *Id.,*¶128.

[30] *Id.,*¶261.

[31] *See,* DLF case, *supra* n. 5.

[32] *See,* DLF case, *supra* n. 5; *Dinesh Trehan v. M/s DLF Ltd.*, 46/2012, July 1, 2013; *DLF Park Place Residents v. DLF Limited,* 18,24,30,31,32,33,34 and 35/2010, January 10, 2013 etc.

while deliberating specific cases.[33] In fact, in November 2013 and January 2014, the CCI directed a detailed investigation into alleged abuse of dominance by Ericsson on the ground that it violated its FRAND commitments in relation to the standard essential patent ("SEP") it held.[34] The crux of this case seems to be rooted in EU law since there is no concept of SEP and related FRAND commitments in India.

Notwithstanding this similarity in legislative text, however, the CCI's has largely diluted the thrust of EU law in Indian competition jurisprudence. The CCI has, time and again, pointed out the need to apply competition law in an Indian context, taking into account the situation prevalent in the economy.[35] In particular, the CCI has propounded somewhat peculiar parameters for assessing abuse of dominance cases—creating substantial divergence from enforcement in developed jurisdictions.

Perhaps germane to understanding this divergence is the long-standing heritage in India of excessive regulations. De-regularization and the subsequent opening of the economy has been a very recent phase for the Indian economy. As a result, Indian tradition is more inclined towards an interventionist approach—consequently preferring a form-based assessment—than the "less-is-more" sentiment present in more developed jurisdictions.

Further, as described above, an important enforcement priority for the CCI—which has further perpetuated the idea of an India-specific enforcement approach—is the protection of consumer interest. The CCI views direct consumer harm analogous with harm to competition. This approach requires the regulation of exploitative as well as exclusionary conducts under the Competition Act.

IV. CONCLUSION

It is interesting to note is that while CCI's priorities—inclined towards an interventionist approach—seem to be suggestive of a robust enforcement in abuse of dominance cases, it has surprisingly taken a rather deferred approach in these cases. Of a total of 98 cases relating to anticompetitive practices investigated to date, 44 were investigated for possible abuse of dominance. However, the CCI concluded an abuse of dominance in only 11 cases.[36] It can be argued that these trends demonstrate a gradual maturity in how to assess cases relating to abuse of dominance, rather than these cases being a low priority for the CCI.

Given this current position as regards to abuse of dominance cases, it is safe to say that competition law in India is still at a relatively nascent stage and is likely to be subject to legislative developments. For example, on December 10, 2012, the Competition (Amendment) Bill, 2012 was introduced in the parliament to amend Section 4 by introducing the concept of collective dominance into the law. However, developments in the Indian competition law are more likely

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[33] *Arshiya Rail Infrastructure Ltd. (ARIL) v. Ministry of Railway (MoR) & Ors.*, 64/2010, 12/2011 & 02/2011, August 14, 2012.

[34] *Micromax Informatics Limited v. Telefonaktiebolaget LM Ericsson (Publ)*, 50/2013, November 12, 2013; and *Intex Technologies (India) Limited v. Telefonaktiebolaget LM Ericsson*, 76/2013, January 16, 2014.

[35] *See,* NSE case, *supra* n. 9, ¶ 10.80.

[36] The data is based on the information available on the CCI website as on March 20, 2014.

to be primarily a result of judicial construction, making the CCI's decisional practices as important, if not more important, than legislative activity.