Submission on the Competition Bureau Bulletin — *Strategic Alliances under the Competition Act*

NATIONAL COMPETITION LAW SECTION
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PREFACE

The Canadian Bar Association is a national association representing over 38,000 jurists, including lawyers, notaries, law teachers and students across Canada. The Association's primary objectives include improvement in the law and in the administration of justice.

This submission was prepared by the National Competition Law Section of the Canadian Bar Association, with assistance from the Legislation and Law Reform Directorate at the National Office. The submission has been reviewed by the Legislation and Law Reform Committee and approved by the Executive Officers as a public statement by the National Competition Law Section of the Canadian Bar Association.

Submission on the Competition Bureau Bulletin — *Strategic Alliances under the Competition Act*

I. INTRODUCTION

The Competition Law Section of the Canadian Bar Association (the CBA Section) welcomes the opportunity to comment on possible revisions to clarify the information bulletin on *Strategic Alliances under the Competition Act* dated November 1995 (the "Bulletin"), further to the Competition Bureau's invitation for comments of September 4, 2002 (the Request for Comments). The CBA Section strongly endorses a consultative approach to important policy initiatives and we support the decision to seek input on possible revisions.[1]

Both the Bulletin and the Request for Comments note that providing general guidance on the potential application of the criminal provisions of the *Competition Act* to strategic alliances is helpful to avoid a "chilling" effect on such alliances[2]. In our view, revisions along the lines suggested by the Request for Comments would be a significant improvement on the current Bulletin and would give potential strategic alliance participants significant additional comfort and certainty in this regard.

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1 Comments were previously provided by the CBA Section in January 1995 (on a draft version of the Bulletin dated August 26, 1994) and April 1995 (on a subsequent draft version of the Bulletin dated February 27, 1995).

2 See also the Antitrust Guidelines for Collaborations among Competitors issued by the Federal Trade Commission and the U.S. Department of Justice, April 2000 (the "U.S. Collaboration Guidelines"), at p. 1: "…a perception that antitrust laws are skeptical about agreements among actual or potential competitors may deter the development of procompetitive collaborations."

Most of the comments from the CBA Section are of a general, conceptual nature, and we hope that the Bureau will give us the opportunity to comment on a specific revised draft of the Bulletin before it is finalized.

Finally, in these comments, the Section is not intending to express any opinion on the need for an amendment to section 45 of the Act or the form that any such amendment may take. Rather, these comments are provided in the context of the Act as presently constituted.

II. GENERAL OBSERVATIONS

The CBA Section is pleased that the Commissioner of Competition continues to recognize the important role of strategic alliances in enhancing the efficiency of Canadian firms[3]. The Bulletin in its current form assists in reducing the uncertainty for private parties contemplating strategic alliances. As the Bulletin is currently drafted, however, it does not fully grapple with the uncertainty flowing from possible interpretations of some portions of the decision of the Supreme Court of Canada in the *PANS*[4] case (e.g., see s. 3.2.1 of the Bulletin) and the issue of how the Commissioner will approach a strategic alliance that involves a restraint on competition among industry participants with market power but also produces significant efficiencies or other pro-competitive benefits. Clearly there are some important instances where industry or competitor agreements can have pro-competitive effects but still involve some degree of restraint on competition. The *BMI* case in the U.S., involving blanket licence fees

3 For example, the Commissioner has stated that the Competition Bureau "need[s] to encourage the strategic alliances that Canadian firms rely on to compete in new, global markets". (Speech to the House of Commons Standing Committee of Industry, April 13, 2000)

4 *R. v. Nova Scotia Pharmaceutical Society*, [1992] 2 S.C.R. 606 ("PANS").

for composers, writers, and publishers, provides an example of this point[5], as does the more recent *Major League Soccer* case which involved an alleged agreement among a new professional soccer league and its operators/investors limiting competition for players' services[6]. The current Bulletin does not advance the issue much beyond commenting that "efficiencies provide no defence under section 45" and that "price fixing, restrictions on output or market sharing are almost always of competitive significance, and hence the Director will view such agreements as constituting injurious behaviour" (section 3.2.1).

In the CBA Section's view, the Bulletin should include a clear expression of the circumstances in which a strategic alliance will be evaluated under the criminal or civil provisions of the Act. Readers of the Bulletin should not have doubt, for example, as to whether, if they are in a BMI-type situation, they will be subject to criminal prosecution. The Bulletin states that the Commissioner retains the option of considering strategic alliances under **any** of the potentially applicable provisions of the Act, but contains little explanation of the precise circumstances in which the Commissioner would elect to proceed, for example, under the Act's criminal conspiracy provisions instead of under the merger provisions[7]. The CBA Section noted this previously: "[t]he Director should clarify the distinction between strategic alliances that will be reviewed as mergers and strategic

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5 *Broadcast Music Inc. v. Columbia Broadcasting Systems, Inc*., 9 S. Ct. 1551 (1979): "not all arrangements among actual or potential competitors that have an impact on price are per se violations of the Sherman Act or even unreasonable restraints….Joint ventures and other co-operative arrangements are also not usually unlawful, at least not as price fixing schemes, where the agreement on price is necessary to market the product at all." (Page 1564). See also s. 3.2 and Appendix, Example 2 of the US Collaboration Guidelines.

6 *Fraser v. Major League Soccer LLC*, 284 F. 3d 47 (2002), U.S. Court of Appeals for the First Circuit. The Court referred to the defendants' rationale that the league was a new and risky venture and held that, notwithstanding the centralized control of players' salaries, the effects of the league arrangements were too uncertain to warrant application of the per se rule and there was "at best a debatable case under the rule of reason".

7 Tim Kennish & Thomas W. Ross, "Toward a New Canadian Approach to Agreements Between Competitors" (1997) 28 Can. Bus. L.J. 22 at 51-2 …"Notwithstanding the decidedly upbeat tone of the introductory and concluding comments contained in the Bulletin ("most strategic alliances will not be an issue under the Act"), a careful reading of its full text suggest that their actual situation, in terms of possible enforcement action under the Act, is considerably more ambiguous".

alliances that will be reviewed under s. 45"[8]. In this regard, the Bulletin does not significantly clarify the existing "election" provisions contained in section 98, section 45.1 or subsection 79(7) of the Act[9].

We therefore welcome the suggestion in the Request for Comments that the Commissioner's approach be further clarified to indicate when strategic alliances that may enhance efficiency or have other pro-competitive benefits would be assessed under the civil rather than the criminal provisions of the Act.

The Request for Comments sets out two options for how the Bulletin could be clarified.

First Option:

The Competition Bureau should define alliances as any agreement that involves meaningful, efficiency-enhancing, economic integration. Such alliances would then be examined under the civil provisions of the Act. Agreements lacking meaningful, efficiency-enhancing integration would not meet the definition of an alliance and would be examined under the criminal provisions.

- When determining whether an agreement involves "meaningful economic integration", the Bureau would consider such factors as the combination of significant capital, technology or other complementary assets. When determining whether an agreement involves "meaningful, efficiency-enhancing" benefits, the firms involved would have to be able to demonstrate economic advantages such as the reduction of costs by a non-trivial amount or introduction of a new product that a firm could not have offered on its own.

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8 See para. 9 of the CBA comments on the Bulletin dated February 27, 1995.

9 We note that the Commissioner's discussion of the application of subsection 79(7) in the *Enforcement Guidelines on the Abuse of Dominance Provisions* is limited to the following observation: "The choice of which provision to pursue will depend on the facts of each case and the nature of the remedy sought to alleviate the competition issue" (s. 5.3.5).

- If competition concerns are related only to the formation of the alliance, then the agreement would be analysed under the approach outlined in the Merger Enforcement Guidelines. If competition concerns are related to alleged anti-competitive conduct, the analysis would follow the Enforcement Guidelines on the Abuse of Dominance Provisions.

Second Option:

The Bureau should definitively set out the types of agreements that would be examined under section 45. All other types of agreements would be examined under the civil provisions.

- Agreements to be examined under section 45 would include those involving any type of price fixing, market sharing, output restrictions or group boycotts.

- Concern has been expressed that this option fails to recognize that benign or pro-competitive alliances might legitimately require this kind of conduct. To address this concern, agreements involving conduct that would normally be examined under section 45 could still be examined under the civil provisions of the Act if the conduct is: (1) part of a larger agreement with pro-competitive benefits; and (2) reasonably necessary to achieve the pro-competitive benefits.

- For conduct to be reasonably necessary, it would have to directly contribute to the achievement of the pro-competitive benefits of the alliance and not be excessive. Conduct is not considered to be reasonably necessary if the benefits are achievable through less restrictive means. If the Bureau determines that the relevant conduct is not reasonably necessary, it would examine that element or aspect of the agreement under the criminal provisions of the

Act. Other elements of the alliance, however, could still be examined under the civil provisions.

We believe that the first option would be an important and welcome step. The recognition that agreements that are characterized by "meaningful, efficiency-enhancing, economic integration" ought not to be treated under the criminal conspiracy provisions is a welcome one, assuming, as we do, that the Bulletin would clearly indicate that such integration may take many forms, and is not limited to equity investments or analogous transactions. We presume that a revised Bulletin would include a more detailed statement of the factors that will determine the Commissioner's election to consider strategic alliances under the criminal provisions of the Act. In addition, if we understand the proposal correctly, it is that if there is a significant or meaningful efficiency enhancing or pro-competitive element to the agreement, then that would be sufficient to cause the Bureau to analyze it under the civil rather than criminal provisions of the Act. In other words, the Request for Comments does not appear to propose that any weighing of the efficiencies against anti-competitive or other effects (which could then invoke the types of issues raised in the *Superior Propane*[10] proceedings) must be conducted at the initial stage of a choice of a criminal or civil track. Finally, it would be helpful to confirm that the Bureau would not, at this stage, be looking for extensive evidence (e.g., detailed economic reports, etc.) for the parties to justify the efficiency-enhancing aspects of a strategic alliance.

We question the viability of the second option proposed by the Bureau. We expect that it would be more difficult to definitively and comprehensively set out the types of agreements that would be examined under section 45. Benign or pro-competitive alliances (such as the BMI arrangement) may legitimately

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10 *Canada (Commissioner of Competition) v. Superior Propane Inc*. (2000), 7 C.P.R. (4th) 385 (Comp. Trib.); *Canada (Commissioner of Competition) v. Superior Propane Inc*., [2001] 3 F.C. 185 (C.A.), leave to appeal to S.C.C. refused 14 C.P.R. (4th) vii; Canada (Commissioner of Competition) v. Superior Propane Inc., [2002] C.C.T.D. No. 10.

include some element of price fixing or market sharing, for example. In fact, these are the very types of alliances for which a chill might reasonably be felt.

It may be that this concern could be addressed by the Commissioner choosing to examine such agreements under the civil provisions (and not the criminal provisions) if they are part of a larger agreement with pro-competitive benefits and are reasonably necessary to achieve the pro-competitive benefits. We suspect, however, that it would be more difficult to confidently assess whether the Bureau would view particular elements of an agreement to be "reasonably necessary" to achieve the pro-competitive benefits, whether the Bureau would consider that other "less restrictive" means are available to achieve those benefits, or whether the Bureau may consider a particular restraint to be "excessive". It may also be difficult for the Bureau to make such assessments at an early stage of an investigation when a choice is to be made between a criminal or civil track. Moreover, such determinations seem more applicable to the question of whether the agreement in question ought to be permitted under the Act, than to the question of whether it ought to be susceptible to criminal prosecution.

However, if the second option is pursued, it may be preferable that, instead of requiring a demonstration that restraints are "reasonably necessary", it be sufficient to demonstrate that such restraints are reasonably related to achieving the pro-competitive benefits. If parties are in good faith pursuing a proposed strategic alliance with efficiency-enhancing or pro-competitive benefits, then a disagreement with the Bureau, with the benefit of hindsight, about whether the restrictions are excessive or "less restrictive means" are available should not, in itself, constitute grounds for pursuing a criminal rather than a civil track. There may also be legitimate business reasons for choosing one means over another that do not detract from the overall efficiencies or pro-competitive aspects of the agreement. Further, if this option were pursued, it may be helpful to clarify that the Bureau would, in assessing whether less restrictive means are available, consider only alternatives that are practical in the business situation faced by the

participants and not search for theoretical alternatives that may not be realistic given business realities (see section 3.36(b) of the U.S. Collaboration Guidelines in this regard). To be clear, our comments are not meant to suggest that these types of agreements involving specific types of restraints on competition should be beyond the scope of review by the Commissioner, but rather that civil rather than criminal review would be more appropriate.

We also note that the Bureau's discussion of the second option states that "[a]greements to be examined under section 45 would *include* those involving any type of price fixing, market sharing, output restrictions or group boycotts" (emphasis added). In our view, this statement illustrates the difficulty of identifying a definitive list of types of anti-competitive agreements.

In summary, the first option is preferable in our view because it approaches the key issue in need of clarification with a more positive statement of the types of agreements that will be reviewed under the civil (rather than criminal) provisions of the Act. The second option starts by defining what we expect would be an inevitably broad category of alliances that would be subject to the criminal track in the absence of certain exceptions that may include subjective components. The first option would do a better job of alleviating any "chilling effect" resulting from uncertainty about the application of section 45 to strategic alliances.

III. SPECIFIC COMMENTS

A. Additional Clarification Points

Goldman and Corley have noted,[11] and the CBA Section agrees, that the Bulletin could also be clarified in the following ways: (1) by stating that, absent unusual

[11] C. Goldman & R. Corley, "The Review of Joint Ventures Under the Canadian Competition Act", Outline of Speaking Notes for Presentation by Calvin S. Goldman, Q.C. to the Federal Trade Commission Joint Venture Hearings, Federal Trade Commission, Washington, D.C., June 30, 1997, posted at http://www.ftc.gov/opp/jointvent/jvent.htm.

circumstances, all legitimate acquisitions of control of another entity or a lesser interest in another entity should be reviewed as mergers as opposed to being subject to the criminal provisions of the Act; (2) by stating that strategic alliances should not be challenged because of restraints on competition with respect to a product or service that would not have been provided by the parties but for the strategic alliance;[12] (3) by identifying the types of ancillary restraints that may be more likely to increase the risk of a criminal investigation under section 45 of the Act; and (4) by clarifying the extent to which the risk of a criminal investigation can be reduced by publicly announcing a strategic alliance or joint venture. On this last point, we recognize that sometimes efficiency-enhancing strategic alliances lose their appeal if competitors are aware of them, something that may discourage public notification of a strategic alliance without necessarily meriting investigation under the criminal provisions under the Act. Accordingly, we think it would also be helpful for the Bureau to set out to what degree, and in what circumstances, privately notifying the Bureau of a proposed strategic alliance will reduce the risk of examination under a criminal track.

We would also observe that, while the Bulletin generally attempts to present a positive message (e.g., "most strategic alliances do not raise issues under the Act"), it is undermined by the numerous qualifications and exceptions contained throughout the Bulletin. This results in an overall negative tone to the Bulletin, as well as unnecessary ambiguity as to how the Act will apply to strategic alliances. For example, almost five full pages are devoted to the potential application of section 45 to strategic alliance arrangements, whereas by contrast the possible application of both the merger and abuse of dominant position provisions to such arrangements is covered in less than two pages. It is our view that, if the Bulletin is revised, it could present a more balanced perspective. Less emphasis should be placed on less frequently occurring situations (e.g., section 45 proceedings) in

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[12] In other words, competition law authorities should be concerned only about the substantial prevention or lessening of competition that would have existed in the absence of the strategic alliance. This principle is adopted in the 1995 FTC/DOJ Antitrust Guidelines for the Licensing of Intellectual Property. See, for example, section 1 ("The key competition issues raised by the licensing arrangement is whether it harms competition among entities that would have been actual or likely potential competitors in the absence of the arrangement"). See also s. 3.1 ("The Agencies will not require the owner of intellectual property to create competition in its own technology.").

favour of areas where strategic alliances raise more frequent concerns under the Act (e.g., under the merger provisions).

B. Application of the Bulletin to Technology Joint Ventures

Judging from the introductory section of the Bulletin, the drafters of the document were aware of the increasing use of joint ventures and strategic alliances in light of trends in international trade and other factors.[13] There is no reason to think that these considerations do not continue to be significant factors in the increased use of strategic alliances by firms.[14]

Since the issuance of the Bulletin in 1995, technology-based joint ventures have become increasingly widespread.[15] Joint ventures in this context include information technology joint ventures such as business-to-business exchanges ("B2Bs"), standard-setting joint ventures which help to facilitate development and adoption of technical standards, outsourcing joint ventures, technology transfer joint ventures, or joint ventures among members of complementary networks.[16] There is no reason to believe that the existing legislative framework is unable to deal with the competition policy issues posed by technology-driven joint ventures such as B2Bs.[17] However, the Bulletin focuses on traditional industries both in the substantive discussion and in the examples which follow at Appendix 1 and does not offer examples reflecting the somewhat distinctive nature of technology-driven strategic alliances. This limits the usefulness of the document to stakeholders contemplating such ventures. It could be improved by including technology-based illustrations.

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13 "In an age of increasing international competitive pressures, globalization of markets, and generally decreasing trade barriers, some companies may find it difficult to match the product and service offerings of their rivals" (Bulletin, Part 1).

14 See, e.g., S. Magun, "The Development of Strategic Alliances in Canadian Industries: A Micro Analysis", Industry Canada Working Paper No. 13, October 1996, posted at http://strategis.ic.gc.ca/SSG/ra01186e.html.

15 The distinctive nature of innovation markets has been discussed in a Canadian context in R.F.D. Corley, "IP and Competition Law: Enforcement Challenges of the Information Economy", in G.F. Leslie, ed., 1999 *Annual Fall Conference on Competition Law* (New York: Juris Publishing, 2000) at 326. See also D. Balto & R. Pitofsky, *Antitrust and High-Tech Industries: The New Challenge*, 153 Antitrust Bull. 583 (1998) for a general discussion in the U.S. antitrust context.

16 This list is drawn in part from Goldman & Corley, *supra*, note 11 at Part II.

17 Remarks of Gwillym Allen, Assistant Deputy Commissioner of Competition, Economic Policy and Enforcement, Competition Policy Branch, delivered at the 2000 Annual Conference on Competition Law, September 20-21, Ottawa, Ontario (unpublished materials).

By way of example, B2Bs are said to possess the advantages of dynamic real-time pricing, informed price competition, transaction timeliness and systems integration. In this sense, they may differ from traditional marketplaces, particularly in the mode and frequency of information exchange. There is little in the Bulletin which casts light on the treatment of such ventures under the relevant provisions of the Act. While the Bulletin does provide helpful detail on the treatment of types of information subject to exchange[18] and other factors which "heighten" the risk of an inquiry (e.g., the mode of exchange and the reasons for the exchange), it does not consider, for example, the treatment for enforcement purposes of the virtually instantaneous and transparent communication of information that often characterizes B2Bs.[19]

There is virtue, of course, in bulletins and guidelines that describe the application of the Act in terms that are sufficiently flexible to address many fact situations. This is particularly true in the case of joint ventures, as already noted in the Bulletin. For this reason, these comments should not be interpreted to favour a narrow approach that would reduce the potential application of a revised Bulletin. However, we think it would be helpful if any revision discussed and reflected the fact that many stakeholders are considering entry into strategic alliances in a technology context.

It may be that this is best accomplished through both substantive discussion in the Bulletin and the addition of particular examples or hypotheticals. Although the Merger Example contained at section VI of Appendix 1 refers to a hypothetical situation involving two producers of high technology equipment, there are no other discussions in a software, network or similar context.[20] An additional hypothetical example could, for example, consider the application of the relevant

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18 The Bulletin notes that "exchanging information in respect to current or future pricing, costs, trading terms, or marketing strategies significantly heightens" the risk of an inquiry: section 3.2.1.2.

19 These issues were canvassed by the FTC in its 2000 report on the antitrust implications of B2B exchanges. See Federal Trade Commission Staff, *Entering the 21st Century: Competition Policy in the World of B2B Electronic Marketplaces*, posted athttp://www.ftc.gov/os/2000/10/index.htm#26.

20 In contrast, the U.S. *Antitrust Guidelines for Collaborations Among Competitors* released in 2000 identify a specific "safety zone" for R&D joint ventures in innovation markets at section 4.3 and provide in the Appendix ten examples, six of which refer to fact situations involving software or network joint ventures or collaborations between competitors in similar industries.

provisions of the Act to a centralized air fare database established by competing airlines.[21] Another useful hypothetical example could consider the application of the Act to a network joint venture. Additional hypotheticals in this vein would be useful to many stakeholders without limiting the overall scope of a revised Bulletin.

C. Specialization Agreements

Section 85 of the Act has not yet been the subject of an application to the Competition Tribunal (the "Tribunal"). Commentators have surmised that this may be attributable to a number of factors, including the requirement that a qualifying specialization agreement concern articles or services in current production, as opposed to being the subject of future production.[22] Whatever the reason, the Bureau now has the opportunity to clarify when the provision will apply and the approach the Commissioner will take to enforcement beyond what is currently contained in section 3.2.3 and Example (V) in Appendix 1. It may also be appropriate for this section to be revised in light of the reference in section 85 to efficiency gains and the potential relevance of the *Superior Propane* case.[23] This could presumably be accomplished through a cross-reference to the *Merger Enforcement Guidelines* (as amended to reflect the decision of the Federal Court of Appeal).

D. Miscellaneous Comments

As previously suggested by the CBA Section,[24] the illustrative scenarios in the Bulletin are helpful. In our view, additional, updated illustrative scenarios, such as those suggested above with respect to technology contexts, could usefully be included.

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21 This hypothetical obviously borrows from the facts in the U.S. *ATP* case which, though resolved by consent order, considered the antitrust implications of the rapid dissemination and exploitation of tariff information communicated through such an exchange: *United States* v. *Airline Tariff Publishing Co. (ATP)* 1994-2 Trade Cas. (CCH) para. 70,687 (D.D.C. 1994) (final consent decree); 58 Fed. Reg. 3,971 (January 12, 1993).

22 Kennish & Ross, *supra*, note 7 at 41.

23 *Supra* note 10.

24 See para. 7, *supra* note 8.

Section 3.2, paragraph 3 of the Bulletin states that "there have been only a handful of cases where the Director has initiated an inquiry under both the civil and criminal provisions of the Act for a particular fact situation". It would be helpful for the Bureau to confirm whether this statement is still accurate and, to the extent possible, provide an indication of the circumstances in which that occurred.

Separate and apart from the discussion above with respect to the application of the Act to efficiency-enhancing strategic alliances, we note that representatives of the Competition Bureau have made strong statements about the Bureau's actual enforcement record that may provide some comfort to private parties. For example, a paper by Robert McCrone on Reform of Section 45 of the *Competition Act* presented to the Annual Fall Conference on Competition Law of the CBA Section in October 2002 stated:

> Although s. 45 can be widely applied, all prosecutions undertaken pursuant to s. 45 and its predecessors involved hard-core anticompetitive behaviour (generally price fixing and market sharing).

In addition to the revisions contemplated by the Request for Comments, we think it would be helpful to include a similar statement which confirmed the Commissioner's past practice as well as his current enforcement policy (i.e., that the Commissioner will prosecute hard-core conduct only under section 45).

As a final note, the discussion in the Bulletin of the merger provisions and the abuse of dominance provisions (sections 3.2.4 and 3.2.6, respectively) should be updated to reflect or refer to amended or new guidelines, such as the amendments to the *Merger Enforcement Guidelines* (and any other changes material to the matters which form the subject of those guidelines, including efficiencies) and the *Enforcement Guidelines on the Abuse of Dominance Provisions* (and in particular, the discussion of joint dominance contained in section 3.2.1(e) therein).

IV. CONCLUSION

We hope that the Bureau finds the above comments to be of assistance. CBA Section members would welcome the opportunity to participate in any follow-up consultations that may be held with regard to possible clarifications to the Bulletin.