Market Power, Efficiencies, and the Public Interest in Canadian Combines Law

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Page

INTRODUCTION 489

THE CANADIAN LEGISLATION 489

a. Behavioral Proscriptions 490

b. Structural Proscriptions 493

THE DIFFICULTIES INHERENT IN THE UNQUALIFIED APPLICATION OF A PER SE RULE 494

THE ASSESSMENT OF MARKET POWER 500

a. Market Power Derived Through Unilateral Action 502
1. Market Share as an Indicant of Market Power 502
2. Excessive Profits as an Indicant of Market Power 505
3. The Problem of the Inefficient Monopolist 506
4. Discriminatory Pricing as an Indicant of Market Power 509
5. In Recapitulation 511

b. Market Power Derived Through Competitor Coordination 513
1. Agreements and Mergers 513
2. Oligopolistic Interdependence 518

THE CONFLICT BETWEEN MARKET POWER AND EFFICIENCY CONSIDERATIONS 523

a. Economic Considerations 524

b. Social Considerations 528

c. Political Considerations 528

CONCLUSION 532

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Introduction

It is the central contention of the analysis which follows that the Canadian courts have historically failed to invoke proper economic standards in their interpretation and application of the *Combines Investigation Act.*[1] The most serious deficiency of the judge-made law lies not in its implicit abandonment of a legislative mandate, but rather in its failure to conceptualize combines problems in terms of the underlying policy considerations. Stated generally, the most overt judicial tendency has been to develop rigid rules which vary with the form of industrial conduct rather than with its substance or consequence; more specifically, judicial rejection of the concepts of market power and economic efficiencies in the evaluation of the behavior of firms has led to the failure to apply similar standards to horizontal integration effected through different means.

With these thoughts in mind, the writer will first analyze the legislative prohibition against undue market power resulting from both behavioral and structural sources. After having considered the difficulties inherent in Supreme Court dicta, he will proceed to suggest an approach whereby the courts can assess market power on the one hand, and evaluate efficiencies on the other. He will conclude with a consideration of the extent to which cost savings, in the context of the Canadian economy, should be deemed to mitigate market power which might otherwise be unlawful. Where relevant, the writer will draw upon the American Antitrust experience, rich both in caselaw and in commentary, in order to shed additional light upon the economic consequences of Anti-Combines decision making.

The Canadian Legislation

The very existence of Combines legislation signifies Parliamentary recognition that a freely-operating market economy does not possess self-adjusting mechanisms to ensure that optimal performance is invariably achieved. Some public interference is thus deemed justifiable in spite of the traditional presumption in favor of a policy of *laissez-faire.* Since the *Combines Act* is merely a legislative attempt to enter the economic arena in a limited way, any understanding of its conceptual framework must be predicated upon

[1] R.S.C. 1952, c. 314 as amended by S.C. 1960, c. 45; Section 32 of the present *Act* was previously embodied in the *Criminal Code,* section 411, S.C., 1953-54, c. 314.

a broad appreciation for the kinds of problems with which it purports to deal.

The reader need not take the foregoing as a declaration of the writer's intent to review in detail the myriad economic theories which attempt to explain how the goal of optimal performance may best be achieved. The only model which we need understand is the generally accepted hypothesis that optimal performance, however it be defined, is in some way determined by the interaction between market structure and market conduct.[2] Given this traditional assumption, the framework within which the *Act* is formulated becomes apparent: either structural or behavioral defects may render a situation unlawful, and accordingly, the Legislature has armed the courts with a range of sanctions sufficiently wide to eradicate both kinds of weaknesses.[3]

a. *Behavioral Proscriptions*

The substantive prohibitions against behavior tending to increase market power are embodied in sections 32 and 33 of the *Enactment*, which declare illegal horizontal coordination of competitor conduct which, whether effected by agreement or merger, might seriously undermine the state of rivalry which the *Act* is designed to foster. Section 32(1)(c)[4] declares illegal informal arrangements which "... prevent, or lessen, unduly, competition..."; section 33, read in conjunction with sections 2(e) and 2(f), establishes similar standards by proscribing mergers or monopolies which lessen, or are likely to lessen competition, "... to the detriment or against the interest of the public...". The latter provision is unequivocal: it is incumbent upon the courts to generate criteria of what constitutes the public interest, and to apply them on a case by case basis.

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[2] Bain, *Industrial Organization,* (1st ed., 1959), at pp. 3 and 44.

[3] The difficulty in drawing an analytically clear distinction between structure and conduct results from the fact that it is the behavior of firms themselves which is always the direct cause of performance, either good or bad. Where performance deviates significantly from the optimum, the issue becomes whether it is most expedient to sanction behavior itself, or rather, to effect structural alterations which would then make behavioral sanctions more effective. See Kaysen and Turner, *Antitrust Policy,* (1959), at pp. 59-60.

[4] For practical purposes, the other provisions of section 32(1) are far less significant. The last reported decision under headings (a), (b), or (d) was that of *R.* v. *Canadian Import Co.,* (1935), 3 D.L.R. 330. The remaining subsections of section 32 itself exempt from section 32(1) certain classes of trade association activities, as well as agreements related to export products.

The prohibition against horizontal arrangement[5] is, however, less clear. The word "competition" in the phrase quoted appears to establish injury to the competitive process as the primary criterion of illegality, rather than some other standard such as prejudice to the public interest. Nevertheless the comma after the word "lessen" indicates that there may be a prevention of competition which is not undue. If Parliament had intended to confine the qualification of the word "unduly" to the preceding word, no comma would have been interposed between the two. That being the case, it is clear that "undueness" cannot be measured by competitive standards alone. Other factors, such as efficiency considerations, may be invoked as a defense to a complete or substantial elimination of competition on the grounds that no harm has resulted to the public interest. The prevention or lessening of competition which the *Act* contemplates becomes undue when, as a consequence, consumer or other public interests are prejudicially affected. Accordingly, there exists no "privilege" to free competition in Canada. The only right which the *Act* embodies is that the public interest be left unimpaired by the concerted action of firms.[6] This line of

[5] It should be noted that the word "arranges" in section 32(1) implies that the prohibition extends to all agreements, informal as well as formal, and whether partaking of a contractual character or not. The prohibition is to this extent redundant, for it is difficult to conceive of a conspiracy, combine, or agreement which would not be subsumed under the broader heading of an arrangement. While Canadian courts have tended to formulate the problem in conspiratorial terms, British authorities have held that the term "agreement" in section 6(1) of the *Restrictive Trade Practices Act, 1956*, 4-5 Eliz. 2, c. 68, as clarified by section 6(3), encompasses all arrangements whereby the participating parties assume moral obligations: *In re Mileage Conference Group of the Tyre Manufacturers' Conference Ltd.'s Agreement*, (1967), L.R. 6 R.P. 49, at p. 102; *British Basic Slag* v. *The Registrar of Restrictive Trading Agreements*, (1963), L.R. 4 R.P. 116, at p. 146.

Conspiracy itself may be proved by adducing either direct or circumstancial evidence: *R.* v. *Northern Electric Co. Ltd.*, 24 C.P.R. 1, at p. 5; *Paradis* v. *The King*, [1934] S.C.R. 165, 61 C.C.C. 184, at p. 186, and the adherence to a pricing manual resulting in identical consumer prices has been held to be conspiratorial: *R.* v. *St. Lawrence Corp. et al.*, (1969), 5 D.L.R. (3d) 263, at p. 272. Nevertheless, proof of consumer cost factors and economic conditions resulting in similar pricing techniques may be exculpatory: *R.* v. *Burrows et al.*, (1968), 54 C.P.R. 95, at p. 129.

[6] Sections 19(1), 22(1) and 22(3) lend further support to this argument, all of which direct the Restrictive Trade Practices Commission to consider "the effect on the public interest" of agreements which the Director refers to it for investigation. Section 22(1) underscores the importance of the evaluative process by requiring the Commission, where such is the case, to state why it is unable to make a meaningful appraisal.

reasoning is consistent with sections 2(e) and 2(f) which, as we have seen, establish public detriment as a prerequisite to the offenses of merger and monopolization contemplated by section 33. The same criterion[7] is applicable, whether the impugned behavior be the consequence of overt agreement, merger, unilateral action, or oligopolistic interdependence.

To argne otherwise is to support the proposition that form should prevail over substance; it is tantamount to the contention that Combines Law is primarily concerned with the means, rather than the ends of concerted action; it assumes that the values incident to competition are of such paramount importance that the source must be preserved, regardless of cost; it is predicated upon the misconception that the *Act* has been promulgated to maintain standards of conduct, rather than to ensure that the public interest, the underlying goal of all legislation, is properly safeguarded. It is no answer to argue that the elimination or substantial reduction of competition, is, by its very nature, incompatible with the public interest. Were such the case, monopolization would be a *per se* offense. This reasoning, moreover, leads to the untenable conclusion that, in precisely the same factual circumstances, a defense based upon the absence of harm to the public interest would be sustainable under section 33, but inadmissible under section 32.

The writer's contentions do not yield the conclusion that different forms of concerted action will be equally defensible. Thus, the very fact that colluding firms retain their separate identities may preclude them from justifying their conduct by invoking substantial efficiency considerations. Proof of monopoly control places beyond reach the argument that the primary design of the scheme, though reducing the absolute number of firms, was nevertheless to facilitate a more effective competition. The point of crucial significance is merely that in specific circumstances the horizontal coordination of competitor behavior may have beneficial effects, and accordingly, where such affects are alleged, the court should look beyond the mere quantitative lessening of competition

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[7] The British Parliament, perhaps less trusting of the courts than its Canadian counterpart, has enacted the same criterion in a more explicit manner. Section 20(3) of the *Restrictive Trade Practices Act, supra,* n. 5, directs the Restrictive Trade Practices Court, constituted under section 2 of the *Act* to determine whether agreements coming within its jurisdiction are contrary to the public interest. The following section establishes a presumption in favor of the Crown, defeasible only by proof that the arrangement comes within the purview of one or more of the seven circumstances enumerated.

in determining whether the provisions of the *Act* have been violated.

b. *Structural Proscriptions*

Section 2(f) of the *Act* defines "monopoly" as

> ...a situation where one or more persons either substantially or completely control throughout Canada or any area thereof the class or species of business in which they are engaged and have operated such business or are likely to operate it to the detriment or against the interest of the public...

A close reading of the definition reveals that the "control" which the "one or more persons" may have need not be derived through agreement in order to come within the purview of section 33. Hence the courts would be justified in relying upon the section to effect structural changes in industries characterized by oligopoly where the evidence indicates that the participating firms could coordinate their pricing or product policies in the absence of communication in its usual form. Thus, the *Act* attacks the problem of oligopolistic interdependence directly, irrespective of whether the parties in question entered into the kind of arrangement proscribed by section 32. The likelihood that the parties will conduct their affairs "... to the detriment or against the interest of the public..." flows from the structural environment itself, and accordingly, section 31(1) permits the court to effect the appropriate structural alterations.

Similar prohibitions apply to the monopolist possessing sufficient market power that he need not predicate his decisions upon the anticipated reactions of the little competition which he might face. Once again, the significant policy question is whether the efficiencies inherent in a unified operation justify the control derived. Where efficiencies fail to mitigate excessive market power, the courts must characterize the source of the defect as either behavioral or structural, in order that the appropriate sanction be imposed.

It is true that the demarcation between structure and conduct is frequently vague and imprecise. Nevertheless, it is equally clear that the characterization cannot be effected by means of a limited inquiry into the conduct of firms themselves. The judiciary must give serious consideration to underlying structural conditions, in spite of the plea of ignorance that "[o]ur lady of the common law is not a professed economist."[8] It may well be true that the administration of combines policy would be facilitated by entrusting technical economic issues to men skilled in the discipline. That notwithstanding, Parliament has chosen to delegate this responsibility to the courts, and they must accordingly respond in order to properly fulfill their constitutionally defined functions.

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[8] *R.* v. *Container Materials Ltd.,* (1940), 74 C.C.C. 113, at p. 118.

The Difficulties Inherent in the Unqualified Application of a Per Se Rule

In this writer's view, both the text of the *Combines Investigation Act* and the dictates of policy require that competition be conceived primarily in a functional sense; that is, as a device to further the public interest rather than as an end in itself. For reasons elaborated upon later in this article,[9] the public interest, in the context of Canadian Combines policy, is best served by a system of industrial organization which maximizes the resources of society. Stated differently, market power resulting from internal expansion or horizontal integration should be deemed permissible in the absence of proof that its debilitating effects clearly outweigh the efficiencies derived. The foregoing does not, of course, preclude the courts from generating presumptive rules of illegality applicable to classes of agreements which consistently prove to be unjustifiable.

In the four judgments which it has rendered, the Supreme Court has made it clear that it does not share the writer's concept of a "functional" competition. In its first decision, the Court had to consider the legitimacy of a price-fixing agreement which yielded monopoly control in the absence of any allegation that some benefit enured to the public. The sole justification pleaded was that.

> ...before an agreement can be said to provide for unduly preventing or lessening competition, the court must be satisfied that it is designed to do so to an extent not reasonably necessary for the protection of the interest of the parties to it, whatever may be its effect upon the interests of the public.[10]

Anglin, J. rejected the argument in the following terms:

> The difference, in my opinion, between the meaning to be attached to 'unreasonably' and that which should be given to 'unduly' when employed in a statutory provision such as that under consideration is that under the former a chief consideration might be whether the restraint upon competition effected by the agreement is unnecessarily great having regard to the business requirements of the parties, whereas under the latter the prime question certainly must be, does it, however advantageous or even necessary for the protection of the business interests of the parties, impose improper, inordinate, excessive, or oppressive restrictions upon that competition the benefit of which is the right of everyone?[11]

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[9] *Infra*, pp. 523 *et seq.*

[10] *Weidman* v. *Shragge*, (1912), 46 S.C.R. 1, at p. 42. The argument invoked by the plaintiff was based upon English law prevailing at the time, as articulated in *Collins* v. *Locke*, (1878-9), 4 A. C. 674, and *Dubowski and Sons* v. *Goldstein*, (1896), 1 Q.B. 478.

[11] *Weidman* v. *Shragge*, *supra*, n. 10, at p. 42.

"That competition" which Anglin, J. contemplates is undoubtedly competition which is consistent with the public interest.[12] Almost two decades later, the Court adopted this reasoning to reject a similar argument in *Stinson-Reeb Builders' Supply* v. *The King.*[13] Hence, until 1942, the governing rule was merely the eminently reasonable, if not self-evident principle, that the business interests of private parties should be excluded from the determination of what constitutes the public interest. The situation had not yet arisen where it was alleged that incidental to the impugned agreement, there enured a public benefit.

The basis of the present state of the law can be found in *Container Materials Ltd.* v. *The King,*[14] where the defendants pleaded that the efforts of the Trade Association in which they participated to fix prices and standardize products was the necessary consequence of a decline in demand inducing heavy losses. The Court seemed unmoved by the fact that the container industry was in a serious state of disrepair and on the verge of a collapse which might have left the vertically related shipping industry and the public which it served without the necessary services.[15] It merely invoked the *Weidman* and *Stinson-Reeb* decisions to support the proposition that the Crown need not allege prejudice to the public interest where there is an undue prevention of competition. The existing rule that private interests must bow where public detriment results was extended to yield the assertion that competition must be irrebutably presumed to coincide with the public interest and hence must prevail even where, as a consequence, the latter is prejudicially affected. The true import of the judgment was to exclude any consideration of effect in determining whether an agreement comes within the proscriptions of the *Combines Act.*

The decision rendered in *Howard Smith Paper Mills Ltd. et al.* v. *The Queen*[16] extinguished any hopes that the Court would reverse itself. Kellock, J. reaffirmed the principle in unequivocal

[12] Sir Charles Fitzpatrick, C. J. held that, "[a]ll agreements which prevent or lessen competition do not come within the operation of the statute; the mischief aimed at is the undue and abusive lessening of competition which operates to the oppression of individuals or is injurious to the public generally." *Ibid.*, at p. 4.

[13] [1929] S.C.R. 276, at p. 278.

[14] [1942] S.C.R. 147.

[15] See in this regard the judgment of Henderson, J. A., dissenting in the Court of Appeal, (1941), 3 D.L.R. 145, at p. 196.

[16] [1957] S.C.R. 403.

terms, even though uncontradicted evidence received by the court of first instance indicated that the establishment of a fine paper industry in Canada without the agreements in question would have been "well nigh impossible." [17] The Supreme Court justice declared that,

> [t]he statute proceeds upon the footing that the preventing or lessening of competition is in itself an injury to the public. It is not concerned with public injury or public benefit from any other standpoint.[18]

Cartwright, J. with whom Locke, J. concurred, found "this conclusion a surprising one",[19] but nevertheless felt himself bound by previous decisions.[20]

The writer has contended that if this rule were consistent with the legislation from which it is supposedly derived, monopolization would be a *per se* offense under sections 33 and 2(f) of the *Act.* Yet this disparity is not its most serious deficiency; courts cannot be condemned for the occasional failure to perceive a frequently ambiguous if not fictitious legislative "intent". The fundamental weakness is that the principle is unworkable in its present form: it provides no conceptual framework which lower courts can apply in analyzing the legality of specific agreements. If the rule were limited to circumstances entailing an elimination of competition, it would merely amount to the analytically workable contention that monopoly power derived through horizontal agreements is illegal *per se.* By extending the presumptive rule beyond these limits, the Supreme Court has in effect left lower courts without effective means of determining when competition has been unduly lessened.

The imminency of the dilemma becomes apparent when it is recalled that the underlying goals of Combines policy are to disseminate market power and to foster efficiency. While the exclusion of one of these policy goals quite obviously undermines the purpose of the legislation, workable rules can nevertheless be formulated around the other. Thus it is meaningful, although not justifiable, to say that market power is to be avoided regardless of cost. The critical defect in the *Fine Papers* decision, however, is that the rule therein formulated fails to reflect either of the two fundamentals of Combines policy.

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[17] [1954] O.R. 543, at p. 571.

[18] *Supra*, n. 16, at p. 411, Rand, Fauteux, and Kerwin, J. J. concurring.

[19] *Ibid.*, at p. 426.

[20] *Idem.*, at p. 427.

Efficiencies, we are told, are utterly irrelevant, for the "... lessening of competition is in itself an injury to the public." The doctrine teaches that it is better for the consumer to be deprived of the product he requires than to be given the choice to pay more for the article than would be the case were an atomistic structural situation, impossible under the circumstances, to prevail.[21] Rivalry must be fostered, not for what it does, but rather for what it is. This notion deprives the concept of any functional meaning, and accordingly precludes the development of criteria of legality which would more closely correspond to the various dimensions of the public interest. The judicial viewpoint is thus inconsistent with contemporary economic models which tend to rely upon the criterion of workable competition as the ultimate goal of industrial organization precisely because of its functionally valuable attributes.[22]

Little more importance is attached to the market power which may emanate from horizontal agreements. While it is true that market power is positively correlated with the concentration level of firms in specific industries, the relationship is by no means perfect. The condition of entry plays an integral role in determining the behavioral parameters within which firms large or small must operate, and hence highly concentrated industries are not in themselves incompatible with the operation of impersonal market forces.[23] The salient point is that regardless of the importance which efficiency considerations may be deemed to have in antitrust policy, the proper question to be asked is not whether competition is to be preserved, but rather, the extent to which market power is to be avoided.

It is true that the monopoly control with which the Supreme Court had to deal rendered the distinction between concentration

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[21] *Supra*, n. 17.

[22] The vital element common to these models is that workability is itself defined in terms of the performance which it yields. The analyses are essentially qualitative in nature, so that competition is "workable" provided that it approximates optimal performance. Thus, J. M. Clark contends that "a contribution is made simply by formulating the concept of the most desirable, practically possible form of competition;" *Toward a Concept of Workable Competition*, (1940), 30 Am. Econ. Rev. 241, at p. 242. One writer has gone so far as to formulate a definition which implies that, in certain circumstances, a monopoly may be workably competitive. See, in this regard, Ferguson, *A Macroeconomic Theory of Workable Competition*, (1964), at p. 80. For an excellent review of the development of the concept, and its implications for antitrust policy, see Knox, *Workable Competition and Public Policy*, (1967-68), 1 Antitrust Law and Economics Review 3, at p. 41.

[23] Bain, *op. cit.*, n. 2, at p. 242.

and market power of lesser importance than would otherwise have been the case. Few economists would argue that the mere threat of entry would deter a monopolist from exacting excessive prices even though only on a short-term basis.[24] Nevertheless, the majority adopted without qualification broad language to the effect that actual power to implement the acts contemplated in the agreement is not a necessary element of the offense. Kellock, J. held that,

> [a]ssuming that during any part of the period of control the aim of the parties to the agreement could not have been successfully carried into execution, such a fact would not, in law, constitute any answer to the indictment.[25]

The justification invoked was that since the behavior attacked was conspiratorial in nature, the crime was constituted upon agreement, "... though in the circumstances of the case it be impossible to commit it."[26]

The real difficulty which this reasoning creates is not the technical legal problem that a conspiracy can only result where the acts agreed upon are themselves illegal, and that no Act of Parliament condemns behavior in restraint of trade.[27] While a *per se* rule which refuses to consider market power when assessing the legality of concerted action is justifiable where the pernicious purpose and power of colluding firms is overt, it is clearly an inadequate instrument to deal with the more ambiguous cases. Herein, then, lies the central weakness of the doctrine.

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[24] One noted author contends that "if the entry of new firms is not too rapid, the merger may make monopoly profits for a considerable period; and even though thereafter the losses are permanent, their discounted value need not be so large as to wipe out the initial gains." See Stigler, "Monopoly and Oligopoly by Merger", in *Readings in Industrial Organization and Public Policy*, (Irwin, 1958). This statement was predicated upon the assumption of relatively free entry.

[25] *Supra*, n. 16, at p. 412.

[26] Stephen, *Digest of the Criminal Law*, (9th ed., 1950), at p. 24, cited with approval by Kellock, J., *id.*, at p. 412, and by Taschereau, J., *id.*, at p. 406. In *R.* v. *Electrical Contractors of Ontario*, [1961] O.R. 265, at p. 279, Laidlaw, J. speaking for the Ontario Court of Appeal, implied that market power is not an element in the offense: "The only essential capacities of the accused are the capacity to conspire, combine, agree or arrange with another person, and the capacity to form the wrongful intent to "prevent, limit or lessen competition unduly in any respect set forth in the section!" For remarks with similar implications, see Idington, J. in *Weidman* v. *Shragge*, *supra*, n. 10, at p. 20.

[27] See, in this regard, Gosse, *The Law of Competition in Canada*, (1962), at p. 95.

By way of example, let us consider the problem noted earlier: how are lower courts to determine what constitutes an undue lessening of competition in the absence of a consideration of either market power or cost savings? The nub of the matter is that a *per se* rule based solely upon proof of horizontal agreement admits only of a quantitative test of legality. Bound by the principle of *stare decisis,* inferior tribunals are free only to hold that it is unlawful to eliminate all competition, or that it is illegal to eliminate any competition. The analytical principles uttered by the Supreme Court are not unlike those articulated by its counterpart in the United States. Thus in *United States* v. *Von's Grocery Co.,*[28] that Court prohibited the integration in question on the grounds that,

> ...Congress feared that a market marked at the same time by both a continuous decline in the number of small business and a large number of mergers would slowly but inevitably gravitate from a market of many small competitors to one dominated by one or a few giants, and competition would thereby be destroyed.[29]

Considering that entry into the Los Angeles grocery market was relatively unimpeded, and that the effect of the merger would have been to place the largest three firms on a more even footing, it is clear that the concept of competition harboured by the American Court is essentially quantitative in nature and based solely upon the absolute number of independent business units which rival for the consumers' patronage. As many authorities have noted,[30] virtually any lessening of competition effected through merger constitutes a technical violation of section 7 of the *Clayton Act.*[31] For practical purposes, the important problems which remain relate to the enforcement of the *Act,* rather than to issues of substantive law. It is true, of course, that the Canadian law applies to agreements rather than to mergers. Nevertheless, it is difficult to see why different analytical rules should be applied to integration effected through these two devices.

The Canadian courts do not have to follow suit. Absurd though it be, they could hold horizontal integration to be permissible provided that some competition, however slight, remains. The im-

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[28] 384 U.S. 270 (1966).

[29] *Ibid.,* at p. 278.

[30] See, for example, Phillips, *Some Implications of the Supreme Court's Antimerger Decisions,* (1967), 21 Southwestern L.J. 429, at p. 441; Bison, *The Von's Merger Case — Antitrust in Reverse,* (1966-67), 55 Georgetown L.J. 201, at p. 231.

[31] 38 Stat. 730 (1914), as amended, 15 U.S.C. s. 12-27 (1959), as amended, 15 U.S.C. s. 13, 21 (Supp. v, 1964).

portant point is that the alternatives are meager indeed, and that hopefully, the doctrine from which they are derived will be honored more in the breach than the observance. It is no easy task to assess the validity of this optimism, because virtually all the agreements challenged did in fact eliminate competition, and hence the presiding judges could apply a quantitative criterion unimpeded by analytical difficulties. Nevertheless, dicta do exist which indicate that the courts are coming to recognize the necessity for analyzing a lessening of competition in terms of the resulting market power.[32] In general it would appear that they have refused to follow the majority of the Supreme Court, and thus have implicitly rejected the quantitative test which would necessarily have followed. In so doing, they have not, however, developed a rigorous methodology for dealing with the concept of market power, and hence it is to this problem that we now turn.

The Assessment of Market Power

Judicial commitment to the concept of market power as an analytical device requires the courts to develop a methodology for assessing the extent to which firms have freed themselves from the discipline of impersonal market forces. Conceptually, excessive power may be viewed as the derivative of either unilateral or collective action,[33] and hence in the analysis which follows, the

[32] In the *Howard Smith* decision, *supra*, n. 16, Cartwright, J., with whom Locke, J. concurred, held at p. 426 that "...it is the arrogation to the members of the combination of the power to carry on their activities without competition which is rendered unlawful." While it is unfortunate that the learned Judge confined his statement to monopolistic power, his was the only judgment which formulated the problem in terms of market power. Subsequent decisions have tended to adopt his logic in this respect, and have accordingly refused to follow the reasoning of the majority. See *R.* v. *Canadian Breweries*, [1960] O.R. 601, at p. 605; *R.* v. *Beamish Construction*, [1966] 2 O.R. 867, at p. 898; *R.* v. *Canadian Coat and Apron Supply Ltd. et al.*, (1968), 2 C.P.R. n.s. 62, at p. 74.

[33] An important distinction may also, of course, be drawn between market power resulting from the behavior of firms, and that which flows from the structural environment itself. The distinction is relevant for the purpose of determining the appropriate sanctions in specific cases, and hence the writer will deal with it in some detail in the discussion of market power emanating from an oligopolistic structural environment, *infra*, at pp. 518-523. For a more complete treatment of the matter, see Friedman, *Monopoly, Reasonableness and Public Interest in the Canadian Anti-Combines Law*, (1955), 33 Can. Bar Rev. 133, at p. 137. In discussing the problem, however, that author pays but scant attention to Canadian law, no doubt because

writer will consider judicial efforts to diagnose and evaluate market power emanating from each of these sources. Where the government has chosen to attack the single-firm monopolist, the courts can look for a number of symptoms, such as the gradual but persistent elimination of competition, profits which significantly exceed the norm for substantial periods of time, and discriminatory pricing techniques. The task is considerably more difficult where the judiciary is called upon to evaluate the legality of horizontal integration recently constituted. Lacking data which might reveal the effects of the alleged power, it must in effect predict what consequences the integration will actually have. Perhaps the most dangerous of these is the threat of oligopoly, and the interdependence that frequently comes with it.

A meaningful assessment of market power, whatever its source, must necessarily be predicated upon a process of market delimitation [34] which closely conforms to economic actuality. An unrealistically narrow definition of the relevant market would exclude actual or potential competition which represents effective safeguards, with the result that an integrated operation would be disbanded without justification. There would follow needless costs inherent in the ensuing corporate reorganization, as well as the potential loss of scale economies. Conversely, where a geographic [35] or product

both courts and administrators have traditionally viewed violations of the *Combines Act* to be purely the result of deviant behavior.

[34] Section 2(f) of the *Combines Act* refers to a "class or species of business." While the phrase appears in the definition of a "monopoly", it is submitted that it is improper to apply different standards of delimitation where the market power is derived from other sources. See in this regard, Jones, *The Brown Shoe Case and the New Antimerger Policy: Comment,* (1964), 54 Am. Econ. Rev., 407, at p. 408; Steckler, *Market Definition and the Antitrust Laws,* (1964), 9 Antitrust Bull. 741. But see *contra,* Martin, *The Brown Shoe Case and New Antimerger Policy: Reply,* (1964), 54 Am. Econ. Rev. 413.

[35] Section 2(f) proscribes monopoly power which exists "... throughout Canada or any areas thereof ..." While a proper determination of the relevant geographical market may be just as critical as an appropriate delimitation of the product market, the writer will not discuss this aspect of the problem. The issue has been of little importance in Canada, no doubt as a result of the sparsity of merger cases to have come before the courts. In the one case where geographical limitations could have been important, a basing price system, deemed legitimate under the circumstances, was held to render transportation costs irrelevant, and hence a broad definition resulted: *R. v. British Columbia Sugar Refining Co.,* (1960), 32 W.W.R. 577, at p. 639. For a review of the current American approach to this matter, see Hale and Hale, *Delimiting the Geographic Market: A Problem in Merger Cases,* (1966), 61 Nw. U.L. Rev. 538.

market is deemed to extend beyond its proper limits, excessive market power would remain undiagnosed, thereby rendering the consumer liable to excessive prices where there is in fact substantial reliance upon the items in question.

The bipolar objectives inherent in Combines policy of stimulating efficiency and eradicating market power remain unambiguous. Hence, if we knowingly possessed flawless techniques for evaluating the extent of the power vested in specific firms, logic would dictate that we first assess the relative weights of power and efficiency, and then proceed to make a policy judgment as to which should be deemed of paramount importance. Unhappily, however, such is not the case, and hence the primary judicial task lies in formulating a technical analysis which properly embodies two fundamental considerations. The courts should initially reduce to a minimum errors in the fact-finding process itself. In addition, although some error will be inevitable, the lack of precise measuring instruments requires the courts to generate principles of market delimitation which, in the more ambiguous cases, will be designed to preserve the objective which has been deemed to be of primary importance.

It might follow from the foregoing that it would be appropriate to initially consider the relative importance of efficiencies and market power before proceeding with the analytical treatment of market delimitation. Nevertheless, the former issue is itself worthy of detailed consideration, and hence for organizational purposes, the writer has relegated the necessary discussion to a later place in this article. It is important only to note that vagaries inherent in the fact-finding process will on occasion make it necessary to import the conflict between power and efficiency into the market delimitation process itself.

a. *Market Power Derived Through Unilateral Action*

1. *Market Share as an Indicant of Market Power*

The traditional competitive model insulates the consumer against abusive pricing techniques by permitting him to look to a number of sources for the product he requires. Thus, where many different enterprises produce identical items, a simple headcount of the number of participating firms and an analysis of their respective market shares will reveal whether there exists a sufficiently atomistic structural environment.

More difficult problems arise where a sole producer of one item alleges that he faces effective competition from producers of qualitatively different substitutes. The dispositive legal, as well as eco-

nomic issue, then becomes the importance which users attach to the distinction between different products. Economists purport to measure the "cross-elasticity of demand" by examining the effect of a price change on one item upon the sales of another. American courts have traditionally used the concept of cross-elasticity, or in lay terms, the interchangeability of alternate products, to define the relevant market, and have then proceeded to evaluate the power of the competing firms in terms of their respective market shares,[36] taking into consideration existing or anticipated structural conditions.[37] Perhaps the most important characteristic of this two-step approach is that it does not entail a comparative analysis of the production costs of products which allegedly form part of the same market. By holding that the existence of monopoly power "... ordinarily may be inferred from the predominant share of the market",[38] the American Supreme Court has (properly, in this writer's view) demanded strong empirical evidence that lower costs and the concomitant power to unilaterally exclude competition actually exists and, in so doing, has chosen performance as the primary indicant of market power. While it is true that the growing judicial fear of incipient oligopoly has, for merger cases at least,

[36] See by way of example only, *United States* v. *Grinnell Corp.,* 384 U.S. 563, 16 L. ed. 2d. 778, at pp. 786-789 (1966); *United States* v. *Continental Can Co.,* 378 U.S. 441, 12 L. ed. 953, at pp. 963 and 965 (1964); *Brown Shoe Co.* v. *United States,* 370 U.S. 294, 8 L. ed. 2d. 510, at pp. 535-536 (1962). The statement by Warren, C.J., *ibid.,* to the effect that within a broad market itself determined by the cross-elasticity principle "... well-defined submarkets may exist which in themselves constitute product markets for antitrust purposes," does not alter the fact that those submarkets must themselves be determined according to the same rule. Note that of the six criteria used to identify a submarket, one is merely a statement of the cross-elasticity principle itself, and four contain qualifying words such as "peculiar", "unique", or "distinct", which tend to indicate the absence of cross-elasticity. The only novel criterion seems to be that of "specialized vendors," which would include the distributional channels in the definitional process itself. See Jones, *op. cit.,* n. 34, at p. 409 where the author states that "the six criteria enumerated by the court... are the same criteria which establish or identify the broad market." It is submitted that the true impact of *Brown Shoe* lies in its hardened antimerger philosophy rather than a significant change in analytical methodology; *United States* v. *E. I. DuPont de Nemoures & Co.,* 351 U.S. 377, 100 L. ed. 1264, at pp. 1282-83 (1956).

[37] *United States* v. *Continental Can Co., supra,* n. 36, at p. 965: "The merger must be viewed functionally in the context of the particular market involved, its structure, history, and probable future." *Brown Shoe* v. *United States, supra,* n. 36, at p. 540; *United States* v. *Philadelphia National Bank,* 374 U.S. 321, 10 L. ed. 2d. 915, at p. 947 (1963).

[38] *United States* v. *Grinnell Corp., supra,* n. 36, at p. 786.

lessened the importance of market share as a criterion of collective market power, the analytical method of predicating market definition upon the cross-elasticity principle itself has remained unchanged.[39]

Certain commentators have contended that the concept of cross-elasticity in itself may lead to an inappropriately broad delimitation of the relevant market in the absence of

> ... a consideration of costs, so that these substitutes will be excluded where the Government shows that at prices producing a high cross-elasticity the alleged monopolist has a substantial cost advantage.
>
> ... The producer with a substantial advantage in comparative preference-cost ratios has what the Court calls monopoly power — the power to control prices or exclude competition.[40]

The substance of the argument is that the failure to consider comparative costs might immunize from the strictures of the *Sherman Act*[41] a monopolist who has the power to exclude competition, but who has chosen not to do so. While such corporate benevolence is conceivable, it is clear that a comparative cost analysis is not a proper device to detect unexercised power. For one thing, experience with the *Robinson-Patman Act*[42] has shown that it is virtually impossible to evaluate the costs of even a single producer with any degree of precision.[43] For another, the determination of cost data, like the estimation of market share, is liable to the objection that the inefficient monopolist might escape the proscriptions of the *Act*. As we shall see,[44] it is this latter difficulty which constitutes one of the central issues in formulating an approach to market delimitation consistent with the underlying policy objectives of Combines law.

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[39] *United States* v. *Von's Grocery Co.*, 384 U.S. 270, 16 L. ed. 2d. 555, at p. 561 (1966); *Brown Shoe Co.* v. *United States, supra*, n. 36, at p. 538; in *United States* v. *Philadelphia National Bank, supra*, n. 37, at p. 946, the Supreme Court seemed far more concerned with basing its decision upon the percentage market occupancy of the defendant.

[40] Turner, *Antitrust Policy and the Cellophane Case*, (1956-57), 70 Harv. L. Rev. 281, at p. 309. Other authors seem to agree, see Broadley, *Oligopoly Power Under the Sherman and Clayton Acts — From Economic Theory to Legal Policy*, (1966-67), 19 Stan. L. Rev. 285, at p. 351; Kaysen and Turner, *Antitrust Policy*, (1959), at pp. 101-102.

[41] 26 Stat. 209 (1890), as amended, 15 U.S.C. ss. 1-7 (1959).

[42] 49 Stat. 1526 (1936), as amended, 15 U.S.C. s. 13, 21(a) (Supp. v. 1964).

[43] See McGee, *Price Discrimination and Competitive Effects: The Standard Oil of Indiana Case*, 23 U. Chi. I. Rev. 398, at p. 399, n. 2. See also *Panel Discussion, The Robinson Patman Act*, (1966), 30 A.B.A. Antitrust L.J. 41, at p. 42.

[44] See *infra*, pp. 506-509.

2. Excessive Profits as an Indicant of Market Power

The exclusion of competition is only one symptom which may reveal underlying market power in view of the potential ability which a manufacturer may also have to exact excessive prices. Where, as in *Alcoa*,[45] the potential strength of a substitute qualitatively identical to the primary product is limited only by a fixed amount such as transportation or tariff costs, a court is justified in assuming identical production costs and using the differential as an index of pricing power upon which to base a delimitation of the market.[46] Low profits in the face of substantial and unequivocal cost advantages offer clear evidence of inefficiency, and hence should not be considered as a mitigating factor to a charge of monopolization.

Where, however, the substitute is qualitatively different, pricing power will be based not only upon costs, but upon interchangeability as well, and hence a rational seller will take the latter factor into consideration in determining the price at which he can maximize profits. In these circumstances, the critical measure of pricing power will be the extent to which the price at which cross-elasticity occurs exceeds the producer's costs, or alternatively, the difference between the costs for manufacturing the primary and substitute products where the latter cost is itself greater than the price at which cross-elasticity would occur. Since either of these disparities will be reflected in the earnings of the efficient monopolist, the courts may justifiably rely solely upon a finding of excessive profits in making a determination that undue pricing power actually exists.

One might well ask why the cross-elasticity principle is necessary at all if exhorbitant profits are taken as *per se* evidence of monopoly power. While the concept is of little aid in further evaluating the extent of the power, it nevertheless sheds light upon its source, and hence is a useful diagnostic device. By permitting the courts to compare the relative profit rates of the producers of close substitutes, it facilitates the determination of whether pricing power exists unilaterally or collectively. Excessively high profits shared

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[45] *United States* v. *Aluminum Co. of America*, 148 F. 2d. 426.

[46] In *United States* v. *Corn Products Refining Co.*, 234 Fed. 964, at pp. 975-977 (1916), Judge Hand theorized that it would be proper to exclude potential competition from the market on this basis. It is important to note, however, that his reasoning was founded upon two assumptions both of which were unverified by the evidence before him. At p. 975, he assumed that "... the two commodities compared are indistinguishable in use..." and, on the following page, that one process was more expensive than the other.

by all participating firms would indicate the existence of underlying oligopoly power.[47]

3. *The Problem of the Inefficient Monopolist*

It is true that reliance upon excessive profits or predominant market share as a criterion of unlawful power immunizes the inefficient monopolist who unknowingly destroys the only evidence which would otherwise illuminate his true character. As already noted, a comparative cost analysis would be of little diagnostic use in view of its vulnerability to the same objection. It is undoubtedly this drawback which has prompted one noted authority to advocate the "*per se* exclusion of qualitatively distinct substitutes." [48] In his view, the monopolist has the choice to overlook possible efficiencies in favor of "the quiet life",[49] and it is this alternative which antitrust policy should attack.[50]

Before proceeding to more important policy considerations, the writer would comment upon this anthropomorphic conception of the corporate monopolist as an inherently slovenly creature. The monopolist, like his counterpart in a more competitive market, will invariably strive to reduce costs, for this is one of the primary ways in which he can augment his profits. With pricing policy ultimately shackled by the demand curve for his product, he will inevitably cast a wary eye towards costs to ensure that inefficiencies are not emasculating a sizeable portion of revenues which are, in the last analysis, immutable. To contend that he would consciously exercise a choice in favor of inefficiency presumes such irrational conduct that merely stating the suggestion warrants its rejection as a valid policy consideration. Indeed, the very finding that oligopoly power is significantly related to excess profits affords strong empirical evidence which militates against this conclusion.[51]

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[47] Bain, *op. cit.*, n. 2, at p. 377. This of course assumes substantial overlapping among the end uses of the substitute products.

[48] Turner, *supra*, n. 40, at p. 312.

[49] *Ibid.*, at p. 310.

[50] This reasoning unquestionably was one of the assumptions underlying the judgment in *Alcoa, supra*, n. 45. After agreeing at p. 427 that a profit of 10 per cent "...could hardly be considered extortionate", Judge Hand continued at the same page to say that "...the mere fact that a producer having command of the domestic market has not been able to make more than a 'fair' profit is no evidence that a 'fair' profit could not have been made at lower prices." (citing *United States* v. *Corn Products Refining Co., supra*, n. 46).

[51] See in this regard, Bain, *Industrial Organization, op. cit.*, n. 2, at pp. 411-416, where the author discusses the result of a study on industrial

The foregoing does not imply that all monopolists will be as efficient as firms participating in atomistic industries, where, in theory at least, competitive forces will systematically eliminate those enterprises which fail to realize the potentials for cost savings. Hence the question arises as to what sacrifices Combines policy should make in order to disband the monopolist who, though trying to produce at the lowest costs possible, nevertheless fails to do so. The salient point is that while the exclusion of distinct substitutes will invariably eliminate the inefficient monopolist, it will also lead to the unnecessary dissolution of firms already subject to the effective discipline imposed by alternate products. In the writer's view, the potential losses from smaller scales of production in addition to the costs of dissolution militate against the *per se* rule.[52]

Thus, in addition to being predicated upon the unwarranted assumption that monopolists are *per se* inefficient, the exclusion of distinct substitutes might well do more harm than good. At any rate, the burden lies with those supporting the rule to demonstrate that inefficiencies inherent in the undetected monopolist are of such a magnitude as to justify its indiscriminate application. In the absence of empirical evidence, it would appear that the inevitable vagaries render the rule too crude to apply on a general basis.

Canadian courts would unquestionably refrain from invoking such an unjustified presumption as the basis for a conviction. Since *Hodge's* case, the rule governing the judicial finding of facts based upon circumstantial evidence and prejudicial to an accused has been

> ...not whether the facts are consistent with the prisoner's guilt, but whether they are inconsistent with any other rational conclusion.[53]

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profits between 1936 and 1940. Of the forty-two industries examined, those in which the largest eight firms supplied seventy per cent or more of industry output earned significantly higher profit rates than the less concentrated industries. It is important to note the author's emphasis at p. 413 that "...within either group the profit rate was not significantly related to concentration." Other investigators have also found that a positive relationship exists between industry profit rates and monopoly power as roughly represented by concentration ratios. See Fuchs, *Integration, Concentration, and Profits in Manufacturing,* (1961), 75 Q.J.E. 278; Weiss, *Average Concentration Ratios and Industry Performance,* (1962-63), 11 J. Indus. Econ., 237. For a theoretical review of the matter, as well as a reply to certain methodological criticisms of the investigative technique, see Kilpatrick, *Stigler on the Relationship Between Industry Profit Rates and Market Concentration,* (1968), 76 Jour. Pol. Econ. 479.

[52] See *infra,* n. 109 and accompanying text.

[53] *R.* v. *Hodge,* (1838), 2 Lew. C.C. 227.

While few technocrats view themselves as "prisoners", they are nevertheless entitled to all the protection applicable to a criminal proceeding. As a result, it would be exceedingly difficult for the Crown to prove the inefficiency of a producer whose behavior is limited only by qualitatively distinct substitutes: a defendant could always plead that his exorbitant costs were the inevitable result of unavoidable defects inherent in the production process itself.

How then can we account for the following remarks of Casey, J., speaking for the Quebec Court of Appeals, wherein he rejected the plea that paper matches competed with the wooden matches which the defendant company produced ?

> It is true that the manufacture of lighting devices, whatever be the type or kind, can be regarded as a general class of business which would include wooden matches. But it seems strange to suggest that within the general class there cannot be as many types of businesses as there are species of devices.[54]

This reasoning, adopted by the Restrictive Trade Practices Commission in the *Propane Investigation* case,[55] amounts to the *per se* exclusion of distinct substitutes. In view of the absence ot any discussion relating to the presumed inefficiency of the monopolist, it seems clear that these decisions were to some extent predicated upon non-economic considerations. The fact that only one Canadian decision [56] has given even passing notice to efficiencies as a proper consideration of Combines policy seems consistent with the adoption of the *per se* rule. That, of course, does not make it correct; on the contrary, it merely indicates that the current judicial conception of a unidimensional approach concerned only with the dissemination of undue market power has manifested itself in the analytical treatment of market delimitation.

Nevertheless, two recent decisions should be noted in which Canadian courts indicated that substitute products, although distinct from the primary item, might be treated as part of the same market. In *R.* v. *J.W. Mills and Sons Ltd. et al,*[56(a)] Gibson, J. impliedly accepted that doctrine but held, nevertheless, that water carriers cannot properly be said to compete with rail transportation. Unlike the *Eddy Match* decision, his reasoning was not founded

[54] *Eddy Match Company Ltd. et al.* v. *The Queen,* (1954-55), 109 C.C.C. 1, at p. 14.

[55] *Monopoly in the Production of Propane, British Columbia,* Ottawa, 1965, at p. 65. In the *Cellophane* decision, *supra,* n. 36, Warren, C. J. reasoned in a similar manner.

[56] *R.* v. *Canadian Coat and Apron Supply Ltd. et al., supra,* n. 32, at p. 74.

[56a] (1969), 56 C.P.R. 1, at pp. 34 *et seq.*

upon a *per se* exclusion; it was based upon the economically sound principle that the demand of users requiring rapid transportation was necessarily inelastic and accordingly, cross-elesticity sufficient to justify including the two forms of transportation in the same market was lacking.[56(b)]

4. *Discriminatory Pricing as an Indicant of Market Power*

The adequacy of the traditional two-step approach which this writer endorses is limited to the situation where cross-elasticity is uniformly distributed amongst the dependent purchasers. More subtle issues arise when certain buyers lack adequate substitutes, that is, where cross-elasticity does not extend to all users. In these circumstances, it will not suffice to merely define permissible market power in terms of market share or pricing power. The additional question arises as to whether the *Act* protects specific buyers whose dependence substantially exceeds the norm.

It was Warren, C.J.'s views, dissenting in the *Cellophane* case,[57] that antitrust law has as its purpose the stimulation of competition which extends to all buyers, and that accordingly, the defendant was possessed of monopoly power. In the subsequent *Grinnell* case [58] the Court seemed to agree. In finding monopoly power, Douglas, J. reasoned that "... the high degree of differentiation means that for many customers only central station protection will do." [59] The Court did not, however, articulate whether the differentiation found rendered the defendant a monopolist because of an excessive number of dependent users, or as a result of the abnormally high reliance of specific buyers, whatever their number, upon the services in question. While the former reason would merely amount to a straight application of the cross-elasticity principle, it would appear that the language cited impliedly modifies, at least in part, the *Cellophane* rule.

It is significant that the mere disparity among demand elasticities for the end uses of a given product will not in itself assure that above-normal profits enure to the manufacturer. To capitalize upon the varying dependencies of his customers, the producer must have a vehicle through which he can effect a discrimination in price

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[56b] See also *R.* v. *St. Lawrence Corp. Ltd.*, (1967), 51 C.P.R. 170, at p. 176 where solid fibre board containers were held to form part of the same market as corrugated containers.

[57] *Supra*, n. 36, at p. 1296.

[58] *Supra*, n. 36.

[59] *Id.*, at p. 788.

between different classes of buyers,[60] and in addition, prevent arbitraging amongst users. Typically, the courts could prevent him from generating the necessary mechanism without tampering with the market definition process itself. Thus section 32(1)(c) of the *Combines Act* would proscribe any attempt to control the channels of distribution through vertical agreement. If the control was derived through merger in circumstances amounting to a lessening of competition, the courts could prevent the exercise of power by ordering the defendant to release his interests in the distributing facilities. A close reading of section 2(e) reveals, however, that section 31(1)(b) would be inapplicable where the manufacturer gains control over the channels of distribution through merger at the time he begins production or through internal expansion at a later date. In the former situation, he may be said to limit, but not to lessen competition; in the latter, he has not merged at all. Nevertheless, where the exclusive position of the manufacturer is derived from a patent, sections 30(c), 30(d), and 30(v) confer upon the Exchequer Court the jurisdiction to take similar remedial measures, irrespective of how the discriminatory power was actually achieved.

A sole producer owing his position to important scale economies might well be able to implement a discriminatory pricing scheme, and hence it would be vital for him to prevent arbitraging among users without having recourse to tie-in devices.[61] Clearly, the possibility of imposing the necessary restrictions would materially depend upon the nature of the product itself, and the extent to which different end uses might require slight alterations in size, shape, or color, of its primary characteristics. Physical properties preventing handling or storage would be of significant assistance. In these circumstances, the sanctions embodies in the *Act* would be predicated upon a finding of monopoly power.

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[60] The proscriptions of section 33A(1)(a) of the *Act*, like those of the *Robinson-Patman Act* in the United States, are limited to discriminations in price between competing purchasers.

[61] The writer would have thought tying arrangements to be violative of section 32(1)(c) of the *Act*. See however, *Report On an Inquiry Into the Distribution and Sale of Automotive Oils, Grease, Antifreeze, Additives, Tires, Batteries, Accessories and Related Products*, R.T.P.C. No. 18, Ottawa, 1962. At p. 232 the Commission recommended that the *Act* be strengthened with respect to tying arrangements in any field of trade. The implication is that the Commission did not think the existing provisions to be dispositive of the matter. Nevertheless the inquiry did not constitute a formal prosecution under the *Act*, and hence the recommendation would be of little assistance to a defendant charged under the existing provisions.

Hence, the fundamental question is whether control over distributive facilities is a valid consideration in market delimitation.[62] It is true that a negative reply would force the courts to assume a rigid stance: it would be incumbent upon them to either systematically disband efficient producers who are unable to seize upon the dependence of a category of customer, or to consistently deny protection to the latter where market power is being effectively employed. A positive reply, however, would constitute an unwarranted judicial exercise of an essentially legislative function. It would in effect extend the application of section 33A to non-competing, as well as competing purchasers, which is clearly contrary to Parliamentary intent. Price discrimination being essentially a behavioral problem, it would be wrong for the courts to recharacterize the issue in structural terms in order to justify a conviction. If an extension of section 33A is in fact justifiable on policy grounds,[63] it should be effected by amendment rather than by judicial lawmaking.

5. *In Recapitulation*

We have seen that the indicants of market power may take the form of undue market share evidencing the ability to exclude competition, excessive profits, or discriminatory pricing techniques. Accordingly, the central judicial problem lies in developing a method of market delimitation which will reveal these symptoms, in order to diagnose the underlying deficiency. In this writer's view the traditional two-step approach adopted by the American courts is an acceptable method for determining whether a defendant has

[62] See this writer's comments on the *Brown Shoe Case, supra,* n. 36.

[63] See in this regard, Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division,* (1965-66), 75 Yale L.J. 373, at pp. 416-424, where the author contends that a prohibition against this kind of discrimination "might easily" do more consumer harm than good. He concludes that the ultimate effect would be "indeterminate" in the absence of knowledge of the various demand curves for the items in question. By implication, he seems to be saying that practical considerations such as difficulties of proof and administrative costs, should militate against the prohibition. It is difficult to say whether this argument is applicable to the Canadian economy where much smaller markets would make scale economies considerably more important. As a consequence, one might speculate that firms would be far less likely to react to a prohibition against price discrimination by significantly restricting output. Nevertheless, what little evidence there is does seem to indicate that plant sizes in Canada are only slightly smaller than their counterparts in the United States. See Rosenbluth, *Concentration of Canadian Manufacturing Industries,* (1957), at p. 85.

the power to exclude competition. Excessive profits are a useful evidentiary device, but they need not invariably be shown in order to justify a finding of undue market power.[64] Low prices, yielding equally low profits in concert with a growing market share may well indicate that a defendant does in fact have the power to charge excessive prices at a subsequent date.

Where, however, the allegation charges that the defendant presently has undue pricing power, profit levels should themselves be dispositive. The resulting immunity of the inefficient monopolist (which also flows from the criterion of market share) finds its justification in the fact that existing analytical techniques are unable to distinguish between this form of corporate creature and other enterprises whose behavior is subject to the control of substitute products. Hence the fundamental question with which both courts and administrators must deal is the extent to which profits must exceed a normal rate of return in order to warrant the finding of unlawful pricing power.

Clearly no hard and fast lines can be drawn. While a close reading of *Alcoa*[65] and *Corn Products*[66] tends to indicate that American courts, for qualitatively similar products at least, would hold any pricing power to be unlawful, that is only theory, and is unworkable as a general rule. Economic yardsticks lack the necessary refinements to detect the minute degrees of market power which may be vested in specific firms. In addition, the principle is essentially incompatible with the lawful attempts which enterprises make to differentiate their product and thereby assure themselves of a certain amount of predictable consumer dependence. The actual profit level which the courts may accept as evidence of excessive pricing power is itself relatively unimportant,[67] provided that the methodological analysis is sound. In this regard, efficiency considerations should and must be regarded as mitigating factors.

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[64] The statement by Williams, C.J.Q.B. in *R.* v. *British Columbia Sugar Refining Co., supra,* n. 35, at p. 633 to the effect that the Crown "...must establish excessive or exorbitant profits or prices," is clearly an unwarranted requirement and should be rejected in future decisions.

[65] *Supra,* n. 45.

[66] *Supra,* n. 36.

[67] Bain, *supra,* n. 2, at p. 413, found that the average annual profit rate of the highly concentrated industries was 11.8% of equity. Taking into account additional inflationary factors, one might venture to estimate that consistent profits in the order of 15 per cent would be an indication of some appreciable degree of pricing power.

Discriminatory pricing, while being a symptom of underlying market power, might be more exactly characterized as a behavioral attempt to capitalize upon unique dependencies of specific purchasers. The underlying analytical problem is whether market definition should be predicated upon the existence of a discriminatory pricing scheme which does not in itself violate any of the behavioral proscriptions embodied in the *Combines Act.*

b. *Market Power Derived Through Competitor Coordination*

Collective competitor action may take the form of private agreement, oligophistic interdependence, or merger. Since mergers are merely agreements constituted on an irrevocable basis, the analytical properties of these two devices are closely aligned for the purposes of this discussion, and hence the writer will treat them as a single category, making the appropriate distinctions where necessary. It is important to note, however, that the separate treatment of market power derived from mergers and agreements on the one hand, and interdependence on the other, is largely arbitrary, because one of the central problems which the Canadian courts have still to recognize, is the oligopoly power which may result from excessive integration.

1. *Agreement and Mergers*

As noted previously, the corporate resultant of a merger initially has no behavioral history which may reveal the existence of underlying market power. Hence the defendant's market share considered in conjunction with other structural features of the relevant industry is the only criterion which the courts have at their disposal to predict whether effective competition remains. Once again, any attempt to draw immutable guidelines would be doomed to failure as a general policy rule. Conditions of entry, as well as concentration levels, significantly determine immunity from market forces, and hence one might venture only to say that permissible market share should bear a crude inverse relationship to the height of entry barriers,[68] and a positive relationship to the number of competing firms.[69]

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[68] To the extent that market share and absolute size correspond, one might well argue that the former may to some extent constitute in itself a substantial entry barrier. For an American decision prohibiting a merger on these grounds, see *Federal Trade Commission* v. *Proctor & Gamble Co.*, 386 U.S. 568, 18 L. ed. 2d. 303, at p. 310.

[69] See *supra*, n. 57.

While Canadian courts have given but scant attention to market occupancy data, there are clearly two divergent viewpoints as to the point at which market power itself assumes a character contrary to the public interest. The judgment of Cartwright, J. in the *Fine Papers* case represents one line of reasoning:

> ...it is the arrogation to the members of the combination of the power to carry on their activities without competition which is rendered unlawful.[70]

The difficulties inherent in this contention are overt. First, it forces the court to delve into the massive evidence relating to the complex question of market power, and thereby precludes the generation of any expedient *per se* rule of illegality based upon specific agreements where the defendant fails to allege efficiency or other mitigating considerations. This deficiency also characterizes a similar viewpoint adopted by the Restrictive Trade Practices Commission to the effect that

> ...an agreement is undue only if the conspirators have sufficient control over the market to make it probable that they will succeed in their intentions to lessen competition.[71]

This reasoning is clearly incompatible with the text of the *Act*, which provides that it is not the agreement, but rather the lessening of competition contemplated by the agreement, which must be undue. It does not however share the more vital deficiency of Cartwright, J.'s requirement of monopoly power. The central weakness of his analysis is that it would consistently fail to avert tendencies towards oligopoly power. While it is true that interdependent pricing will typically emerge between single firms rather than groups of firms, it is nevertheless conceivable that a number of intra-industry trade associations could be formed in order to come within the permissive rule.

One might reasonably have expected that this reasoning would carry little weight in subsequent decisions. Apart from its substantive weaknesses, the statement by Cartwright, J. was clearly unnecessary to the decision in question, for the power derived from the impugned arrangements was held to be monopolistic in character. In addition, the learned Judge, who spoke only for himself and for Locke, J., was, in his own words, merely summarizing

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[70] *Supra*, n. 16, at p. 426. See also *R.* v. *Beamish Construction*, [1966] 2 O.R. 867, at p. 898. In the trial court judgment of the *Fine Papers* case, Spence, J. reasoned in a similar manner: [1954] O.R. 543, at p. 565.

[71] *Distribution and pricing of Pesticides*, R.T.P.C. No. 37, 1, at p. 38, (1965).

the existing jurisprudence, and as others have pointed out, did so incorrectly.[72]

Unhappily, judicial interpretation of the *Combines Act*, all too frequently fails to confirm the reasonable expectation. By a peculiar inversion of reasoning, McGruer, J. upheld a series of mergers in the *Breweries* case [73] from which the defendant had derived a share of the Ontario and Quebec beer markets amounting to 60%. After the merger, the defendant faced competition from only one other major producer in each of these provinces. The substance of the holding was that the criterion of public interests embodied in the *Act* must be interpreted "... in a legal sense and not in a social sense." [74] In spite of unequivocal legislative language to the contrary, he contended that prejudice to the public interest must be equated with an undue lessening of competition, and more particularly, with Cartwright, J.'s misconceived interpretation of what form that competition should take. Proceeding upon this assumption, he dismissed the Crown's complaint on the grounds that it had failed to prove that the merger had "... conferred on the accused the power to carry on its activities without competition, or substantially without competition." [75]

Similar reasoning was invoked only months later in the *Sugar* decision, [76] wherein judicial approval was given to a merger integrating the only refineries of beet sugar in the Provinces of Manitoba and Saskatchewan. Williams, C.J. held that the four existing eastern refineries and the threat of foreign competition of cane sugar imported over a tariff wall constituted effective competition, in spite of the recommendations of the Restrictive Trade Practices Commission made earlier in the same year to the effect that the unduly high concentration of eastern refineries warranted structural alterations in the form of a tariff reduction.[77] The inexplicable failure of the Crown to appeal either of these two decisions [78] or

[72] Gosse, *op. cit.*, n. 27, at p. 128.

[73] *R.* v. *Canadian Breweries, supra*, n. 32.

[74] *Ibid.*, at p. 605.

[75] *Ibid.*, at p. 630.

[76] *R.* v. *British Columbia Sugar Refining Co., supra*, n. 35.

[77] *Report Concerning the Sugar Industries in Eastern Canada*, Ottawa, 1960.

[78] Lyon, *Recent Canadian Anti-Combines Policy: Mergers and Monopoly*, (1963-64), 15 U. of Toronto L.J. 155, at p. 165 speculates that, "[p]ossibly the administration felt that its role of watchmen of merger practices would be better served by not appealing: higher courts might have expressed just enough agreement with the trial courts to dilute merger policy in a way that government did not want." As we shall see however, *infra, the government* itself has treated these two cases as binding upon it.

to institute court proceedings in the nine intervening years constitutes a virtual abandonment of any Canadian policy attempting to contain the tendency towards industrial concentration. Technocrats may now proceed to implement a program of horizontal integration ultimately designed to yield single-firm market power which, though not quite monopolistic, is nevertheless compatible with profits well above the norm. The few remaining giants in each industry can then coordinate their behavior in the absence of overt agreement, and thus unimpeded by legal considerations.

The writer does not oppose "bigness" where justifiable by cost savings. The two merger decisions would have been correct in both economics and law had significant efficiencies resulted. Yet neither of these judgments gave any consideration to potential efficiencies which might have enured to the producing firms. On the contrary, Williams, C.J. expressly endorsed[79] the principle articulated by McRuer, J.[80] that it is not illegal "... for one corporation to acquire the business of another merely because it wishes to extinguish a competitor." The statement is absurd, for there must be a motive underlying an acquisition. If the benefits lie not in cost savings, then it seems justifiable to conclude that the extinction will significantly affect the acquiring firm's ability to restrict output and extract higher prices from the public.[81]

In spite of the foregoing, it is encouraging that most of the decisions dealing with horizontal agreement, as opposed to horizontal merger, have not adopted Cartwright, J.'s stringent requirements of illegality. On the contrary, it has been generally held that the proscriptions of the *Act* are not limited

> ... to those agreements only, which if carried into effect would give the parties to it the power to carry on their business virtually without competition, that is, virtual monopolization situations.[82]

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[79] *Supra*, n. 35, at p. 613.

[80] *Supra*, n. 32, at p. 621.

[81] For the same argument in reverse, see Bork, *op. cit.*, n. 63, at p. 391, where the author contends that horizontal arrangements which do not confer upon the parties the power to increase profits by restricting output must necessarily have as their purpose the creation of efficiencies.

[82] *R.* v. *Faith and Shaver*, (1967), 51 C.P.R. 126, at p. 128; *R.* v. *Canadian Coat and Apron Supply Ltd. et al.*, *supra*, n. 32, at p. 73. See also *R.* v. *Abitibi Power and Paper Co.*, (1960), 36 C.R. 96, at p. 148; *R.* v. *Crown Zellerbach Canada Ltd. et al.*, [1955] 5 D.L.R. 27, at p. 33; *R.* v. *Northern Electric Co. Ltd.*, [1955] 3 D.L.R. 449, at p. 485; *R.* v. *McGavin Bakeries et al.*, (1951), 3 W.W.R. (N.S.) 289, at p. 317; *R.* v. *Electrical Contractors Association of Ontario*, (1961), 131 C.C.C. 145, at p. 159. See, *contra*, *R.* v. *Burrows et al.*, (1968), 54 C.P.R. 95, at pp. 134-135.

While most of the statements with but one exception[83] were not necessary for the decision rendered in that monopoly power was invariably found to exist, it nevertheless seems clear that a defense based solely upon the absence of such power will not assure an acquittal.[84] It would thus appear that Canadian courts have adopted in part, but only in part, the *per se* rule applicable in the United States.[85] Like its American counterpart, the Supreme Court has refused to treat economic justification as a legitimating factor to a charge of price fixing.[86] As we have seen, however, lower courts have not adopted its reasoning that the resulting market power is also irrelevant.[87] One might perhaps make a reasoned prediction that upon appeal the Supreme Court would merely reaffirm its prior holding, but for the present it would appear that in the lower courts at least, the Cown must prove that an impugned agreement extends to a substantial portion of the relevant market in order to achieve a conviction.[87a]

Hence a serious disparity has developed between the permissible degree of a market power which may be generated through horizontal agreement, and that which may lawfully result from merger. The anomaly underlying the difference in judicial opinion is that the principle espoused by Cartwright, J. has been imported

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[83] The only exception is *R.* v. *Abitiby Power and Paper Co., supra,* n. 82, wherein Batshaw, J. seemed unsure as to whether the defendants possessed monopoly power. He concluded at p. 155 that there was not "...such an effective competition as to relieve the accused from the charge that their conspiracy was 'undue'".

[84] The contentions of Gosse, *op. cit.,* n. 27, at p. 137 to the contrary are badly dated. Moreover, his reliance upon the *Fine Papers* case to support the proposition that "...an agreement must virtually eliminate competition before it becomes undue" is wrong. As the writer has already pointed out *supra,* page 498, both Kellock, J., with whom Rand, Fauteux, and Kerwin, J.J. concurred, and Taschereau, J. held that a conspiracy in the absence of power was nevertheless illegal. As we have seen, lower courts have refused to adopt this reasoning, but at the same time have rejected the proposition that monopoly power is itself a precondition of illegality.

[85] See *United States* v. *Socony-Vacuum Oil Co.,* 310 U.S. 150, 84 Law ed. 1129, at p. 1169, n. 59 where Douglas, J., speaking for the Supreme Court rejected both economic justification or the absence of actual power to fix prices as a valid defense to a charge of price fixing.

[86] *Howard Smith Paper Mills et al.* v. *The Queen, supra,* n. 16.

[87] *Supra,* n. 32.

[87a] Once the Crown has satisfied this burden, however, the accused will not be able to exculpate himself by demonstrating that the prices exacted were reasonable, and that the consuming public was not deprived of the product in question: *R.* v. *Burrows et al., supra,* n. 82, at pp. 134-135.

into the law governing mergers, but has been rejected in cases characterized by factual situations more closely aligned with the circumstances from which it arose. While one might think the disparity justifiable on the grounds that mergers are more likely to yield efficiencies favorable to the public interest, a close reading of the cases indicates that such effects have been deemed irrelevant. At any rate, it is doubtful whether the distinction is well-founded as a general policy rule, since the greater efficiencies incident to mergers may in specific cases be less important than the prejudicial market power resulting from the perfect coordination achieved. That aside, its central weakness lies in the implicit dichotomy between monopoly and non-monopoly market control and the corresponding failure to deal with the pervasive issue of oligopoly power. It is to this problem that we now turn.

2. *Oligopolistic Interdependence*

As already noted, the primary defect inherent in both the *Breweries* and *Sugar* decisions lies in the judicial adherence to a concept of competition compatible with oligopolistic interdependence. "Price leadership" is merely one of the more overt forms which the joint action might take. The peculiar character of this kind of behavior is that it may result in the absence of any private communication amongst the participating firms. Since each enterprise has a sizeable market share, any change in policy resulting in an increase in sales for one firm will of necessity result in a significant and identifiable decline in the market share of its competitors. Accordingly, each participant is in the position to predicate his pricing or product quality upon the anticipated reaction of the other competing firms. Since the potential reactions are limited in scope, given the assumption that all parties seek to maximize profits, the firm initiating a price or product change will do so in a manner compatible with the interests of his competitors, and thereby avoid a hostile response on their part.[88] Imperfect knowledge and varying costs may well preclude the achievement of earnings characteristic of the single-firm monopolist,[89] but the

[88] For a more detailed discussion of the processes involved in interdependent action, see Bain, *op. cit.*, n. 2, at pp. 274 and 279-281.

[89] It is unlikely, as Broadley, *op. cit.*, n. 40, at p. 189, seems to imply, that the resulting profit levels "... may be, not unnaturally, the same price that a monopolist intent upon maximizing profits would charge." If monopoly profits were the typical product of interdependence, economists would not be plagued by the wide variations actually observed. A price level allowing all sellers to maximize profits would require, according to Turner, *The*

resulting profit levels may nevertheless be significantly above those which would prevail in a truly competitive atmosphere.[90] Since this kind of communication could not result in efficiency-producing joint action, it clearly runs contrary to the public interest.

The only difference between this activity and other forms of collusive action is that the communication can take place indirectly through the market system itself. Since the effects approximate those which would flow from private agreements in more atomistic industries, it is meaningless to predicate the legality of the resulting market power upon the character of the communicative process itself. Unhappily, by overlooking the inevitability of interdependence, this is precisely what the courts have done in creating such permissive merger law.

It is true that the proscriptions against collusive action embodied in the operative legislation[91] were dependent upon a finding of agreement or arrangement. Hence it might have been argued that since interdependence does not come within the purview of these words, it is improper to disallow a contemplated merger on the grounds that the remaining firms could engage in behavior not itself proscribed. This reasoning, however, neglects the underlying policy articulated in the *Act*. The governing criterion was not how "... a merger trust or monopoly... is likely to operate to the detriment or against the interest of the public..."[92] but whether the public interest would be prejudicially affected. At any rate, a technical argument can be countered with a technical response: it is just as legitimate to include interdependent decision-making under the broad rubric of an "arrangement" as it is to impute a narrow meaning to that word.[93]

No doubt the difficulties stem from the assumption that legal sanctions must necessarily depend upon some form of deviant behavior. Consider the following remarks of the Restrictive Trade

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Definition of Agreement under the Sherman Act: Conscious Parallelism and Refusals to Deal, (1962), 75 Harv. L. Rev. 655, at p. 664, a "...hypothetical case (having) no counterpart in reality." For a theory purporting to account for some of the determinants of the prices actually arrived at through interdependence, see Fellner, *Competition Among the Few,* (1963).

[90] See *supra,* n. 57.

[91] R.S.C. 1952, c. 314 as amended by S.C. 1953-54, c. 51, s. 2. As noted *supra,* p. 493, the current legislation does not require an explicit agreement as a precondition to a finding of collective monopoly power.

[92] *Ibid.,* s. 2 (vi).

[93] For an identical argument applied to the meaning of conspiracy under the *Sherman Act,* see Turner, *op. cit.,* n. 40, at p. 665.

Practices Commission, wherein it was careful to distinguish between price leadership which involved prior communication and that which did not:

> The Commission believes that where a company that is a leader in an industry announces a price increase or a change in terms privately to its competitors, prior to announcing it publicly, and thereafter the leader and its competitors implement the increase or the change, an inference must be drawn that an agreement has been entered into among them.[94]

Keeping in mind that the industry in question was a tight oligopoly sheltered by tariffs ranging from 10 to 35 per cent, it is clear that the privacy of the communication is without significance. The defect, structural in nature, could have been eradicated by a reduction in tariffs, thereby inducing foreign competition. The Commission, however, failed to make any recommendations in this regard, which tends to indicate that the behavioral characterization contaminated its analysis of the substantive nature of the problem.

Similar reasoning was invoked in the *Paper Board Investigation* [95] to uphold a merger, although as a result, the coordination of competitive behavior could be effected in the absence of an overt price agreement:

> There is no evidence, and probably there could be none, that any of those mergers has put the acquiring company in a position to dictate trading practices to others in the industry.[96]

Following the *Breweries* and *Sugar* decisions, the Commission held that the Crown had failed to satisfy the test of monopoly or virtual monopoly power. In so doing, it overlooked the issue of interdependence and, as a result, failed to perceive that the real danger lay in the collective monopoly power of the participating firms.

The Commission should not, however, be too harshly condemned in the light of its recommendation that existing tariffs be removed. Hence, in the last analysis, it did characterize the problem as structural in nature and thus it is difficult to understand why it approved of a merger which could only further debilitate the structure of an industry already seriously in need of alteration. The decision to abide by judicial precedent no doubt accounts for the ultimate holding, but at the same time raises serious questions relating to the present administration of the *Combines Act*. In the writer's view, it is not the Commission's function to act as an additional

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[94] *Pricing Practices in the Pencil Industry*, R.T.P.C. No. 31, Ottawa, 1, at p. 50.

[95] *Report Concerning the Manufacture, Distribution and Sale of Paperboard Shipping Containers and Related Products*, R.T.P.C. No. 19, (1962).

[96] *Ibid.*, at p. 651.

court of first instance, and hence it should consider itself governed by economic principles rather than by legal doctrine. In this way only can it perform its proper role of placing before the courts appropriate theory upon which previous judicial reasoning can be reexamined.[97]

We have briefly referred to an assumption implicit in the Commission's reasoning, particularly in the *Pencil Investigation*,[98] to the effect that legal restrictions upon corporate behavior should in some way be retributive in nature. While this conception of Combines law no doubt results from the philosophy of the Criminal law of which it is a part, a basic difference between the two reveals that the assumption is misplaced: the consequence is of little significance in the evaluation of criminal behavior, whereas public detriment is, or should be, dispositive in assessing the conduct of firms. It follows that the sanction for, rather than the legality of, excessive power should be determined with reference to its cause.[99] Even were it argued (improperly in this writer's view) that some moral or equitable justification is necessary to support this contention, it is readily found in the fact that collusion derived through either conventional agreement or oligopolistic interdependence is merely a rational attempt to maximize profits at the expense of the public. When stated in these terms it becomes clear that the courts should seize upon the wide scope which they have to evaluate the effects of different forms of conduct and, where feasible, levy the appropriate behavioral or structural sanctions.

The salient point is that if any sanction is to be applied to interdependent action, it must attack the structure from which it emanates, because any behavioral penalty or injunctive order would, in the words of one author, "... demand such irrational behavior

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[97] Unfortunately, however, the Director of Investigation and Research seems to allow existing jurisprudence to bear decisive weight in deciding whether to prosecute. See, *Report of the Director*, (1968), at p. 54, where decided cases played an important role in allowing a merger in an industry already dominated by four large companies. See also, *Report of the Director*, (1967), at p. 38, where the Director decided not to apply for a prohibition order because the evidence was inadequate to satisfy the jurisprudential requirement that the already existing monopoly power would thereby be further strengthened.

[98] *Supra*, n. 94.

[99] Monopoly power derived from efficiency is the only exception which comes to mind. In the words of one American judge, "... the *Act* does not mean to condemn the resultant of those very forces which it is its prime object to foster...". See *United States* v. *Aluminum Co. of America*, *supra*, n. 45, at p. 430.

that full compliance would be virtually impossible." [100] Appropriate sanctions must be expedient, and a court order which purports to force a defendant to close his eyes to public knowledge which would enable him to maximize profits could hardly be so described.

The foregoing does not render insignificant the factual issue as to the existence of a private agreement. Where a court concludes from admissions, seized documents, inconsistencies in testimony, or coordination which has eliminated the vagaries necessarily incident to interdependence that such an agreement was in fact constituted, it is justified in imposing a behavioral remedy upon the premise that the structural environment was sufficiently atomistic to preclude the collusion in the absence of specific agreements. The courts should not, however, in the interest of expediency, generate *per se* rules to the effect that proof of such agreement irrebuttably indicates a sufficiently competitive environment. Private agreement may supplement interdependent action and hence structural remedies may be required in addition to behavioral penalties.

It is important to note that economic theory does not advocate the *per se* dissolution of oligopoly power. Thus, the small size of a market may in itself militate against structural alterations in view of the substantial inefficiencies which might result. In addition, the fact that in one-half of Canadian manufacturing industries the largest nine firms account for eighty per cent of employment [101] indicates that a widespread attack upon interdependence would entail such a substantial restructuring of the economy as to be politically and socially unworkable. Clearly, the general policy solution lies in prevention rather than cure.[102] Perhaps it would be helpful to adopt and extend to certain classes of mergers the British requirement that newpaper mergers be submitted for prior approval.[103] Certainly greater government commitment to the anti-

[100] Turner, *op. cit.*, n. 40, at p. 669.

[101] Rosenbluth, *Concentration in Canadian Manufacturing Industries*, (1957), at p. 22.

[102] The Director has himself expressed reservations with respect to the remedy of dissolution. See *Report of the Director*, (1958), at pp. 21-23; see also *Report Concerning the Manufacture, Distribution and Sale of Paperboard Shipping Containers and Related Products, supra*, n. 95, at pp. 657-658.

[103] *Monopolies and Mergers Act, 1965*, c. 50 s. 8. Certain commentators have suggested that a rebuttable presumption of illegality should apply to mergers involving companies who together control twenty per cent of output. See Kaysen and Turner, *op. cit.*, n. 3, at p. 133; Stigler, *Mergers and Preventive Antitrust Policy*, (1955), 104 U. Penn. L. Rev. 176, at p. 182.

merger effort is required.[104] While the writer does not endorse the American judicial doctrine of condemning oligopoly in its incipiency because the very word implies that the problem has not yet arrived,[105] administrative and judicial endorsement of mergers which reduce the number of competing firms from six to five, as in the *Sugar* decision, clearly does injustice to the *Act*.[106] Indeed, the current inertia makes one seriously wonder whether Canadian anti-merger law was intended to be taken seriously in the first place.

The Conflict between Market Power and Efficiency Considerations

We noted previously that by importing the concept of market power into the analytic process, the courts have avoided the rigidity inherent in a *per se* rule of illegality based solely upon a reduction in the absolute number of independent business entities. In so doing however, they have with but one exception [107] failed to give even passing notice to efficiency considerations. The effect of this omission is that one presumptive rule, based upon excessive market

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104 In the fiscal year 1959-1960, total government expenditures under the *Combines Investigation Act* amounted to half a million dollars, or less than one-quarter the amount allocated to the Canadian Government Travels Bureau. See Rosenbluth and Thornburn, *Canadian Anti-Combines Administration 1952-1960*, (1960), at p. 44.

105 Keeping in mind Bain's findings, *supra*, n. 51, it is clear that the American Supreme Court has condemned a number of mergers well before the critical point has been reached. In *United States* v. *Pabst Brewing Co.*, 384 U.S. 546, at p. 551 (1966), the ten leading brewers accounted for 52.6 per cent of national sales; in *United States* v. *Von's Grocery Co.*, *supra*, n. 39, the eight largest firms collectively were responsible for 40.9 per cent of sales; in *Brown Shoe* v. *United State*, *supra*, n. 35, at p. 521, the largest twenty-four shoe manufacturers accounted for only thirty-five per cent of the nation's output. Even those who have traditionally supported the Court's incipiency concept as a general policy rule have characterized the latter decision as "unfortunate". See Blake and Jones, *In Defense of Antitrust*, (1965), 65 Colum. L. Rev. 377, at p. 399. For doctrine criticizing the rigid antimerger judicial philosophy, see the authorities cited *supra*, n. 30. See also Bork and Bowman, *The Crisis in Antitrust*, (1965), 65 Colum. L. Rev. 363, at p. 368.

106 See also *Report of the Director*, *supra*, n. 96, at p. 49 where the Director endorsed the merger creating a firm which would account for sixty per cent of the relevant market on the grounds that entry barriers were low. As noted previously, *supra*, n. 24, relatively free entry, does not ensure that dominant firms in highly concentrated industries will not earn excessive profits on a short term basis. The inevitability of imperfect knowledge renders perfectly free entry a fictitious concept inapplicable to the real world.

107 *R.* v. *Canadian Coat and Apron Supply Ltd. et al.*, *supra*, n. 32, at p. 74.

power, has merely been substituted for another. It is unnecessary to speculate why the law has assumed its current unidimensional form — the fact that judicial analysis has for the most part been concerned with unequivocal price-fixing agreements no doubt forms part of the answer. Suffice it to say that if Combines policy is to be more reality than myth, both prosecutor and judge will have to shed their garb as mere finders of facts and deal directly with the conflict between "bigness" and efficiency.

The methodological difficulties which afflict efforts to measure cost savings with any degree of precision clearly call for the application of presumptive rules to the fact-finding process. In the writer's view, the only rationally justifiable rule would be one which presumes efficiencies to exist where the integration fails to yield the market power necessary to restrict output and raise prices.[108] On the premise that businessmen do not act arbitrarily and without motive, the absence of such power in itself warrants the finding that efficiencies will enure to the firms in question. The same reasoning does not apply where, incident to alleged savings, there is an undesirable degree of market power. In these circumstances, the underlying assumption of rational business behavior does not justify the conclusion that cost savings will result. The generation of market power may well have provided the underlying motivation and hence the courts must look for independent evidence that the alleged efficiencies actually exist, and then weigh these against the prejudicial effects of the resulting market power. Since a proper resolution of the conflict must ultimately be predicated upon economic, social, and political considerations, the writer will deal with each in turn.

a. *Economic Considerations*

In 1959, Harberger [109] reported the results of a study which have since been confirmed as applicable to Canada,[110] that the total welfare loss resulting from misallocation of resources incident to

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[108] See Bork, *op. cit.*, n. 63, at p. 391. The rule suggested runs contrary to the dicta of the majority of the Supreme Court who, as we have seen, have refused to consider the question of market power. Lower courts, however, seem to be on the verge of grappling with the issues of both market power and efficiencies, and hence the presumptive rule herein advocated could simplify their task, while at the same time avoiding the rigidity emanating from the reasoning of the Supreme Court.

[109] Harberger, *Using the Resources at Hand More Effectively*, (1959), Am. Econ. Rev. Proc. 134.

[110] Shwartzman, *The Burden of Monopoly*, (1960), 68 Jour. Pol. Econ. 627.

market power in the American economy amounted to approximately one-tenth of the national income, or to just over two dollars *per capita*. When this virtually insignificant amount is compared to the substantial losses resulting from technical inefficiencies, it becomes clear that economic theory would unhesitatingly reject a *per se* rule which refuses to consider cost savings as a factor which might legalize undesirable market power. A recent report of the Economic Council of Canada[111] estimating that in 1963 "... the net value added per employee was about 23 per cent lower in Canada than in the United States..."[112] clearly indicates that certain forms of horizontal coordination would have a net effect of increasing the collective welfare of Canadian society.

It is true that competitive forces will not coerce firms possessing market power to redistribute savings to the consumer. Nevertheless, the primary question for the purposes of Combines law lies not in identifying the persons to whom the benefit enures, but rather in the determination of whether there is any benefit at all. The former issue relates to problems of income distribution and transfer payments, and while effective tax policies would be hard pressed to compensate for allocative inefficiencies, they might nevertheless be geared to more effectively control the manner in which powerful corporations choose to dispose of their excess profits. By way of example, it has long been recognized that large advertising expenditures are wasteful to the extent that they cease to have additional informational value,[113] and hence public authorities would be justified in reconsidering the legitimacy of treating these sums as valid business expenses.

The latter question, which should be of paramount importance, can only be properly answered by comparing, on a case by case basis, the allocative inefficiencies incident to market power with the technical savings derived.[114] This formula does not imply that the courts should resolve all combines problems by having recourse to the graphs of the economist. It merely indicates an analytical

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[111] Economic Council of Canada, *The Canadian Economy From the 1960's to the 1970's*, Queen's Printer, Ottawa, 1967.

[112] *Ibid.*, at p. 156.

[113] See Bain, *op. cit.*, n. 2, at p. 389. In addition, high expenditures tailored to create high consumer dependence can only have the effect of increasing allocative inefficiencies which may already be the consequence of structural deficiencies.

[114] For a model purporting to deal with this comparison, and a discussion of its implications for American anti-trust policy, see Williamson, *Economies as an Antitrust Defense, The Welfare Tradeoffs*, (1968), 58 Amer. Econ. Rev. 18.

approach which is useful for identifying the different policy considerations. It has the additional advantage of simplifying the problem where technical savings are substantial, because in these circumstances they would invariably exceed the losses resulting from allocative inefficiency, and hence the latter need not be considered at all.[115]

The problem still remains, of course, for the courts to compare the relative weights of the competing considerations. While any estimates will of necessity be crude and imprecise, the method seems justified by the fact that it will yield welfare effects preferable to those which would result where efficiencies are deemed to be irrelevant. This contention is particularly applicable to the Canadian setting where, in addition to the fact that the potential for saving is exceedingly large, existing inefficiencies can to a great extent be attributed to definite causes, and hence in specific cases efficiency-producing integration may be easily identified.

To begin with some well-documented evidence, most cost savings will and do occur at the plant level, rather than at the firm level.[116] In addition, while the average size of the Canadian manufacturing plant is actually larger than its American counterpart,[117] a number of studies indicate that a primary cause of inefficiency is the lack of specialization amongst the producing firms.[118] In other words, although the size of a plant may be large, the number of products which each produces precludes the generation of substantial scale economies. As a result, output is not restricted but costs remain high.

It is difficult to say why Canadian industry has failed to rationalize in view of the lax enforcement of Combines policy. Certain authors contend that the comparative smallness of the production run may be attributed to the control exercised by a few American-

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[115] While Kaysen and Turner, *op. cit.*, n. 3 have not adopted this methodology, they agree, at p. 45, that "...in so far as reduction of market power is incompatible with efficiency and progressiveness, we subordinate the first goal to the second." Bork, *op. cit.*, n. 63, at p. 390 seems to agree that the conflict between power and efficiency should be resolved in favor of a defendant, "...since we have no way of proving whether its interference (i.e. market power) will have the net effect of aiding or injuring consumers." Phillips, *Canadian Combines Policy — The Matter of Mergers*, (1964), 42 Can. Bar Rev. 78, at p. 96 takes the opposite view, contending that the courts should be primarily concerned with the question of market power.

[116] See Bain, *op. cit.*, n. 2, at p. 114.

[117] Economic Council of Canada, *op. cit.*, n. 111, at p. 153.

[118] *Id.*; see also Barber, *Canadian Tariff Policy*, (1955), 21 C.J.E.P.S. 513, at p. 517.

owned firms.[119] Others speculate that tariffs afford the necessary protection for inefficiency, thereby reducing the initiative to lower costs.[120] For the purposes of this discussion it is important only to note that the courts can, and should, take judicial notice of the more overt efficiency-producing behavior.

In the interests of expediency, a reasonable starting proposition might entail the *per se* exclusion of alleged efficiencies resulting from interfirm integration as a defense to substantial market power, particularly where the defendant contemplates no alterations at the plant level itself. Where, however, the substantial reorganization of productive operations constitutes one of the central features of the arrangement challenged, the greater potential for cost saving would render the absence of precise measuring instruments less important than might otherwise be the case. Judicial notice of alleged efficiencies would in such cases find its justification in the greater probability that a proper assessment can be effected.

In addition, the courts would do well to regulate the means through which integration is actually constituted. By way of example, structural inadequacies merely calling for increased industrial specialization could be remedied through short-term horizontal agreement rather than merger, in order to preserve whatever potential competition each of the contracting firms might offer at a subsequent date. The advantages of integration by contract in these circumstances clearly illuminate the difficulties of applying the *per se* rule articulated by the Supreme Court to the Canadian economy.

The foregoing does not imply that the courts will always be able to identify efficiencies without difficulty: it merely provides that they should carefully consider a defense based upon cost savings consistent with the organizational characteristics of the relevant industry. The relevant policy conclusion is that complex economic issues cannot be rendered less difficult by overlooking pertinent and identifiable facts which reveal the very complexity in question. An expedient administration of the law is not justified where it necessarily entails an improper application of the economic theory which it is designed to reflect.

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119 See Skeoch, *International Aspects of Antitrust,* U.S. Senate Subcommittee on Antitrust and Monopoly of the Committee of the Judiciary, April 29, 1966, 89 Congress, vol. 9, at p. 233.

120 English, *Industrial Structure in Canada's International Competitive Position,* Montreal: Private Planning Association of Canada, 1964, at p. 40; Barber, *op. cit.,* n. 118, at pp. 517 and 525.

b. *Social Considerations*

The consequences of undue market power are not confined to the economic arena, for the hardship resulting from an inadequate production of goods does not distribute itself randomly: since price is the ultimate regulator, the relatively poorer segment of society is systematically deprived. Combines policy is not, however, in this writer's view, an appropriate instrument to achieve a more equitable distribution, because the very process of reducing market power without regard to efficiencies will entail higher costs, and hence higher prices. Attempts to apply the law with this end in view must therefore be to some extent self-defeating. A more effective policy solution compatible with the goals of maximizing society's resources lies in a system of transfer payments which would enable the deprived to secure some of the goods which they require. In this regard, a recent Royal Commission has criticized the current tax structure on the grounds that "... the taxes earmarked for transfer payments are probably at least proportionate and possibly regressive, depending on one's assumptions regarding shifting." [121] The proper theoretical approach thus seems unclouded, but the ultimate political solution must necessarily be less so. Unquestionably, it is wrong for the courts to import social values which, although legitimate in another setting, would have the effect of rendering the *Combines Act* incompatible with a truly productive economy. They would commit a serious error by improperly applying one public policy in order to counteract government inertia with respect to another.

c. *Political Considerations*

In view of the extensive literature already existing it would be redundant for the writer to engage in a detailed discussion of the political consequences of undue market power. Nevertheless, a brief review of some recent studies and an analysis of their implications seems justified in the light of their relevance to Combines policy.

The central problem with which most investigators have been concerned is the discretionary power of the "economic elite" [122] to dispose of the earnings of the corporations which they represent.

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[121] *Report of the Royal Commission on Taxation*, Queen's Printer, Ottawa, 1966, vol. 2, at p. 264.

[122] This was a term first coined by Porter in 1956 to depict the 907 executives of 183 dominant Canadian corporations. See Porter, *The Concentration of Economic Power and The Economic Elite in Canada*, (1956), 22 C.J.E.P.S. 199.

Most writers agree that it is the irresponsible power of a small group of self-sustaining corporate decision-makers which is to be attacked, regardless of how the power is actually used,[123] but there is less unanimity of opinion with regard to the appropriate remedy. Certain American authorities contend that antitrust policy is the appropriate medium,[124] while others advocate institutional changes in the internal structure of the corporation itself.[125]

Keeping in mind the unrealized potential for efficiencies in Canadian industry, this writer would adopt the institutional approach if discretionary power were typically the consequence of intra-industry market power. Reported studies do not, however, indicate that such is actually the case. Thus, in 1956, Porter found that 183 "dominant corporations"

> ...were responsible for 40 to 50 per cent of the gross value of production in manufacturing, 63 per cent of the total value of metal production, 90 per cent of railway transportation, 88 per cent of the gross earnings of telegraph and cable services, 82 per cent of the total revenue of Canadian air carriers, 83 per cent of telephone revenues, and 60 to 70 per cent of the hydro electricity produced by privately-owned companies, as well as a large but undetermined proportion of other industries such as industrial minerals, fuels, water transportation, and retail distribution.[126]

It thus seems clear that the corporate conglomerate is largely responsible for the unchecked economic and political power which resides in the 907 persons who hold directorships in these dominant business entities. Porter's study also revealed that interlocking directorships exist between 170 of the major companies. Assuming that there are many Canadians whose resources for effective corporate leadership have gone untapped, it follows that interlocking directorships are without economic justification, and hence warrant

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123 See by way of example Friedman, "Monopoly and the Social Responsibility of Business and Labor", in Mansfield, *Monopoly Power and Economic Performance,* at p. 105 (1964, 2nd ed.); Lewis, "The Social Responsibility of Big Business", in Mansfield, *Monopoly Power and Economic Performance,* (1st ed., 1960), at p. 146; Hacker, *When Big Business Makes Gifts (Tax Deductible),* New York Times Magazine, Nov. 12, 1967.

124 See Kaysen, "The Corporation: How Much Power? What Scope?" in Mason, *The Corporation in Modern Society,* (1959), at p. 212.

125 See Chayes, "The Modern Corporation and the Rule of Law", in Mason, *id.,* at p. 264; Brewster, "The Corporation and Economic Federalism", in Mason, *id.,* at p. 290.

126 Porter, *The Vertical Mosaic,* (1965), at p. 233. A subsequent study which Porter cites by Ashley reveals that even greater concentrations of power are vested in Canadian banks, which number less than 40. See Ashley, *Concentration of Economic Power,* (1967), 33 C.J.E.P.S. 105.

legislative prohibition, at least where they provide formal channels of communication between very large enterprises.

That aside, contemporary structural changes in Canadian industry justify an economic policy which takes a hard line against future conglomerate mergers, given the premise that "bigness", and the concentrated power that comes with it, is inherently undesirable. Thus, only five per cent of the consolidations which took place between 1900 and 1948 were of the conglomerate variety,[127] whereas "... most of the dramatic economic development of the 1950's and early 1960's was undertaken by the dominant corporations." [128] The effect of these mergers was to reduce the number of dominant firms to 163.[129]

Since the ultimate effect of the further rationalization of Canadian industry will take the form of increased concentration in an already highly concentrated economy, a sound economic policy should prevent further integration unless clearly accompanied by cost savings. While those conglomerates possessing important horizontal elements may well involve substantial economies, few efficiencies will typically be incidental to mergers between totally unrelated firms,[130] and hence judicial attemps to make accurate assessments with existing techniques must be correspondingly speculative. Accordingly, the courts should view such integration with a suspicious eye, particularly where it involves a firm whose absolute size is large.

The foregoing is of course predicated upon a reversal of the *Breweries* and *Sugar* decisions, because a "pure" conglomerate could not, by definition, yield the judicially defined concept of monopoly — that is, the virtual elimination of competition. As we have seen, however, a process of reassessment must necessarily depend upon greater administrative commitment to the anti-merger cause, and hence the underlying determinant of ultimate policy may well, in the last analysis, be political rather than legal [131] or

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[127] Weldon, "Consolidations in Canadian Industry, 1900-1948", in Skeoch, *Restrictive Trade Practices in Canada,* (1966), 228, at p. 260.

[128] Porter, *op. cit.,* n. 126, at p. 242.

[129] *Id.,* at p. 243.

[130] See Blair, *The Conglomerate Merger in Economics and Law,* 46 Geo. L.J. 672, at p. 679.

[131] For a review of the American law with regard to conglomerate mergers, and an analysis of the anticompetitive consequences which they may have, see Turner, *Conglomerate Mergers and Section 7 of the Clayton Act,* (1965), 78 Yale L. Rev. 1313. In Canada as well as in the United States, it is the lessening of competition which in the last analysis must be present in order to render a merger unlawful.

economic. In view of the current prosecutorial inertia in the face of the highly concentrated economic and political power which exists in Canada today, and which no doubt will significantly determine future government action, the writer has serious doubts as to whether the necessary efforts to disseminate that power will be forthcoming.

Should this pessimism prove to be unjustified, the Restrictive Trade Practices Commission would assume far more importance than it has today. In this regard, Canadian administrators could well profit from the American experience, where overzealous enforcement agencies coupled with a judiciary generally hostile to big business has rendered the former both prosecutor and judge, thereby increasing the danger that extraneous political considerations might contaminate substantive questions of law and economic policy.[132] The Commission should attempt to avert these difficulties by safeguarding its integrity as an essentially judicial or quasi-judicial body which impartially arbitrates disputes between the Director and private litigants. By way of example, judicial dogma which preaches the sanctity of small business may represent a "victory" for the Director, but it should have no emotive content for the Commission which, always maintaining its character as an independent tribunal, should continuously expose current economic theory to judicial examination.

In the last analysis, however, the law is what the courts say it is, and hence perhaps the clearest lesson which can be drawn from the American experience is the difficulty which emerges from rigid thinking which fails to reflect subtle, but important differences between different circumstances. Someone has to apply the law, whatever it be, to specific cases, and hence the importance of extra-legal considerations must vary inversely with the extent to which the applicable rule conforms to the economic environment. Thus the courts should proceed slowly, all the while ensuring that presumptive rules generated in the name of expediency do not merely have the effect of creating bad law, while simultaneously shifting the burden of administering that law from one public body to another.

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[132] See, in this regard, Cook, *Merger Law and Big Business: A Look Ahead*, (1965), 40 N.Y.U.L. Rev. 710, at p. 717.

Conclusion

The few identifiable threads which run through the fabric of Canadian Combines law point to an administrative laxity on the one hand, and a varied judicial response on the other. The pronounced judicial tendency to perceive economic problems in an exclusively behavioral context has induced the courts to formulate radically different standards for integration constituted through merger, and that effected by agreement. Principles properly applicable to overt price-fixing arrangements which typically form the prosecutorial object have been extended to the more subtle cases as well, without regard to the underlying policy considerations.

Domestic political considerations no doubt account in part for government inertia, but it is important not to understate the relevance of competing policies of international trade and tariff protection, coupled with the limitations flowing from relatively small markets. In this regard, Canadian policy-makers have chosen to further the public interest primarily by improving the country's international position, assuring full employment and the integrity of the dollar, and inducing foreign investment in order to secure goods and services which might otherwise be unavailable. The protection of the consumer at home through the medium of a rigorous anti-combines policy has clearly been deemed a policy of only secondary importance.

These considerations do not, however, account for the unjustifiable mergers which have over the last decade gone without reproach. A peculiar administrative willingness to accept two lower court decisions as the binding and supreme law of the land seems to this writer at least to be a sign that pressure groups are significantly affecting the prosecutorial policies of the enforcement agency itself.