

## Horizontal Agreements as Reviewable Practices<sup>1</sup>

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### *Introduction*

The purpose of this paper is to discuss the proposals to amend the *Competition Act* to provide for review of potentially anti-competitive horizontal agreements (agreements between or among competitors) by the Competition Tribunal. These proposals are usually made in conjunction with proposals to amend Section 45 to eliminate the undue-ness requirement, that is, to make an agreement to lessen or prevent competition a *per se* criminal offence. The idea is that the *per se* criminal prohibition would be applied only to so-called naked restraints, that is, “hard core cartel” agreements with no other apparent purpose than to fix prices or output or allocate customers or markets. All other agreements between competitors would be reviewable by the Competition Tribunal on application by the Commissioner of Competition. This has become known as the two-track approach.

Most of the discussion has been about the criminal track. Much of this discussion has centred on: (1) whether Section 45 has been as ineffective as proponents of the amendments allege; (2) whether there exists a meaningful class of agreements the anti-competitiveness of which can be inferred without any reference to the existence of market power and; (3) whether attempts to avoid over-inclusiveness by clever drafting are merely clumsier versions of undue-ness.<sup>2</sup>

The proposed civil-track reviewable practice has received much less discussion. Perhaps this is because the prospect of being obliged to defend oneself in a civil proceeding before the Competition Tribunal is less daunting than the prospect of being obliged to defend oneself in a criminal court. The lack of discussion of proposals for civil review of horizontal restraints is unfortunate. A badly-conceived law can have serious adverse economic consequences regardless of whether it is criminal or civil. Indiscriminate application of notification requirements and possible civil review to horizontal agreements could be very costly in terms of both reduced productivity and economic growth foregone. It is important to understand what it is that should be challenged but is not now being challenged and what it is that might also get caught in the net.

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<sup>2</sup>On points (1) and (2), see Facey and Assaf (2001-2002), on point (3), see Graham (2002).

Existing discussions of the civil track are very vague in this regard.

The proposal for civil review of potentially anti-competitive horizontal agreements appears to have been motivated by the following concerns:

(1) *The symmetry argument*: Mergers, acquisitions, specialization agreements and R&D joint ventures are reviewable by the Competition Tribunal. Even though they are similar to these practices in many respects, agreements involving non-naked or ancillary horizontal restraints are not reviewable practices under the *Competition Act*. If they are subject to judicial scrutiny at all, it is as possible criminal offences. Criminal courts are not regarded as suitable for “full blown” rule of reason analysis and the jurisprudence under S.45 would not allow for one in any event.

(2) *The chilling effect argument*: The possibility exists that horizontal agreements which are not intended principally to lessen competition could, nevertheless, be the subject of criminal prosecution. The *Strategic Alliances Bulletin* emphasizes that even though the Competition Bureau has confined its S.45 prosecutions to what it regards as “hard core cartels,” it could also prosecute “soft core” cartels under S. 45.<sup>3</sup> Kennish and Ross (1997) argue that fear of criminal prosecution may deter firms from entering into pro-competitive horizontal arrangements and may also induce them to merge when an agreement would be more efficient. This is also known as the “chilling effect” argument. This is also a Type I error argument of sorts. That is, the perceived probability of incorrectly subjecting an innocent horizontal agreement to criminal prosecution is too high under the current law.

(3) *The gap in jurisprudence argument*: The high standard of proof required under criminal law in general and under Section 45 in particular may result in the confinement of prosecutions to horizontal agreements regarded by enforcement authorities as obviously and egregiously anti-competitive and in a corresponding unwillingness to challenge some horizontal agreements that are anti-competitive but are less obviously so. Hughes, Sanderson and Trebilcock (2000) put this succinctly, arguing that there has been no judicial scrutiny in Canada of agreements involving non-naked (ancillary) horizontal restraints where the parties involved have market power. Chandler and Jackson (2000) confirm that prosecutions under Section 45 have been confined to hard-core cartel cases. This implies that there may be anti-competitive horizontal agreements involving ancillary or non-naked restraints that are going unchallenged in Canada. This is a Type II error argument of sorts. That is, the probability of incorrectly acquitting or declining to challenge non-naked horizontal restraints that lessen competition unduly is too high under the current law.

(4) *The institutional competence argument*: Criminal law is a blunt instrument and should be employed only when absolutely necessary. The Competition Tribunal has or should have the expertise to evaluate arguments that impugned horizontal restraints are pro-competitive or to balance pro-competitive and anti-competitive effects or to assess arguments that an anti-competitive agreement increases the wealth of the economy as a whole. Criminal courts do not

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<sup>3</sup> Director Of Investigation and Research (1995).

have this expertise.

The implications of these arguments are that: (1) pro-competitive horizontal agreements have been deterred by the fear of criminal prosecution itself, by the recognition that criminal courts are unlikely to appreciate and give appropriate weight to arguments that an agreement is pro-competitive and by the recognition that existing jurisprudence under S.45 would not allow for consideration of efficiencies flowing from an otherwise anti-competitive agreement; (2) for the same reasons, less efficient mergers or acquisitions have been substituted for horizontal contractual agreements and; (3) notwithstanding point (1), anti-competitive horizontal agreements involving non-naked or ancillary restraints are entered into without fear that they will result in prosecution, let alone conviction.

An empirical implication of these arguments is that there should be a lower incidence of pro-competitive horizontal agreements and a greater incidence of agreements involving anti-competitive ancillary horizontal restraints in Canada than in the U.S. where the law provides for a rule of reason review under civil law. The magnitude of the implied distortion of business decisions and market institutions and outcomes in Canada is not known. It may not be knowable. In any event, it has not been investigated. What kind of arrangements would the Commissioner challenge before the Tribunal? Are these arrangements simply going unscrutinised at the moment or are they subject to some other form of regulatory oversight or compliance program?

#### *Bill C-472*

Bill C-472 was a private member's bill given first reading in the House of Commons on April 6, 2000. It died on the Order Paper on October 22, 2000. It proposed to give the Commissioner of Competition the power to seek an order from the Competition Tribunal prohibiting agreements between competitors which substantially prevent or lessen competition. This provision was to be embodied in a new section of the *Competition Act*, Section 79.1, immediately following Section 79, which deals with abuse of dominance. It was worded as follows:

- 79.1** (1) Where, on application by the Commissioner, the Tribunal finds that
- (a) a person has entered into an agreement or arrangement with one or more competitors of the person with respect to the production, supply or acquisition of a product; and
  - (b) the agreement or arrangement has had, is having or is likely to have the effect of preventing or lessening competition substantially in the market affected by the agreement or arrangement;

the Tribunal may make an order directed against any person who is a participant in the agreement or arrangement,

- (c) prohibiting the person from carrying into effect or continuing the agreement or arrangement or part of it;
- (d) in addition to or in lieu of making an order under paragraph (c), ordering the person to take

such actions as the Tribunal considers reasonable and necessary to overcome any of the effects of the agreement or arrangement or to restore competition in the market including, without limitation, directing modifications to the agreement or arrangement.

Bill C-472 also provided an exception for agreements, the duration of which is limited to the reasonable time needed to facilitate the entry of a new product, or a new supplier of a product, into a market.

Section 79.2 of Bill C-472 provided for the expeditious issuance of clearance certificates by the Commissioner which would preclude any challenge to the agreement covered by the certificate under either Section 45 or Section 79.1 for a period of three years or less unless circumstances differ materially from those on which the decision to issue the certificate was based.

The major comments on the amendments to Section 79 proposed in C-472 were that: (1) there was no provision for the explicit consideration of any efficiencies resulting from an agreement; (2) if the numbering of the section was meant to imply that horizontal agreements would be treated as another form of abuse of dominance, this approach would be incorrect (this is discussed below); (3) the horizontal restraints section could replace either of or both Section 86 (on specialization agreements) and Section 95 (on R&D joint ventures) of the *Competition Act* which have not been used and which would become redundant if horizontal agreements in general became reviewable; (4) the provision for pre-clearance would probably not be helpful given the Bureau's present practice of granting them in merger cases only when there are no competition concerns; (5) the three year time limit on pre-clearances is inconsistent with the provision for pre-clearance of mergers and would eliminate the potential of pre-clearance "for the vast majority of persons"<sup>4</sup>and; (6) there should be a deadline for the granting of clearance certificates.

### *The Industry Committee*

In its May 2002 report, A Plan to Modernize Canada's Competition Regime, the House of Commons Standing Committee on Industry, Science and Technology recommended that the *Competition Act* be amended to make horizontal agreements reviewable on the same terms (Sections 92-96) as mergers:<sup>5</sup>

Nevertheless, a strategic alliance should be afforded a similar review to that of a merger. The Committee, therefore, recommends:

That the Government of Canada amend the civilly reviewable section of the *Competition Act* to add a new strategic alliance section for the review of a horizontal agreement between competitors. Such a section should, as much as possible, afford the same treatment as the

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<sup>4</sup>National Competition Law Section, Canadian Bar Association (2000) pp.52-3.

<sup>5</sup><http://www.parl.gc.ca/InfoComDoc/37/1/INST/Studies/Reports/indurp06-e.htm>

merger review provisions (sections 92 through 96), and should authorize the Commissioner of Competition to apply to the Competition Tribunal with respect to such agreements that have or are likely to have the effect of “preventing or lessening competition substantially in a market.” (pp.63-4)

The Committee made it clear that the abuse of dominance section of the Act (S.79) is unsuitable for the review of horizontal agreements. S.79 is designed to deal with the abuse of dominance and the abuse of joint dominance. Abuse of dominance is generally defined as involving exclusionary conduct. Specifically, S.79 is not intended to prevent a dominant firm from restricting output and raising prices. It is intended to prevent dominant incumbents from engaging in practices that sustain dominance by impeding the emergence of new competition. In contrast, the purpose of Section 45 and any civil equivalent is to prevent competitors from combining in order to raise prices and earn excess profits. For this reason, Section 79 is not the appropriate repository for a civil horizontal agreements provision.

The Committee recommended that the new reviewable practice be explicitly confined to agreements between competitors or potential competitors that are likely to prevent or lessen competition substantially in a market, that is, to horizontal agreements. Vertical agreements should be explicitly exempt because they are covered under S.77, S.79 and S.61. Others have suggested that the application of civil review be limited to cases in which the parties are competitors or potential competitors in the market to which the agreement applies. Presumably, that would be the first question that would be asked in a rule of reason assessment.

The Committee recommended that the Commissioner be authorized to issue pre-clearance certificates as is presently the case with mergers if he is satisfied that the agreement, as proposed and implemented, does not substantially lessen competition or pose a threat under Section 45 or under the newly proposed civil track. The Committee appears to be recommending several levels of clearance. One level would absolve the parties from criminal liability. Another would absolve them from both civil and criminal liability.

There are good reasons for the separation of the criminal and civil pre-clearance procedures and criteria. There is a more persuasive case for speed, flexibility and simplicity on the civil side (see below). The Committee leaves open the possibility that a pre-clearance certificate might exempt an agreement indefinitely from any action by the Commissioner barring a material change in circumstances. This would be preferable to a limited time exemption. The Committee also suggests that a certificate be deemed to have been issued if the Commissioner does not reach a decision within a reasonable period of time.

The Committee also recommended that, in the event that the Commissioner refuses to grant a pre-clearance certificate, the parties be granted standing to obtain one from the Tribunal. Presumably this applies only to an exemption from a civil track challenge by the Commissioner. It is not clear how this process would differ from a situation in which the Commissioner sought a prohibition order from the Tribunal.

The Committee considered but did not recommend the award of damages to victims of agreements found by the Tribunal to lessen competition substantially. Nor did the Committee recommend administrative penalties (fines). There are troublesome aspects to a policy of levying fines and awarding damages for engaging in business practices that are not known to be anti-social until there has been a full-blown *ex post* rule of reason analysis.<sup>6</sup> While it may not be necessary to do so, it is not apparent how practices requiring full-blown rule of reason analysis could satisfy a objective intent requirement. At the same time, however, some form of damage award, symmetrically applied might reduce the incentive of either the respondent or the Commissioner to draw out proceedings or threaten to do so.

In sum, the Industry Committee's report recommended that the proposed civil review of horizontal agreements be as similar as possible to the existing merger provisions of the *Competition Act*. This includes Section 93 which would require the Tribunal to consider the availability of close substitutes, barriers to entry, foreign competition, the extent of competition remaining, innovation and change in the market and other relevant factors in determining whether the lessening of competition resulting from a horizontal agreement would be substantial. It also includes Section 96 which, according to current interpretations, would allow an anti-competitive agreement if it resulted in large enough cost-savings. The Committee also made it clear that while the merger provisions of the *Act* cover horizontal, vertical and conglomerate mergers, the proposed reviewable practice would be confined to agreements between competitors or potential competitors.

### *Strategic Alliances*<sup>7</sup>

In its report, the Industry Committee makes repeated use of the term "strategic alliances" although it appears to be referring to all horizontal agreements. Perhaps this is merely in keeping with its modernization theme. If the Committee is arguing that strategic alliances should be the subject of more intensive antitrust scrutiny, however, it is making a serious mistake.

It is important to understand that strategic alliances as commonly defined, constitute a small subset of horizontal agreements. A strategic alliance can be defined simply as the realization of synergies by contract. The realization of synergies implies that the parties in the alliance possess complementary assets, frequently intangible assets.

A more traditional but similar definition of strategic alliances is given by Khemani and Waverman (1997):

..a form of inter-firm agreements or arrangements between independent firms which

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<sup>6</sup>Hughes, Sanderson and Trebilcock (2000) argue in favour of private actions before the Competition Tribunal for damages resulting from "soft-core" horizontal agreements.

<sup>7</sup>For a more detailed discussion, see McFetridge (1999).

involve knowledge production or sharing activities aimed at developing new products or processes and new forms of production. In this regard, the alliance may entail exchange of R&D and or transfer of various [types of] information.<sup>8</sup>

Strategic alliances may be defined in different terms but there is some consensus regarding their common characteristics. They are arrangements between independent firms (i.e. firms that are not jointly controlled). They are entered into for the purpose of new product, process or market development. They involve the exchange of complementary intangible assets. Intangible assets are information in various forms including tacit and codified knowledge and reputation.

Strategic alliances generally involve reciprocal exchange or swaps. There are several reasons for adopting this type of arrangement. It reduces the need to price the assets involved. Instead, they are traded for something that is perceived to be of equivalent value. This facilitates trade in the core assets of a firm. Core assets are central to a firm's market identity or competitiveness and, as a consequence, are especially difficult to price.

Reciprocity reduces the considerable monitoring and enforcement costs normally associated with transactions in information. Each party reveals something of roughly equal value to the other. The threat of the loss of reciprocal benefits reduces the incentive for opportunistic behaviour.(Williamson, 1983) Each party in an alliance can credibly threaten to punish a lack of cooperation by the other party with a reduction in its own contribution. An important virtue of strategic alliances is that they avoid the detailed specification of obligations, procedures and limitations.

A study by Magun (1996) provides some information on the nature and objectives of strategic alliances entered into by Canadian firms. Magun finds that the most important motive for entering a strategic alliance is to gain access to new markets, often foreign markets.<sup>9</sup> Consistent with this is the finding by Magun that distributors are the most common type of partner in a strategic alliance (35 percent of all alliances). Thus, the most frequently observed strategic alliances in Canada are vertical and market development oriented.

Other motives for strategic alliances (in order of importance) include: gaining access to new technologies or resources; reducing financial risks; integrating markets and technologies; speeding new product development; reducing R&D risks or coping with escalating R&D and technology costs and; attaining cost competitiveness. The importance of knowledge acquisition as a motive for entering a strategic alliance is apparent from this list.

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<sup>8</sup>This reference is to page 4 of an earlier (1992) mimeographed version of their paper.

<sup>9</sup>Magun finds that 63 percent of the alliances in which Canadian firms are involved are with foreign firms (p.22).

Other types of partners in strategic alliances include competitors (20 percent of alliances) and suppliers (13 percent of alliances). The remaining 32 percent of alliances are with firms that are neither competitors nor distributors nor suppliers. The vast bulk of alliances (80 percent) apparently do not involve firms that regard themselves as competitors and may thus not pose any threat to competition.

The implications of this discussion are, first, that strategic alliances are often informal and flexible. They are adaptive and self-enforcing. They are not close substitutes for mergers and, in my opinion, it is a mistake to try and impose a merger review regime on them in the name of symmetry. Different statutory treatment, even markedly different treatment, is not going to induce firms to substitute a merger for a horizontal agreement or *vice versa* very often.

Second, the great majority of strategic alliances could not bear the cost of the formalization required for a full blown rule of reason hearing before the Tribunal. Even the formalization required for notification would often be in excess of what the parties would choose for their own purposes. Added to that is the cost of the notification process itself.

Third, public disclosure would discourage many strategic alliances. The adjective “strategic” should provide a clue in this regard. Strategic alliances frequently involve the acquisition of complementary, intangible assets for purposes of line of business extension or development of new markets. The parties will be loathe to signal even the general nature of their competitive strategy to rivals, let alone the details of it. Moreover, review by the Tribunal or by the Competition Bureau pursuant to the issue of some form of advance ruling would invite strategic intervention by rivals to thwart the aims of an alliance if only by stalling it.

Fourth, more than in most business arrangements, timing is of the essence with strategic alliances. It is difficult to imagine how even the most expeditious of review processes, even without strategic intervention by rivals could help but delay the implementation of a strategic alliance thereby reducing if not eliminating any first mover advantage. Moreover, in a dynamic market environment, a full-blown rule of reason analysis is at the continuing risk of being rendered obsolete by changing circumstances. As Richard Posner put it, there is “... a mismatch between law time and new economy real time.”<sup>10</sup>

Fifth, if it were to come to review before the Tribunal, strategic alliances would be disproportionately costly to litigate. There are several reasons for this. First, product markets may not yet exist and the review process may be stuck with the elusive and probably unworkable concept of an innovation market. Second, the notion that cooperation can be “pre-competitive” and somehow be “confined to R&D” assumes a largely discredited linear model of innovation. With an interactive feedback model of innovation, there is no meaningful distinction between pure research, applied research and development. Third, incentives are much more complex to model in the case of a strategic alliance than with a merger in which the parties simply cease to compete.

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<sup>10</sup>Posner, (2001) p.939.

With a horizontal agreement, competition may cease on some margins, be attenuated on others and may actually increase on still others. Analysis must also allow for the possibility that there may be cheating on the agreement. Fourth, proving efficiencies in the case of a horizontal agreement is frequently much more difficult than in the case of a merger. In merger cases, efficiencies tend to be technical and can be demonstrated with reference to conventional cost accounting data. In the case of strategic alliances and horizontal agreements in general, the efficiencies are typically less concrete. They may involve a reduction in opportunism or free-riding or a saving in transaction costs. Measuring them may involve quantifying the future rents accruing to a new product or successive new products.

To the extent that the Industry Committee's proposed civil review of horizontal agreements is actually aimed at strategic alliances, it is a mistake. If it is aimed at other horizontal agreements but could catch strategic alliances in the net, considerable thought should be given to measures which would minimize this possibility. *De minimis* provisions, measured in sales or assets would help but would probably not be sufficient. The exception for agreements of limited duration proposed in C-472 would also be helpful. Consideration should also be given both to a statutory deadline for the issuance of civil pre-clearance certificates and to limiting the window of time available to the Commissioner to seek a remedial order from the Tribunal.

#### *Flexible Rule of Reason Review in the United States*

Strategic alliances between competitors account for only 20 percent of all strategic alliances. It is therefore not unreasonable to assume that horizontal strategic alliances account for a small fraction of horizontal agreements. Strategic alliances should not be the focus of antitrust scrutiny whether criminal or civil. This begs the question of what type of agreement would elicit a civil challenge from the Commissioner. Hughes, Sanderson and Trebilcock (2000) express a general concern regarding ancillary horizontal restraints where the parties have market power. Examples of actual agreements or types of agreements which have hitherto escaped scrutiny in Canada and which would likely be prohibited under the proposed review process would be helpful.

Examination of the leading horizontal restraints cases in the United States may provide some insights. Of course, the leading cases may not be representative of cases decided. They represent turning points in the evolution of the jurisprudence. In the case of jurisprudence under Section 1 of the Sherman Act, the leading cases reflect the ongoing struggle of the courts to distinguish *per se* from rule of reason offenses and to establish a middle ground ("quick look" or "truncated rule of reason") with the simplicity of the *per se* approach and the economic rationality of the rule of reason approach. Of course, under the amendments to the *Competition Act* proposed by the Industry Committee, all these decisions would be made by the Commissioner of Competition. He will decide whether to challenge a horizontal agreement as a *per se* criminal offense under an amended Section 45 or to challenge it as a reviewable practice to be subject to a

full-blown rule of reason analysis by the Competition Tribunal.<sup>11</sup> Any quick looks would occur within the Competition Bureau and the wider community may or may not have an accurate sense of the criteria used.

Examination of the leading horizontal restraints cases in the United States reveals that many have involved the pricing and advertising rules of professional associations. The closest the leading U.S. cases have come to a strategic alliance is *Topco* (1972), an agreement among independent regional supermarket chains to create a common private brand. Ironically enough, the Supreme Court ruled in this case that, notwithstanding evidence that the Topco agreement created a new brand and that the market shares of its members varied between 6 and 12 percent, the allocation of exclusive territories to individual Topco members was itself a *per se* offence.<sup>12</sup>

*Broadcast Music* (1979) involved blanket licensing by a copyright collective. The Supreme Court found that while this was literally price-fixing, *per se* condemnation was not warranted because blanket licensing reduced transaction costs and was necessary if the product was to be marketed at all. The Court did not apply its own rule of reason analysis. In his dissent, Justice Stevens suggested that if it had, it would have found that the arrangement would have failed due to its all-or-nothing nature and the supracompetitive price involved (Tom and Pak, 2000, pp.403-5).<sup>13</sup>

*Maricopa* (1982) involved an agreement among physicians in Maricopa County, Arizona to set a fee ceiling for purposes of negotiating with certain insurance companies. This would not be an issue in Canada at least to the extent that it involved physicians. The Supreme Court majority in *Maricopa* found that this fee ceiling was a *per se* offence and therefore that pro-competitive justifications need not be considered. The minority found that physicians were free to serve non-participating insurance companies or individuals at whatever fees they could negotiate and there were no restrictions on individual patients and thus that while there was literal price-fixing, an examination of the possibility that the fee ceiling could be pro-competitive was at least

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<sup>11</sup>This raises the question of whether the Tribunal would have any flexibility in applying rule of reason analysis. Application of Sections 93 and 96 of the Competition Act as envisaged by the Industry Committee would require geographic and product market definition, the demonstration of market power and the quantification of both the anti-competitive effects and efficiencies flowing from the agreement concerned. It thus appears as if full-blown rule of reason analysis as presently applied in merger cases would be unavoidable in all civil track cases. This may or may not be a desirable outcome.

<sup>12</sup> An edited version of the Court's decision, together with Chief Justice Burger's spirited dissent can be found at <http://www.ripon.edu/faculty/bowenj/antitrust/topco.htm>.

<sup>13</sup>In Canada, the tariffs of copyright collectives are regulated by the Copyright Board.

warranted.<sup>14</sup>

*NCAA* (1986) addressed restrictions imposed by the National Collegiate Athletic Association (NCAA) on the televising of college football games. These restrictions limited the number of televised games available and effectively fixed the price received by individual colleges from broadcasters. The Supreme Court viewed this as price-fixing and output-restricting but declined to condemn it *per se* on the grounds that some form of agreement among colleges was necessary if college football was to be televised at all. The Court did, however, condemn the restrictions after a quick look analysis which focused on the efficiency rationale for the restrictions and did not define the product market or consider whether the NCAA had market power (Tom and Pak, 2000, pp.406-7).

*Indiana Dentists* (1986) involved a collective refusal of dentists to submit dental x-rays for review by insurers. There was no direct attempt by the dentists to fix fees, restrict the supply of dental services or allocate markets or customers. There was no attempt by the government to establish that the dentists involved possessed market power or that their actions lessened competition or that dental services were more costly than they would have been in the absence of the agreement (Kattan, 2001, p.741). Nevertheless, the Supreme Court concluded that an anti-competitive effect could be presumed because information had been withheld from insurers and withholding of information from consumers necessarily disrupts the proper functioning of the market thus obviating the need for a full-blown rule of reason analysis.

*Massachusetts Board* (1988) involved restrictions on advertising by optometrists in Massachusetts. In this case, the Federal Trade Commission decided that conduct that was inherently suspect but would be eligible for rule of reason consideration provided the respondent could provide a valid efficiency justification. In this case, the FTC found that while there was a plausible efficiency justification for restrictions on advertising, in the light of the evidence on the consequences of restrictions on advertising this justification was not valid. As a consequence, the restrictions involved could be condemned without proceeding to a full rule of reason analysis. (Muris, 2000)

In *California Dental* (1999) the allegation was that the Dental Association, through its Code of Ethics and implementing guidelines, had unreasonably restricted price advertising, particularly advertising of discounted fees and advertising about the quality of dental services and had effectively prohibited certain pricing discounts by its members. The Federal Trade Commission treated the Association's restrictions on discount advertising as illegal *per se* and those on quality advertising to be illegal under abbreviated rule of reason analysis. The Court of Appeal upheld the Commission but found that it had erred in applying *per se* analysis rather than abbreviated rule of reason analysis to the price advertising restrictions. On appeal, the Supreme Court vacated the Court of Appeals' decision finding that the Court of Appeals erred in applying

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<sup>14</sup>Edited versions of the respective opinions of the majority and the minority can be found at <http://www.rapon.edu/faculty/bowenj/antitrust/arizvmar.htm>.

abbreviated or quick-look analysis rather than a more detailed rule of reason analysis warranted by the circumstances. More precisely, it erred in failing to canvas the evidence on the consequences of restrictions on professional advertising in general before dismissing the respondent's efficiency justifications (Muris, 2000).

The examination of leading U.S. horizontal restraints cases raises a number of questions regarding the application of the proposed civil review of horizontal restraints in Canada. The emphasis appears to be on how full-blown rule of reason analysis can be avoided rather than how it should be applied. Under the civil track review proposed by the Industry Committee, the Competition Tribunal will have no choice but to apply full-blown rule of reason analysis. This is not necessarily bad. Quick look analysis which ignores market power and competitive effects and obliges respondents to prove that the restraints they are employing are "valid" has been the subject of withering and justifiable criticism (Meese, 2000). On the other hand, quick look analysis may evolve for the better and the only place it would be applied in Canada would be within the Competition Bureau in support of decisions as to whether and where to challenge horizontal agreements. A consequence of this is that the jurisprudence on ancillary horizontal restraints may remain underdeveloped.

Many of the leading U.S. horizontal restraint cases involve professional associations. Given concerns about maintaining the quality of professional services, even price and output restraints are arguably ancillary and thus potential candidates for something beyond *per se* analysis. An interesting question is whether the often-stated unsuitability of Section 45 for dealing with other than egregious, naked horizontal restraints has resulted in the promulgation of rules by professional associations in Canada that are much more restrictive than in the United States and whether there is evident dissatisfaction with this among consumer groups. A related question is whether the application of civil review under the *Competition Act* might still be limited in some instances by the regulated conduct defence.

#### *Enforcement and Compliance under Section 45*

Hughes, Sanderson and Trebilcock (2000) state that ancillary horizontal restraints between parties with market power is one of the most under-developed areas of the law. Insofar as Canada is concerned, it is hard to dispute this. Chandler and Jackson (2000) state that the Competition Bureau has prosecuted nothing other than hard-core, naked, horizontal restraints under S.45. There is considerable debate about whether the Bureau's record in prosecuting these naked restraints is one of success or failure. Obviously there is no such prosecution record to judge with respect to ancillary, horizontal restraints. Nor is there any jurisprudence. A possible implication of this is that there may be many examples of anti-competitive ancillary horizontal restraints that would or did fail a rule of reason test in the United States but which have not been challenged in Canada. Another possibility is that potentially anti-competitive ancillary horizontal restraints have been dealt with in Canada by some combination of informal compliance with Section 45, regulation and other institutional arrangements. An obvious example of the use of regulation in place of competition law is the Copyright Board which regulates the tariffs of

copyrights collectives. An example of the use of alternate institutional arrangements is single-payer remuneration of physicians and some other health professionals. The results may have been better or worse than would have been obtained under competition law but this is what should be investigated.

It appears, however, that although there may not have been any prosecutions, the Competition Bureau has had an ongoing compliance program covering naked and ancillary horizontal restraints, a program which it regards as successful. In particular, the Competition Bureau has long taken the position that restrictions on price competition or advertising are not necessary to maintain the quality of professional services (Goldman, 1989).

While it is difficult to dispute the point that, if it comes to litigation, the Competition Tribunal has or should have both an absolute and a comparative advantage over the criminal courts in balancing the pro- and anti-competitive effects of ancillary horizontal restraints, there are good reasons to believe Section 45 is not unworkable as it stands. First, the undueness test is a competitive effects test. The U.S. interpretation of cognizable efficiencies as being those that make the market more competitive could be accommodated under the undueness test. Judicial decisions in the United States have recognized two broad categories of efficiency-enhancing agreements: those that reduce the cost of providing a product or raise its quality and those that are necessary for the product to be provided at all.<sup>15</sup> Agreements resulting in new products or better products or lower price products than would otherwise have existed can hardly be construed to have lessened competition unduly. Second, the rules of thumb suggested for adjudication of non-naked restraints in the United States are very similar to the factors considered by the Supreme Court of Canada in its interpretation of the requirements for undueness in its *PANS* decision.<sup>16</sup> Third, the courts have ruled that market definition need not be proven beyond a reasonable doubt. Fourth, remedies in Section 45 cases include consent prohibition orders which do not carry with it the stigma of a criminal conviction. Fifth, at least one of the recent defeats suffered by the Crown in a Section 45 case was apparently not due to the inability of the court to analyse the issues of economics properly.<sup>17</sup>

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<sup>15</sup>McFetridge (1999a).

<sup>16</sup>Tom and Pak (2000); Graham (2002).

<sup>17</sup>In *Freight Forwarders*, the Crown failed to prove that the product market was confined to freight forwarding and thus that the freight forwarders had market power. In their commentary on the case, Hughes and Sanderson (1998) said:

In sum, the approach to market power and market definition taken by the Court is consistent with economic principles. The conclusion that relevant market is not an essential element of the offence that must be proved beyond a reasonable doubt provides scope for the use of economic evidence which is often more suggestive than conclusive on specific aspects of market definition. Furthermore, no matter how strong the evidence is in respect of the object

As many have pointed out, Section 45 could not incorporate an efficiencies defence such as now exists under any of the three alternate interpretations of S.96 (total surplus, balancing weights, consumers surplus).<sup>18</sup> Under each of these interpretations of S.96, efficiency gains could save a price-increasing, anti-competitive agreement. This appears to be a serious disadvantage on the face of it but, given the disenchantment with S. 96 in some quarters and given the possibility of harmonization around the U.S. competitive effects approach, it may not be such a big disadvantage.

### *Conclusions*

The Industry Committee's proposed civil track review of non-naked horizontal restraints is very similar to the original civil track proposal of Warner and Trebilcock (1993). The general arguments for replacing Sections 86 and 95 of the *Competition Act* with a provision which would make any potentially anti-competitive horizontal agreement reviewable by the Competition Tribunal are persuasive. Whether this is an urgent priority is not as obvious. There is not even a rough indication of extent to which the economy is presently burdened with anti-competitive, non-naked horizontal restraints which have either been incorrectly acquitted under the current law or not been challenged. Moreover, civil track review as proposed by the Industry Committee does have its downside.

Mergers and horizontal agreements should be treated the same in the sense of being treated as reviewable practices under civil law. While there is much to be said for treating both as reviewable practices, there is less to be said for treating them as *identical* reviewable practices. It is not necessarily a good idea to subject all non-naked horizontal restraints to full-blown, indeed, as it turns out, over-blown, rule of reason analysis of the type that has evolved in merger review. Quick look analysis in the United States has been criticized and justifiably so but the search for a sensible alternative to full merger-style review of horizontal restraints continues. It appears as if the Industry Committee's proposal would lock the Tribunal into merger-style analysis. Quick look methodology might be used within the Competition Bureau as part of its case selection process. While it might be described cryptically in guidelines and press releases, it would remain largely a black box and the jurisprudence on ancillary horizontal restraints would remain in its present, underdeveloped state.

While proposals for civil review may appear innocuous, there is a downside in the form of increased cost, reduced flexibility, delay and increased opportunities for opportunism and rent seeking and these would be visited on the most dynamic or potentially dynamic sectors of the economy. A shift to civil review should not bring with it more invasive antitrust scrutiny of

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of the agreement, the court makes it clear that it is necessary to also demonstrate market power. (p.171)

<sup>18</sup>McFetridge (2002)

strategic alliances. There is considerable potential for Type I error, not necessarily in the sense of formally prohibiting socially benign behaviour but in the sense of discouraging it by reducing timeliness and adaptability and increasing cost. It is not obvious that the chilling effect of the threat of criminal prosecution is much reduced by adding the prospect of a civil challenge and leaving the Commissioner with the discretion to take either track. Guidelines could be helpful but past experience suggests they are not the solution. Further thought should be given to *de minimis* provisions, to limitations on the time allowed before pre-clearance is deemed to have occurred and to limiting the window of time during which an agreement would be liable for a civil track challenge.

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