Submission on Draft Enforcement Guidelines:
The Abuse of Dominance Provisions (Sections 78 and 79
of the *Competition Act)* as Applied to the Retail Grocery Industry

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INTRODUCTION

Please find the following written comments as to the Competition Bureau's Draft Abuse of Dominance Guidelines as applied to the retail grocery industry.

The Bureau's Draft Guidelines suffer from major deficiencies. The most important deficiencies are:

1. There are no market definition, market shares, market concentration data (concentration ratio; Herfindahl-Hirschman Index) as to the grocery industry's three main sectors: manufacturing; wholesaling; and retailing;

2. The Bureau retains a narrow interpretation of subsection 79 (1) of the *Competition Act;*

3. Profits are not used as an indicator of market power;

4. There is no appropriate measure of cost as to predatory pricing;

5. The interpretation of subsections 45 (1) and 79 (1) of the *Act* regarding conscious parallelism does not reflect the state of the law.

Because of these shortcomings the Draft Guidelines would not serve the interests of consumers and independent grocery retailers.

I. THE CANADIAN RETAIL GROCERY INDUSTRY

The language used in the Draft Guidelines to describe the grocery industry is confusing and inaccurate. The Draft Guidelines mention that the *"retail grocery industry"* is composed of three sectors: manufacturing; wholesaling; and retailing. (*DG p.3)* This is'wrong. These are the three sectors composing the grocery industry of which the retail sector is a segment. It is astonishing that the Bureau could not identify properly the three main sectors of the grocery industry in a draft document purporting to inform the public about the Bureau's enforcement

policy in this very industry. In addition, the Bureau did not define the relevant markets (i.e. the product and geographic markets) within each sector of the grocery industry -- manufacturing; wholesaling; and retailing. Similarly, the market shares of each participant within well-defined markets as to the three sectors of the grocery industry do not appear in the Draft Guidelines. Finally, there is no information as to the level of concentration (*i.e.* four-firm concentration ratio; Hirfindahl-Hirschman Index) within the grocery industry three sectors. The Draft Guidelines contain only very sporadic descriptions of the grocery industry structure. (See *Draft Guidelines p. 2 bottom; p. 3 second paragraph; section 5.1.3 second paragraph)*

A definition of the product market in the retail grocery industry can be found in U.S. antitrust cases involving antitrust challenges to mergers between supermarket chains. For instance, *In the Matter of Albertsons Inc. and American Stores Company (File No. 981-0339),* a consent order entered between the Federal Trade Commission and two supermarket chains, the parties defined the relevant product market in these terms: *"Supermarkets" means a full-line retail grocery store that carries a wide variety of food and grocery items in particular product categories, including bread and dairy products,. refrigerated and frozen food and beverage product; fresh and prepared meats and poultry; produce, including fresh fruits and vegetables; shelf-table food and beverage products, including canned and other types of packaged products, staple foodstuffs, which may include salt, sugar, floor, sauces, spices, coffee and tea; an other grocery products, including non-food items such as soaps, detergents, paper goods, other household products, and health and beauty aids. ".* A somewhat similar approach was followed *In the Matter of American Stores Company et al. 111 F.T. C. 80; State of California by Van de Kamp v American Stores* 697 *F. Supp. 1125 (C.D. Cal.* 1988). This approach stems from the concept of *" cluster market"* an approach used where *" a range of products can be grouped together to measure market power, even though they are not good substitutes, because they are related or complementary in production or distribution ". Pitofsky, Robert " New Definitions of Relevant Market and the Assault on Antitrust " 90 Columbia Law Review 1805 (1 990) p. 1862*

It is virtually impossible to elaborate a coherent, effective and enforceable antitrust enforcement policy in the grocery industry without reliable data as to industrial organization. An analysis into the industrial organization of the grocery industry is essential in order to identify in which sector of the industry an abuse of dominant position is most likely to occur . There are two possible explanations as to why the Draft Guidelines contain no such analysis. Either, the Bureau failed to analyse the grocery industry industrial organization; or, the Bureau did analyse that industry's industrial organization but refuses to share its findings with members of the public. The Bureau cannot invoke section 29 of the *Act* (the confidentiality section) to justify the absence of analysis into the industrial organization of the grocery industry. The Bureau could release a study conducted by the Bureau's staff based on publicly available data. The Bureau decided not to provide a detailed analysis of the grocery industry industrial organization probably because it would show that leading firms therein have acquired a dominant position *(i.e.* they have market power) and that such dominant position was not acquired by way of superior competitive performance. This in turn would unveil a structural problem in the grocery industry calling for enforcement action to restore a competitive market structure. (See *infra* next section on the scope of the abuse of dominant position provision)

II. THE SCOPE OF THE ABUSE OF DOMINANT POSITION PROVISION

Both the Draft Guidelines and the Bureau's guidelines on abuse of dominant position issued in July 2001 adopt a restrictive interpretation of subsection 79 (1) of the Act thereby limiting substantially its scope and effectiveness. The Bureau assumes that subsection 79 (1) of the Act sanctions only maintenance of market power through anticompetitive practices. In other words, the Bureau takes the position that the *Act's* abuse of dominant position provision does not remedy acquisition of market power through anticompetitive practices -- *i.e.* acquisition of market power not stemming from superior competitive performance. (See Draft Guidelines section 5.1/ p.5; section 5.2.3/ p.13) This is a major shortcoming. In *D.I.R. v Laidlaw Waste Systems Ltd.* 40 *C.P.R. (3d)* 289 the Competition Tribunal ruled that the acquisition of market power through mergers and maintenance thereof through restrictive covenants constitutes an abuse of dominant position. However, the Tribunal noted at page 345 of the decision: *" The acquisitions practices increased concentration in the market, at times to monopoly levels. Laidlaw bought all firms in the market so that at times it held a 100% market share. This by itself constitutes at leastprima facie lessening of competition, which is substantial. The Tribunal does not purport to determine whether those practices alone, in the absence of the Laidlaw contracts, could have resulted in a substantial lessening of competition. It is sufficient to say that the acquisitions form part of the anticompetitive practices in that regard. ".* The Bureau opts for an interpretation of subsection 79 (1) of the *Act* that excludes acquisition of market power through anticompetitive means despite the Tribunal's ruling in *Laidlaw* leaving that very important legal issue unsettled. This is all the more revealing.

A liberal interpretation of subsection 79 (1) of the *Act* is consistent with the statutory framework of the *Act* and the Tribunal's decision in *Laidlaw*. The purpose clause of the *Act* specifically provides that the *Act* aims *inter alia* at providing consumers with competitive prices. Furthermore, subsections 79 (2) and (3) of the *Act* provide for structural relief *(i.e.* divestiture of assets and shares) and a defence of superior competitive performance. In the United States the offence of monopoly embodied in section *2* of the *U.S. Sherman Act* encompasses both acquisition and maintenance of market power through anticompetitive acts: *"The offence of monopoly under section 2 of the Sherman Act has two elements: (1) the possession of monopoly power in the relevant market and (2) the wilful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident. " U.S. v Grinnell Corp. 384 U.S. 563 (p. 570-71); Microsoft Corporation v U.S. 253 F.3d 34 (D. C. Cir. 2001) p.50.*

The Bureau's restrictive interpretation of subsection 79 (1) of the *Act* undermines significantly the effectiveness of this provision as it relates to the regulation of monopoly. This is so for two reasons. First, monopolization *(i.e.* acquisition of market power through anticompetitive practices) is a structural anticompetitive feature as opposed to an anticompetitive conduct. Since monopolization is continuous in nature it is much more difficult to raise the *Act's* statute of limitation (three years) as a defence. Second, structural relief is more likely to be ordered where structural anticompetitive issues are involved than where purely anticompetitive conduct is being complained of. Thus, it is paramount that the Bureau and the guidelines favour a liberal interpretation of subsection 79 (1) of the *Act*. Interestingly, the Bureau concedes in the Draft Guidelines that a high level of concentration prevails in the retail grocery sector stemming

from intense merger activity over the last years: *" Mergers in this sector have increased over the past decade, to the extent, the Bureau estimates, that the four largest supermarket chains now account for approximately 75 % of total Canadian food store sales. ". (p.* 2) Accordingly, the major players in the grocery industry who may have market power (a reasonable assumption since the Bureau would not propose the adoption of specific guidelines as to abuse of dominant position adapted to the grocery industry) have not acquired a dominant position by way of superior competitive performance (e.g. internal growth; patent). This may explain why the Bureau did not incorporate in the Draft Guidelines detailed information on the grocery industry industrial organization.

III. MARKET POWER

Market power should not be assessed based solely on market shares, barriers to entry and other market characteristics. Profits should be used to determine whether one or more firms have market power within a relevant market since the Draft guidelines define market power as *" the ability to profitably maintain prices above competitive levels for a significant period of time, normally one year", Draft Guidelines section 5.1 p.5.* This can be done by *" determining whether profits over a long period of time are exceptionally high compared to similar product lines or industries". Pitofsky, supra p. 1847.* Using profits as an indicator of market power may have another advantage: dispense with the necessity to define the relevant market: *" When relatively high profit level exist, the market definition process can be abandoned entirely and market power inferred directly from profitability". Pitofsky supra p. 1847*

IV. PREDATORY PRICING

The Draft Guidelines discuss predatory pricing without specifying an appropriate measure of costs. Whether a particular price is predatory cannot be assessed without first selecting an appropriate measure of cost. *(" Predatory pricing may be defined as pricing below an appropriate measure of cost for the purpose of eliminating competitors in the short run and reducing competition in the long run." Cargill Inc. et al. v Monfort of Colorado Inc. 479 U.S. 104 (p.117)* In *D.I.R. v NutraSweet* Co *et al.* 32 *C.P.R. (3d)* I the Competition Tribunal enumerated appropriate measures of cost for the purpose of determining whether a price is competitive or anticompetitive (*i.e.* predatory). There are basically three measures of cost: average variable cost; average total cost; and marginal cost. In NutraSwet the Tribunal opted for marginal costs finding that it was an *"appropriate standard"* in the context of this case. Incidentally, the Director's predatory pricing claim in NutraSweet was dismissed precisely because: *" The Director did not present a consistent or coherent case as to the proper measurement of cost for this purpose. " NutraSweet p. 44*

The Draft Guidelines must determine an appropriate measure of cost. To be appropriate a measure of cost must take into consideration the specificity of the cost structure in the grocery industry. Otherwise, it will be impossible to prevent predatory pricing in the grocery industry. The Draft guidelines in their present form give endless prosecutorial discretion to the Bureau.

V. TACIT COLLUSION

Section 5.2.3 in the Draft Guidelines dealing with tacit collusion deserves specific comments. The Bureau claims outright that there is no evidence suggesting that market dominance through conscious parallelism or tacit collusion is ongoing within the grocery sector (again without referring to any well-defined market). Moreover, the Bureau's interpretation of subsections 45 (1) and 79 (1) of the Act as applied to conscious parallelism is narrow and do not take into consideration a provision that was added to section 45 in 1986. In the Abuse of Dominant Position Guidelines adopted in July 2001 the Bureau clearly mention that conscious parallelism in itself does not contravene section 45 of the *Act: " The jurisprudence in respect of the criminal conspiracy provisions is clear in not condemning 'conscious parallelism '. The Bureau has adopted a similar position with respect to the abuse provisions, recognizing that something more than mere conscious parallelism must exist before the Bureau can reach a conclusion that firms are participating in some form of coordinated activities. " (p.17)* The Bureau cites two decisions in support of its interpretation of subsection *45* (1): *R. v Canadian General Electric 17 C.C.C. (2d) 433; R. v Armco 21 C.C.C. (2d) 129.*

First, paragraph 79 (1) a) of the *Act* does not require an agreement or conspiracy to control a market. It only requires that *" one or more persons substantially or completely control"* a market. Second GE and Armco do not represent the state of the law with respect to the conspiracy requirement of subsection 45 (1). In 1986, Parliament amended section 45 adding subsection 45 (2.1) thereto. Subsection 45 (2.1) provides in pertinent part that *" the court may infer the existence of a conspiracy, combination, agreement, or arrangement from circumstantial evidence with or without direct evidence of communication "*. Therefore, since 1986 pure conscious parallelism *(i.e.* a conscious decision made by competitors to follow the line of conduct of a leader within a market in order to avoid competition) may be sanctioned under both subsections 45 (1) and 79 (1) of the *Act.* The Bureau's position as to conscious parallelism is intellectual dishonestyper se.

The addition of subsection 45 (2.1) was a judicial amendment whereby Parliament repudiated the majority opinion of the Supreme Court of Canada in the matter of *Atlantic Sugar Refineries Co. Ltd. et al. v Attorney General of Canada 115 D.L.R. (3d) 21. In Atlantic Sugar* the majority of the Court ruled that the existence of a conspiracy must be established by evidence of direct communication between the accused in order to establish the first element of a violation of subsection *32* (1) of the *Combines Investigation Act* (now subsection 45 (1) of the *Competition Act).* This is not the state of the law anymore. Subsection 45 (2.1) was added to section 45 in order to confirm the dissenting opinion of Justice Estey in *Atlantic Sugar i.e. " The agreement may be proven, in the sense of being capable of discernment by the finder offactfrom all the surrounding facts and circumstances, including the conduct of the parties.* " Thus, since the coming into force of subsection 45 (2.1) conscious parallelism is subject to the same legal standard under Canadian and U.S. antitrust laws: *" Although conspiracy may be inferred from circumstantial evidence, the evidence must tend to exclude the possibility that the defendants acted independently and lawfully. . . . Under the doctrine of conscious parallelism, an agreement may be inferred if each participant knew that concerted action was contemplated and invited, gave its adherence to and participated in the scheme, and understood that cooperation was essential to the plan." City of Long Beach v Standard Oil Co. of California et al. 872 F.2d 1401*

(CA9) p. 1404-1407. Also: *" The essential combination or conspiracy in violation of the Sherman Act may be found in a course of dealing or other circumstances as well as in an exchange of words. Unites States v Schrader's Son 252 U.S. 85. Where the circumstances are such as to warrant a jury finding that the conspirators had a unity of purpose or a common design and understanding, or a meeting of mind in an unlawful arrangement, the conclusion that a conspiracy is established is justified." American Tobacco v U.S. 328 U.S. 781 (p.809-810).*

There is another point that deserves specific comment. As already mentioned the Draft Guidelines assume that conscious parallelism is nonexistent in the grocery industry. There is no evidence or analysis in the Draft Guidelines supporting this important finding. The Draft Guidelines point out that certain practices facilitate conscious parallelism: pre-announcing price increases, publicizing price lists, and engaging in delivered pricing. However, the Draft Guidelines fail to mention the most important condition conducive to conscious parallelism: a concentrated market *i.e.* an oligopolistic market structure. It seems that this condition exists in the grocery industry in large part because the Bureau failed to enforce the *Act's* merger provisions in this industry. *(Supra section II 3rd paragraph herein).* According to the Bureau there is ground for concern that a group of firms may have control over a market where they hold collectively a market share of 60% or more. *(Draft Guidelines; p.* 7) Similarly, under the Federal Trade Commission and the U.S. Department of Justice *Horizontal Merger Guidelines* a market is deemed concentrated where the Hertindahl-Hirschman Index is above 1800. Other conditions are conducive to conscious parallelism: product or firm homogeneity; existing pricing practices; availability of information about competitors or market conditions. *(FTC/USDOJ Horizontal Merger Guidelines; Sections 1.51 and 2.11).*

CONCLUSION

This memorandum outlines the main deficiencies in the Bureau's abuse of dominance guidelines as applied to the grocery industry. The Bureau's proposed guidelines are incomplete, vague and rely on a legal interpretation of the *Act's* abuse of dominance provision that is highly arguable. Accordingly, without a significant redraft of the Draft Guidelines addressing the major deficiencies identified above, they will not serve their intended purpose.