Competition Tribunal | Tribunal de la Concurrence

CT-1989-004 – Doc # 88a

IN THE MATTER OF an application by the Director of Investigation and Research for an order pursuant to section 75 of the *Competition Act*, R.S.C., 1985, c. C-34, as amended, requesting that the respondent accept the Exdos Corporation as a customer for the supply of a product

B E T W E E N:

The Director of Investigation and Research

Applicant

and

Xerox Canada Inc.

Respondent

REASONS AND ORDER

Dates of Hearing:

June 11 - 20 and July 19-20, 1990

Presiding Member:

The Honourable Madame Justice Barbara Reed

Lay Members:

Dr. Frank Roseman
Mr. Victor L. Clarke

Counsel for the Applicant:

Director of Investigation and Research

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INDEX

COMPETITION TRIBUNAL

REASONS AND ORDER

The Director of Investigation and Research

v.

Xerox Canada Inc.

I. INTRODUCTION

The Director of Investigation and Research ("Director") brings an application seeking an order to require Xerox Canada Inc. ("Xerox") to accept Exdos Corporation ("Exdos") as a customer for the supply of certain Xerox copier parts. This application is brought pursuant to section 75 of the *Competition Act*[1].

Xerox followed the practice, for a number of years, of freely selling parts for its photocopier machines to any purchasers willing to pay the list price, of whom Exdos was one. Sales were made without regard to the use subsequently made of the parts, whether they be used by the purchasers as end users[2] of the photocopier machines, or as suppliers of maintenance service to owners of Xerox photocopiers, or as refurbishers of second-hand Xerox machines for resale into the used photocopier market. Then, in August 1988, in response to a policy originating with Xerox *Corp.* (U.S.) but subsequently adopted by Xerox (Canada), the supply of such parts was curtailed. This was done in order to eliminate competition from organizations which had grown up and were providing maintenance service for Xerox photocopiers. Xerox determined that some of the "margin-rich area" of service revenue was being lost to these competitors. The competitors are referred to in the evidence as independent service organizations ("ISOs"). The curtailment of the supply will also effectively eliminate most of the second-hand market in Xerox copiers, except to the extent that such is controlled by Xerox. Exdos was one of

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[1] R.S.C. 1985, c. C-34, as amended.

[2] The "end user" is the person who, irrespective of ownership, is in possession of and actually uses one or more Xerox copiers.

the organizations caught in this general refusal to supply copier parts. Insofar as the particular position of Exdos is concerned, the relevant facts follow.

II. BACKGROUND AND REFUSAL TO SUPPLY

A. Initiation of the Business Relationship

In 1982 Xerox found itself with an overly large inventory of used photocopiers. It was Xerox's practice, at the time, to either scrap such machines or to refurbish them to an "as new" condition. In the latter case the machines were resold, leased or rented with a "new machine" warranty. Xerox was concerned about the drain the oversupply of used inventory was creating on the financial position of the company.

The oversupply of used machines was the result of a number of factors: there was a general economic downturn in 1980-81; the patent which Xerox held on the photocopier technology had expired in the mid-1970s and, with that expiry, Xerox faced increasing competition from other manufacturers of photocopiers. In addition, Xerox was moving to a new technology, described generally in the evidence as "10 Series copiers", which was eventually introduced in 1983[3]. It was anticipated that many of Xerox's customers would wish to move to this new technology. Consequently, as a result of both the increased competition which Xerox was facing and the desire of customers to move to the new technology, it was expected that the return of old machines to Xerox would increase.

The normal practice of Xerox, prior to the late 1970s, had been to place machines with customers on a rental basis. Under this practice ownership of the machines remained at all times in the hands of Xerox or returned to Xerox at the end of the lease. In the late 1970s, the practice in the industry began to change to one of selling the machines to customers either by way of an outright sale or through a lease-purchase arrangement.

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[3] The "10 Series copiers" are also referred to in the evidence as the "Marathon" family of copiers.

With more and more machines owned by customers directly, it was anticipated that a considerable second-hand market in the machines would develop.

In 1982, Terry Reid was an employee of Xerox. Terry Reid subsequently became and remains the president and majority shareholder of Exdos. Xerox and Reid determined that a mutually advantageous arrangement might be created if Reid left the Xerox company and created an independent company which would purchase some of the used copier machines from Xerox in an "as is" condition, refurbish them and sell them into the second-hand market[4]. It was contemplated that this would tap an area of the market not previously served by Xerox. It would also free the Xerox sales force to concentrate on selling the newer model machines. It would give Reid an opportunity to develop his own business and would have a positive effect on the Xerox balance sheet. It was contemplated that Reid would create a dealer network throughout Canada for the purpose of disposing of the used copiers. It was also contemplated that he would himself market some of the machines directly into the end user market.

In May 1983, Exdos (initially carrying the name XDS Corp.) and Xerox entered into a contract pursuant to which Exdos was to be allowed to purchase certain copier models[5] at specified prices. Delivery of the equipment was taken by Exdos at Xerox's three distribution centres in Toronto, Montreal and Calgary. Exdos was also given, under the May 24, 1983 contract, the right to purchase copier parts for the various second-hand models covered by that contract. Such parts were to be sold to Exdos at 50 percent off list (drums for the machines were to be sold at an even more advantageous price, namely twice the Canadian landed price). The contract was expressed to run for a year or to come to an end at an earlier date should Exdos purchase, by that time, a certain dollar volume of equipment. For four months Exdos was given an exclusive right to purchase the used

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[4] The other options open to Xerox at the time were to: (1) refurbish as many of the machines as the market would bear to an "as new" condition and scrap the remainder (as it had been doing in the past); or (2) develop an in-house second-hand market division.

[5] Model Nos. 660, 3100, 3103, 3107, 4O00, 4500, 2400, *3600,* 7000; all were pre-10 Series machines.

copier models (from May 24, 1983 until October 1, 1983). At the time, this arrangement was clearly, in the eyes of Xerox, an experiment; it was designed to determine if a mutually advantageous business arrangement could be developed.

It was recognized from the beginning that there was a potential for Exdos' activity, in moving into or feeding a market for second-hand copiers, to lead to conflict with Xerox's mainline sales activity. Indeed, the initial contract signed by the parties contained an extensive list of Xerox's major customers to which Exdos agreed it would not market the used machines purchased from Xerox. It is clear that Reid understood from the very beginning that if his activities in selling second-hand copier equipment resulted in conflict with Xerox's mainline sales efforts ("raised the field noise level") this could result in the cancellation of his contract.

B. Contract Modifications - Copiers from Sources Other than Xerox - Parts from Xerox

The contract between Exdos and Xerox was extended and modified from time to time. Many of the changes need not be detailed here. Suffice it to say that Exdos' exclusive right to purchase certain used photocopier models from Xerox, which was originally designed to operate for only four months, was extended indefinitely; a reciprocal exclusivity obligation was imposed on Exdos (to purchase the models covered by the contract from Xerox only); the contract was varied to one of indefinite duration, subject to termination by either party at first on 60 days notice and later on 30 days notice. The list of copiers which Reid was entitled to purchase from Xerox under the contract was expanded slightly from time to time to include three or four additional models as such became "obsolete", that is moved off Xerox's active sales list, but this list never included used 9000[6] or 10 Series machines[7]. The 50 percent discount off list, for

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[6] The 9000 Series of copiers both pre-dated and post-dated 1983 **and** the introduction of the 10 Series. They were manufactured from 1979 to 1986.

[7] Some 9000 and 10 Series copiers were acquired by Exdos, at a later period of time, through Xerox sales representatives. Such representatives, when faced with competition from other copier manufacturers for the business of a particular customer, would persuade the customer to buy a new Xerox machine by offering a better price for the old machine. They would contact Reid to buy the customer's machine because Exdos would pay more for the used copier than Xerox allowed on a trade-in. In such cases, Exdos sometimes made the purchase cheque payable to the customer and sometimes to Xerox directly, depending on who actually owned the machine. Reid did not hide from Xerox the fact that this activity was taking place although he did refuse to name the sales representatives who were approaching him. Xerox did not approve of this activity by its sales representatives.

parts for the used machines which Reid obtained from Xerox, was subsequently modified to a 25 percent discount and eventually eliminated. He thereafter paid list price for the parts purchased. The most significant change in the contract arrangement between the parties, for the purposes of this case, however, was the addition of provisions with respect to the purchase and sale of parts for copier models acquired by Exdos from sources other than Xerox, about which more will be said later.

Almost from the beginning Exdos began purchasing second-hand Xerox copier models from sources other than Xerox. These were obtained, for example, from finance companies who had repossessed the equipment for non-payment, or from owners of the equipment who were upgrading to a newer model, or at auction. The used copiers obtained in this way at first included only pre-1983 copier models not covered by the contract[8]. Eventually they also included the newer 9000 and 10 Series models. They never, however, included the 50 Series machines which were introduced by Xerox in 1989.

Reid used Exdos to purchase the second-hand equipment, either from Xerox or other sources. When the copiers were placed directly into the end user market, Reid used a company called Nezron Office Products ("Nezron") to deal with the end user. Reid acquired a 70 percent interest in Nezron shortly after he established Exdos. (In late 1989, Exdos acquired the remaining 30 percent interest.) Exdos also established contacts with existing Canadian ISOs and encouraged the creation of other ISOs in various locations throughout the country, to which Exdos sold used copier equipment. Eventually, equipment was also sold into the United States and abroad.

After a photocopier is sold, there is a continual need to provide maintenance service to support the machine in the customer's hands. Reid used Nezron to support the second-hand machines he placed directly into the end user market. The other ISOs offered service for the machines they placed in that market. Alternatively, the final purchaser could contract with Xerox for service, providing Xerox’s terms for dealing

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[8]Models Nos. *2300*, 2350,5400, 5600 and the older 9000 Series machines.

with used machines were met. The usual practice in the industry is for the purchaser of a machine to obtain service from the vendor of the machine.

In order to provide service, access to spare parts is of course necessary. From the beginning Reid purchased parts from Xerox for this purpose. The parts purchased related to both the used equipment purchased from Xerox and the used equipment purchased elsewhere. This included parts for the newer copier models (9000 and 10 Series). Some of the ISOs who purchased used equipment from Reid apparently bought at least some Xerox parts through him; several of them also bought parts directly from Xerox.

C. Xerox's Reaction to Exdos' Purchasing Equipment Outside the Initial Contract

Various Xerox employees of Xerox testified that the activity of Exdos (Reid), in purchasing used machines from sources other than Xerox and in purchasing parts from Xerox for those machines, was considered by Xerox from the beginning to be a breach of, at least, the spirit of its May 1983 contract with Exdos. It was contended that Xerox, with one exception, did not knowingly supply Reid with parts for copier models other than those expressly covered by the May 24, 1983 contract (or any successor contract). The one exception was said to be the supply of parts to Reid when these were required for his *own* end use. The evidence does not support that conclusion. While the initial formal written contract between Exdos and Xerox governed only the purchase of parts and supplies for photocopier models sold under the contract, it is clear that from a very early stage Xerox was aware of both Exdos' expansion of its business into other copier models and its purchase of parts for these machines from Xerox.

Insofar as the expansion of the business is concerned Xerox documents record, as early as April 1984, that:

> EXDOS may ... source [buy] Xerox equipment that we will not supply him from other sources. There are several models that we will not sell him and these are the units that we are still actively marketing. He buys these from many sources[9].

[9] Exhibit A-1, tab 26.

With respect to the purchase of parts for the copier models not covered by the contract, during the first year of the contract orders for such were lumped together by Exdos with orders for the copier parts on which Exdos was entitled to a 50 percent discount under the contract. This was not considered by Xerox to have been intended. Thus, when Xerox conducted

an internal review of the Exdos contract in December 1984, one of the concerns expressed was that:

> EXDOS/NEZRON or its agents as a condition of our agreement must be prohibited from ordering parts for any piece of equipment not sold to them by Xerox other than at full retail mice at which they are available to any customer. (underlining added)[10]

Consequently, Exdos was given separate customer numbers: one under which it was to order parts for copier models pursuant to the May 1983 contract and another under which it could order parts not covered by the contract. The May 1985 version of the contract expressly provided that:

> Parts and drums for equipment not listed **in** Appendix A [Appendix A listed equipment available from Xerox] may be purchased by Exdos (subject to availability and Xerox's right to limit quantities at any one time at standard retail prices in effect at the time of purchase[11].

There is no evidence that Exdos (Reid) tried to circumvent or abuse this ordering system, for example, by ordering parts for the newer copier models under the number which was to be used for the ordering of parts on which he was entitled to a discount.

As has been noted, Xerox argues that throughout its relationship with Reid its policy was to sell parts for the newer copier models to the end users of photocopiers only and that it was on this basis that Reid was allowed to purchase parts for models not covered by the contract, including eventually the post-1983 copier models. This is not supported by the weight of the evidence. There is no documentary record of such a

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[10] Exhibit A-1, tab 35.

[11] Exhibit A-1, tab 56A, clause 12.

restriction having been communicated to or imposed upon Exdos. There is no documentary evidence of such a restriction having been communicated to the employees of Xerox who processed the Exdos orders. There was no monitoring by Xerox of either the volume or type of parts being purchased. And there is no evidence that any monitoring took place with respect to any other customer purchasing Xerox parts. By mid-1985 a monitoring system was easily available to Xerox, as a result of a change made to its parts ordering system at that time.

The volume of 10 Series parts Reid purchased is entirely inconsistent with the suggestion that Xerox was only providing such to Exdos for its own end use. In this regard, Xerox employees were aware of the approximate size and nature of Reid's operation. For example, Mr. Hyde visited the Exdos-Nezron business premises in the late fall of 1984 and saw used 10 Series machines in the showroom at that time. Reid sought and received, from Xerox, copies of both parts price lists and service manuals for the 10 Series machines. Such activity is entirely inconsistent with the suggestion that Xerox was only selling parts to end use customers and that Reid's acquisition of post-1983 copier parts was in some way accomplished through subterfuge. It is clear that post-1983 copier parts were being purchased by Exdos and other independent service organisations openly and without restriction.

Although not directly relevant to the issues in this case, for completeness one further aspect of Reid's expansion of his business during the 1984-1985 period should be referred to. Reid expanded his business into the United States and purchased and resold second-hand copiers and parts in that market. This expansion was with Xerox Canada's knowledge and at least tacit permission. Again there was a need to support the photocopier sales with a supply of spare parts. In this context some of the parts being purchased by Exdos from Xerox at a discount (particularly the drums) found their way into the United States market. The parts, having been purchased from Xerox at 50 percent off list, and the drums at a more advantageous price, could be resold into the United States market at prices which undercut the sales efforts of the marketing arm of Xerox Corp. (U.S.). This entity is referred to in the evidence as the United States Marketing Group ("USMG"). In response to concerns expressed by USMG, the discount to Reid for

parts for the pre-1983 copier models was revised in the May 1985 contract renegotiations; the 50 percent discount was lowered to 25 percent. In addition, the list prices of the parts themselves were raised. These changes led Xerox officials to conclude with respect to the concerns raised by USMG:

> The contract has recently been renegotiated with Exdos. The issues you have alluded to ought not to occur unless Exdos wishes to take advantage of any currency exchange Fluctuations[12].

D. Expansion of Exdos and Other ISOs - Consumer Benefit

At the same time that Exdos was expanding its activities in the marketing and servicing of second-hand Xerox equipment, others were doing likewise. A number of ISOs were becoming established in Canada as they had been for some time in the United States. These enterprises provided competition to Xerox with respect to the provision of service for Xerox machines, both second-hand and new. The second-hand machines also provided some competition at the lower end of the market to the sale of new Xerox machines. With respect to this last, however, Reid generally managed to avoid sales conflicts with Xerox. In general there was little "field noise".

Evidence before the Tribunal makes it clear that the second-hand copier market and the option for an alternate source of service provided by ISOs are beneficial to consumers. They allow for customer choice which would not otherwise be available. With respect to the sales of copiers, Exdos-Nezron and other dealers selling second-hand equipment provide the market with machines at a lower price than is the case for a new machine (e.g. $55,000 for a refurbished model 1090 copier as compared to approximately $95,000 for a new machine)[13]. Also, the evidence demonstrates that Exdos-Nezron and other ISOs provide service of a quality comparable to that provided by Xerox, and on

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[12] Exhibit A-1, tab 55.

[13] Exhibit A-1, tab *230.* These prices are taken from a February 1990 letter soliciting business for Nezron. The Tribunal has taken due account of the fact that this is promotional material.

occasion better and at a lower price. Reid speculated that this was possible, even though the ISOs had to buy the parts for the newer copier models from Xerox at full retail price, because the smaller organizations had less overhead and more flexibility than Xerox. In addition, some customers indicated that they preferred to be free of the rather oppressive overselling of Xerox sales representatives. They were unhappy, for example, with the fact that equipment did not always last the life of a given lease and with the continual pressure from Xerox sales personnel to upgrade even though such might not be in the customer's best interest.

The customers of Exdos who were called as witnesses were operating, in general, under significant cost restrictions (some were described by counsel as "mom and pop businesses"). It is clear that a second source of supply for Xerox machines, albeit used machines, and a second source of supply for maintenance services are extremely important in enabling such individuals to obtain quality machines and quality service at an affordable price. In one instance the evidence indicates that in the absence of Exdos the customer, Raymar Equipment Service of Beaton, Ontario, would not have been able to acquire a Xerox machine because service was simply not provided by the company to that geographical area. (Beaton is about an hour northwest of Toronto.)

The evidence of Mr. Kelly, Director of Purchasing for Humber College, is particularly illustrative. Humber College has a heavy capital investment in its reprographic equipment. During the 1986-87 period it owned approximately sixty Xerox machines. About thirty of these had been purchased two years previously. In 1986, Humber College was receiving less than satisfactory service with respect to these machines:

> Everything was fine for the first few years, but service began to deteriorate. ...
>
> You have [to] realize that in an academic institution, a copier is very essential as far as preparation of materials for various classrooms. So, it is a very high priority product in our organization.
>
> Service deteriorated to the point where equipment was down for four and six days at a time. Complaints to service management -- to our marketing rep -- they tried a number of remedies. Nothing seemed to work. They basically explained that it was the high volumes that were causing the problems.

> It got to the point where it became critical. ... We had professors going -- walking right into the President's office and throwing it at him. Now, that is something that a President certainly does not need, ...
>
> We had to start to source some kind of an alternative. We had heard about -- through colleagues in purchasing -- that there were some independent service people out there, so we sourced the marketplace, and found a company by the name of Anco Equiprnent[14].

Accordingly, Humber College began using Anco Equipment to service its machines:

> We found that the independent operators were certainly cheaper. We were very skeptical, though. It was about four months of interviews and reassurances to really separate from Xerox and we started off with just a couple of machines and let Anco look after a couple, ...
>
> As he progressed and proved that he could look after our equipment, we added more and more equipment to **his** installed base[15].

Humber College subsequently purchased nineteen used Xerox copiers from this same IS0 to replace some of its existing unsatisfactory machines:

> That was very beneficial to the college. We bought them and installed them and, of course, set him [Anco] up as the service agent for that equipment. ...
>
> [With respect to the service received from Anco] we are looking at least 75 per cent better than it was with the same volumes. ... It is much cheaper[16].

E. Photocopiers - Service and Parts Revenue - Xerox's Market Position

Photocopiers, by their nature, require constant service. This is so whether the machine be second-hand or new. Indeed, there was evidence that the purchaser of a machine, either second-hand or new, is unlikely to make a purchase without at the same time making some arrangement for its servicing. Because photocopiers require constant service, the revenue received therefrom rivals, if not exceeds, that obtained from the original sale of the machine.

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[14] Transcript at 547-48 (13 June 1990).

[15] *Bid.* at 550.

[16] *Ibid.* at 552.

When buying a machine from Xerox, customers are given several options with respect to a possible service agreement. Customers can choose a full service maintenance agreement under which they pay Xerox an amount which is calculated by reference to the usage which the machine receives. The cost of parts and service are not separated out or identified in the amount paid. For example, Humber College paid Xerox, under its service contract, a certain base charge which was paid as a lump sum at the beginning of each year and then 1.15 cents for each copy produced by the machines. Ninety-five percent of Xerox's customers choose a full service agreement. A second option which customers can choose is a time and materials service agreement. Under this arrangement they pay for parts and service only as and when the machine breaks down. A third option is available for some large volume customers. An employee of the customer can be trained by Xerox to service the photocopiers (at least insofar as the less complicated repairs are concerned). Under this option the customer provides its own service and the required parts are purchased from Xerox. The University of Manitoba, for example, is one customer who chooses this option.

Xerox obtains the parts which it either sells (now only to end users) or provides to its service representatives from Xerox *Cop.* (U.S.). In determining a retail price for these parts there is no evidence that competitive factors are taken into account. Xerox simply uses a grid formula pursuant to which the landed Canadian price, paid by Xerox to its parent, is multiplied by a factor of from two to eight with the multiples being inversely related to the landed price of the parts. Xerox parts are generally more expensive than comparable parts for other copiers. A study of comparable parts was placed in evidence. It shows that prices for Xerox parts are from 198 percent to 951 percent (the median being 389 percent) higher than similar parts used in two equivalent copiers. While Xerox challenges the accuracy of this study it produced no direct evidence to support that challenge. Accordingly, the probative value of that study has not been seriously undermined.

Xerox is the largest supplier of copiers in Canada. In 1989, Xerox had a dominant position in the high-volume end of the market (90 percent share of copier placements) and accounted for almost one-half of the copier placements in the medium volume range[17]. It accounts for about one third of the low-volume copier placements but does not compete in the personal copier market. The copier market is described by Professor Wilson, testifying on behalf of the Director, as a differentiated oligopoly with an active competitive fringe. As Professor Wilson stated, and which the Tribunal accepts, while there is obviously competition in the copier market, with success critically dependent upon an ability to sell upgraded equipment from a cost and features standpoint, the evidence does not warrant the conclusion that Xerox has little market power in the copier market.

F. Introduction of an IS0 Policy (United States)

In January 1987 a policy respecting ISOs was issued by USMG for the United States market. This was a revised version of an earlier policy which had been developed in April 1984 but which had not been implemented. The policy was to refuse, thereafter, to supply ISOs with 10 Series and any new product parts for resale. Part of the documentation describing the initial policy change in 1984 reads:

> We have had a long standing policy of selling parts at commercial list price to all third parties, including direct purchasers of our equipment, third party leasing companies and third party service companies. The establishment of resellers authorized to service Xerox equipment has necessitated a significant change to this policy[18].

The January 1987 policy reads in part:

> For 10 Series copiers ... we will not knowingly supply ISOs with parts for resale, technical training, technical documentation, or other resources (not generally available to end-users). When an order for such resources is received, we may require verification that the purchaser is an end-user and that any parts are not intended for resale. (Resources for new Xerox products introduced after the effective date of this policy likewise will not be offered to ISOs.[19])

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[17] "Volume" refers to the copier's rate of copy production per minute.
[18] Exhibit A-1, tab 114A.
[19] Exhibit A-1, tab 114E.

The IS0 policy for the United States was clearly designed to undercut the viability of the ISOs and to preserve, if not enhance, the revenue derived by Xerox *Corp.* from the service aspect of its business. This policy was subsequently adopted in similar form by Xerox Canada in June 1988 and led to the refusal to supply which is in issue in this case[20]. Before dealing further with the events which led to the refusal to supply, evidence respecting the Xerox-Exdos business relationship during the April 1987 to August 1988 period will be referred to.

G. Xerox/Exdos' Business Relationship -- April 1987 to August 1988

In April 1987, Reid received notice that Exdos' contract with Xerox for the purchase of used equipment was being terminated as of the end of May. It was the view of the person in charge of dealing with Reid at that time (Mr. Haltigin) that the contract was not profitable from Xerox's point of view. This view was based on Mr. Haltigin's analysis of the difference between the cost to Xerox of scrapping the used machines (including the recoverable metal obtained in that process) and the profit received as a result of selling the machines to Reid. The analysis was successfully challenged by Reid who pointed out that it had not taken into account the revenue received by Xerox from the sale to Exdos of parts and supplies for the machines.

Thus, while Reid's 1983/ 1985 contract was cancelled, subsequent negotiations led in November 1987 to an arrangement whereby he was allowed to purchase second-hand equipment from Xerox on a "one off basis". There was no change, however, in Reid's pattern of purchasing parts from Xerox. He continued to purchase parts for both the used machines which he had purchased from Xerox and for the used copiers, including post-1983 models, which he had purchased elsewhere. Both categories of parts were sold to him at full retail price.

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[20] Discussed *infra* at 27ff.

Correspondence which documents the agreement clearly provides that:

> Parts for Xerox equipment not purchased by EXDOS from XCI [Xerox] (i.e. equipment not listed in Attachment B), will continue to be available for EXDOS purchase at standard retail prices. Order fulfilment will be subject to availability and Xerox's right to limit quantities[21]. (some underlining added)

This portion of the correspondence was a direct response to Reid's May 1987 request for clarification from Xerox of various issues arising from the contract termination:

> There are a number of models of Xerox equipment which we service which were not purchased directly from XCI but rather were purchased from XCI customers, through XCI sales representatives, leasing companies and end users directly. We need confirmation that parts for this type of equipment will continue to be available at a standard retail rate[22].

All during the May 1987 to August 1988 period parts for both pre-1983 and post-1983 copier models were sold to Exdos.

H. Development of Canadian IS0 Policy -- Refusal to Supply Parts

To return to a consideration of the Xerox IS0 policy, the evidence establishes that the USMG policy, concerning the refusal to sell 10 Series and newer copier parts to ISOs, would not be effective unless it was implemented by Xerox worldwide. Thus, this IS0 policy which originated in the United States was subsequently adopted in Canada. Xerox argued that insofar as Canada was concerned, the implementation of the policy was nothing more than the formalization of what had always been the company policy, that is, that it would only sell post-1983 copier parts to end users of the machines**.** As has been noted, the evidence does not support that conclusion except, perhaps, with respect to 50 Series parts, which were not on the market until well after the effective date of the Canadian policy.

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[21] Exhibit A-1, tab 153, Attachment A.

[22] Exhibit A-1, tab 117.

The first draft of the Canadian IS0 policy was prepared by Xerox in December 1987. This policy was modeled on the Xerox Corp. (U.S.) policy. Background documents on the policy provided Xerox employees with the following information:

> Senior management is increasingly emphasizing the importance of service revenue to XCI profits.
> Our challenge is to grow service revenue stream which is essential to Xerox success.
>
> Sale of parts, training documentation and other support requirements for 10 Series, EP, 0s products to ISOs (independent service organizations) is contrary to this Objective[23].

On March 7, 1988, a meeting was held to discuss the final draft and implementation of the policy. As part of that implementation procedure, Xerox compiled a list of its top 150 parts customers for the purpose of identifying those among them who were ISOs. The highest volume parts purchaser identified as an IS0 was Exdos. In June 1988 the Canadian IS0 policy became effective[24]. By July 6, 1988, a list of ISOs had been prepared along with a draft letter notifying them of the parts cut off.

On August 26, 1988, a letter was sent to Exdos advising it that Xerox had recently reviewed its product strategy and determined that:

> ... continuation of a used equipment sales and support channel would conflict with other market initiatives presently underway. As a result, we find it necessary to discontinue the sale of used equipment, supplies and parts to EXDOS ...[25].

The cut-off date for used equipment sales was September 26, 1988; parts for resale or service would be unavailable after October 26, 1988. Exdos purchases as an "end user customer" were unaffected.

On August 29, 1988, letters were sent by Xerox to all the other Canadian ISOs announcing the refusal to continue to sell 10 Series parts, 9000 Series parts and parts for various other listed products, other than to end users. For this purpose, ownership of a

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[23]Exhibit A-1, tab 179.

[24] A copy of the policy is included in Exhibit A-1, tab 201.

[25] Exhibit A-1, tab 198.

machine was considered to be irrelevant. The person who actually used the machine, regardless of who owned it, was classified as the end user. Thus ISOs who owned used Xerox equipment, which they had placed under rental to customers, were not entitled to parts for even those machines.

III. COMPETITION LAW ISSUES

An order is sought pursuant to section 75 of the *Competition Act* to require Xerox to supply Exdos (Reid) with post-1983 copier parts. For the purposes of the present case, section 75 can be excerpted as follows:

> 75. (1) Where, on application by the Director, the Tribunal finds that
>
> (a) a person is substantially affected in his business ... due to his inability to obtain adequate supplies of a product anywhere in a market on usual trade terms,
>
> (b) the person ... is unable to obtain adequate supplies of the product because of insufficient competition among: suppliers of the product in the market,
>
> (c) the person ... is willing and able to meet the usual trade terms ..., and
>
> (d) the product is in ample supply,
>
> the Tribunal may order that one or more suppliers of the product in the market accept the person as a customer. (underlining added)

There is no dispute that the parts in question are in adequate supply. There is no dispute that Exdos is willing and able to meet the usual trade terms. There is little doubt that Exdos is unable to obtain adequate supplies of the parts. And, there is little doubt that the inability to obtain supply of the parts has and will substantially affect Exdos' business.

The main competition law issue in this case is the proper product market definition and concomitantly whether it can be said that Exdos' inability to obtain adequate supplies of the product arose because of "insufficient competition among suppliers of the product in the market" ("en raison de l'insuffisance de la concurrence

entre les fournisseurs de ce produit sur ce marché"). More particularly, does section 75 encompass a situation in which the product is proprietary and derives largely from a single source?

A. Inadequate Supply

Prior to Xerox's refusal to sell post-1983 copier parts, except to end users, Exdos could obtain supplies from Xerox itself and from other ISOs either in Canada or the United States. It also could obtain parts from Rank Xerox, the British arm of the Xerox corporate family. Indeed, for some time after the supply of parts had been cut off in both Canada and the United States the supply from Rank Xerox continued. As of February, 1990, however, this source dried up as Rank Xerox implemented the IS0 policy which had been adopted previously in the United States and Canada.

Exdos can now obtain Xerox copier parts: (1) from Xerox, to the extent that Exdos is recognized by Xerox as an end user of any given machine; (2) from the "cannibalization" of used machines; and (3) from independent manufacturers of Xerox parts. With respect to the first source of supply, upon being notified of Xerox's refusal to supply parts except to end users, Reid moved a number of different copier models into his showroom. He had them registered with Xerox in the name of Exdos, as an end user. He is receiving through this process a limited number of parts. This source of supply was described by counsel for the Director as a "trickle" of parts.

The second source of supply, the "cannibalization" of machines, is not an adequate source of supply over the long run. Many parts in a photocopier are "consumable" parts. That is, they wear out on a regular basis, after a given amount of use. They must be frequently replaced. Consumable parts which are obtained from used machines automatically have a more limited life than new parts. Thus replacing a worn out consumable part with a used one invites more frequent service calls. In addition, an IS0 is left with a stock pile of unused parts (from the rest of the machine) which do not need to be replaced with the same frequency as the consumable parts. The cannibalization of machines is not in the long run an economically viable source for consumable parts.

With respect to the third source of supply, the evidence establishes that there were and are independent manufacturers who make some Xerox copier parts. They manufacture the parts that are in heavy demand but they do not manufacture all the parts necessary to properly service the machines. Some unique parts, which are essential for proper service, cannot be obtained from this source. It is clear on the basis of the evidence, then, that the sources of supply of Xerox parts left, in the face of Xerox's refusal to supply, are inadequate.

B. Business Substantially Affected

The evidence establishes that the Exdos-Nezron business has three overlapping aspects. The first is the purchase and sale of used Xerox photocopiers from a variety of sources and the marketing of them, together with the parts required to refurbish and service them, to customers in Canada and elsewhere. This is sometimes referred to as the "brokering" aspect of the business. The second is the refurbishing of the machines by Exdos-Nezron and the marketing of those machines directly into the end-user market, whether by sale, lease or rental. This involves both the placement of the copiers in the end-user market and the provision of continuing service for the machines in the customers hands, should the customer so wish. The third aspect of the business is the servicing of Xerox copiers independently of the sale of the machines. All three aspects of the business require access to Xerox copier parts for the business to survive.

Xerox argues that since it is still willing to supply Exdos with pre-1983 copier parts there should be a finding of no substantial effect on the Exdos business. This is not convincing both because of the volume of the Exdos-Nezron installed 10 Series customer base and because the pre-1983 copier market is **a** shrinking one. Xerox further argues that since its policy is to allow end users to purchase parts, there should be a finding of no substantial effect. It argues that Reid’s customers can order service from Exdos-Nezron, then order the parts themselves directly from Xerox, after which Exdos-Nezron can complete the service. This is clearly so impractical that it has the appearance of a charade. Customer after customer testified that this was not a viable procedure. In the first place, customers do not want to be involved in the administrative task of ordering

parts. More importantly, however, they will not tolerate the machine down-time which such a process of service and repair would entail.

While it seems axiomatic, from the nature of the Exdos-Nezron business and from the facts set out above, that the refusal to supply will substantially affect if not destroy the Exdos-Nezron business, the Tribunal does not rely solely on the evidence which has already been described. The evidence of Mr. Banks, the accountant who performed an audit of the Exdos-Nezron business for the purpose of assessing the effects of the Xerox refusal to supply, establishes beyond any doubt that the Exdos business will be substantially affected by the refusal. One caveat must be added to this conclusion. No evidence was led with respect to the effect that the non-supply of 50 Series parts would have on Exdos. Mr. Banks did not deal with this matter in his evidence. Mr. Reid did not give evidence with respect thereto. As the Tribunal understands it, the 50 Series operates by means of new technology. They were first marketed in 1989 and parts have apparently never been sold to Exdos or to other ISOs.

C. Product/Market

Section 75 requires that one find that a person is unable to obtain adequate supplies "of a product anywhere in a market". In this case, there is little question about the geographic dimension of the market; it was tacitly assumed to be Canada. The main issue between the parties is the relevant product and, concomitantly, the relevant product market. The Director argues that the relevant product is Xerox copier parts, in particular post-1983 Xerox copier parts. The respondent submits that the relevant product market is that in which Xerox itself competes, namely "the provision of reprographic equipments, parts and service to end use customers."

The various arguments which have been raised before the Tribunal with respect to product definition will be considered in the following order: (1) whether, in the present case, Xerox parts should be considered to be a relevant product market for section 75 purposes; (2) whether vertical integration exists as a norm in the industry and the extent to which such might be relevant in the identification of a relevant market; (3) the

significance of the complainant's conduct to the identification of the relevant market; and (4) whether the respondent need exercise market power in the relevant market in order for section 75 to apply.

(1) Xerox Parts

The parties called various economists to testify on their behalf as to the relevant product market. While the process of product market definition is clearly founded on economic analysis, the question of the "relevant" market for the purposes of section 75 depends largely on the construction of section 75 and the identification of its objectives within the context of the *Competition Act* as a whole. It is clear that much of the difference between the expert economists in this case rests upon differing views as to the objectives of section 75 rather than upon differences regarding the proper economic principles respecting market definition. This is particularly true of the evidence given by Professor Waverman. Whether much of this expert evidence was proper opinion evidence was not raised by counsel. In any event, to the extent that Professor Waverman or any other expert was opining on questions of law or on what they considered to be the proper policy of the legislation rather than giving what can legitimately be classified as expert evidence as an economist, the Tribunal has treated that opinion as the personal policy preference of the witness only.

"Product" is a term of art in competition law[26]. The determination of what is a relevant product, for any given purpose, carries with it an identification of the relevant product market. The relevant product and product market may be very broad or may be very narrow depending upon the context within which and the purpose for which that identification is required.

The Director argues that section 75 focuses on the objective of promoting efficiency and consumer choice through the enhancement of participation by individual businesses and that, therefore, the product market is most appropriately defined by reference to the acceptable substitutes available to the business refused supply in

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[26] S. 2(1) of the *Competition Act* defines "product" as "including an article and a service".

satisfying its customers. The Director submits that Exdos must satisfy its customers' demands for the refurbishing, service and sale of used copiers. Those customers own or wish to purchase Xerox machines and therefore, the Director continues, the technical inability to substitute other parts, to make or to keep the machines operational, limits the product definition to Xerox copier parts.

This is consistent with the position taken by the Tribunal in *Director of Investigation & Research v. Chrysler Canada Ltd.:*

> Products and markets can only be meaningfully defined in a particular context and for a particular purpose. The approach to defining these terms may be entirely different where, as in the case of a merger, the ultimate test is whether the merger will substantially lessen competition and the definition must be consistent with the attempt to determine whether the merger will result in an increase in prices or in other effects consistent with a lessening of competition. In the case of paragraph 75(l)(a), the ultimate test concerns the effect on the business of the person refused supplies. Where products are purchased for resale, the effect on the business of the person refused supply will depend on the demand of the person's customers and whether substitutes are acceptable to them. Therefore, the starting point for the definition of "product" under section 75 is the buyer's customers[27].

The Director's expert economist in the present case, Professor Gillen, defined an economic market by reference to the following criteria:

> An economic market is defined as an area in which prices of qualitatively similar goods tend to equality with allowance for transportation or transactions cost. In essence a market defined in this classical economic sense is the set of products within which prices are closely linked to one another by supply and demand and whose prices are relatively independent of prices of goods not in the market. The extent of the market can be measured by the degree of product substitution in the presence of relative price changes [cross elasticity of demand]. ... Products which are close substitutes will exhibit a high cross elasticity of demand or supply and would be included in the same market[28].

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[27] (1989), 27 C.P.R. (3d) 1 at 10.

[28] Expert affidavit of D. Gillen at para. 17 (Exhibit A-1, tab 2).

Professor Gillen accepted as a starting point that one possible market definition in this case was the product refused, post-1983 Xerox copier parts. In order to test this hypothesis, he asked: (1) whether a market for parts used by ISOs could be defined separately from a market for a service package demanded by end users; (2) whether parts and service are distinct and separate products; (3) whether other companies' copier parts should be included in the market; and (4) whether Xerox sourced parts alone form the supply side. That is, he asked as a factual matter whether a market existed: whether there were demanders, suppliers, and transactions occurring. Then, he examined the boundaries of that market and since parts for different vintages and models of Xerox equipment cannot be substituted, he concluded that post-1983 Xerox copier parts was a relevant market.

The respondent's expert economist, Professor Waverman, considered this to be an overly simplistic approach. He attempted to demolish the analysis by stating that if post-1983 Xerox copier parts was a market (or submarket) then logically each part for each machine should be considered a separate market because they are non-substitutable one for the other. The Director's expert was not claiming, however, that post-1983 Xerox copier parts was an exclusive definition of the market which might exist in relation to copiers. Rather he was "limiting the scope of the parts under *consideration to those which were refused and which constitute the base of the definition for the market*[29].

This approach is consistent with that which has been articulated in the academic literature. For example, Areeda and Turner emphasize the need to determine products and product markets by reference to the legislative purpose for which such identification is required:

> One cannot determine ... the "proper" market definition, without reference to the legal context in which the issue arises. One must consider what is under attack, the substantive rules of liability that govern the particular case, and the relief that is at issue....[30]

[29] Expert affidavit of D.W. Gillen (reply to L. Waverman) at para. 4 (Exhibit A-3, tab 6) (emphasis added).

[30] P. Areeda & D.F. Turner, *Antitrust Law: An Analysis of Antitrust Principles and Their Application*, vol. *2* (Boston: Little, Brown, 1978) at para. 518 [references omitted].

And, in a recent supplement to the same text, the authors note that:

> ... talk of markets and submarkets is both superfluous and confusing in an antitrust case, where the courts correctly search for a relevant market -- that is a market relevant to the legal issue before the court[31]. (underlining added)

This approach is also consistent with the decision in *R v. J.W Mills & Son Ltd.*[32] a decision to which both counsel referred. In *J.W Mills & Son Ltd.*, a conspiracy prosecution, Mr. Justice Gibson stated:

> In examining and assessing the competitive feature of the market structure, what is pertinent is the boundaries of the market because the determination of what competition is relevant is one of the key issues, ...
>
> As a matter of law of course there is no definition of the "market" in relation to which the evidence of any alleged violation ... may be examined. What is the relevant market in every case is a matter of judgment based upon the evidence. ...
>
> But speaking generally, it is of importance to bear in mind that the term "market" is a relative concept. In one sense, there is only one market in an economy since, to some extent, all products and services are substitutes for each other in competing for the customer's dollar.
>
> In another sense, almost every firm has its own market since, in most industries, each firm's product is differentiated, to some extent, from that of all other firms.
>
> Defining the relevant market in any particular case, therefore, requires a balanced consideration of a number of characteristics or dimensions to meet the analytical needs of the specific matter under consideration.
> ...
> For this purpose the dimensions or boundaries of a relevant market must be determined having in mind the purpose for what it is intended. For example, two products may be in the same market in one case and not in another.
>
> And many characteristics or dimensions may be considered in defining the relevant market. All are not of the same order. And, in any particular case, usually, not all of the many characteristics or dimensions will have to be considered. In some instances, the definition may turn on only one characteristic or dimension or two ... [33]. (underlining added)

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[31] P.E. Areeda & H. Hovenkamp, *Antitrust Law: An Analysis of Antitrust Principles and theirApplication,*1989 Supp. (Boston: Little, Brown, 1989) at para. 518.1c[references omitted].

[32] [1968] 2 Ex. C.R. 275, aff'd (sub nom. *J.W. Mills & Son Ltd. v.* R.) (1970), [1971] S.C.R. 63.

[33] *Bid.* at 304-6.

Mr. Justice Gibson then listed a number of characteristics which could be used in the definition of a relevant market: actual and potential competition; integration and stages of manufacturers; method of production or origin; physical characteristics of products or services; end users of products; product substitutability; geographic area; relative prices of goods or services. As arranged, the first three characteristics relate primarily to the supply side of the market, and the subsequent three to product substitutability. "Geographic area" is a conclusion rather than a factor in market definition and it would often be established after extensive analysis of the other factors. Price information can be used to draw conclusions about substitutability in supply, between products and over distance.

Professor Waverman for the respondent stated that the relevant product in the present case is the provision of a package of services which leads to the creation of an imaged piece of paper[34]. He was of the opinion that this definition is consistent with the manner in which the product is purchased by the final consumer. The respondent's expert economist did not deny that Xerox copier parts are products for which an identifiable market exists, a market in which persons wishing to service Xerox machines are customers. However, it was his view that this was not the *relevant* market for section *75* purposes. He argued that the product market which was relevant for section 75 purposes should be determined by reference to the market in which Xerox competes and that that is the end user market:

> ... the relevant competition is not that for Xerox proprietary parts, but among the providers of photocopying services, of which there are many.
>
> To argue that the market is Xerox parts ignores the manner in which consumers make decisions. End-users (those who want photocopying services) are not indifferent to the prices of Xerox parts since ultimately that price, whether explicit or implicit, is a component of the cost per copy. Competition among providers of photocopying services in the cost per copy provides discipline in the market for parts[35].

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[34] Expert affidavit of L. Waverman at para. 9 (Exhibit A-3, tab 3):
"the provision of the services of imaged pieces of paper with a given set of cost and performance specifications, through the provision of reprographic equipment and the service, parts and supplies, required to enable the equipment to produce copies on a regular basis with minimum interruption from the equipment not working."

[35] Expert affidavit of L. Waverman (rebuttal to D.W. Gillen) at para. 9 (Exhibit A-3, tab 4).

Professor Waverman took the position that Xerox's actions in curtailing supply were motivated by competition in the copier market and would only, in the long run, result in the intensification of that competition. He was of the view that an order under section 75 would cause a welfare loss to consumers by substituting inefficient distribution systems for efficient (as dictated by the market) systems. Therefore, it was argued that the fact situation does not fall within either the spirit or intention of section 75.

Even if this position were correct, however, the evidence in the present case would not support a conclusion that the end-user market provides competitive discipline to the parts market. It is clear that at present Xerox does not price its parts by reference to competitive factors but, rather, sets prices according to an arbitrary "formula". In addition, even if Xerox were forced to price parts competitively in the long run, a present owner of a Xerox machine cannot easily, during the economic life of that machine, switch to another manufacturer's brand of copier. As counsel for the Director argues, it is no answer to Exdos' customers to tell them that "based on some Chicago School of Economics theory ... [they] should wait until the market rights itself' and that in the long term when they purchase their next copier they can purchase from a company that provides better and cheaper parts and service.

To turn then to a consideration of whether or not proprietary replacement parts should ever be categorized as a "product" or as constituting the base of a "product market", it should first of all be noted that the *Competition Act* and, in particular, section 75, is not limited to ensuring the availability of *final* products at competitive prices. The Act itself is not expressly so worded and there is nothing in the statement of its purposes which leads to a conclusion that such a limitation was intended. Indeed one of the purposes set out in section 1.1 of the Act is "to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the Canadian economy". This would seem on many occasions to contemplate, if not require, action to preserve the competitive situation in an intermediate market. It was argued to the Tribunal that if the respondent's interpretation of the legislation was correct, it would mean, for example, that because General Motors and Ford compete in the final market for automobiles there

would be no definable market for captive parts for Ford cars. Or, it would mean that for purposes of the *Competition Act*, the concentration of upstream assets in the hands of suppliers, such as oil companies, should be ignored because such companies face retail competition downstream.

In other competition law contexts intermediate markets in proprietary replacement parts have been identified as relevant markets. None of these, of course, relate to section 75 of the *Competition Act.* They can only be cited, and have only been cited, for the purpose of demonstrating that such product markets *may* be relevant for competition law purposes. For example, in *R v Chatwin Motors Ltd.*[36],the Crown alleged a conspiracy between franchised dealers with respect to one part of the motor vehicle parts and accessories market: captive parts for Ford and General Motors vehicles and, in particular, those captive parts secured on special orders where the dealer paid the freight charges. The British Columbia Supreme Court held that the only substantial competition in captive parts was between franchised dealers and that, however narrow a field of competition, the public was entitled to have it preserved[37].

In *Hugin Kassaregister AB v. Commission of the European Comrnunities,*[38] Article 86 of the Treaty of Rome was under consideration. Article 86 provides that any abuse of a dominant position within the European Economic Community ("EEC') or a substantial part of it shall be prohibited insofar as it may affect trade between member states. The Swedish company and its subsidiaries had refused to supply spare parts for Hugin cash registers to a British firm that specialized in the service, reconditioning and renting out of Hugin cash registers. Hugin Kassaregister AB ("Hugin AEY) argued that the supply of spare parts and of maintenance services was not a separate market but rather a component of the cash register market. The headnote describing the Commission's decision that Hugin Al3 had infringed Article 86 states in part that:

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[36] (1978), 37 C.P.R. (2d) 156 (B.C.S.C.). The appeal courts quashed the Crown's appeal on the basis that it involved questions of fact: (1978), 7 B.C.L.R. 171,40 C.P.R. (2d) 106 (CA.), aff'd [1980] *2* S.C.R. 64.

[37] The Court found an agreement between the dealers to levy a freight charge on the special orders but also decided that the agreement had no effect on the competitive nature of their dealings. In fact, the Court accepted the defendants' argument that they were improperly joined in the same conspiracy charge since there was never any competition between Ford and General Motors dealers that could have been restricted by an agreement.

[38] (No. 22/78), I19791 C.M.R. 7439 (E.C.J.).

> Where a particular brand of a product uses spare parts which are not interchangeable with spare parts of other brands of the same product and cannot otherwise be economically reproduced, and the parts are made to the (non-EEC) manufacturer's design, with tools belonging to the manufacturer and are exclusive to the manufacturer such that the manufacturer controls the supply of all its spare parts throughout the world, it enjoys a monopoly in the parts and thus, with its subsidiaries established in the EEC, holds a dominant position in the Common Market for the supply of such spare parts. It therefore has also a dominant position for the maintenance and repair of the product itself in relation to companies which need a supply of the spare parts. This is so even if the market share of the manufacturer in the product itself does not give him a dominant position in the product.
> ...
>
> A manufacturer who has a monopoly in the supply of spare parts for his product and who delivers such parts only to his own subsidiaries and authorized dealers for their own use and not for resale abuses his dominant position in that he restricts competition through his refusal without objective justification to supply others[39].

In *Image Technical Service, Inc., v. Eastman Kodak Co.*[40], it was held that a refusal by Eastman Kodak Co. ("Kodak") to sell copier equipment parts to ISOs, after having sold them to such businesses for several years, was a triable issue under section 2 of the Sherman Act[41]. Section 2 makes it an offence to monopolize or to attempt to monopolize "any part of the trade or commerce among the several States, or with foreign nations". No definitive ruling was given on the facts of the case because the issue was addressed by the Ninth Circuit Court of Appeals in the context of an appeal from the summary dismissal of the plaintiffs' private antitrust action. In reaching the decision that such a summary dismissal was not appropriate, the Court stated:

> ... there is logical appeal in Kodak's theory that it could not have monopoly power (let alone market power) in the service market since it lacks economic power *in* the interbrand market. But in light of appellants' evidence we cannot say that this theory mirrors reality[42].

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[39] *Liptons Cash Registers and Business Equipment Ltd v. Hugin Kassaregister AB* (1977), [1978] 1 C.M.L.R. D19. The Court of Justice also found that Hugin parts required by independent undertakings constituted a relevant market for the purposes of applying Article 86 to the facts before it and that Hugin had a dominant position in that market. The Court annulled the decision of the Commission on the narrow ground that the actions of Hugin had not affected trade between member states since the servicing, rental and sale of cash registers was a local business by nature.

[40] No. *88-2686* (9th Cir., 1 May 1990).
[41] 15 U.S.C. *0* 1-7.
[42] *supra*, note 40 at 3643.

The same case also involved an allegation that Kodak had infringed section 1 of the Sherman Act in refusing to sell replacement parts to end users of its equipment except on condition that they not engage ISOs to service the copiers[43]. Kodak argued that parts and service formed a single product market and that therefore there could be no tying arrangement. The Court held that this argument presented, at best, a disputed issue of fact.

> That products must be used together does not eliminate the possibility that they form distinct markets. ... Kodak's policy of allowing customers to purchase parts on condition that they agree to service their own machines suggests that the demand for parts can be separated from the demand for service[44].

The Court also stated that, assuming a tying arrangement existed, there was an issue of material fact as to whether Kodak had the requisite economic power in the tying product market. Plaintiffs/appellants argued that Kodak had power in the parts market because its parts were unique and because owners of its machinery could not readily switch. Kodak countered that it did not have market power in the interbrand market for copiers and therefore could not have market power in the after-market for spare parts. The Court stated:

> We believe that competition in the interbrand markets might prevent Kodak from possessing power in the parts market. ... In this case, Kodak has tied parts to service, not equipment to parts. Interbrand competition in the equipment market does not in the abstract negate appellants' claim that Kodak has power in the parts market.
> ...
> While appellants have not conducted a market analysis and pinpointed specific imperfections in the copier and micrographic markets, a requirement that they do so in order to withstand summary judgment would elevate theory above reality. It is enough that appellants have presented evidence of actual events from which a reasonable trier of fact could conclude that Kodak has power in the interbrand market and that competition in the interbrand market does not, in reality, curb Kodak's power in the parts market[45].

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[43] Section 1 of the Sherman Act declares "every contract, combination ... or conspiracy, in restraint of trade or commerce" illegal. The particular restraint alleged in this case was the illegal tying of parts to service. In order to be successful in such a claim, the plaintiff had to prove: (1) that separate markets for parts and service existed and (2) that the defendant had sufficient economic power in the tying product market (parts for Kodak copiers) to restrain competition appreciably in the tied market (service for Kodak copiers).

[44] Supra, note 40 at 3632-33.

[45] *Bid.* at 3634-36.

In coming to this decision the Court distinguished one of its earlier tying decisions: *General Business Systems v. North American Philips Cop.*[46]

The decision in the *Image Technical Service, Inc.* case has been quoted at length because much of the expert evidence filed by the respondent in the present case seems infused with and based on concepts which exist in United States antitrust jurisprudence and upon arguments which have been made or are being made in relation thereto. These are not necessarily relevant to the interpretation of the Canadian legislation[47]. The case does demonstrate, however, that even in that jurisdiction proprietary replacement parts may be a relevant product market for competition legislation purposes.

In the present case, a determination of the relevant product market and an assessment of the extent of the market in which that product **is** situated, by reference to the product which has been refused and to factors such as those set out in the decision of Mr. Justice Gibson, are appropriate. The geographical extent of the market is not seriously in doubt; it has basically been assumed to be Canada. Prior to the implementation of the refusal to supply by both Xerox *Corp.* (U.S.) and Rank Xerox, the market might have been described as larger in extent; parts could, at that time, be imported.

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[46] 699 F. 2d 965 (9th Cir. 1983). The dissenting judge in *Image Technical Service, Inc.* described the argument accepted by the Ninth Circuit in *General Business Systems* as "similar" to the reasoning set out by Judge Posner (of the Seventh Circuit) in dissent in *Pam* & *Electric Motors, Inc. v. Sterling Electric, Inc., 866* F. 2d 228 (7th Cir. 1988). The dissenting judge was of the opinion that:

> the majority has misconstrued the nature of Kodak's argument. Applying Judge Posner's analysis in Sterling, competition in the interbrand market dictates a simple choice: Kodak may either price parts competitively and maintain its interbrand market share, or it may price parts supercompetitively - yielding a short-term gain but over the long term destroying its share of the interbrand market. In either case Kodak is not harming competition: if it adopts the latter strategy, competitive forces will exact a heavy toll in the interbrand market, and profits gained from the short-term parts mark-ups will quickly be eclipsed. The result would be "a brief perturbation in competitive conditions -- not the sort of thing the antitrust laws do or should worry about.

Supra, note 40 at *3646.* The dissenting judge considered that the majority in *Image Technical Service, Inc.* had rejected this line *of* reasoning as too theoretical to serve as a basis for summary judgment.

[47] Unlike the *Competition Act* the concept of refusal to supply in both US. law and EEC law operates within the framework of provisions preventing abuse of dominant position or monopolization and tied selling and other vertical restraints.

The boundaries of the product market can properly be defined as parts for Xerox copiers. The relevant submarket or class of product falling within that market, for purposes of the present case, is parts for post-1983 model copiers. There is no compelling reason flowing from either the legislative text of section 75 or from general economic principles which requires that proprietary replacement parts should not be considered to be a relevant product for section 75 purposes.

The consumers of the product are Exdos, other ISOs and those Xerox customers who service the machines themselves. While the Director's expert economist's position is that Xerox is the sole supplier, he also notes that this is essentially a factual question rather than one for expert evidence. Professor Gillen identifies Xerox as the sole supplier because other sources of supply located both within Canada and without are qualitatively different from the supply provided by Xerox. In the Tribunal's view, it is more accurate to identify the suppliers, prior to the refusal to supply, as Xerox, other ISOs, Rank Xerox, and the independent manufacturers of parts.

(2) Vertical Integration

The respondent has put forward several arguments with respect to the proper market definition which are based on conclusions of fact not supported by the evidence. For the sake of completeness, however, they will be discussed. One such argument is that the end-user market and not the parts market should be identified as the relevant market because the industry norm is one of vertical integration. It is argued that vertical integration is adopted by firms for reasons of efficiency and that it should be assumed in this case that this is the reason for Xerox's desire to remain with or return to a system of vertical integration.

"Vertical integration" was used by the respondent's expert in a very limited sense, as meaning only that Xerox did not sell parts except to end users, not that Xerox only provided its parts through its own service technicians. It is clear that Xerox, for many years, sold parts freely and openly to anyone who wished to purchase them; sales were not limited to end users. Xerox did not practice a system of vertical integration even in the sense in which that

term has been used in the evidence by Professor Waverman and Xerox does not practice vertical integration in any more comprehensive sense, since it is still willing to sell parts directly to end users. Nor does the evidence establish that vertical integration is the norm in the industry either in this restricted sense or in a more general one.

The respondent's expert stated that firms adopt vertically integrated structures for reasons of economic efficiency[48] and that if vertical integration is not preserved the benefits which accrue therefrom (e.g. the use of increased service revenues to defray high research and development costs or the ensuring of a consistent quality of service) are denied to consumers. The difficulty with the respondent's expert's argument is that it is entirely hypothetical. While it may be true that firms adopt systems of vertical integration for efficiency reasons, there is no evidence that such is true in the present case.

Whether situations where vertical integration is either the norm in the industry or is dictated by reason of economic efficiency fall within section 75 can only be determined in the context of cases where a relevant factual basis exists. It may be that such factors would lead the Tribunal to conclude that a product market did not exist or it may be that they would lead the Tribunal to conclude that the complainant's inability to obtain supply did not arise "because of insufficient competition among suppliers of the product in the market". But it suffices for present purposes to note that the conclusions of fact which are sought to be drawn, in this case, to support such an argument cannot be substantiated.

(3) Conduct of Complainant/Burden on Xerox

The respondent alleges that no market was established because Reid acquired parts through subterfuge. As has been noted elsewhere, this is not supported by the evidence. *Also,* the evidence does not support a conclusion that Reid was refused supply because of particularly onerous administrative obligations and expenses which arose for Xerox as a result of dealing with him (e.g. inventory costs). Nor is there convincing

[48] The term "efficiency" has (at least) two meanings in economic literature: (1) welfare benefits (the best allocation of resources in society as a whole); (2) cost minimization by a firm (see J. Tirole, *The Theory of Industrial* Organization (Cambridge, Mass.: MIT Press, 1988) at 16). In the present context "efficiency" is being used as synonymous with the cost-minimizing organization of economic activity. Efficiency gains from vertical integration may arise for technological reasons or because of reduced transaction costs and reduced uncertainty.

evidence that Exdos can "free ride" on Xerox's investments in many areas. There is evidence that many of the IS0 dealers who were part of the Exdos network and some of the Nezron service people were ex-Xerox employees who had been trained by Xerox to service Xerox equipment. But this is hardly sufficient to constitute the "free-riding" which is alleged. There is also no convincing evidence that Xerox could be injured because Exdos generally would not, and could not be expected to, take the standard of care in maintenance and repair of Xerox machines that Xerox would. Nor is there evidence to support the assertion that Xerox's reputation suffers every time Exdos is unable to service a photocopier properly or that if Exdos-Nezron is unable to fix a machine it then calls on Xerox to fix the machine. In fact, it might be argued that Exdos, perhaps more than Xerox, has an *immediate* interest in providing timely, high-quality service and repairs since that is its business. In general, it is to be noted that Professor Waverman's expert affidavits are replete with assertions of fact that are entirely unsupported by the evidence.

Whether factors relating to the conduct of the complainant or the administrative burden or other costs placed upon a supplier might be relevant to a determination of the existence and the definition of a product market can only be assessed in the context of a case where factual evidence establishes that *such* factors exist. It may be that the existence of those factors would lead the Tribunal to conclude that a "product market" did not exist, or more likely, it may be that they would lead the Tribunal to conclude that the inability of the complainant to obtain adequate supplies did not arise "because of insufficient competition among suppliers of the product in the market" but rather for objectively justifiable business reasons, or that as a matter of discretion an order to supply should not be given. It suffices for present purposes to note, as with the arguments based on vertical integration, that the conclusions of fact which are sought to be drawn, in this case, to support those arguments, cannot be substantiated.

(4) Market Power of the Respondent

One last consideration respecting the definition of the relevant product market should be considered, that is, whether the market must be one in which the respondent exercises "market power". As will be noticed from the references above to both EEC

competition law and the United States antitrust jurisprudence, this is a question which is relevant in those jurisdictions. A similar argument was addressed by the Tribunal in the *Chrysler Canada Ltd.* decision:

> The economist, Professor Ralph A. Winter, who appeared as an expert witness on behalf of the respondent, submits that the Tribunal should approach the definition of product and market not from the point of view of Brunet as a buyer, but from the viewpoint of determining whether Chrysler has substantial market power. This, he submits, can only be done by considering what Chrysler sells and with whom it competes. He concludes that the relevant market is synonymous with the worldwide sale of automobiles since the price of auto parts is established in conjunction with the pricing of vehicles. It is Winter's view that Chrysler's pricing of parts is constrained by the effect this *can* have on the sale of its vehicles and that it faces very stiff competition in the sale of its vehicles. Winter concludes that since Chrysler does not have substantial market power as a seller of vehicles, its decision to discontinue supplying Brunet was motivated by concerns for efficiency and not to increase its market power.
>
> This argument is presented by Winter in relation to the definition of product and market and also in conjunction with the Tribunal's use of its discretion to grant an order in the event that it finds that all of the elements have been satisfied by the applicant. The Tribunal is satisfied that a broad consideration of Chrysler's market power is not required in determining whether the specific elements of section 75 of the Act have been satisfied but may be relevant in the Tribunal's exercise of its discretion[49].

This argument has already been dealt with to some extent above, in the context of the discussion of what constitutes a relevant product market for section 75 purposes. If the relevant product market is identified as parts, then it is clear that Xerox has almost a monopoly position in that market. If the product market is copiers then Xerox still has substantial power in that market. Whether or not it could be said to have a dominant position was not in issue in this case. In any event, it is useful to stress that the respondent's market power is not an element which need be proven for the purposes of obtaining a section 75 order. It may be that it will be rare to find a situation in which a supplier refuses to supply a would-be purchaser, for anti-competitive reasons, without holding significant market power in the relevant market. It would be counterproductive if

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49 *Supra*, note 27 at 12.

the would-be purchaser could easily find an alternate source of supply. Nevertheless, neither the identification of the relevant product nor the definition of the relevant market hinges, for section 75 purposes, on an assessment of the respondent's market power in the relevant market. All that is required is that the complainant's inability to obtain adequate supplies occur "because of insufficient competition among suppliers of the product in the market".

D. Insufficient Competition Among Suppliers of the Product

Although section 75 does not directly demand that the Tribunal find any specified effect on competition in the market resulting from the refusal to supply, it is clear that not all situations where a supplier decides to discontinue selling its products to a customer will fall within the section. Paragraph 75(l)(b) requires that the person who has been refused the product be "unable to obtain adequate supplies of the product because of insufficient competition among suppliers of the product in the market".

Thus, a particular market situation must exist at the time of the refusal, a situation that can fairly be described as "insufficient competition among suppliers". How much competition between suppliers is insufficient will depend on the facts of the particular case. Clearly a market composed of numerous suppliers acting independently would not qualify. (It is also very difficult to conceive of a case before the Tribunal where ***so*** many of a multitude of suppliers would refuse to supply an individual that his business could be "substantially affected. One would postulate that if one supplier did not want the business, another would be more than happy to earn the extra revenue.)

In addition, the refusal to supply must occur *"because* of insufficient competition among suppliers of the product". That is, the overriding reason that adequate supplies are unavailable must be the competitive conditions in the product market.

In this case, the Director submits that since the relevant product market is confined to Xerox parts, the only issue raised by paragraph (b) is whether adequate supplies can be obtained from sources other than Xerox itself. Since, as was discussed

above, the alternative sources are neither adequate nor economically viable, the Director argues that, by definition, the market for these parts is characterized by insufficient competition. On this characterization, this is undoubtedly true, since Xerox is, for all practical purposes, a monopolist in its own proprietary parts.

The respondent's argument on this point is inextricably linked to its position on the question of the definition of the relevant product market for section 75 purposes. The respondent submits that the wording of paragraph (b) contemplates that the "market" should consist of more than one supplier since the word "suppliers" is specifically used. Therefore, the respondent reiterates, the relevant market must be that in which the manufacturers of copiers compete.

In response to questions concerning the proper interpretation of the phrase "because of insufficient competition *among suppliers* in the market", counsel for the Director pointed out that the usage of the word "suppliers" in that phrase can legitimately apply to a situation where the refusal emanates not only from a dominant manufacturer/supplier of parts but also from a single supplier. Subsection 33(2) of the *Interpretation Act*,[50] clearly establishes at least a presumptive rule that "words in the plural include the singular".

Counsel for the Director further argued that, although such a presumption could be overturned if dictated by the context in which the particular phrase occurred, an interpretation including the singular[51] is supported by reference to the rest of section 75. He submitted that the intent of section 75 was clearly to *catch* rather than to *exclude* the single supplier market. Counsel pointed to subsection 75(2) to support this argument: subsection 75(2) would allow an article differentiated by a trademark or proprietary name to be considered a separate "product" for the purposes of the section *if* the article occupies such a dominant position in the market as to substantially affect the ability of the person

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[50] R.S.C. 1985, c. 1-21.

[51] The words "among suppliers" would have to be read out of the phrase altogether for it to continue to make grammatical sense in the singular.

denied access to carry on business. In appropriate circumstances, he argued, this would lead to a product market definition limited to a proprietary or trademarked article with a dominant position and therefore the order would issue against a sole supplier.

The Tribunal accepts that the use of the plural in paragraph 75(l)(b) includes the singular. There has been no convincing argument before us that would lead us to conclude that the statutory context of that paragraph dictates otherwise. It would import a logical inconsistency into the section to hold that a supplier of the relevant product in, for example, a market with three or four suppliers, could be subject to review by the Tribunal for refusing to supply while a supplier with a monopoly position could not be.

Many arguments were made to the Tribunal concerning the implications an order to supply proprietary replacement parts would have for the future application of section 75. The *Chrysler Canada Ltd.* decision has already established that an order to supply proprietary replacement parts can properly be issued pursuant to section 75. Many of the arguments raised before the Tribunal in this case were also raised in that case; many refer to hypothetical situations which it is suggested might arise in the future and with respect to which it is argued that the Tribunal might, then, have to make a section 75 order if such an order is granted in this case.

As has already been noted, it is difficult to deal with this kind of argument. In the absence of an actual situation establishing the facts which are hypothesized, a conclusion that they might or might not justify a section 75 order is difficult to make. For example, it has been suggested that if an order can be given in the circumstances of this case one might also issue in a situation where a manufacturer/supplier of proprietary parts had never unbundled the sale of its parts from the sale of its machines. Whether such an order could properly be obtained under section 75 is not in issue in this case, but one can ask whether the Director, in such circumstances, would be able to prove the existence of a market for the product in question; one can ask whether a complainant could say that his or her business was substantially affected by such a refusal to supply. It is useful to quote some of the respondent's argument which seems to recognize this:

> It was accepted by all the economic experts that from an economic perspective there is nothing either inefficient or anti-competitive about a manufacturer carrying on business within a vertically integrated structure.
> ...
> The only competition issue arises then, when a manufacturer operates in a fashion to "break the bundle" of goods and services and to create a market where none previously existed. The most typical situation in which this occurs is at the dealer level.
>
> If a manufacturer distributes his product through a dealer network then it may be appropriate to look at the competition aspects of this market so created to ensure that as between dealers there is not discrimination and restricted competition.
> ...
> Absent the conduct of the manufacturer which can clearly and unequivocally be said to have created a market for parts at the dealer level there is no competition issue to be dealt with[52].

In the present situation the manufacturer/supplier did create a market for Xerox copier parts. It created a market for Xerox copier parts not through use of a dealer network but by selling to anyone who wished to purchase.

Another hypothetical situation raised was whether section 75 could catch a manufacturer who refused to supply certain customers merely because he wished to change his distribution system for the product. Again, in the absence of an actual factual situation, it is impossible to conclusively answer such a question. At the same time, one can question whether an inability to obtain supply in such circumstances would necessarily meet the test of occurring "because of insufficient competition among suppliers of the product in the market". It may very well be that the inability to obtain supply in such circumstances could be related to a legitimate business decision unconnected to anti-competitive factors. In any event, the present situation is not one in which the respondent is attempting to change its dealer distribution system. And, it is abundantly clear that the decision was taken for the very purpose of curtailing competition in the after-sale market.

The last consideration which is relevant to this issue is the legislative framework of section 75. Counsel for the Director argues and the Tribunal accepts that section 75

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[52] Written argument of Xerox at paras 148,150,151,160.

must be read in the light of the express purposes of the legislation and the other provisions of the Act. Section 1.1 describes the purposes of the *Competition Act* as including "to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the Canadian economy" and "to provide consumers with competitive prices and product choices." Both these purposes would be served by granting an order in favour of Exdos as sought by the Director. Exdos will continue to have an "equitable opportunity to participate" and consumers will have price and product choices available which they would not otherwise have.

IV. CONSTITUTIONAL ISSUES

The constitutional jurisdiction of the Parliament of Canada to enact section 75 is challenged. The respondent argues that if the Tribunal can make an order under section 75 to govern a supplier's conduct without reference to the effect on competition that section is legislation with respect to property and civil rights in the province (subsection 92(13) of the *Constitution Act, l867*[53] and that it is not legislation with respect to any matter falling under Parliament's jurisdiction pursuant to section 91 of the *Constitution Act*, 1867. Even if the section might otherwise be constitutionally valid, counsel argues that it is inoperative with respect to the facts of this case because the facts do not encompass a situation where the refusal to supply is one having anti-competitive effects.

In addition, issues respecting the constitutionality of the Tribunal itself are raised. These last rely on the decision of Mr. Justice Philippon of the Superior Court of Quebec in *Alex Couture Inc. c. P.G. Canada*[54].

A. Constitutionality of Section 75

The starting point for a discussion of the constitutionality of a provision of the *Competition Act* is the Supreme Court decision in *General Motors* of *Canada Ltd. v. City National Leasing*[55]. That decision dealt with the constitutionality of section 31.1, added

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[53] (U.K.), 30 & 31 Vict., **c.** 3.
[54] (6 April 1990), Quebec 200-05-001361-877.
[55] [1989] 1 S.C.R. 641.

to the *Combines Investigation Act* in 1976[56], which section provided that a person who had suffered damage as a result of conduct contrary to Part V of that Act (the criminal offences) or in breach of an order of the Restrictive Trade Practices Commission or a court, could sue for damages. In the *City National Leasing* decision, Chief Justice Dickson referred to the history of subsection 91(2) (the federal trade and commerce power) of the *Constitution Act, 1867*[57]. He noted that *Citizens Insurance* Co. *of Canada v. Parsons*[58] had established three important propositions with regard to the federal trade and commerce power:

> ... (i) it does not correspond to the literal meaning of the words "regulation of trade and commerce"; (ii) it includes not only arrangements with regard to international and interprovincial trade but "it may be that ... (it) would include general regulation of trade affecting the whole dominion"; (iii) it does not extend to regulating the contracts of a particular business or trade[59].

The Chief Justice noted that since *Parsons*, the jurisprudence relating to subsection 91(2) had largely consisted of an elaboration of federal authority with respect to "international and interprovincial trade" and that the second branch of federal authority, that with respect to the power over "general trade and commerce affecting Canada as a whole", had remained largely unexplored. He indicated that in assessing the interaction of subsection 91(2), Parliament's authority to legislate in relation to trade and commerce, with subsection 92(13), provincial legislative authority in relation to property and civil rights in the province, a balance must be struck:

> ... somewhere between an all pervasive interpretation of s. 91(2) and an interpretation that renders the general trade and commerce power to all intents vapid and meaningless[60].

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[56] R.S.C. 1970, c. C-23 as am. S.C. 1974-75-76, c. 76, s. 12. The same section, slightly modified, appears as section 36 of the *Competition Act*, R.S.C. 1985, c. C-34, as am. *Miscellaneous Statute Law Amendment Act, 1987*, R.S.C. 1985 (4th Supp.), c. 1, s. 11.

[57] Initially set out in A.G. *Canada v. Canadian National Transportation, Ltd.*, [1983] 2 S.C.R. 206.

[58] (1881), 7 App. Cas. 96 (P.C.)

[59] Quoted in *General Motors* of *Canada Ltd. v. City National Leasing, supra*, note *55* at 656.

[60] *Ibid.* at 660.

The Chief Justice cited *MacDonald* ***v.*** *Vapor Canada Ltd.*[61],where three criteria were set out as relevant in assessing the constitutionality of legislation in relation to general trade and commerce under the second branch of *Parsons:* (1) the impugned legislation must be part of a general regulatory scheme; (2) the scheme must be monitored by the continuing oversight of a regulatory agency; (3) the legislation must be concerned with trade as a whole rather than with a particular industry[62]. Chief Justice Dickson also adopted two further criteria, identified in *A.G. Canada v. Canadian National Transportation Ltd,*[63] that were relevant in assessing the constitutional validity of legislation in relation to general trade and commerce; (4) the legislation should be of a nature that the provinces jointly or severally would be constitutionally incapable of enacting; and (5) the failure to include one or more provinces or localities in a legislative scheme would jeopardize the successful operation of the scheme in other parts of the country[64]. The five factors thus identified were said to be *indicia* which, however, *did not represent an exhaustive list* of *traits* which might be relevant for the purpose of characterizing legislation as general trade and commerce legislation. *Also, the presence or absence of any one criteria was held not to be necessarily determinative,* in reaching a decision with respect to the legislation's constitutional characterization.

Throughout its history, various provisions of the *Combines Investigation Act* have been subject to challenge on constitutional grounds[65]. The Act was extensively amended in 1976 and again in 1986 when it was renamed the *Competition Act.* It is unnecessary to describe the substance of these amendments; they are well known. Suffice it to say, they too have given rise to several constitutional challenges.

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[61](1976), [1977] 2 S.C.R. 134.

[62] *General Motors of Canada Ltd. v. City National Leasing, supra,* note 55 at 661. In *MacDonald v. Vapor Canada,* paragraph 7(e) of the *Trade Marks Act,* R.S.C. 1970, c. T-10 was found to be invalid federal legislation. That section was a general catch-all section which prohibited a person doing "any act" or adopting any "business practice contrary to honest industrial or commercial usage in Canada". It was not connected to a federal regulatory scheme relating to the general trade and commerce.

[63] *supra,* note 57.

[64] *General Motors* of *Canada Ltd. v. City National Leasing, supra,* note *55* at *662*.

[65] See, *e.g., R. v. Hoffman-La Roche Ltd. (Nos. 1* & 2) (1981), 33 O.R. (2d) 694,125 D.L.R. (3d) 607 (Ont. CA.) (predatory pricing offence could be supported under s. 91(2) as well as s. 91(27) and the residual power); *A.G. Canada v. Canadian National Transportation Ltd., supra,* note 57 (the three judges of the Supreme Court who dealt with the issue would have supported the conspiracy provisions under s. 91(2)).

In addition to the Supreme Court decision in *City National Leasing*, several other *of* the 1976 amendments were challenged and supported. In *P.G. Canada* c. *Miracle Mart Inc.*[66], the Court held that the prohibition on making sales above advertised prices (a criminal offence) was constitutionally valid under Parliament's power over trade and commerce. The Federal Court of Appeal in *Re BBM Bureau of Measurement and Director of Investigation and Research*[67] was of the opinion that the reviewable trade practice of tied selling (previously the jurisdiction of the Restrictive Trade Practices Commission and now within that of the Tribunal) was valid federal legislation under subsection 91(2). Most recently, in *Alex Couture Inc. c. P.G.Canada,*[68] Mr. Justice Philippon upheld Parliament's legislative authority to enact the civil merger provisions, added to the *Competition Act* in 1986, under the trade and commerce power. He struck down those provisions on the basis that they violated the freedom of association of commercial undertakings subjected to them.

As a result of the various constitutional challenges and particularly the Supreme Court decision in *City National Leasing* it is clear that the general legislative scheme of the *Competition Act* is constitutionally valid. In *City National Leasing* Chief Justice Dickson wrote with respect to the *Combines Investigation Act* as amended up until 1980:

> From this overview of the *Combines Investigation* Act *I* have no difficulty in concluding that the Act as a whole embodies a complex scheme of economic regulation. The purpose of the Act is to eliminate activities that reduce competition in the market-place. The entire Act is geared to achieving this objective. The Act identifies and defines anti-competitive conduct. It establishes an investigatory mechanism for revealing prohibited activities and provides an extensive range of criminal and administrative redress against companies engaging in behaviour that tends to reduce competition. In my view, these three components, elucidation of prohibited conduct, creation of an investigatory procedure, and the establishment of a remedial mechanism, constitute a well-integrated scheme or regulation designed to discourage forms of commercial behaviour viewed as detrimental to Canada and the Canadian economy[69]

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[66] [1982] C.S. 342, *(sub nom. R. v. Miracle Mart Inc.) 68* C.C.C. (2d) 242 (Que. S.C.) [translation].

[67] (1984), 9 D.L.R. (4th) *600, (sub nom. BBM Bureau of Measurement v. Director of Investigation and Research under the Combines Investigation Act)* 82 C.P.R. (2d) *60.*

[68] *supra,* note 54.

[69] *Supra,* note *55* at 676.

While that decision related to the *Combines Investigation Act* before the amendments of 1986, the reasoning and conclusions are equally applicable to the amended legislation[70].

Indeed counsel for the respondent does not contest the constitutional validity of the Act as a whole. Rather he argues that section *75* is invalid, if it carries an interpretation which would allow it to apply whether or not there is an effect on competition. Counsel's argument in this regard mirrors Chief Justice Dickson's characterization of the *City National Leasing* case as one where:

> The issue is not whether the Act as a whole is rendered *ultra vires* because it reaches too far, but whether a particular provision is sufficiently integrated into the Act to sustain its constitutionality[71].

Counsel for the respondent argues, in addition, that even if section 75 is valid it cannot support an order which affects a manufacturer's legitimate business interests but is not founded upon an effect on competition. That is, the section may be constitutionally valid but still inoperative with respect to certain factual situations. If the section's breadth is such as to encompass both orders directed at the preservation of competition and those which are not, then

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[70] See Memorandum of law (constitutional issue) of the Director at para. 18:
The basic structure of the *Combines Act* referred to by Mr. Justice Dickson was kept intact in the amendments that created the *Competition Act* and *Competition Tribunal Act* in 1986. The major changes implemented in 1986 were:

(i) insertion of a purpose clause (s. 1.1);
(ii) provision for application of the Act to crown corporations (s. 2.1);
(iii) revision of the investigatory powers of the Director to comply with the Hunter *v. Southam* decision and other considerations (ss. 11-20);
(iv) addition of an offence concerning banking conspiracies (s. 49);
(v) addition of the civilly reviewable abuse of dominance (s. 78-79) and merger provisions (s. 91-100), including special procedural remedies for mergers such as interim injunctions;
(vi) addition of a scheme of merger prenotification (sections 108-124);
(vii) abolition of the RTPC and its jurisdiction over research inquiries and "s. 18" inquiries and its replacement with the Competition Tribunal for adjudication of civilly reviewable matters, and the regular courts for adjudication of search warrants and other investigative applications.

[71] *Supra*, note *55* at 670.

the section might be operative to support the former but inoperative with respect to the latter. This second prong of the constitutional argument is easily disposed of given the findings of fact which have been made. It is clear that the order sought, in the present case, is directly related to the preservation of competition in the service market for Xerox copiers. It is also directed to the preservation of the competition which exists as a result of the existence of a second-hand market for those machines. Thus, if section 75 is valid it is operative to support an order in the present circumstances.

To turn then to the constitutional validity of section 75. The approach to be taken, when an isolated section of an Act is being assessed for constitutionality, was addressed in *City National Leasing.* In that case it was argued that section 31.1 taken alone was clearly unconstitutional because it was legislation in relation to property and civil rights in the province. A contrary argument was put, urging that the section could not and should not be assessed in isolation but had to be considered in the context of the scheme of the Act as a whole. The Chief Justice answered these arguments by stating that if the impugned provision was clearly constitutional as within federal authority and did not intrude on provincial authority, then, no further consideration was needed:

> [I]f in its pith and substance the provision is federal law, and if the act to which it is attached is constitutionally valid (or if the provision is severable or if it is attached to a severable and constitutionally valid part of the act) then the investigation need go no further. In that situation both the provision and the act are constitutionally unimpeachable. If, as may occur in some instances, the impugned provision is found to be constitutionally unimpeachable while the act containing it is not, then the act must be assessed on it *[sic]* own. In these instances, it is clear that the claim of invalidity should originally have been made against the act and not against the particular provision[72].

In most cases, however, it was noted that it was likely that an impugned section could be characterized as being, *prima facie,* in relation to a provincial head of power (intruding to some extent on provincial powers). The degree of "intrusion on provincial powers" is to be assessed not for the purpose of ascertaining the section's constitutionality but in order to weigh this as a factor in assessing the justification of the section as part of the regulatory scheme of the legislation as a whole.

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[72] *Bid.* at 667.

Next, it is necessary to assess the constitutional validity of the legislative scheme as a whole. Once this is done the relationship between the impugned provision and the legislative scheme is to be assessed by reference to a test which is of varying strictness. The strictness of the test varies with the degree of intrusion which the impugned section exhibits with respect to provincial powers. The mere inclusion of a provision in a valid legislative scheme does not *ipso facto* confer constitutional validity upon that provision:

> [T]he court must focus on the relationship between the valid legislation and the impugned provision. Answering the question first requires deciding what test of "fit" is appropriate for such a determination. By "fit" I refer to how well the provision is integrated into the scheme of the legislation and how important it is for the efficacy of the legislation. The same test will not be appropriate in all circumstances. In arriving at the correct standard the court must consider the degree to which the provision intrudes on provincial powers. The case law, to which I turn below, shows that in certain circumstances a stricter requirement is in order, while in others, a looser test is acceptable. For example, if the impugned provision only encroaches marginally on provincial powers, then a "functional" relationship may be sufficient to justify the provision. Alternatively, if the impugned provision is highly intrusive vis-*à-vis* provincial powers then a stricter test is appropriate. A careful case by case assessment of the proper test is the best approach.
>
> In determining the proper test it should be remembered that in a federal system it is inevitable that, in pursuing valid objectives, the legislation of each level of government will impact occasionally on the sphere of power of the other level of government; overlap of legislation is to be expected and accommodated in a federal state. Thus a certain degree of judicial restraint in proposing strict tests which will result in striking down such legislation is appropriate[73].

The Chief Justice then referred to the various ways the required "fit" or test had been described. He listed these in what appears to be an ascending order of strictness: having a rational and functional connection; ancillary to the main purpose of the legislation; necessarily incidental; truly necessary; having an intimate connection; being an integral part of the scheme.

The Chief Justice found that since section 31.1 of the *Competition Act* constituted a minimal intrusion on provincial authority, it was only necessary to demonstrate that a rational

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[73] *Ibid*. at 668-69.

and functional connection existed between that section and the overall scheme of the legislation. At the same time he indicated that section 31.1 could also have been justified on the basis of a stricter test; it could have been classified as an integral part of the legislative scheme.

What then of section 75. It is obvious that a section 75 order may affect the property and civil rights of the person who is ordered to supply and of the person receiving supply. The effect of the section, however, as an intrusion into a provincial legislature's domain with respect to property and civil rights in the province, is not generally very extensive. The section is not, as the respondent has suggested, aimed primarily at governing or regulating contractual relations. That effect is secondary. The section's impact is limited and carefully constrained to redress conduct which is considered to be of competitive prejudice. Simply refusing to supply is not an offence in itself. Section 75 is one of a group of trade practices that are *reviewable* and that *may* be prohibited if certain conditions are met. The elements of paragraphs 75(l)(a), (b), (c) and (d) limit the application of the section and its effect.

Pre-1976 the only prohibitions in the *Combines Investigation Act* which dealt, indirectly, with refusal to supply, were conspiracy, monopoly and resale price maintenance. It was decided that there was a need to deal with refusal to supply in cases having anti-competitive effects, that is, where a person, because of an uncompetitive supply situation in a market, was unable to obtain adequate supplies of a product essential to the operation of his business. Section 75 provides that this type of refusal may be prohibited by the Tribunal; other, justifiable refusals will not be so prohibited.

Section 75 is not a greater interference with provincial jurisdiction than many other valid remedial or prohibitory provisions of the Act which are directed toward controlling competitively undesirable conduct. Such remedies or prohibitions always affect property and civil rights or local contracts within a province to some extent. Certainly the effect on property and civil rights of an order under section 75 is no greater than one under section 77 of the Act (tied selling) or those which regulate mergers and hence affect contracts that may involve parties wholly within a province.

While section 75, unlike section 31.1, is a substantive provision, it is limited in scope and application. It can only be called into play when the Director, after investigation, initiates an action. There is good reason to conclude, then, that the section attracts a no more stringent test than the rationally and functionally related test which was applied to section 31.1. However, like section 31.1, it could satisfy a more stringent test if required.

Section *75* can certainly be characterized as ancillary to the main purpose of the legislative scheme as well as having an intimate connection thereto. The immediate effect of an order to supply is to open up channels of distribution and free competitive forces hindered by lack of access to supplies. The section's objective is to promote or preserve competition. Section 75 operates within the same regulatory parameters as do the other provisions of Part VI. Only the Director may bring an application to require that an order to supply be issued. The Director does so after investigation and in the context of the common enforcement policy of the Act with which he is charged.

Accordingly, section *75* meets the required test set out in *City National Leasing.*

B. Constitutionality of the Competition Tribunal

The parties filed an agreed statement of facts on which an argument could be founded to challenge the constitutionality of the Tribunal. The argument contemplated would follow that set out in the decision of the Quebec Superior Court in *Alex Couture Inc. c. P.G. Canada*[74]. This argument, however, was being considered by another panel of the Competition Tribunal, insofar as it related to that panel's constitutional validity, in the hearing of the application in *Director* of *Investigation and Research v. The NutraSweet Company.* The parties to the present proceeding, accordingly, agreed that rather than rearguing the issue in the context of this case, they would be bound by the decision given in *The NutraSweet Company* case. The agreement provides that either party is free to appeal from a finding of the Tribunal as though the constitutional question raised in *The NutraSweet Company* case had been fully argued and decided in the context of this case.

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[74] *supra,* note 54.

The decision in *The NutraSweet Company* case has now been Rendered[75]. The conclusion reached, contrary to that in the *Alex Couture Inc.* case, is that the panel of the Tribunal hearing that case was validly constituted. Pursuant to the agreement of the parties, that decision is taken as also applicable to the panel hearing this case.

V. CONCLUSION

As has been set out above, Xerox followed a practice, for a number of years, of selling parts to willing purchasers. As a result of that practice independent service organizations grew up and a second-hand market in Xerox copiers developed. The refusal of Xerox to supply parts to Exdos and to others (except end users) was specifically designed to eliminate competition in the service market. Xerox's refusal was part of a concerted effort to eliminate such competition. This effort was initiated originally by Xerox Corp. (U.S.). It was subsequently adopted both in Canada and elsewhere, for example, by Rank Xerox in the United Kingdom.

Section 75 of the *Competition Act* states that where, pursuant to an application by the Director, the Tribunal finds that a person is substantially affected in his business due to an inability to obtain adequate supplies of a product in the market and that inability occurs because of insufficient competition among suppliers of the product, the Tribunal may order a supplier to accept the person as a customer.

In the present case, for the reasons which have been given, the Tribunal finds that all the requirements of section 75 have been met. Therefore an order will issue, as requested by the Director, requiring Xerox to accept Exdos as a customer for post-1983 Xerox copier parts. These will not include parts for the 50 Series copiers. As has been noted, there has been no evidence adduced that a lack of supply of those parts would substantially affect the Exdos business.

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[75] (4 October 1990), CT-89/2, Reasons and Order (Competition Trib.).

VI. ORDER

FOR THESE REASONS, THE TRIBUNAL HEREBY ORDERS THAT:

The respondent, Xerox Canada Inc., shall accept the Exdos Corporation as a customer for the supply of Xerox copier parts, manuals and related resources on usual trade terms.

This order does not encompass parts for 50 Series copiers or for any model of copier which has not yet been introduced, with respect to which no evidence was placed before the Tribunal.

DATED at Ottawa, this 2nd day of November, 1990.

SIGNED on behalf of the Tribunal by the presiding judicial member.

(s) B. Reed
B. Reed