The Eric John Hanson Memorial
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The Role Of Competition Law And
Policy Within The General Government
Policy Framework: Bank And Airline
Mergers As Illustrative Examples

by
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Competition Bureau
Industry Canada

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Edmonton, Alberta
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Foreword

The Eric John Hanson Memorial Lecture Series recognizes the many contributions made by Dr. Eric Hanson to the University of Alberta and to the wider community. Eric Hanson taught at the University of Alberta from 1946 to 1975. He was Head of the Department of Political Economy in from 1957 to 1964, and was instrumental in building our department. Many have benefitted from his dedicated efforts and his wisdom.

The 10th Eric J. Hanson Memorial Lecture, "The Role of Competition Law and Policy within the General Government Policy Framework: Bank and Airline Mergers as Illustrative Examples", was delivered by Konrad von Finckenstein on Tuesday, September 26, 2000. Konrad von Finckenstein is the Commissioner of Competition at the Competition Bureau, a position that he has held since February 1997. As Commissioner of Competition, Mr. von Finckenstein is responsible under the Competition Act for the administration and enforcement of competition law in Canada as well as three labeling statutes, the Consumer Packaging and Labelling Act, the Precious Metals Marking Act, and the Textile Labelling Act.

Prior to becoming Commissioner of Competition, Mr. von Finckenstein held a number of positions in the Government of Canada. These include the following (year of appointment in parentheses): (i) Legal Advisor, Property and Commercial Law Section, Department of Justice (1976), (ii) Director, Commercial Law Division, Department of Justice (1979), (iii) Senior General Counsel, Department of Regional Industrial Expansion (1982), (iv) Senior General Counsel, Trade Negotiations Office (1987), (v) Assistant Deputy Minister, Trade Law, Department of Justice (1988), (vi) Assistant Deputy Minister, Free Trade Policy and Operations, External Affairs (1989), (vii) Assistant Deputy Attorney General, Tax Law and Coordinator for the Implementation of the North American Free Trade Agreement (1990), and (viii) Assistant Deputy Minister, Business Law, Industry Canada (1994).

Mr. von Finckenstein obtained a B.A. (Honours) in Political Science from Carleton University and an LL.B. from Queen's University. He is a member of the Ontario Bar and a graduate of the Advanced Management Program at the Canadian Centre for Management Development. He was appointed Queen's Counsel in 1984.

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Previous Lectures

Inaugural  Dr John Whalley, University of Western Ontario
           Tax Reform Options for Canada

Lecture II  John W Crow, Governor, Bank of Canada
            The Work of Canadian Monetary Policy

Lecture III Dr Cliff Walsh, Australian National University
           The Political Economy of Economic Advice

Lecture IV Dr Jozef MM Ritzen, Erasmus University, Rotterdam
             Minister of Education and Science, The Netherlands
             Government and Job Training

Lecture V  Dr David Foot, University of Toronto
            Demography, Dependency, and Deficits: The Case of Alberta

Lecture VI Dr Thomas E Kierans, President and CEO, CD Howe Institute
            Le Défi québécois: The Quebec Challenge

Lecture VII Arthur Kroeger, distinguished Federal civil servant (retired), now
            Chancellor of Carleton University
            Governments and the “Jobs” Issue

Lecture VIII Mrs Judith Maxwell, President
            Canadian Policy Research Networks, Ottawa
            The Social Dimensions of Economic Growth

Lecture IX  Dr Richard M Bird, Professor of Economics and
            Director, International Centre for Tax Studies,
            University of Toronto
            Taxation and Social Policy
The Role of Competition Law and Policy within the General Government Policy Framework: Bank and Airline Mergers as illustrative Examples

by Konrad von Finckenstein

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Introduction

The topic of this paper is the role of competition law and policy within the general government policy framework. I imagine that readers’ interests lie in the bank and airline mergers, particularly the latter, since this merger continues to receive media attention. Therefore, I will use the bank and airline mergers as illustrative examples of how we do our work. My intention is to describe how the Competition Bureau’s approach to achieving compliance with the law, known as the Conformity Continuum, affected the broad government policy response to the restructuring of the bank and airline industries. I will also stress and explain the considerable expansion of competition policy as a dimension of national economic policy in Canada.

I will first outline what we do at the federal Competition Bureau by explaining our mandate, the main roles we play, and the guiding principles that govern our work. I will then describe the Bureau’s general approach to administering and enforcing legislation. We call this approach the Conformity Continuum because of the interdependent and complementary nature of the component instruments. Our main objective in using the Continuum is to ensure maximum conformity with the law, and we emphasize choosing the most appropriate instruments or set of instruments for the given circumstances.

Having described what we do at the Competition Bureau, I will then explain why I consider the process surrounding the bank and airline mergers to be a good example to show the role competition law and policy plays within the general government policy framework. The bank and airline industries have strikingly similar structures, and respond similarly to the challenges of the continuously evolving marketplace.

I will then outline how the Competition Bureau followed its Conformity Continuum approach when looking at the proposed bank and airline mergers. By selecting the appropriate instruments for the circumstances to mitigate competition concerns and ensure legislative conformity, the Bureau had a significant impact on the overall government policy and regulatory response to restructuring the bank and airline industries. This response facilitated the industries’ transition to more competitive structures and helped the industries meet the challenges of the new world environment. I will conclude by sharing with you some lessons for the future that we learned from our experiences with the bank and airline industries.
Overview of the *Competition Act* and the Competition Bureau

**Competition Act**

The *Competition Act* is a federal law of general application to the Canadian economy. The Act governs, with some exceptions, all business conduct in Canada, and contains both criminal and non-criminal provisions. It aims to promote competition in the marketplace by stopping anti-competitive practices. Its ultimate objective is to safeguard and protect the competition system rather than individual competitors.

**Competition Bureau Mandate**

The Competition Bureau's mandate is straightforward. We strive to ensure that Canada has a competitive marketplace and that all Canadians enjoy the benefits of competitive prices, product choice and quality service.

**Bureau Roles**

The Bureau administers and enforces the *Competition Act* and three statutes dealing with labelling requirements: the *Precious Metals Marking Act*, the *Textile Labelling Act* and the *Consumer Packaging and Labelling Act* (for non-food products).

The main roles of the Competition Bureau are to:

- Investigate violations of the Competition Act, especially involving international cartel activity including price fixing, bid rigging and price maintenance;
- Review notifiable mergers to ensure that they do not lead to market dominance;
- Act as referee differentiating between anti-competitive behaviour and vigorous competition in such matters as abuse of dominance, refusal to deal and exclusionary practices;
- Ensure that accurate and adequate information is available to inform and protect market participants from misleading representations, telemarketing scams and pyramid schemes, and;
- Advocate competition principles before federal regulatory boards and tribunals and, when invited, before provincial governments and other regulators to provide the objective view of the role of market forces.
Guiding Principles

Throughout all of its work, the Bureau endeavours to apply five fundamental principles.

The first principle is fairness. We know we must respond to many competing interests (e.g. those of consumers and producers, wholesalers and retailers, and dominant players and minor players, and the public interest and the private interest). We try to weigh these interests fairly and objectively and to strike the right balance between compliance and enforcement.

The second principle is transparency in what we do and how we do it. When we communicate what we do, we may deter those who might otherwise engage in anti-competitive behaviour. We are as open in our dealings as the law and our confidentiality requirements permit. We also pursue transparency through performance standards. These standards are public, and we are prepared to be judged according to our ability to meet them.

The third principle is timeliness. We know that delays in making decisions can cost businesses money, and so we strive to deal with issues promptly. We decide whether to proceed with or to discontinue a matter as quickly as possible.

The fourth principle is predictability, which allows businesses to arrange their affairs so they comply with the law. When legislation is vague or ambiguous, we state how we intend to apply it. We provide appropriate background information on Bureau decisions, and publish our position on as many issues as possible, both in print and electronically.

The final principle, confidentiality, affects all the others. We cannot perform our work without access to confidential information from businesses and the legal community. We protect that information with all the means at our disposal.

Conformity Continuum

The Bureau has developed over the past several years a variety of educational, compliance and enforcement instruments. Collectively, these instruments are known as the Conformity Continuum. In its simplest terms, the Continuum is meant to capture everything we do. It represents a comprehensive, integrated approach to achieving the ultimate goal of conformity with the legislation. With the publication of the Conformity Continuum Information Bulletin in June 1999, the Continuum has been given shape, substance and context. Figure 1 is a schematic depiction of the Conformity Continuum.

The Continuum is guided by the five principles described above and presumes that most businesses and their managers prefer to comply with the law rather than become involved in enforcement proceedings.
The Continuum runs from compliance to enforcement. It can be best understood as a system of compliance and enforcement instruments designed to complement one another and work interdependently toward promoting conformity with the law. No individual part of the Continuum is more important than any other; no part stands alone and no part can be effective in isolation.

With this integrated approach, the Bureau is able to choose the appropriate instrument or combination of instruments to address the issues any specific situation raises. The continued development of both compliance and enforcement initiatives and the integration of all instruments as part of the Conformity Continuum ensure that the business community has the knowledge and tools necessary to understand and comply with the legislation. The Bureau also makes clear that, in appropriate circumstances, it needs to take vigorous enforcement action to deter, punish, educate and ensure lasting conformity.
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**GENERAL APPLICATION**

**SPECIFIC APPLICATION**

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**Figure 1 CONFORMITY CONTINUUM**

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As illustrated in Figure 1, the instruments that make up the continuum fall into three broad categories: conformity through education, facilitating conformity and responses to non-conformity.

Conformity Through Education. The Bureau believes that, if businesses are informed about their obligations, the majority of them will comply with the applicable legislation. The Bureau has developed several instruments to communicate with the business community and promote competition policy. These instruments include the publication of informative documents, direct communication with the public and advocacy for a pro-competitive marketplace.

The Bureau takes an active role in promoting a pro-competitive marketplace and developing competition policy and legislation. The Competition Act recognizes this advocacy role by providing the Bureau with a statutory right to intervene before federal regulatory boards and tribunals such as the Canadian Radio-television and Telecommunications Commission and the Canadian International Trade Tribunal. The Bureau also makes representations to provincial boards, upon invitation or with the consent of the board in question. Through interventions, appearances and submissions, the Bureau makes full use of its advocacy mandate to promote competition. Other departments frequently seek the Bureau’s advice as they develop policy.

Facilitating Conformity. The Bureau's efforts to facilitate conformity include both those of general application (e.g. proactively monitoring the marketplace to detect and prevent anti-competitive conduct) and specific application (e.g. working directly with individual stakeholders to provide instruments for voluntary compliance). The Bureau uses these instruments to ensure conformity before resorting to enforcement measures to remedy anti-competitive activity.

Responses to Non-conformity. These are grouped into three categories: adversarial instruments, suasion and consent. Adversarial instruments are the logical choice in cases of serious or deliberate criminal conduct, or when resolution of civil or criminal matters on consent is inappropriate. These instruments include those that involve the Bureau or the Attorney General in contested court or tribunal proceedings, as well as product seizures under the standards-based Acts. However, the availability of alternative case resolution mechanisms in the form of both suasion (e.g. information contacts and information letters) and consent (e.g. undertakings and consent orders) allows the Bureau to increase compliance without resorting to contested proceedings.

One can clearly see how the interdependent and complementary nature of the instruments creates a continuum-like approach. Education leads to an understanding of the law, which helps businesses voluntarily comply. For those who disregard the law, we use enforcement action. Deterrence that results from contested proceedings is also a form of education. Once a matter is concluded, whether through a negotiated settlement or prosecution, the results are made public on the Bureau Web site. In this way, we link our enforcement
efforts to education and identify areas we may need to address through information bulletins or enforcement guidelines.

With this approach, the Bureau places increased emphasis on providing businesses with the knowledge and tools they need to comply. It is the businesses' responsibility to use these tools and to be aware that, in challenging certain types of serious anti-competitive behaviour, the Bureau may make immediate use of adversarial measures. We do not consider enforcement instruments as last resorts but rather, as with all other instruments, as tools to be used at the appropriate time and in the appropriate circumstances. We do not in any way suggest that all other efforts must be exhausted before we consider using adversarial instruments.

Bank and Airline Mergers: Illustrative Examples

Let me now take up the central topic of this lecture: the bank and airline mergers as illustrative examples of the role of competition law and policy within the general government policy framework.

The bank and airline industries share a number of similarities, which I outline below, making even more appropriate the choice of recent merger proposals in these industries to illustrate how the Bureau applied the conformity principles to influence the overall government policy and regulatory response.

Similar Structures

Banks and airlines in Canada display striking structural similarities. They are both subject to regulation.

Banking is certainly one of the most regulated industries in Canada. Bank powers are set out at the federal level in the Bank Act, which is typically updated every 10 years. The June 1992 Bank Act included a five-year sunset clause, which may signal a new trend toward more frequent revisions. In addition, the Office of the Superintendent of Financial Institutions monitors banks' ongoing operations for financial soundness and compliance with the Bank Act. Banks are also subject to securities and other financial instruments regulation across the country and abroad through such institutions as the Canada Deposit Insurance Corporation.

The domestic airline industry was, until 1987, closely regulated by the federal government. With the passage of the National Transportation Act that year, the government reduced economic regulation and put greater reliance on market forces to enhance competition and provide more efficient and cost-effective transportation services to shippers and travellers. As a result, no regulations govern services and fares in Canada; however, the industry is always subject to the policies and regulations developed and administered by Transport Canada relating, for instance, to safety and foreign control. The Canadian Transportation Agency is another important body whose mandate is to examine all aspects of the industry that relate to legislated ownership and control.
requirements, including all financial transactions, and to report annually to the Minister of Transport on the operation of the Act.

In sum, the bank and airline industries are currently more open to market forces than they were previously, but they are still partially regulated.

Another similarity between the industries is that, unlike most other industries, mergers in the banking and airline industries are subject to joint decision making involving the Competition Bureau and federal ministers. Mergers between federal financial institutions require the ultimate approval of the Minister of Finance. Consequently, the Bureau sends a copy of the letter addressed to the financial institutions containing the Bureau's assessment of any proposed merger to the Minister of Finance. In the Canadian airline industry, the final decision to approve a merger or acquisition rests with the Governor in Council on the recommendation of the Minister of Transport.

The existence of restrictive ownership rules is another structural similarity between the bank and airline industries. The government has rules in place to ensure that these industries remain in domestic hands. For instance, in the banking industry no entity can own more than 10 percent of any class of shares of any bank listed in Schedule I of the Bank Act. This restriction prevents entry into the Schedule I banking sector through mergers, and protects inefficient banks from takeover.

In the airline industry, the Canada Transportation Act includes a 25 percent limit on foreign ownership of voting shares. The policy on foreign ownership is one of the largest regulatory barriers to entry. The Bureau believes that raising the limit on foreign ownership of voting shares to 49 percent would enhance competition in the domestic air market, particularly given the capital-intensive nature of the airline industry and the need by new entrants and existing carriers for capital.

In addition to restrictive ownership rules, the bank and airline industries share a number of other barriers to entry.

In assessing the competitive effect of the two proposed mergers of the Royal Bank of Canada and the Bank of Montreal and the Toronto-Dominion Bank and the Canadian Imperial Bank of Commerce, the Bureau concluded that the barriers for new entrants into branch banking are high. For instance, the extensive branch networks of the five major banks represent a significant sunk cost investment that is difficult for new entrants to replicate. Moreover, it takes an extended period of time, estimated to be from three to seven years, for a branch to break even. It should also be noted that the major banks have a first-mover advantage over new entrants because they have already secured the best locations in most markets. In addition to the cost of establishing a branch banking network, new entrants face a number of other barriers.

There is some evidence that economies of scale and scope make entry more difficult for smaller firms. The major sources of economies associated with
being large would appear to be the ability to spread the largely fixed costs of technological improvements over more units, and the ability to take on larger risks. Regarding economies of scope, financial institutions that produce a complete line of products have an advantage over competitors with more limited offerings. As with economies of scale, this increases the expenses and risk associated with competitive entry.

Evidence also indicates that customers are reluctant to switch their transaction account from one financial institution to another. Contributing factors would be the widespread use of direct payroll deposit and automatic bill payment. In addition, the major banks have developed strong brand names through decades of advertising reinforced by strong local presence throughout Canada.

There are also a number of regulatory barriers that discourage entry into the financial services sector. These include capital requirements to start a financial institution, access to the Canadian Payments System, which is limited to federally and provincially regulated deposit-taking institutions, and various ownership restrictions such as the one mentioned earlier. These were effective barriers to entry when the Bureau reviewed the Royal Bank-Bank of Montreal and Toronto-Dominion-Canadian Imperial Bank of Commerce mergers. In introducing legislation in the summer of 2000 to create a new policy framework for the financial services sector, the government proposed new measures to reduce the height of these regulatory barriers and thereby foster new entrants into the sector.

Significant barriers to entry also characterize the domestic airline industry. In its letter to the Minister of Transport in the fall of 1999 on the competition issues related to potential industry restructuring, and in its analysis of the proposed merger of Air Canada and Canadian Airlines, the Bureau concluded that barriers to entry are high for scheduled network service of the type these two airlines offer. Within the context of the dominant carrier environment that resulted from this merger, barriers to entry cover numerous areas under the effective control of Air Canada and Canadian Airlines, such as slots, airport facilities, computer reservation systems, frequent flyer programs, interlining, code sharing, surplus aircraft and travel agent commission overrides.

Slot access is a key concern. A slot is a scheduled time of arrival or departure available or allocated to a particular airline on a specific date at an airport. While the focus of the Bureau's discussion was Pearson International Airport in Toronto, where the dominant carrier controls the majority of slots, it is obvious that similar constraints to other existing carriers and potential new entrants could occur in the future at other airports. New carriers might also have difficulty obtaining access to airport infrastructure, such as gates, loading bridges, counter space and baggage facilities. Airline frequent flyer programs can also act as a powerful entry barrier. It is much easier and cheaper for the large network airlines to provide these programs than it is for entrants. In addition, travel agent commission overrides, when used by dominant carriers, may also create a major barrier to entry. Travel agents are by far the most important distribution mechanism for air travel, accounting for more than 75
percent of ticket sales by scheduled airlines in Canada. Airlines pay travel agents base commissions on a fixed percentage of the ticket price, up to a capped value, and make additional payments, called override commissions, when agents meet certain sales targets. These override commissions provide strong incentives to agents to steer business to particular carriers. In a dominant carrier environment, the targets could be set so high that these override commissions would have a powerful exclusionary effect. Again, I point out that these were effective barriers to entry when the Bureau reviewed the proposed merger of Air Canada and Canadian Airlines. The Minister of Transport, in introducing legislation to implement elements for protecting the public interest, has put forward measures intended to reduce the height of some of these barriers.

**Similar Challenges**

As we have seen, banks and airlines in Canada share common characteristics regarding their industrial structure. These two industries are also responding to a host of challenges leading consequently to another category of similarities between them. Both airlines and banks are now living in a continuously evolving era characterized by technological advances, new policy directions such as deregulation, and new market forces such as globalization.

The pace of technological innovation is very fast. For instance, notwithstanding that branch banking is still the core business of Canada’s Schedule I banks, electronic transactions are changing the face of banking. In the airline industry, technology has enabled airlines to develop valuable computer reservation systems (CRS). The technology behind the CRS industry, as with that in other information technology industries, has developed at a rapid pace and CRS owners will probably continue to invest vast sums to improve CRS technology. Therefore, banks and airlines have to compete fiercely to develop early leads on emerging technologies.

Banks and airlines are facing globalization pressures. Globalization can be seen as the integration of capital, technology and information across national borders to create a single, global marketplace, and means the spread of free markets to virtually every country in the world. The global economy is based on a specific set of rules that revolve around opening, deregulating and privatizing economies. This much faster, more open and more complex marketplace is shaping domestic policies and international relations around the world.

The bank and airline industries are responding to these challenges by attempting to create strong home bases. The banks especially invoked the need for consolidation through merger to compete effectively with large foreign banks. Given the globalization trend, it is understandable that both the Canadian banking system and the domestic airline industry envisaged mergers as a competitive strategy. The Bureau and the *Competition Act* do not disapprove of consolidation via mergers *per se* and indeed recognize that these two industries face globalization pressures. However, when reviewing the recent bank and airline mergers, given the regulatory and industry structures
in place, the Bureau sought to avoid creating dominant firms protected from foreign competition. Firms need to be competitive both at home and abroad in the interest of consumer welfare. It is, thus, of prime importance to foster competition in domestic markets by reducing foreign entry barriers to create favourable conditions for new players to enter the market. This contributes to the creation of more competitive structures within which firms can face the organizational challenges involved in implementing global strategies.

The government cannot ignore the degree and intensity with which the world is being linked together into a single globalized marketplace. It has, therefore, to adjust itself to globalization by proposing policy changes that would foster free and more open markets. Transport Canada and the Department of Finance Canada have introduced measures to create the appropriate policy framework in order to increase competition in the domestic marketplace, ensure that the regulatory environment responds to the evolution of the airline and banking industries, and provide greater structural flexibility to compete in the global marketplace.

The Bureau actively participated in this restructuring process. It played a significant policy advocacy role in forming the overall government policy and regulatory response. In the following section, I describe in more detail the involvement of the Bureau in the reforms to show how the Bureau applied the conformity principles outlined previously. The Bureau chose the best set of instruments for the circumstances and was able to influence the overall government policy and regulatory response in this restructuring process.

**Competition Bureau Role: Choice of Appropriate Tools**

The Competition Bureau is convinced that fostering a competitive environment was a crucial aspect of the restructuring of the Canadian bank and airline industries. Any restructuring process also had to be designed to capture the public interest, since in both these industries consumers, employees and residents of small and remote communities would be affected. This section underlines the important role the Bureau played in the restructuring of the bank and airline industries by explaining three appropriate tools that we selected from the Conformity Continuum: competition advocacy, merger review and policy development.

**Competition Advocacy**

**Banks**

In 1997, we had anticipated that the merger wave would eventually catch up to Canada’s banking industry. Indeed, the Bureau did not take long to play a sustained advocacy role in the most recent reform process of financial services, which the federal government initiated in December 1996 when it established the Task Force on the Future of the Canadian Financial Services Sector. The Task Force was to provide advice to the government on public policy issues related to the development of an appropriate framework for the
financial sector in the 21st century. On June 13, 1997, the Task Force released a discussion paper intended to identify the issues and solicit the views of Canadians. In that paper, the government proposed a number of initiatives to protect the interests of consumers, to ease the regulatory burden on financial institutions, and to keep the legislation current with evolving trends.

In November 1997, in response to the discussion paper, the Bureau made a written submission to the Task Force. The submission contained 17 recommendations, some of which addressed the regulations and policies in place at the time. These specific recommendations related, for instance, to the ownership rules for Schedule I banks, entry by foreign banks, the business powers of financial institutions, and the review of the Canadian Payments System.

From a competition policy perspective, ownership restrictions such as the one that limits single investors to no more than 10 percent of any class of shares of a Schedule I bank may also limit these banks’ ability to avail themselves of the competitive opportunities of the global economy. Ownership restrictions preclude mergers with foreign banks and other corporate entities and, thereby, can adversely affect the ability of domestic banks to successfully compete with large foreign banks in the emerging global market. In its submission, the Bureau recommended that consideration be given to removing the 10 percent rule, hence putting greater reliance on market forces. The Bureau’s submission also recommended the removal of the restrictions on the ability of foreign banks to establish branches in Canada. While the Bureau recognizes that the removal of the subsidiary requirement would require new regulations to ensure the prudential operation of foreign banks in Canada, this may be a means to encourage further entry into the domestic marketplace.

Regarding the business power of financial institutions, there is no apparent public policy rationale to restrict banks from offering auto leasing and insurance products to their clients through their branch networks. It is the Bureau’s view that entry into these lines of services would be pro-competitive and consistent with the general trend toward liberalization of financial sector regulations. The greater the number of firms supplying or able to supply a product, the broader the array of price and quality choices available to consumers. The submission, therefore, recommended that, subject to other public policy considerations, banks should be permitted to offer auto leasing and insurance products to their clients through their branch networks. More generally, the submission recommended that all financial institutions be afforded the greatest flexibility to choose the financial products and services to offer consumers.

Finally, it is the Bureau’s view that limiting access to the Canadian Payments System to only deposit-taking institutions places other institutions, such as insurance companies, mutual funds and security dealers, at a competitive disadvantage. The submission, therefore, recommended that access to the Canadian Payments System be provided to any institution that can demonstrate a justifiable need for using the system, the technical ability to participate in clearing and the ability to meet the capital and risk requirements.
As mentioned previously, the Bureau had anticipated the merger wave in the banking industry. This explains why we attached draft bank merger guidelines to our submission to the Task Force two months before the Royal Bank-Bank of Montreal merger was announced. In light of the unique characteristics of Canada’s banking industry, the Preliminary Draft for Consultation of the Merger Enforcement Guidelines as Applied to a Bank Merger outlined how the Bureau would apply its existing enforcement guidelines when assessing the competitive effects of a merger of two or more Schedule I banks. An extensive consultation process started in March 1998 and ran until June of that same year. The Bureau invited representatives from banks, other financial institutions, the business community and consumer associations, along with academics and members of labour groups, to respond to its approach to reviewing bank mergers. Except when confidentiality was requested, the Bureau posted the submissions on its Web site.

Participants in the consultation process agreed that, with only some modest refinements, the general principles articulated in the draft merger enforcement guidelines could be applied to mergers between banks. Given this the Bureau released its final guidelines on July 15, 1998. These do not differ greatly from the draft version. The Bureau later clarified some issues, including that it would examine the already announced proposed mergers of the Royal Bank and the Bank of Montreal and of Toronto-Dominion Bank and the Canadian Imperial Bank of Commerce concurrently as recommended by most of those consulted. As a result of these consultations, it also became apparent that the interface between the Minister of Finance and the Bureau was unclear. Consequently, the procedural interaction between the Commissioner of Competition, who heads the Bureau, and the Minister of Finance was spelled out in Annex I of the guidelines. These were the first industry-specific guidelines the Bureau released, emphasizing the importance of the financial services sector.

In the end, it appears that the whole process and the careful planning in which the Bureau engaged with its submission to the Task Force and the consultative process launched with the bank merger guidelines was productive. After the review of the two proposed bank mergers, the Task Force and the House and Senate committees reviewing the work of the Task Force endorsed our process. In sum, in anticipation of the bank merger wave and in response to the government’s financial services reform process, the Bureau took the opportunity to make full use of its advocacy mandate to promote competition. This advocacy role enabled the Bureau to develop an appropriate policy tool - the merger guidelines for banks - which was then applied to a specific activity - that is, the two proposed bank mergers.

**Airlines**

The Bureau also provided significant input into the restructuring process of the domestic airline industry. The airline restructuring exercise began in August 1999 when Canadian Airlines announced that it did not have enough capital to keep operating for more than one year. To deal with this situation, the ministers of transport and industry issued on August 13, 1999, a 90-day order under section 47 of the Canada Transportation Act permitting the two major Canadian
airlines and other interested parties to come up with proposals to restructure the airline industry without being subject to the confines of the Competition Act. At that time, the Minister of Transport requested that the Bureau provide competition policy advice on how a restructured airline industry could be made as pro-competitive as possible in the context of a dominant carrier scenario; whether from the merger of Air Canada and Canadian Airlines or from the failure of Canadian Airlines.

In requesting our advice, the Minister asked the Bureau to follow certain terms of reference. Specifically, any restructuring would have to take place within the current framework of Canadian ownership and control of air carriers. This was to be a Canadian-based restructuring, so foreign carriers would not be allowed to fly domestic routes. The policy of designating any interested Canadian air carrier under the Canada-U.S. Open Skies air agreement was also to remain in place; however, the Minister left open the possibility of a review of Canada’s policy on air carrier designation in other international markets.

The Bureau interviewed most of the players in the airline industry, airport authorities, consumer groups and academics, and hired economists and lawyers. A letter addressed to the Minister of Transport on October 22, 1999, set out our views on the competitive aspects of restructuring the domestic airline industry. Assuming the emergence of a dominant carrier, the letter described a number of possible anti-competitive effects and recommended possible remedies to alleviate them. The letter also laid the groundwork for the subsequent analysis of the merger between Air Canada and Canadian Airlines, identifying for instance barriers to entry that cover numerous areas under the effective control of these two airlines. While the letter outlined recommended conditions that could be required with the approval of a restructured airline industry, it also pointed out limitations regarding the merger-related remedies. Therefore, in addition to possible terms of restructuring, the Bureau put forward a number of recommendations on possible regulatory, policy and legislative changes. Finally, the letter recommended changes to the Competition Act to deal more effectively with anti-competitive conduct, particularly predation, in the airline industry.

Given the market power of the dominant carrier that was likely to result from restructuring, it was vital to take the opportunity to promote and create competition. Therefore, the letter contained three key recommendations, one requiring regulatory change and the other two requiring legislative change.

On the regulatory side, the Bureau recommended that the limit on foreign ownership of voting shares of Canadian air carriers be raised by regulation from 25 to 49 percent. This would increase access to foreign capital for carriers competing with the dominant carrier. It would also provide a greater incentive for foreign carriers to strike up alliances with a domestic carrier other than the dominant one. It would not affect the issue of foreign control given that the Canadian Transportation Agency’s mandate to review control issues would not change.
On the legislative side, the Bureau recommended two changes in particular that would allow new competitors to create real choices for the flying public and impose price discipline on the dominant carrier: the creation of Canada-only carriers, and a modified sixth freedom approach.

The Bureau suggested that the creation of Canada-only carriers, which would require a change to government policy regarding ownership and control, would provide a significant amount of competition in the dominant carrier scenario. By Canada-only carriers the Bureau was referring to airlines that would be allowed to fly within Canada and serve only Canadian airports. Being Canadian licensed carriers, these carriers would have the same cost base as the dominant carrier (i.e., they would pay the same cost for fuel, crews and meals, and be subject to the same licensing, noise control and other regulations as the dominant carrier). These carriers, however, would be free of all ownership and control restrictions, given that they would not be permitted to cross international borders. This would provide a greater opportunity for creating strongly capitalized new entrants aligned with knowledgeable foreign operators who have the expertise to operate as efficient and effective competitors to the benefit of Canadian consumers. This new class of Canada-only carriers would also be consistent with international bilateral agreements.

The Bureau also suggested using a modified sixth freedom right. This would allow foreign carriers to pick up passengers in Canada and fly them to another Canadian city via a U.S. destination. At the moment, it is possible to buy two tickets, for instance one from Toronto to Chicago and another from Chicago to Vancouver, but carriers cannot market and sell a single ticket at a low price for such a flight. The Bureau recommended that the Minister of Transport negotiate a reciprocal arrangement with the U.S. to allow the dominant Canadian carrier to take passengers from New York to Los Angeles via Toronto and U.S. carriers to fly routes such as Toronto-Chicago-Vancouver with single-ticket passengers. In the Bureau's view, such a reciprocal arrangement would install price discipline on the dominant carrier to the benefit of travellers, particularly transcontinental business travellers. In the absence of such an arrangement and if within two years of the creation of the new dominant carrier there is compelling evidence that competition is not being provided by other carriers, the Bureau advocated that the Minister should allow modified sixth freedom on a unilateral basis.

As in the case of the financial services reform process, the Bureau made a significant contribution to the overall government policy and regulatory response. The Bureau has used the letter to the Minister of Transport as a key instrument in advocating new policies for the post-merger airline industry. This sustained advocacy role led to amendments to the Competition Act to address airline-specific predatory behaviour. In this regard, the government chose to rely on a strengthened Competition Act, as opposed to a full industry regulatory regime, to address the potential concerns of abuse by a carrier of its dominant market position.
Banks

I mentioned earlier that the Bureau had anticipated the merger wave in the banking industry. With the release in July 1998 of the final *Merger Enforcement Guidelines as Applied to a Bank Merger*, we were thus well prepared to concurrently review the bank mergers in 1998 between the Royal Bank and the Bank of Montreal and between Toronto-Dominion Bank and the Canadian Imperial Bank of Commerce (CIBC), and the 1999 proposed merger between the Toronto-Dominion Bank and Canada Trust.

**Royal Bank-Bank of Montreal and Toronto-Dominion Bank-GIBG Mergers**

The 1998 proposed mergers of the Royal Bank and the Bank of Montreal and of the Toronto-Dominion Bank and CIBC were the two most extensive and exhaustive merger reviews ever carried out in Canada. The combined Canadian assets of the four merging banks totalled $590 billion. The analysis of the two mergers was lengthy and difficult. Our examinations took us into every corner of Canada. We combed through 1100 boxes of documents, and almost half a million pages of data. The entire process involved close to 100 individuals. We met with the banks and their competitors and suppliers and with industry analysts. We followed an open process, starting with our consultations on the bank merger enforcement guidelines. Once public, the guidelines constituted the conceptual framework for the Bureau’s work, and led to an in-depth analysis of the following lines of business: branch banking for individuals and businesses, credit cards, including products and services for consumers and merchants, and securities, including brokerage services and underwriting. The unique nature of these mergers led us to use a two-stage process by which the Bureau first identified competition problems and identified remedies, and then negotiated the remedies.

As mentioned earlier, bank mergers need the ultimate approval of the Minister of Finance under the *Bank Act*. On December 11, 1998, each of the banks received a letter copied to the Minister of Finance, which marked the first time in Canada that the findings of the Bureau’s detailed analysis of the merger review process were published. Naturally, the letters contained only information that could be made public through our Web site without violating the law. Drafting these letters was not an easy task. We tried to achieve the twin goals of being transparent by explaining our decision in detail and keeping the data provided confidential.

The release of the letters to the parties and to the Minister of Finance ended the Bureau’s direct involvement in the first stage of the merger review. Our conclusion at that stage was balanced. We recommended neither endorsement nor rejection of the mergers. We pointed out that the mergers as then structured would substantially lessen competition. In particular, we found that,
in the case of the Royal Bank-Bank of Montreal merger, competition would be substantially lessened in a number of local markets for branch banking, credit card networks and full service brokerage, and that the merger might substantially lessen competition in equity underwriting. With the Toronto-Dominion-CIBC merger, competition would be substantially lessened in branch banking, credit card Visa acquiring and full service brokerage.

Following our analysis, the Bureau was quick to point out that if after hearing the public interest concerns of the Minister of Finance, the banks wished to suggest remedies for these competition concerns, we were prepared to look at their proposals. In light of the Minister’s decision not to approve the mergers, this proved to be unnecessary. The process ended with the first stage of the merger review.

Mr. Jim Baillie, who served as chairman of the Task Force on the Future of the Canadian Financial Services Sector during a portion of its work, commented favourably on our analysis, as did the Minister of Finance, who congratulated the Bureau on its thorough research and comprehensive work. During the whole process, we remained wedded to our principles of transparency, fairness, timeliness, predictability and confidentiality.

Toronto-Dominion-Canada Trust

In August 1999, we were called upon to assess the proposed merger between the Toronto-Dominion Bank and Canada Trust. Again, we followed our process, using our analytical framework contained in the Merger Enforcement Guidelines as Applied to a Bank Merger and delivering our results in the form of a letter to the principals of these financial institutions, with a copy to the Minister of Finance.

The Bureau looked at all the products the two financial institutions and their competitors offered. We focussed primarily on offerings in Southern Ontario, British Columbia and Alberta where most Canada Trust branches are located. We then conducted an in-depth analysis of each market in which Toronto-Dominion and Canada Trust compete: branch banking for individuals and credit cards, including products and services for both consumers and businesses. We concluded that competition would be substantially lessened or prevented in three of 74 local markets for branch banking services for individuals, as well as in the general purpose credit card networks market.

In response to the Bureau’s concerns, Toronto-Dominion and Canada Trust proposed to sell certain branches in the affected markets as well as to either sell the Canada Trust MasterCard portfolio or convert Toronto-Dominion’s Visa credit card portfolio to MasterCard. In the letter to the Minister of Finance, we pointed out that these proposed remedies, once fully implemented, would

IWhen the combined market share of the merging parties is 45 percent or greater, the Bureau concludes that the proposed transaction would substantially lessen competition.
address the anti-competitive impact of the proposed merger. The Minister of Finance ultimately approved the merger provided that the merging parties committed to divesting themselves of 13 local branches as well as the entire Canada Trust MasterCard portfolio.

**Airlines**

In November 1999, with the expiry of the 90-day suspension period of the *Competition Act*, the Bureau was officially notified of the proposed acquisition by Air Canada of Canadian Airlines and began a review under the merger provisions of the *Competition Act*. Given the thorough analysis included in our previous letter of advice to the Minister of Transport, we rapidly came to the conclusion that the emergence of Air Canada as a single dominant Canadian airline would raise very significant competition concerns. In particular, the merged entity would account for close to 90 percent of domestic passenger revenues and in excess of 80 percent of domestic passengers carried. In addition, the various barriers to entry identified in the letter continued to be of concern.

Notwithstanding the foregoing, the Bureau announced on December 11, 1999, that it would not oppose the proposed merger based on undertakings negotiated with Air Canada. Having determined that Canadian Airlines was facing imminent insolvency, the Bureau decided that the merger, with undertakings, was more pro-competitive than a liquidation through bankruptcy proceedings. In the undertakings, Air Canada agreed to a number of conditions designed to enhance the competitive climate in the airline industry in Canada, including the following key conditions:

- selling its new interest in Canadian Regional Airlines Limited, at reasonable terms and subject to a timetable set out by the Bureau;
- surrendering a number of slots during peak period at Pearson International Airport for assignment to other Canadian carriers;
- surrendering gates, loading bridges and counters at a number of airports across the country;
- delaying launching a low-cost carrier in Eastern Canada until September 30, 2001, to give other Canadian carriers the opportunity to become established;
- allowing other Canadian carriers to participate in its frequent flyer plan, Aeroplan;
- basing its domestic travel agent commission overrides on volume rather than on market share; and
- entering into interline and joint fare agreements with other Canadian carriers.

The Minister of Transport subsequently approved the merger based on these undertakings and on commitments Air Canada made. In the Bureau’s view, these commitments alleviated competition concerns but were not sufficient to preserve competition. The industry still needs a number of policy changes. In fact, the government embarked on a regulatory process in both the bank and
airline industries. However, in the Bureau’s view, not enough has yet been done.

Policy Development

Banks
The Bureau actively participated in the reform process that the federal government initiated in 1996 to develop an appropriate framework for the financial services sector in the 21st century. As described above, the Bureau developed a number of recommendations for its submission to the Task Force on the Future of the Canadian Financial Services Sector, and during the consultative process launched for the bank merger guidelines, and took other opportunities to provide its views on the state of competition in financial services. Specific recommendations related to the entry by foreign banks, entry by banks into the auto leasing and insurance markets through branches, access to the Canadian Payments System for other financial services institutions, establishment of a public interest process related to bank mergers, the ability of the Bureau and other federal authorities to exchange confidential information, and the full functionality of the Interac system.

Some of these key recommendations were part of the legislative measures proposed by the Department of Finance Canada in Bill C-38, which was tabled in the House of Commons on June 13, 2000. Its progress through Parliament was halted due to the federal election in November 2000. The new legislation, if passed, would lower barriers to foreign entry by allowing foreign banks to offer services to businesses and individual consumers via branches, in addition to subsidiaries. The Bill would also broaden access to the Canadian Payments System to accommodate the entry of life insurance companies, securities dealers and money market mutual funds that meet certain criteria, including regulatory oversight and liquidity. Permitting these financial institutions to join the payments system would enable them to offer a broader range of services to their clients and improve efficiency, thus promoting increased competition for consumers’ business. For example, life insurance companies would be able to offer accounts with roughly the same features as those of deposit accounts offered by banks.

A recommendation that was partially adopted by the new legislation dealt with the establishment of a public interest process related to mergers among banks with equity in excess of $5 billion. Bill C-38 set out the framework for the new merger review process characterized by three distinct phases: an examination stage, a decision stage and, if required, a remedies stage. The public interest process was part of the first stage. It included some valuable proposals that would need, however, to be clarified. Essentially, the merging parties would be required to prepare a Public Interest Impact Assessment (PIIA) explaining the rationale for the merger and the steps that they could take to mitigate any potential costs or concerns. The document would be made widely available to be the solid basis for public hearings that would be conducted concurrently by the Bureau, the Office of the Superintendent of Financial Institutions (OSFI) and the House of Commons Standing Committee on Finance. However, to
ensure transparency during the whole process, the nature of the PIIA and the respective roles played by the Bureau, the OSFI and the Finance Committee needed to be clearly defined.

When financial institutions are involved in a merger, three federal authorities must review the transaction: the Minister of Finance, the Superintendent of Financial Institutions and the Commissioner of Competition. Here again, the government endorsed the Bureau’s recommendation of allowing the three federal authorities to exchange confidential information. This would facilitate the proper coordination of the reviews and expedite decision making.

Other policy changes the Bureau strongly recommended were not in the package of new measures included in Bill C-38. The government did not endorse our recommendation to allow banks to offer auto leasing and sell insurance products through their branch networks. It has always been the Bureau’s view that the banks’ entry into these lines of services would be pro-competitive and consistent with the general trend toward liberalization of financial sector regulations. Bill C-38 also ignored the move toward full functionality for the Interac system that the Bureau first advocated in 1996. Anyone should be able to withdraw, transfer or deposit funds or pay bills at any automated teller machine no matter to which financial institution that machine belongs.

**Airlines**

The Bureau took an active role in promoting a pro-competitive marketplace in the Canadian airline industry. In the summer of 2000, the federal government adopted the policy advice the Bureau set out in its 1999 letter to the Minister of Transport recommending that Parliament amend the *Competition Act* to provide the government with the power to define airline-specific anti-competitive conduct or predatory behaviour. As a result, the Bureau published in August 2000 two categories of new airline regulations. The first describes eight specific acts that constitute anti-competitive behaviour in the airline industry. The second specifies the types of facilities and services that are essential to the market operation of an air service. Bill C-26, in which these regulations were contained, provided the Competition Bureau and the Competition Tribunal with special cease-and-desist powers to deal with anti-competitive behaviour.

The amendments to the *Competition Act*, the policy changes made by the Minister of Transport and Air Canada’s undertakings to close the merger respond to many of the Bureau’s recommendations. However, concerns remain about the state of competition in Canada’s airline industry. Bill C-26 did not include three key recommendations that would have allowed new competitors to create real choice for the flying public and impose price discipline on the dominant carrier:

- raising by regulation the limit on foreign ownership of voting shares of Canadian air carriers to 49 percent from the current 25 percent;
allowing modified sixth freedom rights that would permit U.S. carriers to market as a single ticket travel from one Canadian city to another via a U.S. destination; and
- allowing the creation of Canada-only carriers that would be free of any foreign ownership and control restrictions but limited to serving points within Canada.

One can observe that the legislation the government introduced in the summer of 2000 responded to a certain degree to the challenges these two industries face. However, a number of policy changes are still required to create a dynamic policy framework that will respond appropriately to the new world environment.

Lessons for the Future

The Bureau's involvement in the reform of the bank and airline industries provides some lessons for the future.

First, the Conformity Continuum ensures that the Bureau achieves the maximum outcomes with the resources available. However, we also need to ensure that we have effective tools for competition law enforcement, and that we update our laws and policies to reflect changing business trends. Consequently, recommending to amend the Competition Act to address airline-specific anti-competitive behaviour was an important component of this process. Clearly, effective use of all the tools at our disposal helps ensure the appropriate outcome.

Second, it is obvious that in the case of merger review, early presentation of remedies helps the merging parties and the regulator reach an appropriate conclusion. In the merger involving Air Canada and Canadian Airlines, Transport Canada could announce that the government was prepared to approve the transaction based on undertakings previously negotiated between the Competition Bureau and Air Canada. Moreover, when an undertaking involves the obligation to offer assets for sale, as was the case with Canadian Regional Airlines, the price and terms of sale have to be set in advance.

Third, banks and airlines in Canada are regulated industries that are nevertheless open to competitive forces. Such an environment presents the Bureau with additional challenges as it promotes competition and efficiency in the Canadian marketplace. Our experiences in the bank and airline merger review processes clearly demonstrate the requirement for close cooperation between the Bureau and the other authorities involved in decision making. And in this regard, the respective authorities must be allowed to share confidential information. Moreover, in the context of joint regulation, the role of the respective authorities must be clearly specified in advance to facilitate the proper coordination of the review and decision making. In this regard, the bank merger enforcement guidelines spell out the procedural interaction between the Commissioner of Competition and the Minister of Finance. In the airline industry, the legislation Transport Canada introduced in the summer of 2000
set out a step-by-step procedure for merger review with the Canadian Transportation Agency, the Minister of Transport and the Competition Bureau.

Finally, our experience in the merger review process has shown us that there is a cost to preventing foreign ownership. It is the Bureau's view that a truly competitive environment can only be achieved by opening up the domestic market to more foreign competition. Once such a major policy change is introduced, mergers might again surface as a global strategy without raising competition issues. The *Competition Act* specifically recognizes the importance of foreign competition and the benefits of efficiencies to determining whether mergers will lessen competition. It is, thus, of prime importance to reduce and even eliminate foreign entry barriers to create more favourable conditions for potential new players. This will, in return, contribute to the creation of more competitive structures within which firms will be able to face the organizational challenges of implementing global strategies.

In sum, in preventing foreign competition, it will be extremely difficult to prevent domination of home markets, which will have a negative impact on our economy. Indeed, industrial sectors such as banks and airlines will not be able to take full advantage of the significant volume of trade, capital and labour flowing across borders. This could have a significant detrimental impact on the ability of the Canadian economy as a whole to achieve sustained economic growth and continued high standard of living in the future.

**Conclusion**

I hope that this paper has achieved its purpose of providing a good overview of how the principles underlying the Bureau's approach to achieving compliance with the law affected the broad government policy response to the restructuring of two industries vital to Canadians and to the economy. The bank and airline mergers are good illustrations of the role of competition law and policy within the general government policy framework. These two examples also demonstrate that there are challenges to preserving competition in a partially regulated market. We need to constantly ensure close cooperation with the other authorities involved in decision-making processes, such as the one related to merger review. We will then all serve the common purpose of building the competitiveness of the Canadian marketplace. We also need to be as vigorous and innovative as we can in applying the *Competition Act*. This means that we must use the full arsenal of tools at our disposal. Finally, we are also convinced that the advocacy of competition and policy advice are key instruments in the context of reform. We believe that, in the context of the bank and airline industries, our participation clearly illustrates our strong advocacy and policy role performed to facilitate the transition of regulated industries toward more competitive structures.