Competition Tribunal Tribunal de la Concurrence

CT - 1991 / 001 – Doc # 155a

IN THE MATTER OF an application by the Director of Investigation and Research for orders pursuant to section 92 of the *Competition Act*, R.S.C., 1985, c. C-34, as amended;

AND IN THE MATTER OF the acquisition by Hillsdown Holdings (Canada) Limited of 56% of the common shares of Canada Packers Inc.

B E T W E E N:

The Director of Investigation and Research

Applicant

- and -

Hillsdown Holdings (Canada) Limited
Maple Leaf Foods Inc.
Nine-Five Investments Limited
Ontario Rendering Company Limited

Respondents

REASONS AND ORDER

Dates of Hearing:

November 25-28, December 2-5, 9-10 and 18-19, 1991

Presiding Member:

The Honourable Madame Justice Barbara J. Reed

Lay Members:

Madame Marie-Hélène Sarrazin
Mr. Victor L. Clarke

Counsel for the Applicant:

Director of Investigation and Research

Randal T. Hughes
Peter J. Cavanagh
Rory R. Edge
Andrea Safer

Counsel for the Respondents:

Hillsdown Holdings (Canada) Limited
Maple Leaf Foods Inc.
Nine-Five Investments Limited
Ontario Rendering Company Limited

Glenn F. Leslie
Neil R. Finkelstein
John J. Quinn
Jeffrey W. Galway
George Vegh

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COMPETITION TRIBUNAL

REASONS AND ORDER

The Director of Investigation and Research

v.

Hillsdown Holdings (Canada) Limited et al.

I. INTRODUCTION

An application is brought by the Director of Investigation and Research ("Director") pursuant to subparagraph 92(1)(e)(ii) of the *Competition Act*,[1] to require the respondent Hillsdown Holdings (Canada) Limited ("Hillsdown") to divest itself of the business operated by the respondent Ontario Rendering Company Limited ("Orenco") or to divest such assets as the Tribunal may designate.

The application was triggered by Hillsdown's acquisition on July 4, 1990 of Canada Packers Inc. As a result of that acquisition Hillsdown obtained control of Orenco, a rendering company previously controlled by Canada Packers Inc. Hillsdown already controlled, through its wholly-owned subsidiary, Maple Leaf Mills Limited, a rendering business carried on by its rendering division, Rothsay. It is alleged that the common control of these two

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

businesses is likely to result in a substantial lessening of competition in the non-captive red meat rendering market in southern Ontario.

Subsequent to the acquisition, Canada Packers Inc. and Maple Leaf Mills Limited were amalgamated and continued under the name Canada Packers Inc. This name was subsequently changed to Maple Leaf Foods Inc. Orenco is presently operated as a wholly-owned subsidiary of Nine-Five Investments Limited which is in turn a wholly-owned subsidiary of Maple Leaf Foods Inc.

Orenco operates a rendering facility in Dundas, Ontario. Rothsay operates a facility in Moorefield, Ontario. The two sites are within approximately 60 miles of each other. Orenco and Rothsay (Moorefield) are approximately 40 miles west and 90 miles northwest of Toronto respectively. Rothsay also operated until recently a rendering facility at a lakeshore location in downtown Toronto ("Rothsay (Toronto)"). This property was expropriated by the City of Toronto on July 26, 1988. The facility was finally closed on November 30, 1990 after Rothsay had moved its Toronto business to the Orenco plant in Dundas and elsewhere.

The interaction of the expropriation and the merger is a major complicating factor in this case. The respondents argue that significant efficiencies occurred as a result of the merger. The applicant contends that the moving of the Rothsay (Toronto) business to Orenco and elsewhere was not a

rationalization arising as a result of the merger but a response to the expropriation notice which Rothsay (Toronto), at this time, was under. The transfer of the Rothsay (Toronto) business to Orenco occurred before the Director filed his application on February 15, 1991, seeking divestiture of the Orenco business. Thus, the interim order requiring that the two businesses be held separate and apart was obtained only after the integration of Rothsay (Toronto) and Orenco had been underway for some time. An additional important consideration in this case is the contracting nature of the red meat rendering business. The respondents say it is declining. The applicant says it is flat.

II. THE RENDERING BUSINESS

Rendering involves the processing of the left-over parts of livestock such as cattle, hogs and poultry which are either unfit or unsuitable for human consumption. The primary sources of supply for renderable materials are slaughterhouses, meat packing plants, poultry processing plants, abattoirs, grocery stores and butcher shops. The materials include: fresh packing house material (such as beef and pork heads, feet, offal, bones, fat and blood); material such as fat and bone discarded in preparing cuts for the retail consumer trade; and poultry material including offal and feathers. Renderable material is also obtained from deadstock, that is, from animals which have died or been killed outside the

slaughtering process.[2] Such animals may have died as a result of disease or accident on the farm or in transit to the slaughterhouse.

The quantity of renderable material available depends on the number of cattle, hogs and poultry which are killed in the market area served by the renderer. This in turn will vary with consumer demand for beef, pork and poultry products. Slaughterhouses are required to have all renderable materials produced as a result of a day's kill removed before they can commence operation the following day. The value of the renderable material compared to the value of a cattle beast or hog is insignificant.[3] Thus, the supply of renderable material does not depend on the price paid by the renderer for the material. The supply of renderable material is essentially inelastic in response to the price paid for it.

Two types of renderers exist. One is the "integrated renderer" which processes material produced in the slaughtering, packing or processing activities of affiliates in a vertically integrated operation (captive material). The other is the "non-integrated renderer" which collects and processes renderable material obtained from suppliers who are not affiliated with the renderer (non-captive material). Integrated renderers may or may not also process renderable material that is non-captive. Both Orenco and Rothsay are integrated renderers that also process non-captive material.

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[2] Often referred to in the evidence as "fallen animals".

[3] The ratio of the value of the renderable material as a percentage of carcass cost, as of June 1991, was estimated as 1.15% for beef and 0.38% for hogs.

Non-captive material is picked up in specially equipped trucks. The renderer either pays the supplier for the renderable material or charges the supplier for its collection. Whether the material is purchased or a charge is levied depends upon a number of factors including the type of renderable material involved, the volume being acquired, and transportation and processing costs. Deadstock is often picked up from the farm by deadstock collectors rather than by the renderer directly. The collectors remove the hide for tanning and debone the carcass to provide meat for pet food. The rest of the carcass is then delivered to the rendering facility or picked up at the deadstock plant by the renderer.

At the rendering plant the material which has been collected is graded, sorted and dumped into receiving pits. It is then processed through either a continuous or batch rendering cooker. This involves cooking the material in a pressure cooker and feeding it through a press. Blood can either be rendered with other red meat by-products or separately. Poultry feathers are processed in specialized equipment (a hydrolyzer) and are processed separately.

Two products are produced from the rendering process: tallow and protein meal. Tallow is used in the production of soaps, animal feeds, cosmetics, paints, rubbers and in a variety of other consumer and industrial products. It is produced in a variety of grades (for example, top white, bleachable fancy, special, yellow grease, pet food grade). The grade or quality of the tallow depends upon

the type of renderable material from which it comes. Beef tallow is the highest quality, white in colour and has a comparatively high melting point (titre point). Tallow produced from poultry material is yellow in colour and has a lower melting point. Tallow produced from pork materials is of an intermediate quality.

The meal produced from the rendering process is used primarily in animal feed, fertilizers and pet food manufacturing. It also comes in a variety of grades depending upon its protein value. Blood meal is the highest quality. Meal rendered from poultry material is of a higher quality than meal rendered from red meat material.

Both the tallow and the meals compete with products such as coconut oil, palm oil, soya oil and soya meal which are sold on the commodities markets. The prices at which the products produced by the rendering process can be sold, then, are determined by the international market. A bulletin is published weekly in Ontario by a brokerage house called Eastern Packinghouse Brokers Ltd. It lists the current prices for at least some of the various grades of tallow and protein meal. The protein meal is listed as Unground Dried Rendered Tankage (U.D.R.T.) and its price varies with its protein content. The renderer thus is a "price-taker" with respect to these products.

III. EXPROPRIATION THEN MERGER

On July 26, 1988 an expropriation notice was issued by the City of Toronto transferring ownership of the land on which the Rothsay (Toronto) facility[4] was located to the Corporation of the City of Toronto. The City notified Rothsay that it required possession of this property by November 1, 1988.

Rothsay negotiated with the City for an extension of the time limit to enable it to find alternate premises from which to operate its business. Rothsay did not vacate the premises on November 1, 1988 and a lease with the City was eventually signed on December 19, 1989. That lease was stated to be for the period November 1, 1988 to June 30, 1990. A clause which would have required Rothsay to waive any right to apply, at the end of the lease period, for a postponement of the City's claim for possession was explicitly deleted from the lease.

Rothsay sought information concerning possible sites for the relocation of its Toronto business. The Hamilton harbour area was identified as the best. Rothsay commenced negotiations with the Hamilton Harbour Commission. Appropriate sites were identified and the Hamilton Harbour Commission was willing to accept Rothsay as a tenant. Unfortunately, the Harbour Commission was slow in acquiring the property required for the relocation. Rothsay also began exploring the possibility of expanding its Moorefield facility in order to accommodate the Toronto volumes.

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[4] Maple Leaf Mills Limited was the legal entity that held title to the property which was expropriated.

By March 1990, Rothsay was still waiting for the Hamilton Harbour Commission to come forward with a proposal. As an alternative it decided to "fast track" expansion of its Moorefield facility. Any expansion of the Moorefield facility required approval from the provincial Ministry of the Environment which would entail at some point a public meeting to explain and discuss the proposal. Rothsay estimated that Ministry of the Environment approval might be obtained by December 31, 1990 and construction of the expanded facilities completed nine to twelve months thereafter. It therefore sought an extension of its lease with the City of Toronto until December 31, 1991.[5] The City granted an extension to August 31, 1990 with the indication that any further extension would be considered after discussion with its business consultants. A further extension to September 30, 1990 was granted because the City's business consultants were not available to consult during July and August.

On May 29, 1990 a representative of Rothsay met with Orenco for the purpose of seeing if that company could process the Rothsay (Toronto) volumes. It is clear that the possibility of a Hillsdown acquisition of Canada Packers Inc. was known. An attempt was made to characterize this meeting as having as its primary purpose the assessment of Pat Jones, who was general manager of Orenco, to see if he would fit into the Rothsay organization after a merger should such occur. That is not a credible characterization of the purpose of the meeting. The notes of Joseph F. Kosalle, Vice-President, Finance,

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[5] Applicant's Selected Documents, vol. 1, tab 19 at 43 (Exhibit A-7); vol. 2, tab 185 at 2 (Exhibit A-8).

Agribusiness Group of Maple Leaf Foods Inc., regarding the meeting make it clear that the primary purpose was to seek a solution for rendering the Rothsay (Toronto) volumes. The assessment of Mr. Jones as a potential employee was an unexpected afterthought.

The documentary evidence makes it clear that Orenco contemplated during the second half of its 1990 fiscal year upgrading certain components of its rendering equipment. The equipment in place was old and the company was operating at or above capacity.[6] Adequate time for preventive maintenance was not available and when breakdowns occurred the company was vulnerable to losses arising therefrom. Part of the planned expansion involved installation of a hydrolyzer to enable Orenco to process poultry feathers.

Mr. Jones told Rothsay that Orenco was prepared to process the Rothsay (Toronto) volumes "with or without a merger". As of May 29, 1990, Orenco estimated that it would take six months for it to put certain equipment in place so that it could render the additional red meat material and if some of Rothsay's Toronto equipment was used for this purpose, the time frame would be even shorter. Thus, should Rothsay have been required by the City to leave the Toronto harbour area before either a new facility was built in Hamilton or Moorefield expanded, an available option was to have Orenco process the

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[6] Joint Book of Documents, vol. 15B, tab 56 at 9, 11, 50 (Exhibit JB-15B).

Toronto volumes for the interim period. It is clear that tolling agreements between renderers are not uncommon in the industry.

In June 1990, Rothsay submitted reports concerning environmental concerns (water pollution and odour control) to the Ministry of the Environment regarding the proposed expansion of Moorefield. Ministry of the Environment concept approval for the expansion and an expression of support with respect thereto were eventually communicated to Rothsay sometime in or prior to November 1990. The public hearing necessary before final approval could be given was never held since sometime before November 30, 1990, Rothsay had moved a significant portion of its Toronto volumes to Orenco and relinquished what was by that time its month-by-month lease to the City.

A reorganization of the collection and processing of renderable material took place after the merger and the relinquishment of the Toronto premises. This resulted in renderable materials east of Oshawa, which had previously been collected by both Orenco and Rothsay (Toronto), being collected by Rothsay's rendering facility near Montreal, Laurenco, for processing at that plant. Prior to the merger, Rothsay (Laurenco) had been losing money due to low volumes.[7] Oshawa is approximately 270 miles from Montreal. Some materials which had previously been rendered at Rothsay (Moorefield) were sent to Orenco.

[7] The transfer of approximately 150,000 lbs (68 metric tonnes) per week to that location did not appreciably improve Laurenco's financial situation because volumes have continued to decline. (Transcript at 703 (3 December 1991)).

Rothsay (Moorefield) was able then to process one-third of the remaining Rothsay (Toronto) volumes and Orenco processed the other two-thirds.

IV. MARKET DEFINITION

In order to determine the likely effects of any merger or acquisition it is first necessary to determine the boundaries of the *relevant* market. A *relevant* market is that product or service with respect to which after a merger there is likely to be a substantial lessening of competition. Once the *relevant* market is defined, an assessment can be made as to the likely effect of the merger or acquisition on that market. Market boundaries, however, are not static. They expand and contract in response to price. One can conceptually think of a series of concentric areas whereby as the price rises the radii lengthen. The very definition of the market boundaries therefore carries with it an assessment as to whether the merged firm has or is likely to have market power. While the various elements relevant in considering the effect of a merger, first market boundaries and then whether a substantial lessening of competition is likely to occur, will be discussed in a linear fashion, the non-linear aspect of the analysis should be kept in mind.[8]

It is useful to refer to the explanation of the concept of a *relevant* market set out in the monograph *Horizontal Mergers: Law and Policy*:

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[8] H. Hovenkamp, *Economics and Federal Antitrust Law* (St. Paul, Minn.: West, 1985) at 58:

The correlation between market share and market power can be rigorously expressed in a formula. However, the formula contains *three* relevant variables: market share, market demand elasticity, and the elasticity of supply of competing and fringe firms. If the two elasticity variables remain constant, then market power would be proportional to market share. In the real world, however, market elasticities vary greatly from one market to another. Thus in order to estimate a firm's market power we must gather some information not only about a firm's market share, but also about the demand and supply conditions that it faces.

For purposes of assessing the likelihood that a merger will create or enhance single-firm market power, market definition has been characterized as "an analytical construct enabling us to compensate for our inability to measure market power directly." Areeda and Turner explain:

> Market definition becomes crucial only when there are no other discoverable facts establishing the existence and degree of market power more directly and with tolerable accuracy. One would never need to define the market if he could accurately establish the firm's demand and cost curves - the quantities that could be sold at various prices, and the costs of producing those quantities. That information would directly establish both the presence of market power and the magnitude of potential monopoly profits. The firm's demand curve would reflect the availability of any substitutes, without further need for identifying them or their closeness.

Because direct measurement of a firm's market power is extraordinarily difficult, a two-step indirect measurement process has evolved: first define the relevant market, and then infer power within the market through the use of proxies such as market shares and other factors.[9] (footnotes omitted)

[9] ABA Antitrust Section, Monograph No. 12, (1986) at 62-63.

The identification of the relevant market in which it is alleged a substantial lessening of competition is likely to occur is normally assessed from two perspectives: the product or products with respect to which a merged firm acting alone or in concert with others is likely to be able to exercise market power and the geographic area within which such power is likely to be exercised.[10] The term "product" is used in the legal and economic literature relevant to competition law as meaning the output (product or service) which the producer (seller) provides to the consumer (purchaser). Thus, the use of that term should not be taken as excluding services.[11]

A. Product Dimension (Product Market)

Conceptually, the product in issue in this case can be thought of as the renderable material obtained by the renderers from the suppliers of that material or it can be thought of as rendering services provided by the renderers to slaughterhouses, meat processing plants, grocery stores, etc. If the first characterization is used then the analysis for competition purposes focuses on the possible monopsony power of the renderers as buyers of the raw materials. If the second characterization is used then the analysis focuses on the possible market power of the renderers as sellers of the rendering service. No significant difference results from the two characterizations. The Tribunal accepts that the

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[10] *Ibid*. at 59-61 for a discussion of relevant markets.

[11] Subsection 2(1) of the *Competition Act* expressly provides that for the purposes of the Act "product" includes an article and a service.

more convenient way of describing the product is the latter, that is, as the sale of rendering services. This is more convenient because it avoids the conceptual awkwardness which arises from the fact that sometimes the renderer pays for the renderable materials and sometimes charges for its collection.

In determining the product dimensions of the market, the first step is to identify the product or products with respect to which, prior to the merger, the two firms were competitors. The second step is to ask whether there are any close substitutes to that product to which consumers could easily switch if prices were raised (an indication of demand elasticity). If two products appear to be close substitutes when both are sold at marginal cost, then the two should be included in the same product market.

At the time of the acquisition, Rothsay (Moorefield) rendered red meat by-products, blood, deadstock, poultry offal and feathers. Orenco rendered red meat by-products, blood, deadstock and grease but not poultry offal or feathers. Rothsay (Toronto) rendered the same kind of materials as Orenco.

The grease rendered by both Rothsay (Toronto) and Orenco is in general "restaurant grease" which has been used for deep frying certain foods. Although both Rothsay (Toronto) and Orenco processed grease it is processed differently from other renderable materials, usually in different equipment and it is collected independently of the other renderable materials. Rothsay (Moorefield)

has not and does not render grease. Little evidence was led with respect to grease or as to how the merger affected competition in this segment of the industry. Thus, it has not been established that it should be considered as part of the relevant product market.

The Director has not suggested that poultry offal and feathers should be included in the relevant market. Orenco did not process such material before the merger. It lacked the equipment required to process poultry feathers. Special equipment is not required to render poultry offal. While there is some documentation which indicates that prior to the merger Orenco was planning to acquire equipment to enable it to process poultry feathers, it has not been suggested by the Director that the merger would lead to any substantial lessening of competition with respect to rendering services for producers of that material.

Prior to the acquisition approximately 30% of the material rendered by Orenco came from affiliated Canada Packers Inc. operations. The remaining 70% was acquired from non-captive sources. Approximately 14% of Rothsay's material came from affiliated Maple Leaf Mills Limited operations. The remaining 86% was acquired from non-captive sources. There is no dispute that captive materials are not included in the product dimension of the relevant market.

It is clear that there are few "product substitutes", that is, alternatives available to the consumer of rendering services (demand elasticity is low). Some deadstock presumably might be buried but this is not a viable option for a significant amount of renderable material.[12] Landfill-site regulations often prohibit the disposal of renderable material at those locations and, as noted above, slaughterhouses require that renderable materials be removed on a daily basis.

While conceptually it would seem that supply elasticity with respect to the product dimensions of the market should also be included in defining the market, this factor is often considered when assessing whether the merger is likely to lessen competition substantially in the relevant market. Supply elasticity would be high and market power therefore would not likely be significant if other firms could immediately respond to a price rise by flooding the market with the relevant product either because they have excess capacity or because they can easily switch their production facilities to produce the relevant product. Those factors will be considered when the likelihood of substantial lessening of competition is assessed.[13]

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[12] Ronald L. Dancey gave evidence that when Orenco started charging seven cents a pound for the collection of blood rather than picking it up at no charge, his company, Morrison's Meat Packers Limited, started routing the blood into a holding tank to be pumped out as sewage. (Transcript at 130, 158 (26 November 1991)).

[13] A discussion of three different ways of treating supply substitution, i.e., when defining the market, when determining market shares or when assessing the significance of market share figures, is found in G.J. Werden, "Market Delineation and the Justice Departments' Merger Guidelines" [1983] Duke L.J. 514 at 518-20.

The Tribunal accepts the Director's contention that the product dimension of the relevant market is the provision of rendering services for non-captive red meat renderable material which includes deadstock materials and blood.

B. Geographic Dimension (Geographic Market)

Determining the geographic dimensions of the relevant market is similar to determining the product dimensions; one asks whether there is a geographic area within which the merged firm either alone or in concert with others is likely to have market power. This requires identifying some area such that the merged firm has an advantage based on geographic considerations over firms not inside that area. Frequently this advantage results from transportation costs but often other factors may also be relevant, such as differing labour costs in the two areas or governmental restrictions and regulations.[14]

An assessment of geographic boundaries requires an assessment as to whether a significant number of consumers within the alleged area are willing to turn to suppliers outside of that area to obtain, in this case, rendering services and whether there are suppliers outside the proposed boundary who could supply consumers within that area with rendering services, as effective competitors to the

[14] The United States jurisprudence indicates that the definition of the geographic dimension of the relevant market has been determined by reference to tests such as: the area where "the effect of the merger on competition will be direct and immediate" or "the area in which the acquired firm is an actual direct competitor". (*United States v. Marine Bancorporation*, 418 U.S. 602, at 619, 622 (1973)).

merged firm (indicators of demand elasticity and supply elasticity respectively). It is clear that such switching or "substitutability" is more likely to occur on the edges of the defined geographic boundaries as the distance between the consumer of rendering services and the merged plant increases, provided there is another supplier of rendering services in the vicinity. Clearly, geographic boundaries of adjacent markets overlap and they are neither static nor precise. As in the case of the product market dimensions, a useful starting point for their definition is the existing pattern or patterns of competition which existed pre-merger.

The geographic dimensions of the market in issue in this case will be discussed by reference to three factors: distance, borders and consumer preference.

(1) Distance

The Director adopted submissions which were made to him on behalf of the respondents as accurately describing the distances applicable in defining the geographic dimensions of the relevant market:

> A good indicator of the relevant geographic market of a renderer is its current collection area. In general, the distance a renderer will travel to collect raw material is directly related to the value of the material available. There are three factors that affect the value of raw material and, thus, delineate the geographic area from which a renderer can effectively collect raw material: the type of raw material available, the perishable nature of the raw material and the cost of collection.
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> ...

The interplay of these factors sets the distance from a rendering plant that a renderer will travel to get raw material. The need for product freshness sets a maximum collection distance. In general, waste is not [to] be shipped more than a few hundred miles because of the need for freshness. Because of transportation costs, a renderer will only travel that far for a large supply of high quality materials. For small amounts, the maximum distance might only be 75 to 100 miles.

...

The only possible overlap in the collecting areas between Rothsay Rendering and CP is in Southern Ontario based on a maximum collection distance of 300 miles from a plant. (In fact, the maximum collection distance may be much shorter for different types of by-products.) Consequently, in this submission we will only consider the effects of the merger in Ontario.

In Southern Ontario, Rothsay has two plants; one in Toronto and a larger one in Moorefield which is north of Kitchener-Waterloo. The Orenco plant is located in Dundas which is just west of Hamilton. The major collection area for both Rothsay and Orenco for most by-products is bounded by Windsor to the west, Kingston to the east, Owen Sound to the north and Northern New York State to the south. Orenco has a collection company called Liberty Reductions which collects raw material in the Buffalo area and delivers it to Orenco.

In the case of Orenco, from Dundas, Ontario it is about 193 miles to Windsor, 169 miles to Owen Sound and 204 miles to Kingston, so a 200 mile limit is a fairly accurate measure of the realistic collection distance of a Southern Ontario renderer. As for the Southern limit of Orenco's area, it is about 155 miles to Rochester, New York. Orenco will, however, go as far as Sault Ste Marie for a pick-up of high yielding waste (a distance of nearly 400 miles), but a service call of that distance is unusual.

Thus, we submit the relevant geographic market is the area within a 200-mile radius of the Rothsay and Orenco facilities. This area includes at least Southern Ontario, Northern New York State (the sector bounded by Rochester to the east and Jameston to the south) and South-Eastern Michigan (Port Huron, Detroit and their environs).[15]

...

Because of the low value-to-weight ratio of raw material for rendering, and its perishability, the cost of collection is relatively high in comparison with the value of the end product. A renderer will only pick up raw material where it is

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[15] Applicant's Selected Documents, vol. 1, tab 6 at 5-7 (Exhibit A-7).

> economical to do so. Whether it is economical in a given case depends on several factors, namely the type of material available, the amount of material available, and the distance to be travelled. While no fixed maximum economical distance can be established, for the reasons set out in our Submission it is appropriate to consider as a bench-mark a range of 200 miles (about 320 kilometres).[16]

Despite these initial submissions, the respondents called evidence to demonstrate that some renderers can and do travel over 200 miles to collect renderable material. Reference was made to the fact that Baker Commodities Inc. ("Baker") has a plant in Lowell, Massachusetts[17] and collects red meat material at a distance of 500 miles from that location. Most of the plant's tonnage, however, is collected from within 350 miles of the plant. Transfer depots are used in collecting the materials. Transfer depots are large collection containers into which material collected locally is dumped so that only full trailer loads travel the long distances. Transportation costs are a significant factor in this Industry. [18]

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[16] *Ibid.*, tab 13 at 4.

[17] More accurately, Tewksbury, Massachusetts.

[18] Fred D. Bisplinghoff, speaking of North American markets generally, states in his expert affidavit:

> Normally renderers can only economically pick up raw material within a seventy-five mile radius of the plant. There is a point of diminishing returns due to overtime hours, spoilage of raw material, and insufficient time to maintain trucks. The above conditions have led to building receiving stations, which can be constructed approximately 125-150 miles from the plants. Two to four straight trucks can operate from this facility, dump their loads onto an open top semi-trailer which can be pulled to plant by a tractor. This enables the renderer to service an area approximately 200 to 250 miles from the plant, but it significantly increases the hauling costs as it adds reload and station costs to the route cost. This appreciably increases the overall haul cost but is an economical alternative to operating several plants at less than one-half capacity. (Expert Affidavit of Fred D. Bisplinghoff at 7-8 (Exhibit R-8)).

Lomex Inc. ("Lomex"), also referred to as "Couture", has begun very recently to collect red meat material in Toronto for its plant in Montreal over 300 miles away. It is allegedly trying to establish a transfer depot outside Toronto but has not yet done so. Evidence was also given that Phil's Recycling,[19] a low overhead (mainly deadstock) collector with a non-unionized work force has transported materials for a distance of up to 600 miles and on a regular basis takes material 400 miles from Toronto to Montreal at a profit.

The Tribunal is reluctant to place much emphasis on the activity of Baker out of Lowell, Massachusetts, since it relates to another market area. The geographic dimensions of the relevant market have to be determined by reference to the economic factors existing in the relevant area. Thus, the evidence of Baker operating out of Massachusetts and into Quebec is of limited usefulness. Counsel states that the evidence is only being put forward to demonstrate that it is physically possible in some circumstances to collect from such distances and the Tribunal accepts it for that purpose.

Insofar as Lomex is concerned, it is collecting two full truck loads from two fairly large slaughtering operations and this activity is of very recent origin.[20] The Tribunal heard evidence that in the opinion of one industry participant Lomex was trying to "buy" its way into the Toronto market.

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[19] Until recently named Phil's Rendering Service Inc.

[20] While it is not entirely clear when the activity commenced, the evidence indicates that it was probably during the summer of 1991.

Lomex's activity is more consistent with a market entry *initiative*[21] rather than being evidence of a viable competitor which is established in the relevant market.

Phil's Recycling which operates out of Peterborough, Ontario is a unique and somewhat specialized operation. The profitability of its collection and delivery operation is aided by carrying "haul backs" (e.g., firewood from Quebec for the Toronto market, white stone from Perth). More importantly, Phil's Recycling is not a renderer. It is not Phil's Recycling which must be assessed as an effective competitor to the merged firm but the renderers to whom it sells. Phil's Recycling sells to renderers located in southern Ontario as well as to renderers located in Quebec. It collects about 100 to 150 metric tonnes a week and sells about one-half of that to Quebec renderers. The activity of Phil's Recycling is peripheral in nature.

It is clear that there has not been and there is not now much vigorous and effective competition to Rothsay (Moorefield) and Orenco from renderers located more than 200 miles away. Particularly significant is the fact that when Rothsay (Toronto) was faced with expropriation it did not choose to send its Toronto volumes (i.e., those collected west of Oshawa) to Rothsay (Laurenco) near Montreal for rendering despite the fact that that plant had and continues to have low volumes.

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[21] The concept "entry" is defined in *Director of Investigation and Research v. Laidlaw Waste Systems Ltd.*, (20 January 1992), CT-91/2, Reasons for Order (Competition Trib.) at 77.

(2) Borders

In addition to a 200 mile distance limitation, the Director argues that both provincial and international borders create boundaries to the geographic dimensions of the relevant market. This assertion will be considered from two perspectives: United States restrictions respecting the importation of renderable material and Canadian federal and provincial legislation respecting the handling and disposition of the renderable material.

Insofar as United States restrictions are concerned, the practice of the United States Department of Agriculture ("USDA") with regard to the importation of renderable material from Canada is allegedly set out in a letter from Robert Melland to counsel for the respondents. That letter states:

> Animal products originating from a Canadian-approved slaughterhouse that are accompanied by a sanitary certificate of origin issued by the Canadian Government are allowed unrestricted entry into the United States.
>
> Animal products that do not originate from a Canadian-approved slaughterhouse and for which the exporter is unable to obtain a Government certificate attesting to the origin of the materials must be consigned directly from the port of entry under USDA seal to an approved rendering plant in the United States.
>
> There are several USDA-approved rendering facilities authorized to receive animal products of Canadian origin.[22]

[22] Letter dated 25 November 1991 to Jay D. Kendry from Robert Melland, Administrator, United States Department of Agriculture (Exhibit R-6).

Counsel for the Director objected to this evidence being relied upon because it had not been adduced through a witness and therefore could not be subjected to cross-examination.[23] The Tribunal takes cognizance of that defect.

Canadian federal legislation is found in the *Meat Inspection Act*,[24] and in the regulations promulgated pursuant to that Act. Sections 7 and 8 of the Act provide:

> 7. No person shall export a meat product [includes the carcass of an animal or a product or by-product of a carcass] out of Canada unless
>
> *(a)* it was prepared or stored in a registered establishment that was operated in accordance with this Act and the regulations;
> *(b)* that person provides an inspector with evidence satisfactory to the Minister that the meat product meets the requirements of the country to which it is being exported; and
> *(c)* that person obtains a certificate from an inspector authorizing the export of that meat product.
>
> 8. No person shall send or convey a meat product from one province to another unless
>
> *(a)* it was prepared or stored in a registered establishment that was operated in accordance with this Act and the regulations; and ... (underlining added)[25]

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[23] Especially since the respondents had refused to allow the Director to rely on pages from the relevant USDA manual without calling a witness to attest to the procedure set out therein.

[24] R.S.C. 1985 (1st Supp.), c. 25, as amended.

[25] Limitations also exist with respect to the importation of meat products. Section 9 provides:

9. (1) No person shall import a meat product into Canada unless
(a) at the time it was prepared for export, the country from which it originated and any country in which it was processed had meat inspection systems, those systems and the relevant establishments in those countries were approved in writing by the Minister before that time and the approvals were valid at that time;
(b) that person provides an inspector with evidence satisfactory to the Minister that it meets the prescribed standards for imported meat products;
(c) it meets the prescribed standards for imported meat products; and
(d) it is packaged and labelled in the manner prescribed.
(2) Every person who imports a meat product into Canada shall, as soon as possible, deliver it, in its imported condition, to a registered establishment for inspection by an inspector.
(3) No person shall have in his possession an imported meat product that the person knows
(a) has been imported into Canada in contravention of subsection (1); or
(b) has not been delivered to a registered establishment for inspection as required by subsection (2).

The *Meat Inspection Regulations, 1990*, however, provide:

> 3.(1) Sections 7 to 9 of the Act do not apply in respect of
>
> ...
>
> *(k)* a meat product that has not been condemned and is destined for inedible rendering.
>
> ...
>
> (3) Section 8 of the Act does not apply in respect of the following meat products:
>
> ...
>
> *(c)* a meat product that has been condemned and is destined for inedible rendering in accordance with paragraph 54(1)(b);[26]

Thus, there is no prohibition arising from federal legislation which prevents renderable material being taken across either provincial or international prevents renderable material being taken across either provincial or international borders unless it is condemned material. Also, condemned material is not prohibited from being moved interprovincially. However, since section 7 of the *Meat Inspection Act* applies to such material, it cannot be exported unless it originates in a federally licensed slaughterhouse or meat processing plant (a registered establishment).[27]

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[26] SOR/90-288, as amended.

[27] There are also certain conditions which must be met in dealing with condemned materials. For example, paragraph 54(1)(b) of the *Meat Inspection Regulations, 1990* provides that federally registered slaughterers must identify condemned material, convey it to the inedible products area of their establishments, and then either render it themselves or denature it and convey it either to another registered establishment *or* to a rendering plant. Notably though, paragraph 54(1)(b) does not seem to place any interprovincial restrictions on the location of the rendering plant to which the condemned materials are shipped.

Insofar as provincially licensed slaughterhouses and meat processors are concerned, s. 108 of *Regulation 607,* promulgated pursuant to the *Meat Inspection Act (Ontario)*[28] provides:

> **108**. Where this Regulation prescribes that,
>
> *(a)* an animal be condemned and killed;
> *(b)* a carcass or a part or organ thereof be condemned; or
> *(c)* inedible offal and meat that is not food be disposed of,
>
> an inspector shall direct that such animal, carcass, part, organ, inedible offal or meat that is not food be disposed of by,
>
> *(d)* delivery to a rendering plant,
>
> (i) licensed under the *Dead Animal Disposal Act*, or
>
> (ii) approved under the *Meat Inspection Act* (Canada),
>
> in a vehicle constructed and equipped in accordance with the *Dead Animal Disposal Act*;
>
> *(e)* burying with a covering of at least sixty centimetres of earth;
> *(f)* incineration by a method approved by the Director [Director of Veterinary Service Branch of the Ministry of Agriculture and Food;
> *(g)* rendering in a plant that is equipped with high temperature rendering facilities approved by the Director; or
> *(h)* any other method approved by the Director.[29]

While subparagraph 108(d)(ii) seems to contemplate the licensing of renderers under the federal *Meat Inspection Act*, in fact no such licensing is done and all Ontario renderers are provincially licensed. Thus, under Ontario law provincially licensed slaughterhouses must deliver condemned materials, inedible offal and meat that is not food to provincially licensed renderers. There is no evidence suggesting that paragraph 108(g) or 108(h) has been used to broaden this restriction

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[28] R.S.O. 1980, c. 260, as amended.

[29] R.R.O. 1980, Reg. 607, s. 108.

Provincial legislation also imposes restrictions on the disposition of deadstock by collectors of that material. Section 4 of the Ontario *Dead Animal Disposal Act*[30] requires that dead animals (horses, goats, sheep, swine, cattle) be collected by licensed collectors and provides:

> (2) No collector shall give, sell or deliver a dead animal to any person other than the holder of a licence as an operator of a receiving plant or a rendering plant under this Act.

And section 5 requires:

> **5.**(1) No person shall engage in the business of,
>
> *(a)* a broker;
> *(b)* a collector;
> *(c)* an operator of a receiving plant; or
> *(d)* an operator of a rendering plant,
>
> without a licence therefor from the Director.
>
> (2) No person shall collect a dead animal unless he is the holder of a licence as a collector.

Thus, Ontario law prevents deadstock being delivered to a renderer who is outside Ontario (i.e., who is not provincially licensed).

Federally inspected slaughterhouses account for 80% of the cattle slaughtered in the southern Ontario region and for 90% of the hogs slaughtered.[31] Deadstock and condemned material comprise from 5 to 10% of the total red meat renderable materials available for rendering.

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[30] R.S.O. 1980, c. 112, as amended.

[31] Transcript at 173 (26 November 1991).

There is evidence that the regulatory constraints described above do not impose a significant impediment to the movement of most renderable materials across the Canada-United States border. In 1975-76, Rothsay (Moorefield) had a contract with a pork slaughterer in Detroit whereby renderable material was brought across the border for rendering. Mr. Kosalle gave evidence that the handling of deadstock and condemned material caused no problems. These were simply put in a separate container by the slaughterer and picked up under a side agreement which Rothsay had with a Detroit renderer. There is no reason to suppose that a similar arrangement would not work with respect to material flowing into the United States from Canada. The Detroit contract was lost when a renderer closer to the slaughterer obtained the account. Rothsay (Moorefield) had become uncompetitive when the exchange rate changed.

Orenco operated a collection service called Liberty Reduction Inc. in the Buffalo area for some time. The material collected was brought to Orenco in Dundas for rendering. This operation was eventually sold to Darling & Company, Ltd ("Darling") on January 7, 1991. The volumes were not high enough for it to make economic sense for Orenco to continue that operation. It was not discontinued as a result of difficulties arising because of regulatory constraints related to crossing the border. Darling closed its Buffalo plant a few months later because of low volumes.

When Darling had labour difficulties at its Toronto plant sometime during 1988-89, materials were taken to Darling's Detroit and Buffalo plants for rendering. Also, there is evidence that some material (grease) is now being taken from Sault Ste. Marie to Detroit. While it is clear that Darling has consistently brought materials from the London and Windsor areas to its Toronto plant rather than taking it to the Detroit facility, this is not necessarily evidence that difficulty exists in taking materials across the border.[32] That behaviour can result, for example, from factors related to the capacity utilization of the various Darling plants.

Baker has been importing renderable material from Quebec to the United States since June 1991 and is currently importing 227 metric tons of material a week including packinghouse material, bone and fat, and deadstock. (Quebec legislation respecting deadstock may be different from that in Ontario.) Baker has experienced delays at the border on two occasions. One problem was resolved when the letter referred to above[33] was given to border officials and they verified its contents with authorities in Washington. The other problem was clerical in nature and was quickly resolved.

It is clear that there has been some but not a great deal of cross-border transportation of renderable materials. In the Toronto-Hamilton area this

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[32] James A. Ransweiler, Vice-President and Division Manager of the Great Lakes Division of Darling & Company, Ltd., gave evidence with respect to the past and present activities of Darling. That evidence was given in confidence. Where the facts found in these reasons do not coincide with that evidence this should not be taken as a reluctance to refer to Mr. Ransweiler's evidence because it was given in confidence but rather as a decision by the Tribunal that it does not wish to give that evidence much weight.

[33] *Supra*, note 22.

was probably largely due to the fact that until recently Darling had a rendering plant in Buffalo, New York. Thus, the lack of cross-border activity can be attributed to market configuration rather than to regulatory or other practical constraints arising from the existence of the Canada-United States border.

(3) Consumer Preferences

It is suggested that consumers are unwilling to turn to a supplier whose rendering plant is more than 200-250 miles distant or whose rendering plant is located in the United States. Since renderable materials must be removed on a daily basis, there is a need for reliable service. The Tribunal is not convinced that the alleged consumer preferences play much of a role in the market definition. To the extent that such preferences exist the Tribunal considers them as resulting more from lack of supplier recognition than from any innate reason related to distance or borders. In fact, Lomex has acquired two customers and it operates from a distance of over 250 miles away.

C. Conclusion

The purpose of determining the product and geographic dimensions of the relevant market is of course to allow for identification of the competitors to the merged firm and the calculation of the respective market shares of the market participants. It is important to emphasize, however, that market

boundaries cannot and will not in many instances be precise. They can only be approximations. As long as market share statistics are not taken as the only indicators of the existence of market power, the exact location of those boundaries becomes less important. Restraints on a merged firm's (alleged) market power can come from both inside and outside the market as defined.

It is useful to refer to some comments set out in the text entitled *Competition Law* by Whish. While that text is directed to the difficulties in defining the product dimensions of a market, they equally apply to geographic dimensions:

> The idea of interchangeability [substitutability] is simple enough. In practice of course one finds that identification of the relevant product [geographic] market can give rise to great difficulty. The reason for this is that the concept of the relevant market is just that - a concept; it is a useful theoretical device which facilitates an understanding of the problem of monopoly, but it is not to be supposed that it is reflective of the real commercial world.[34]

And further:

> The difficulties associated with the relevant product [geographic] market issue can be overcome provided that definition of the market is not thought to be of fundamental significance: in particular it is vital that having identified the relevant market, competitive pressures which come from outside that market should still be considered. The mistake is to suppose that in the commercial world there is a whole series of independent, discrete relevant product [geographic] markets which exert no influence on one another. In fact in business there exists a complex web of interlocking markets and sub-markets which may have an influence on one another in a more or less tangential way. Once that has been recognized, the danger of defining the market too narrowly ceases to be a problem, because the identification of the market is seen to be

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[34] R. Whish, *Competition Law* (London: Butterworths, 1985) at 216.

> only a staging post on the way to the really important question which is whether a firm is in a position to behave independently of its competitors. For this purpose it is relevant to consider not only the position of firms within the defined product [geographic] market but also the competitive pressure that can be exerted from those in other markets. ... If this approach is [not] adopted, then immense strain is imposed on the meaning of the relevant product [geographic] market, greater than the concept can realistically bear.[35]

In the present case, as has been noted, the product dimensions of the relevant market are easy to define: the provision of rendering services for non-captive red meat renderable material which includes deadstock materials and blood. The geographic dimensions, however, are more uncertain. This uncertainty arises because of the inherent ambiguity with respect to where market boundaries begin and end and, more importantly in this case, because of changes which have been occurring in the market since the merger.[36]

With respect to the geographic dimensions the Tribunal considers that transportation and other costs related to operating at a distance are such that a renderer located over 200-250 miles from Rothsay-Orenco should not be included in the relevant market. While it is clear that the Canada-United States border will result in some additional costs for renderers who engage in the cross-border collection of the material as a result of required paper work and possible delays at the border, the Tribunal is of the view that renderers located within the United States but close to the border could provide effective competition to the

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[35] *Ibid.* at 218-19.

[36] *Infra* at 59ff.

merged firm.

In the present case regardless of whether one defines the geographic market as the Ontario market (as the Director contends) or as the Ontario market plus parts of northern New York State and southeastern Michigan (as the respondents contend), the market is still highly concentrated.[37]

D. Identification of Competitors

The purpose of defining the relevant market is of course to facilitate identification of the merged firm's competitors and to assess the market share of the relevant market which each holds vis-à-vis the merged firm. A significant difficulty in identifying the merged firm's competitors in the present case arises because of the dramatic changes which have taken place and are taking place independent of the merger. It is relatively easy to identify Rothsay and Orenco's competitors at the time of the merger in July 1990. These were Darling (Toronto), F.W. Fearman Company Limited ("Fearman"), Banner Packing Limited ("Banner"), J.M. Schneider Inc. ("Schneider"), and Ray Bowering. In addition, it was anticipated that Central By-Products would soon become a competitor.[38]

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[37] Expert Affidavit of David D. Smith at para. 32 (Exhibit A-4); Expert Affidavit of Thomas W. Ross at para. 38 (Exhibit A-1).

[38] A small amount of material was also being taken out of the market to Quebec by Phil's Recycling. As has been noted, the Tribunal does not consider Quebec renderers to be established in the relevant market.

As of the date of the merger, Darling had rendering plants in Buffalo, Toronto and Detroit. Darling is the largest independent renderer in North America and has thirty-four rendering plants throughout the United States and one in Canada. Darling has been experiencing financial difficulties. Darling closed its Buffalo plant some time during either the winter or spring of 1991. Darling's Toronto plant was situated on land leased from the Toronto Harbour Commission. On the most recent expiration of the lease (October 31, 1990) the Commission refused to renew. A court order for vacant possession by January 7, 1992 was obtained. Even without the cancellation of this lease, there was speculation that Darling intended to leave the harbour area because of the costs involved in meeting environmental requirements.[39] Whether that company will relocate in Canada is not clear. Thus, at present the only Darling plant whose existence can be relied upon to provide competition to the merged firm is in Detroit.

Fearman was a competitor prior to the merger but it was bought by Canada Packers Inc. (now Maple Leaf Foods Inc.) on February 18, 1991. That acquisition has not been challenged by the Director. Fearman is therefore no longer a competitor and must be treated as part of the Rothsay-Orenco group. Fearman was and is a pork slaughterer whose rendering operation was mainly devoted to processing captive materials although more recently some non-captive material is being processed.

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[39] Applicant's Selected Documents, vol. 1, tab 14 at 11 (Exhibit A-7).

Banner remains a competitor to the merged firm. It is a fairly small renderer located in downtown Toronto. Much of its finished product material (tallow and meal) goes into its own pet food operation. It was a vigorous competitor to Orenco, Rothsay (Toronto) and Darling (Toronto). At the same time, its costs of operation have risen as a result of amounts which must be spent to meet environmental concerns and revenue is dropping because of the depressed state of prices for the finished products (tallow and meal).[40] Prices charged by Banner to its customers for rendering services have accordingly been rising. Banner has indicated an interest in selling its Toronto rendering facility since it moved its pet food operation to Trenton, Ontario.[41]

Schneider is located in Kitchener, Ontario and it remains a competitor in the market. Its rendering facility until recently were used to process only captive material. As a result of the closure of its beef slaughtering operations in Ontario, capacity became available to render non-captive materials and it entered the non-captive red meat material rendering market.

Ray Bowering, a deadstock collector located in Melbourne, Ontario, remains a competitor. He operates a small batch cooker and renders very small volumes.

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[40] Transcript at 246 (26 November 1991).

[41] *Ibid.* at 500 (2 December 1991).

Central By-Products is not yet in operation but the evidence indicates that it soon will be. It is being constructed by David T. Smith and James W. Murray. Messrs. Smith and Murray operate deadstock businesses. They decided in February 1990 to construct their own rendering facility near Hickson, Ontario, on land owned by Mr. Murray. He operates Oxford Deadstock Limited and presently uses Darling as a renderer. Mr. Smith operates a deadstock collecting and processing operation as well as a pet food business, Atwood Pet Food Supplies Ltd and presently uses Orenco as a renderer.

There is no evidence that Baker's plant in Rochester, New York has historically been a competitor of Rothsay and Orenco in southern Ontario. That plant, like Darling, is also part of a large multi-plant firm. It is the second largest renderer on the North American continent. The Baker (Rochester) plant is within geographical reach of the relevant market, being located 135 miles from Orenco's plant in Dundas. It is clear that both Baker (Rochester) and Darling (Detroit) would become increasingly competitive in the southern Ontario market served by the merged firm (insofar as geographical location is concerned) in proportion to any supra-competitive price rise which might be exacted. Since Baker (Rochester) has not historically been in the market and since it is not immediately adjacent to the border, it may be that it should be considered a potential entrant rather than a competitor in the market. Its relationship to the merged firm will be considered from both points of view.

Lomex commenced operating in the Toronto market in the summer of 1991[42] and, as has been noted, is taking two full truck loads from two of the larger Toronto area producers of renderable materials to Lomex's plant outside Montreal. The Tribunal has not classified Lomex as a competitor within the market but recognizes that as a potential entrant Lomex will provide some discipline on the merged firm's ability to raise prices.

V. SUBSTANTIAL LESSENING OF COMPETITION

Market power in the economic sense is the ability to maintain prices above the competitive level for a considerable period of time without such action being unprofitable. In a competitive market, prices will tend towards marginal cost. Market power can be viewed as the ability of a firm to deviate profitably from marginal cost pricing. In assessing the likely effects of a merger, one considers whether the merged firm will be able to exercise market power additional to that which could have been exercised had the merger not occurred. A merger will lessen competition if it enhances the ability of the merging parties to exercise "market power" by either preserving, adding to or creating the power to raise prices above competitive levels for a significant period of time. One considers the degree of any such likely increase and whether by reference to the particular facts of the case it should be characterized as substantial.

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[42] *Supra*, note 20.

Whether an enhancement of market power exists as a result of a merger and whether it is substantial is determined by reference to a number of factors. Market share data can give a *prima facie*[43] indication as to whether such is the case.

A. Market Concentration

The market concentration in the relevant market can be measured by reference to a number of different indicia. What measure will be chosen will depend upon the nature of the industry in question and the data available. In this case two measures have been used: the amount of renderable material actually processed in the recent past by the firms (historical output) and the plant capacity of the competitors (productive capacity). With respect to firms which have not previously been active in the market but which as a result of changes are now considered to be competitors, only the second method of measurement can be used.

A market share measurement based on pre-merger volumes of renderable material processed in southern Ontario indicates that Orenco and Rothsay were each servicing approximately 30% of that non-captive red meat rendering market. Darling's Toronto plant was processing 13%. Banner was processing 12% and Fearman 2%. An extrapolation from those data indicates

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[43] *Prima facie* is being used in its ordinary dictionary meaning of "at first sight" or "on first impression". This does *not* signify that the Director has by merely proving market share thereby proved his case subject to whatever rebuttal evidence the respondents might adduce. A responsibility still remains with the Director despite the market share evidence to adduce some evidence regarding barriers to entry.

that after the merger the merged Rothsay-Orenco firm will hold approximately 62-63% of the southern Ontario market. The next largest firm, Darling, for the moment at least would hold approximately 12-13%. Banner would hold 11-12%. Schneider and Ray Bowering would continue to process small amounts of non-captive material.

While the increased market share concentration calculated on that basis can be seen at a glance, two tools which have been developed in the United States for measuring market concentration in a summary fashion were referred to in evidence: the four-firm concentration ratio[44] and the Herfindahl-Hirschman Index ("HHI"). The four-firm concentration ratio measures market concentration by adding together the market shares of the four largest firms in the market. If the post merger concentration is very high and the merged firm accounts for a significant proportion thereof, then the merger is one which if assessed solely by reference to market shares will be considered to lead to a substantial lessening of competition. The HHI is computed by adding together the squares of the market shares of all the firms in the market.[45] The HHI can theoretically range from near zero to 10,000 (100 x 100) for a monopoly. In the context of anti-trust enforcement in the United States, it is generally thought that if a market has an HHI over 1,800 it is highly concentrated. An HHI between 1,000 and 1,800 is of medium concentration and below 1,000 relatively

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[44] Sometimes referred to in the evidence as "CR4".

[45] The HHI was derived from oligopoly theory; see G.J. Stigler, *The Organization of Industry* (Homewood, Ill.: R.D. Irwin, 1983) at 31; Expert Affidavit of David D. Smith at para. 43 (Exhibit A-4).

unconcentrated.[46] If the increase in HHI as a result of the merger exceeds 100 and the post merger HHI for the market exceeds 1,800, according to the Director's expert, one should assume (at least on a *prima facie* basis) that the merger will substantially lessen competition.[47]

Thomas W. Ross, who gave expert evidence on behalf of the Director, noted that the pre-merger four-firm concentration ratio for the total red meat renderable materials (captive and non-captive) in southern Ontario was 86.8% measured by reference to the volume of renderable materials processed each week by the firms.[48] The post-merger four-firm concentration ratio for these materials is 90.4%. The pre-merger ratio for non-captive materials only was 90.4% and post-merger is 91.6%.[49] While the application of this method of measurement clearly demonstrates how highly concentrated the markets are, it tells little about the effects of the merger. It demonstrates the inadequacies of the four-firm concentration ratio as a measure of increased concentration[50] in a case

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[46] H. Hovenkamp, *supra*, note 8 at 304-305.

[47] Expert Affidavit of David D. Smith at para. 44 (Exhibit A-4). In the United States, if the HHI increases by more than 100 as a result of the merger and the post-merger HHI is between 1,000 and 1,800, then the merger is likely to be challenged. If the post-merger HHI is over 1,800 and the increase as a result of the merger is over 50, then the merger is likely to be challenged. (*1984 [U.S.] Justice Department Merger Guidelines*, 49 Fed.Reg. 26,823 (1984) at para. 3.11(b)). Thus, the Director's expert is applying a higher test than pertains in the United States, an approach which will likely be more appropriate for Canadian industries which will often already be highly concentrated.

[48] Expert Affidavit of Thomas W. Ross, table 1 at 15 (Exhibit A-1). Dr. Ross' analysis assumes market boundaries of 200-250 miles and one restricted by the Canada-United States border.

[49] Orenco, Rothsay and Fearman were treated as one entity post-merger for the purposes of this analysis and Fearman is added to the Rothsay volumes pre-merger because that acquisition has not been challenged.

[50] Transcript at 337 (27 November 1991).

such as the present where the changes resulting from the merger are primarily occurring among the top four firms.

David D. Smith, who also gave expert evidence on behalf of the Director, did an analysis applying the HHI to measure increased concentration and using as a measure of market share the volume of non-captive red meat renderable material being processed in July 1990 by Ontario renderers. This analysis led to a finding that the increase in the HHI as a result of the merger with respect to the rendering of red meat by-products and deadstock was 1,594 points to a total HHI for that market of 3,608. Insofar as non-captive material is concerned, it is estimated that the increase is 1,526 points to a market total of 3,791.

The second variable by reference to which the position of the various competitors was assessed is plant capacity. This allows some measurement to be made with respect to Baker (Rochester) and Darling (Detroit) as competitors even though they have not historically been such. The capacity of some of the plants is not greatly in dispute: Darling (Detroit) can process approximately 1,600 metric tonnes per week; Baker (Rochester) can process approximately 1,600 metric tonnes per week; Schneider can process approximately 800 metric tonnes per week; Banner can process approximately 510 metric tonnes per week; Central By-Products will be able to process approximately 363 metric tonnes and Ray Bowering has capacity for 23 metric

tonnes; Fearman's capacity is approximately 450 metric tonnes per week, which should now be added to that of the merged firm.[51]

The capacity of the Orenco and Rothsay (Moorefield) plants are subject to more dispute. The respondents say Orenco's capacity is approximately 2,500 metric tonnes per week; the Director argues that it is approximately 2,900 metric tonnes. It is not necessary to consider in detail the dispute with respect to Orenco's capacity because the difference is small. However, the positions of the two parties vary greatly with respect to the capacity which should be attributed to Rothsay (Moorefield). The respondents argue that insofar as the equipment at that plant is presently used for rendering poultry materials, it should not be considered to be capacity available to render red meat. Rothsay (Moorefield) has two cookers; one is used full- time to render poultry materials and the other part-time for poultry offal and part-time for red meat. Approximately 200 metric tonnes per week of poultry offal is processed on the second cooker. This occupies approximately 17 to 18 hours per week with an additional seven hours required for cooking and cleaning the equipment when it is switched over.

The Tribunal accepts the position that capacity for present purposes should be assessed by reference to the equipment that is able to render red meat materials rather than to the purpose for which it is presently being used. The Tribunal understands from the evidence that this is the basis on which the

[51] The Tribunal has selected what we consider to be reasonable approximations although we should point out that a range of numbers was given to us respecting plant capacities and utilization.

capacities of the other plants, at least Baker (Rochester) and Darling (Detroit), were assessed. The extent to which Rothsay (Moorefield) would actually switch from processing poultry materials to processing red meat is more appropriately considered in assessing the significance of market share and plant capacity estimates, particularly in the context of assessing the import of excess capacity. Accordingly, for present purposes the Rothsay (Moorefield) red meat rendering capacity is approximately 3,200 metric tonnes per week.

On this basis the merged firm including Fearman would hold approximately 56% of the total productive capacity of the market if both Baker (Rochester) and Darling (Detroit) are considered to be competitors and approximately 66% if only the latter is included. Dr. Smith did a number of HHI calculations based on plant capacity. These were based on a number of different possible scenarios with respect to who was in and who was out of the market. While such calculations could be done by reference to the capacities which the Tribunal has accepted, it is not obvious that they add much in the present case.

The various measurements indicate that the merger increases market share considerably in an already highly concentrated market and gives rise to at least an initial concern that the merger will likely substantially lessen competition in that market.

B. Excess Capacity - Increasing Available Capacity by Switching Rendering Equipment Presently Used for Poultry - Increasing Capacity by Easy Expansion of Existing Facilities

As has already been noted, market share is not necessarily a reliable determinant of market power. As an indicia of such it may either overstate or understate a firm's market power. If other firms in the market have excess capacity, they can respond to a supra-competitive price rise by flooding the market at a lower price level. As a result, the best question to ask when assessing market power, in some circumstances, is whether the respondents' current competitors have capacity available to serve what otherwise would be the merged firm's customers. One of the most significant sources of high supply elasticity is the excess capacity of competing firms. The respondents argue that Rothsay-Orenco competitors have extensive excess capacity in comparison to the merged firm and therefore the merged firm will not be able to exercise significant market power.

Insofar as the alleged excess capacity of Rothsay-Orenco's competitors is concerned, the situation of Darling is quite problematic. As has been noted, it has lost its Toronto lease and will have to move. Mr. Kosalle's view is that Darling will stay in the Toronto-Hamilton area and probably construct a new plant. He is also of the view that Darling will transport Toronto materials to its Detroit plant in the interim. Darling was processing approximately 850 metric

tonnes per week at its Toronto plant; 40% of this was collected west of Lambeth which is near London, Ontario. For the purpose of assessing excess capacity (existing or likely to exist in the near future) the Tribunal is not willing to place much reliance on Darling constructing a new plant in the Hamilton area. At the same time, since Darling is a large multi-plant firm with plants in Cleveland, Ohio, Detroit, Michigan, Coldwater, Michigan and Milwaukee, Wisconsin, the Tribunal accepts the argument that a considerable amount of capacity could be opened up at the Detroit location by shifting volumes between the Cleveland, Coldwater and Milwaukee facilities.

The Tribunal heard evidence that Banner was operating at capacity (approximately 500 metric tonnes per week) but could increase that capacity by approximately 390 metric tonnes per week if $400,000 was spent on additional equipment.

Schneider also has excess capacity as a result of closing its Ontario cattle slaughtering operations. Its capacity is estimated to be approximately 800 metric tonnes per week of which approximately 400 metric tonnes is presently being used. Central By-Products is installing a plant with the capacity to render approximately 360 metric tonnes. It will use only 113 metric tonnes per week for its captive materials. Baker (Rochester) could open up excess capacity of approximately 400 metric tonnes.[52] Lomex in Montreal is thought to have

[52] This assumes that there is an ability to shift material between Rochester, N.Y. and Lowell, Mass. (see Transcript at 1080-81 (10 December 1991)).

excess capacity and Rothsay (Laurenco) at that same location is known to have excess capacity of approximately 800 metric tonnes. Although, as has been noted, the Tribunal has not considered the Montreal plants to be in the relevant market.

Insofar as the merged firm's excess capacity is concerned, it is alleged that after the merger Orenco will have only 233 metric tonnes excess capacity per week and Rothsay (Moorefield) will have only 78. These figures appear to significantly understate the excess capacity of those establishments. In the first place, this estimate assumes that Fearman's rendering plant will be closed and the material previously rendered at that plant will be rendered in the future at Rothsay (Moorefield) and Orenco. The decision to close Fearman's rendering plant and thereby reduce Rothsay and Orenco's excess capacity is a matter which is within the control of the Agribusiness Group of Maple Leaf Foods Inc. It is a decision which apparently was only discussed two or three weeks prior to the Tribunal's hearing. This alleged decision, at the moment, is speculative.

In addition, the excess capacity of Rothsay (Moorefield) has been calculated on the assumption that priority will be given to the rendering of poultry materials at the expense of red meat materials. The excess capacity figures for Moorefield are calculated by excluding usage of the equipment which is presently dedicated to processing poultry materials. It is assumed that the equipment will continue to be used for that purpose. With respect to whether Rothsay

(Moorefield) would switch its equipment to rendering poultry material if rendering red meat material became more profitable, there is much reason to think that it would not. While poultry offal does not produce high quality tallow, poultry feathers do produce a high quality meal.[53] In addition, much of Rothsay's poultry volumes are captive materials for which disposal would have to be provided in any event.

It is known that Maple Lodge Farms Ltd, a poultry processing firm not related to Maple Leaf Foods Inc., has entered the poultry material rendering business and might expand this activity. Maple Lodge Farms Ltd produces 36-38% of Ontario's poultry.[54] It is estimated that Maple Lodge Farms Ltd was processing 23 metric tonnes per week in June 1990, and in October 1991 it was processing 218 metric tonnes per week. To the extent that that firm ceases to use Rothsay (Moorefield) to process its renderable materials, capacity would be freed up. Most important with respect to the respondents' estimates of their excess capacity is a letter written in December, 1990. It states:

> ... Rothsay (Moorefield) and Orenco have sufficient cooking capacity to handle all the raw material currently processed by Rothsay, Orenco and Darling & Co. in Ontario. This cooking capacity could be fully utilized if relatively inexpensive modifications were made to the Rothsay Moorefield and Orenco plants to de-bottleneck their production lines. For example, Orenco could increase its capacity by installing additional press equipment.[55]

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[53] On average red meat material yields 22% tallow and 24% meal. Poultry offal yields 8% (low quality tallow) fat and 20% meal. Raw feathers yield about 26-30% feather meal. (Applicant's Selected Documents, vol. 1, tab 6 at 2 (Exhibit A-7)).

[54] Transcript at 523-24 (2 December 1991).

[55] Applicant's Selected Documents, vol. 1, tab 38 at 1 (Exhibit A-7).

It is clear that in general in this industry it is fairly easy for renderers to increase their capacity or when they are a multi-plant firm to shift the renderable material among different plants to open up capacity at a given plant when it is needed. Some of the larger firms, at least, plan their plants with a view to being able to respond quickly in this way. With respect to the ease with which the firms can increase or reallocate their capacity, this can be seen in the reallocation which took place among Rothsay (Laurenco), Rothsay (Moorefield) and Orenco after the merger in response to the expropriation of Rothsay (Toronto). With respect to the ability to move material between plants and thereby free up capacity, Joseph G. Huelsman, General Manager, Baker Commodities Inc., gave evidence as to how this could be done at the Baker (Rochester) plant if it was deemed advisable to do so in order to enable that firm to enter the southern Ontario market. There appears to be significant excess capacity in the industry generally and the merged firm is not capacity-constrained. The excess capacity of firms both within and outside the relevant market will provide a degree of competitive pressure on the merged firm and restrain to a considerable extent its ability to raise prices.

C. Market Environment

A significant factor in this case is the changes which are taking place in the red meat material rendering market. The Director describes the market as flat, the respondents describe it as declining. The Tribunal finds the

respondents' description persuasive, particularly the evidence of Erna H.K. van Duren.[56] She estimates that the supply of renderable red meat material resulting from cattle slaughter in Ontario is likely to decline by 4% per year until at least 1995. She estimates that the renderable red meat material from pork slaughter is expected to decline 0.3% per year over the same period. Poultry materials are expected to increase by approximately 3.2% per year. As has been noted, beef materials are sought-after because they produce high quality tallow. Poultry feathers, however, produce high quality protein meal.

Dr. van Duren's opinion is based on several factors. Firstly, consumer preference for red meat has been declining since 1970. This change in consumer taste from red meat to poultry and non-meat products results from concern that eating red meat is not as healthy as eating the other products. The relative price of red meat vis-à-vis other products is also referred to as a factor.

Secondly, insofar as Ontario is concerned, there has been a marked decline in cattle-rearing activity in the province. Such activity has been shifting westward to the provinces of Alberta and Saskatchewan. The trend westward is due to the increased size of herds needed to stay competitive. These can be raised much more economically in Alberta and Saskatchewan than in Ontario.

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[56] Expert Affidavit of Erna H.K. van Duren (Exhibit R-11).

The shift of cattle-rearing operation westward has been accompanied by a movement to locate slaughter operations close to where the cattle are raised. Instead of transporting either live cattle or cattle carcasses east, the various cuts for the consumer trade are more likely to be prepared at a slaughterhouse located close to where the cattle have been reared. Transportation costs are less for what is known as boxed beef than for live animals or carcasses.

There was some discussion before the Tribunal about projections prepared by Agriculture Canada for Canada East and Canada West which projected a much smaller decline in cattle slaughter in Canada East than Dr. van Duren estimates. Dr. van Duren notes that the Canada East and Canada West models are merely mirrors of each other and thus the Agriculture Canada model is one that really pertains to Canada as a whole and says little about the Ontario situation.[57]

The Director argues that the market may have been declining but that there is no reason to assume that the past trend will continue. Dr. van Duren, on the other hand, argues that there is little indication that the

[57] Dr. van Duren noted that the amount of renderable material which would be available in the future depends upon: (i) the number of animals slaughtered; (ii) the carcass size; and (iii) the proportion of the carcasses which is renderable. She assumed a carcass size for her model that was equal to the 1990 levels. She noted that insofar as the proportion of renderable material to carcass size is concerned, over the years there have been significant reductions in this regard as leaner and leaner cattle have been bred. The most significant factor for present purposes, however, is the drop in cattle slaughter which has occurred and is occurring in Ontario as a result of both the decrease in consumer demand for red meat and the shift westward of cattle-rearing and slaughtering operations. She looked at the declines which have occurred between 1981 and 1990 and made estimates for the next five years on the assumption that such trends would continue.

restructuring of the North American red meat industry which has been occurring is likely to stop, especially in Canada. Thus, it is argued that it is likely that the Canadian industry will continue to consolidate and increase its geographic concentration westward with a consequent decline of beef slaughter in Ontario. The Tribunal accepts Dr. van Duren's opinion.

Reference was also made to the trends and restructuring which have been occurring in the industry generally, particularly in the United States markets since the 1970s. While the Tribunal is reluctant to put much weight on events which occur in other markets, in this instance it agrees that industry trends in general provide some relevant information concerning the context within which the industry as a whole is operating. Since 1970 there has been a decline in the number of independent renderers in the United States from over 600 to under 350. This decline has been particularly noticeable in large metropolitan areas. The New York Metropolitan Area has seen a reduction from seven to two rendering facilities since the early 1980s. In the Los Angeles Metropolitan Area, the amount of rendering has dropped from four plants operating 24 hours a day, six days a week, to two plants operating at two-thirds capacity. Finally, in the Chicago Metropolitan Area the amount of rendering has been reduced from nine large plants, including the largest in the world, plus several smaller plants in 1975 to only one small plant.[58] While it is true that a city or state boundary may tell one little about the geographical dimensions of the relevant markets, the reduction in

[58] Expert Affidavit of Fred D. Bisplinghoff at paras. 23, 39-41, 66 (Exhibit R-8).

the number of plants in the larger metropolitan areas does give some indication of the trends in this market.

Decline in the volumes of red meat material available for rendering in Ontario, of course, opens up additional excess capacity for renderers, thus providing an additional incentive for renderers to compete aggressively for material in their current collection areas and to increase the size of those collection areas. There is also incentive as volumes decline to purchase adjacent renderers in order to acquire the requisite volumes.

In addition to the decline in red meat materials, this industry faces increasing costs as a result of environmental concerns and as a result of changes in what is considered to be appropriate use for the land on which some rendering plants are located (or for the land proximate thereto). These factors force changes in market configurations. For example, both Rothsay (Toronto) and Darling have lost their Toronto harbourfront property and lease respectively. The Toronto harbourfront location afforded proximity to the major suppliers of renderable materials in the Toronto area and access to port facilities from which tallow could be shipped to the international market in which it is sold. It is argued that environmental concerns would lead to difficulties with respect to any proposed expansion of Rothsay (Moorefield). While the Tribunal is not convinced that this would necessarily be the case, it is clear that failure to meet environmental standards in the past has been the subject of much adverse publicity for that plant.

Banner also has experienced increased costs as a result of environmental considerations.[59]

Another factor which is having a negative impact on this industry is the relatively depressed prices at which tallow and meal are being sold. The respondents state that the protein meal which is produced from the rendering process is, in general, sold within Canada but that the tallow products are exported. It is noted that there is an abundant supply of alternative non-animal based products which compete with the tallows and which are being promoted as preferable to the animal-based products.

In general, then, the industry is one in which there has been and is a decreasing supply of quality renderable materials, costs have been rising and there is little ability to control the price at which the finished products (tallow and meal) are sold. Renderers have been increasing their prices to customers, for example, by charging for the pick-up of materials which previously had been collected without charge and by picking up but ceasing to pay for materials which previously had been purchased. While some of the witnesses see these changes as resulting from the merger, the evidence indicates that such is not the case. These changes are a result of the increasing costs and decreasing revenues which the renderers are experiencing. Rendering is a necessary service and thus

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[59] Transcript at 246ff (26 November 1991).

renderers are not likely to disappear completely from an urban area. The pressures on the industry, however, have led to increasing consolidation.[60]

D. Barriers to Entry

In the absence of significant entry barriers it is unlikely that a merged firm, regardless of market share or concentration, could maintain supra-competitive pricing for any length of time. An attempt to do so would cause competitors to enter the market and the additional supplies created in that manner would drive prices back to the competitive level.

As has been noted above, whether one classifies a firm which has not previously been active as a competitor to the merged firm as a competitor in the relevant market or as a potential entrant whose existence restrains the merged firm from levying supra-competitive prices is not of great importance. The respondents argue that entry can be defined in a number of ways: to include new firms entering the market, firms expanding their activities into the relevant market from another geographic area, local firms beginning to offer the relevant product (which did not do so before), and firms already in the relevant market (sometimes

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[60] See also Joint Book of Documents, vol. 17A, tab 74 at 36 (Exhibit JB-17A Confidential):

> We are in a mature market. The only way a renderer can significantly increase his supply of raw material is by obtaining an existing supply. Hence, we do expect to see further rationalizations of the industry. These changes will see packer renderers no longer rendering, and independent custom renderers being bought-out by larger competitors.

called "fringe firms") expanding their output.[61] The Tribunal has chosen not to classify the expansion of output by existing firms, be they "fringe firms" or major competitors, as entry decisions. The Tribunal considers entry to be either the establishment of a new firm in the market whether entirely new to the industry or new to the geographic area (e.g., the Tribunal has already indicated that it considered Lomex to be attempting entry) or local firms which previously did not offer the product in question commencing to do so (e.g., deadstock operators or slaughterhouses commencing to also operate a rendering facility).[62]

The Director has alleged that barriers to entry into the relevant market consist of: the environmental and regulatory requirements which must be met; the difficulty which exists with respect to acquiring sufficient supplies to become viable; the sunk costs involved in starting a rendering plant.

(1) Environmental and Regulatory Constraints

There is no doubt that provincial Ministry of the Environment, Ministry of Agriculture and Food and municipal approvals are needed to start a rendering plant and that some locations are simply not available for this use. Many sites in urban areas or sites close to urban areas are not likely to be

[61] *R. v. J.W. Mills & Son Ltd. et al.* (1968), 56 C.P.R. 1 (Ex. Ct.) at 37; *United States v. Baker Hughes, Inc.*, 908 F. 2d 981 (D.C. Cir. 1990); *United States v. Syufy Enterprises*, 903 F. 2d 659 at 666 (9th Cir. 1990); *United States v. Waste Management, Inc.*, 743 F. 2d 976 (2d Cir. 1984); *United States v. Calmar, Inc.*, 612 F. Supp. 1298 (D.C.N.J. 1985); *Re The Echlin Manufacturing Company*, 105 FTC 410 (1985).

[62] *Supra*, note 21.

available. Environmental and regulatory approvals can more easily be obtained, however, if an appropriate site is chosen, for example, a site in an industrially-zoned area of a large municipality. Mr. Kosalle testified that the Hamilton Harbour Commission has several sites suitable for rendering facilities and that the Hamilton Harbour Commission is amenable to leasing a site for such a facility. These sites are particularly attractive as they provide access to a wharf which allows for the economical transportation of finished products.[63]

Reference was made to the fact that Central By-Products had been delayed in opening its newly constructed facility as a result of the need to comply with environmental requirements. Central By-Products commenced construction of its facility in February 1990 without obtaining prior environmental approval. Professional engineers were not retained to design air and water treatment until after construction had been started. Ministry of the Environment approval for the new plant is expected shortly.[64]The experiences of that firm demonstrate the difficulties which an inexperienced entrant into the market can encounter.

The Tribunal does not put much weight on the length of time Rothsay took in trying to locate a new site when faced with the expropriation of its Toronto plant. There would be good reasons for Rothsay to try to retain its Toronto location for as long as possible. The Tribunal is of the view that *de novo*

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[63] Transcript at 45-46 (4 December 1991) (confidential); 495 (2 December 1991).

[64] Transcript at 223-25 (26 November 1991).

entry would likely take approximately 18 months to accomplish. At the same time, entry by a supplier from an adjacent geographic market through expansion of its collection area would not entail this difficulty. Also, forward integration on a small scale by the larger slaughterhouses would likely be less difficult if land were available at the site and the slaughterhouse already located in an appropriately zoned area.

(2) Sufficient Supplies

Insofar as obtaining sufficient supplies are concerned, the amount of material needed will depend on the size of the plant in question. Central By-Products clearly is of the view that 113 metric tonnes is sufficient.[65] A slaughterer or deadstock operator who establishes a rendering plant at the same location as his slaughtering or deadstock operation, will incur less costs in rendering material produced therefrom than a non-integrated renderer since no collection costs will be involved. Fearman, for example, has been operating a rendering plant for its captive pork products having a capacity of 450 metric tonnes per week. Schneider has a capacity of approximately 800 metric tonnes per week. Banner which has no captive material operates a plant having a capacity of approximately 510 metric tonnes per week.

[65] This may not be entirely accurate as deadstock volumes have dropped considerably since Messrs. Murray and Smith decided to build their plant. The drop in deadstock coincided with the decision to start charging for the pick-up of deadstock. (Transcript at 220 (26 November 1991)).

Better Beef and Quality Meat Packers are examples of slaughterers with sufficient supply to establish at least a small scale rendering operation. They respectively produce approximately 900 and 1,000 metric tonnes of renderable material per week. Groups of smaller suppliers might also have the requisite minimum volume to justify construction of a rendering plant.[66]

Such enterprises, of course, would not be able to establish a rendering facility of the scale of Orenco or Rothsay. What is more, given the contracting nature of the industry one can question whether or not much entry is in fact likely to occur as a result of forward-integration by slaughterers such as Better Beef and Quality Meat Packers or by a group of smaller companies. But this is clearly more than just a mere possibility. Central By-Products has taken this initiative recently and insofar as poultry is concerned, Maple Lodge Farms Ltd appears to have done so. The test as to whether potential entry will discipline the market is whether such entry is likely to occur, not merely whether it could occur.

(3) Sunk Costs

Insofar as sunk costs are concerned, there is little evidence as to the proportion of the investment which is sunk in a rendering plant. There is evidence, however, that the total investment required can vary considerably depending on the size of the facility. Central By-Products has recently built a

[66] Transcript at 217-18 (26 November 1991); 1012 (9 December 1991); 568-69 (2 December 1991).

plant in Hickson, Ontario at a cost of $1.1 to $1.2 million. Ray Bowering is a small collector who originally sold material to Phil's Recycling. Ray Bowering built his own plant which can render 23 metric tonnes of material per week.[67] At the other end of the scale, however, Rothsay has estimated that $10 million would be reasonable as an estimate for the cost of a new plant.[68] While there is no direct evidence concerning the proportion of costs which would be sunk, it is clear that some must be involved, for example, the costs of obtaining regulatory approvals, the specialized equipment and building required which on resale would command a lower price than that for which they were bought.

(4) Conclusion

The extent of the barriers to entry depends upon the would-be-entrant. They are moderately high for a *de novo* entrant. The regulatory and environmental approvals which are required together with the construction time involved, as has been noted, would probably mean that approximately 18 months would be required to effect entry. In addition, the obtaining of sufficient volumes, unless one purchased such from an existing competitor in the market, as well as the fact that some sunk costs would be involved would discourage such entry. Indeed, given the state of this market one would not expect *de novo* entry.

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[67] Transcript at 219 (26 November 1991); 1012 (9 December 1991); Tables Referred to in Testimony of Joseph Kosalle, tables XVIII and XX (Exhibit R-4).

[68] For a lower figure, see Joint Book of Documents, vol. 17A, tab 74 at 39 (Exhibit JB-17A Confidential).

As has been noted, entry on a small scale by forward integration of the larger slaughterhouses or groups thereof cannot be dismissed as a possible source of entry particularly if they are located in an area where such industry is accepted and where adjacent physical space is available. The experience of Messrs. Murray and Smith in constructing Central By-Products indicates that the investment required for a small operation can be relatively modest; sunk costs did not deter that initiative. While the Tribunal heard evidence that the small slaughterhouses would not contemplate attempting to render their own materials, there is no evidence that this is so for the larger ones. At the same time, the Tribunal does not rely on forward integration by the larger slaughterhouses as a significant source of probable entry. The most probable source of entry in response to a price rise is entry by existing suppliers already established in adjacent regions. Barriers to entry would not preclude entry by such renderers in response to a price rise. Also they might in any event attempt to do so in order to expand their collection area because of low volumes.

E. Renderable Materials Are Not Homogeneous

Renderable materials are not homogeneous. That is, they vary as to quality and in the distance at which they are located from the rendering plant. Some are picked up; some are delivered to the plant by the producer of the material or by others. The price paid for the material or the pick-up charge levied will differ depending on the quantity and the quality of the material. Quality will

differ, for example, as between beef and pork material, as among shop bones and fat (e.g., material from supermarkets), packing house materials, low grade deadstock materials, blood. The quality will also vary depending upon the freshness of the material. There are no published price lists relating to the collecting of renderable materials. While the main thrust of the Director's case has been that the merged firm will become a dominant firm, insofar as any increased market power might be alleged to lead to collusion or tacit price following rather than to dominant firm behaviour, the non-homogeneous nature of renderable materials (including differences in quality, quantity and distance from the rendering plant) would make such behaviour difficult.

F. Conclusion

It is clear that a lessening of competition will result from the merger. What will constitute a likely "substantial" lessening will depend on the circumstances of each case. It is difficult to articulate criteria which might be applicable apart from the obvious ones of degree and duration. The degree of lessening can in some circumstances be assessed by reference to factors such as the number of competitors left in the market, the amount of harm which can be done before the market is likely to again become competitive, for example, as a result of new entry. Various tests have been proposed: a likely 5% price rise sustainable for one year; a 5% price rise sustainable over two years; a small but significant and non-transitory price rise. The Tribunal does not find it useful to

apply rigid numerical criteria although these may be useful for enforcement purposes.

In addition to the lessening which will occur as a result of the merger, lessening is also occurring as a result of changes in the market independent of the merger. It seems clear that the Toronto area was the most competitive in North America. The competition was driven largely by the aggressiveness of Darling (Toronto) and Banner. A highly competitive situation existed between three firms all located within the City of Toronto (Darling, Rothsay and Banner) and one located 40 miles distant (Orenco). That competitive situation of course cannot be re-established.

The Tribunal is asked to assess the effects of the merger in the light of the new situation because it will be within that context that the merged firm will operate. The merger of the two largest firms and the closure of the Darling (Toronto) plant will substantially change the structure of the market. Even if Darling remains in the market and competes from Detroit it will not be as effective a competitor from that location as it was when it had a plant located in Toronto. Darling will take on the character of a fringe firm rather than a major competitor. While, as has been noted, the view has been expressed that Darling will build a plant in Hamilton, there is no verifiable evidence of such intention. One would have thought that if Darling intended to maintain a plant in that area it would have taken concrete steps with respect thereto before now.

Dr. Ross expressed the opinion that with the merger and the departure of the Darling plant from the Toronto-Hamilton area, the merged firm would likely assume the behaviour of a dominant firm with the remaining firms functioning as a competitive fringe. He expressed the view that the price increases which would follow could be very high because the elasticity of demand is so low (producers of renderable material must dispose of it). That conclusion depended upon a number of assumptions including high barriers to entry and limited excess capacity in the hands of the merged firm's competitors.

The respondents argue that the likely effects of the merger should be assessed by reference to a longer time frame than two years. Given the declining state of the market it is argued that in the not too far distant future (the respondents say five years) there will only be enough red meat renderable material to support one plant and some smaller specialty fringe firms. It is also argued that with or without the merger, given the projected increase in poultry materials together with the decline in red meat materials, Rothsay (Moorefield) will be dedicated to processing poultry materials and will be out of the red meat material rendering business.[69]

The decision in *United States v. General Dynamics Corp.*[70] is cited for the proposition that in assessing a merger one must consider changes that are

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[69] Discussed further *infra* at 101-102.

[70] 485 U.S. 486 (1974).

occurring in the market and that are likely to occur in the future. That case concerned the coal industry. The United States government relied on statistical evidence to show that there was concentration in that industry, that the concentration was increasing and that the acquisition in question would increase the market share of General Dynamics Corp. and contribute to the concentration trend. The Supreme Court upheld a finding of a lower court that despite this statistical evidence there would be no lessening of competition because of the acquired firm's current production and its much more limited potential for future production as a result of its depleted reserves.

While market share statistics are high and barriers to *de novo* entry are moderately high, the Tribunal cannot ignore the fact that a significant source of competitive discipline will exist from those firms which border geographically on the relevant market and which would be prepared to expand their area of collection in the face of a price rise by the merged firm. Indeed, such firms may find it necessary to do so in any event in order to obtain sufficient volumes for themselves. The fact that there is excess capacity everywhere in the relevant market and in the rendering plants proximate thereto means that constraint will exist on the merged firm's ability to raise prices.

It is true that the merger was not caused by a need to rationalize the firms as a result of lower volumes. Nor did the merger happen for the purpose of limiting competition in the market. The merger "just happened" as part of the

larger acquisition of Canada Packers Inc. by Hillsdown. At the same time, the declining nature of the market is a significant factor to be taken into account since it will lead to increased excess capacity and increased expansion of existing collection areas.

In the light of these considerations, the Tribunal finds that it has not been convinced, on the balance of probabilities, that a substantial lessening of competition is likely to arise as a result of the merger of the two rendering businesses. This decision is very much a borderline one and the difficulty relates to the dynamic changes which are occurring in the market.

In addition, the effectiveness of any divestiture order which might be given is a relevant consideration. It will be discussed below after discussion of the evidence and arguments respecting efficiencies are considered.

VI. EFFICIENCIES

Section 96 of the *Competition Act* provides:

> 96. (1) The Tribunal shall not make an order under section 92 if it finds that the merger or proposed merger in respect of which the application is made has brought about or is likely to bring about gains in efficiency that will be greater than, and will offset, the effects of any prevention or lessening of competition that will result or is likely to result from the merger or proposed merger and that the gains in efficiency would not likely be attained if the order were made.

> (2) In considering whether a merger or proposed merger is likely to bring about gains in efficiency described in subsection (1), the Tribunal shall consider whether such gains will result in
>
> *(a)* a significant increase in the real value of exports; or
>
> *(b)* a significant substitution of domestic products for imported products.
>
> (3) For the purposes of this section, the Tribunal shall not find that a merger or proposed merger has brought about or is likely to bring about gains in efficiency by reason only of a redistribution of income between two or more persons. (underlining added)

Section 96 recognizes the fact that mergers which result in or are likely to result in a substantial lessening of competition may have beneficial consequences as well as detrimental and anti-competitive ones. Mergers can increase the efficiency of firms, for example, by enabling them to benefit from economies of scale (the unit cost of production decreases as the amount of output product increases); economies of scope (when lower costs are included in producing two or more products together than in producing them separately); dynamic efficiencies which arise because of improvements to product quality or innovation.[71]

A. Assessment of Cost Savings Claimed as Efficiencies

Three types of efficiencies are claimed by the respondents as arising out of the merger: administrative cost savings; transportation savings; and manufacturing costs savings.

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[71] P. Areeda & L. Kaplow, *Antitrust Analysis: Problems, Text, Cases*, 4th ed. (Boston, Toronto: Little, Brown, 1988), ¶120.

(1) Administrative Cost Savings

The total annual administrative cost savings alleged is $1,101,337. These arise from a reduction in the number of positions which are no longer required at Orenco allegedly as a result of the merger, positions such as a marketing manager, an accountant, a route service manager, three grease salesmen. The cost savings arise from the money which would have been spent on salaries and associated benefits as well as expenses (e.g., travel expenses). The numerical amount claimed as cost savings is not in dispute. What is disputed is whether these savings arose from the merger or from some other cause. Also, a consideration not raised in argument is why, if grease is not now considered to be in the relevant market, savings with respect to grease salesmen are included in the efficiency calculations.

The Director's experts challenge these administrative cost savings as efficiency gains arising out of the merger on the ground that: (i) information relating to them is entirely in the hands of the respondents and it is easy in the context of a merger to camouflage the dismissal of redundant employees; (ii) these kinds of savings are due to spreading fixed costs over larger output and thus they could have been obtained through means other than the merger, e.g., internal growth, joint venture, or as a result of another merger. The Director's position is that cost savings that do not arise *uniquely* out of the merger are not to be considered as efficiency gains. The respondents' position is that the test to be

applied is whether the efficiency gains would *likely* have been realized in the absence of the merger. The Tribunal accepts the respondents' position.

The most significant difficulty in assessing whether these cost savings arose as a result of the merger, however, arises because they are based on assumptions with respect to the likely structure of the market had the merger not occurred and those assumptions do not appear to be the appropriate ones. This same consideration arises with respect to at least some of the transportation cost savings and will be addressed in discussing them.

(2) Transportation Cost Savings

Three sources of savings on transportation costs are identified: the rationalization of truck routes in Western Ontario; the rationalization of routes in Toronto; and the savings arising from transporting material to Orenco in Dundas rather than to Rothsay (Moorefield). With respect to Western Ontario, since Rothsay (Moorefield) and Orenco covered much of the same territory in Western Ontario, it is possible after the merger to use fewer trucks to collect the same amount of material, resulting in savings of mileage, labour and capital. The total annual savings from these is calculated to be $241,433.46. There is no serious argument that these figures and savings are not accurate. Insofar as the savings respecting the Toronto routes are concerned, these routes were serviced prior to Rothsay (Toronto) volumes being moved to Dundas out of Rothsay

(Toronto) and Orenco. Combining these routes resulted in savings in mileage, labour and capital of $1,451,522.69.

The respondents claim only one-third of these (an annual cost saving of $483,841) as being attributable to the merger. This apportionment is based on the assumption that Rothsay would not have solved its expropriation problems by expanding Moorefield or by obtaining a location on the Hamilton Harbour, but would have had to relinquish two-thirds of its Toronto business. Since it could accommodate one-third of the business at Moorefield without expansion of its existing facility, it claimed only one-third of the savings arising under this heading. A similar one-third allocation was made with respect to the savings claimed as arising out of transporting material from Toronto to Orenco in Dundas rather than from Toronto to Moorefield. One-third of $519,905 was claimed ($173,302) as an annual cost savings.

There is little quarrel with the numbers which are claimed. The validity of the claims with respect to the last two categories of transportation savings, however, is based on the assumption that Rothsay would have responded to the expropriation notice it was under by moving as much material as it could to Moorefield (i.e., one-third of the Toronto volume) and abandoning the rest.[72] This is not a credible assumption. Mr. Kosalle's evidence was that the most likely solution to the expropriation notice would have been for Rothsay to have

[72] Supplemental Affidavit of Donald G. McFetridge at para. 11 (Exhibit R-20).

constructed a new plant in the Hamilton Harbour area. In addition, notices given to drivers who were terminated from the Rothsay (Toronto) plant on transfer of the Toronto volumes to Rothsay (Moorefield) and Orenco were told that their termination was the result of the expropriation of the Toronto plant. Mr. Kosalle admitted that it was impossible to distinguish cost savings which might have arisen as a result of the merger from those which arose as a result of the restructuring which occurred in response to the expropriation. Insofar as efficiency gains likely to arise from the merger are concerned, the burden of proof is on the respondents. The respondents have not met that burden with respect to the claimed efficiency gains insofar as such claims depend upon the assumption that Rothsay would have responded to the expropriation by moving one-third of its Toronto volumes to Moorefield and by abandoning the rest.

(3) Manufacturing Cost Savings

The savings in manufacturing costs which are alleged to result from the merger relate to Orenco's purchase before the merger of approximately 6 million pounds of bleachable fancy tallow to mix with its raw material in order to produce higher quality tallow. This tallow was purchased from Taylor By-Product in the United States. It cost Orenco $184,400 more annually than would have been the case had it purchased the tallow locally. In addition, the cost of heating, milling and refining the tallow was $33,600 annually. It is alleged that Orenco can now produce the same product using Rothsay raw materials.

The Tribunal is not convinced that this is a saving arising out of the merger. It is argued that Orenco could not buy the quantity of tallow required in Canada before the merger because it was not available in the amounts required and that it could not buy the raw material to itself produce this grade of tallow because at the time it was operating at full operational capacity. It seems clear that the savings in question arose because Orenco upgraded its machinery, thereby increasing its capacity, and not as a result of the merger. This should therefore not be considered to be an efficiency gain.[73]

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[73] With respect to the admonition in subsection 96(3) of the Act that a gain in efficiency shall not be considered appropriate for a decision if it arises "by reason only of a redistribution of income between two or more persons", while this is not relevant given the conclusion that the Tribunal has reached with respect to the cause of the cost saving in question, it is useful to refer to the comments of the former Director of Investigation and Research in a speech on October 15, 1988. These provide content to the subsection 96(3) exception:

> ... gains in efficiency that are pecuniary in nature, that is arising as a result of a distribution of income between two or more persons, are unacceptable.
>
> By way of illustration, cost savings that result when a firm is able to use increased bargaining leverage to extract volume discounts from suppliers are not eligible per se for consideration. The fact that the purchaser is able to obtain products at a reduced cost in these circumstances is only a transfer of income from suppliers. However, cost savings resulting from
> larger volume orders, which enable the purchaser to attain economies of scale or incur lower transaction costs, may reflect real efficiency gains and consequently may be accepted for consideration. If the placement of larger volume orders also enables the supplier to reduce costs, part of which are transferred to the purchaser in the form of lower prices, then that part may also qualify as real efficiency gains. Other examples where such pecuniary gains in efficiency may arise, and are thus not allowable, might be found in labour procurement situations and tax savings matters. (C.S. Goldman, "Mergers, Efficiency and the Competition Act: Notes for an Address", Commercial and Consumer Workshop, Faculty of Law, McGill University, Montreal, Quebec, October 15, 1988).

And an explanation found in Areeda also sheds light on this concept:

> In addition to the "technological" economies of scale ..., many large firms enjoy "pecuniary" economies of scale to some degree, for example, higher discounts for volume advertising or lower rates for heavy utility use not related to resource savings. Unlike technological economies, these pecuniary economies do not represent long-run savings in the use of socially valued resources. And they may raise barriers to entry in some cases. Indeed, pecuniary economies may be a euphemism for the surplus profits made possible by monopoly on the buyer's side of the market. Monopsony, as buyer monopoly is called, spoils economic efficiency just as seller monopoly does. Consequently, restructuring of large firms can hardly be resisted on the ground that it would deprive them of pecuniary economies. (*Supra*, note 71 at 36.)

Donald G. McFetridge prepared expert evidence assessing the deadweight loss[74] which likely could arise from the merger and compared it to the efficiencies claimed by the respondents. He assumed for the purposes of this analysis a 20% (and alternatively a 30%) decrease in the price paid by the renderers to the suppliers of renderable material. He also did an analysis based on a 40% increase with an elasticity of 0.1. On the basis of that analysis he concluded that the claimed efficiency gains outweighed the deadweight loss. Dr. McFetridge chose the 20% figure as a starting point because on examination for discovery the Director's representative, Stephen Peters, had referred to this percentage. It is clear that the percentage decreases which were used may not be very realistic for this industry. The prices can vary from a fairly small amount (e.g., three cents per pound) to a charge being levied for pick-up. In any event, given the Tribunal's findings elsewhere it is not necessary to express any conclusions with respect to this analysis.

(4) Conclusion

It is first necessary to address the question of the burden of proof which must be met by respondents when alleging efficiency gains. Counsel for the respondents seemed to argue that once they had established the claimed efficiency gains on a *prima facie* basis, that was sufficient to transfer the onus of disproving them to the Director. He argued that if on the balance of probabilities

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[74] Described *infra* at 88.

there was uncertainty, the doubt should be resolved in the respondents' favour. The Tribunal does not accept that argument. The respondents have the onus of proving the existence of the efficiencies claimed, or the likelihood of their existence when the merger has not been consummated, on the balance of probabilities in the normal way. Many of the claimed efficiency gains in this case, as has been noted, have not been proven to have arisen out of the merger as opposed to having arisen as a result of the restructuring caused by the expropriation. More importantly, however, the respondents based their trade-off analysis on a legal interpretation of section 96 which the Tribunal does not think is correct. That interpretation will be discussed below.

B. Legal Interpretation of Subsection 96(1)

In order to understand the arguments which were presented to the Tribunal respecting the proper interpretation of section 96, it is necessary to refer to a distinction which is made by economists between two different types of detrimental effects which may result from a firm having a monopoly or a dominant position in a market. If the merger results in the merged entity being able to raise prices above what would exist in a competitive market, then a transfer of funds (the wealth transfer) from the consumer to the producers is likely to occur. While this will be detrimental to individual consumers personally, it is not necessarily classified by economists as detrimental to society as a whole. This thesis postulates that there is no reason to suppose that the wealth transfer in

the hands of the purchaser (consumer) would be used for any more socially beneficial purpose than would be the case if it were in the hands of the producer (seller). What is important under this economic value judgment, is the detrimental effects which arise from the merger which lead to losses for society as a whole.[75]

Detriment to society as a whole is said to arise, for example, when consumers because of the higher prices choose an alternate and less appropriate substitute product for the use they have in mind. They substitute a product which would have been their second choice in a competitive market. This inefficient substitution is seen as a misallocation of resources; it is seen as a loss to society as a whole. It is referred to as allocative inefficiency or the deadweight loss.

Both the Director and the respondents argue that subsection 96(1) directs the Tribunal to balance "the gains in efficiency" which will arise from the merger against this allocative inefficiency or deadweight loss.[76] The Director's *Merger Enforcement Guidelines* states:

> Section 96(1) requires efficiency gains to be balanced against "the effects of any prevention or lessening of competition that will result or is likely to result from the merger or proposed merger". Where a merger results in a price increase, it brings about both a neutral redistribution effect and a negative resource allocation effect on the sum of producer and consumer surplus (total surplus) within

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[75] O. Williamson, "Economics as an Antitrust Defence: The Welfare Tradeoffs" (1968) 58 Am. Econ. Rev. 18 at 21-23; "Economics as an Antitrust Defense Revisited" (1977) 125 U. of Pa. L. Rev. 699, at 710ff.

[76] For explanations of the economic theory, see: H. Hovenkamp, *supra*, note 8 at 295-99; B. Dunlop, D. McQueen & M. Trebilcock, *Canadian Competition Policy:A Legal and Economic Analysis* (Toronto: Canada Law Book, 1987) at 160-65.

> Canada. The efficiency gains described above are balanced against the latter effect, i.e., the deadweight loss to the Canadian economy.[77] (footnote omitted)

This interpretation of section 96 is also found in the text *Mergers and the Competition Act* by Crampton.[78] The Tribunal[79] has difficulty accepting this interpretation.

In the first place, the Tribunal is directed by subsection 96(1) of the *Competition Act* to balance "the gains in efficiency" against the "effects of any prevention or lessening of competition that will result or is likely to result".[80] If only allocative inefficiency or the deadweight loss to the Canadian economy was intended by Parliament to be weighed in the balance then one would have thought that the section would have been drafted to specifically so provide. The interpretation which both the Director and the respondents put on section 96 requires a reading down of the phrase "effects of substantial lessening of" so that it does not include the transfers from consumers to producers which will generally be the largest effect of the substantial lessening.[81]

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[77] Director of Investigation and Research, Information Bulletin No. 5, March 1991 (Supply and Services Canada, 1991) at 49.

[78] P.S. Crampton, *Merger and the Competition Act* (Toronto: Carswell, 1990) at 520-31, especially 524-31.

[79] When the word Tribunal is used here and elsewhere in these reasons and the decision relates to a matter of law alone that decision has been made solely by the presiding judicial member.

[80] The French text speaks of "des gains en efficience" against "les effets de l'empêchement ou de la diminution de la concurrence qui résulteront ou résulteront vraisemblablement".

[81] Whether one would expect to see terms such as "allocative inefficiency" or "deadweight loss" in the text of the statute does not matter; these concepts can be phrased in less technical terms.

Indeed, earlier bills respecting proposed revisions to the *Combines Investigation Act*, which preceded the *Competition Act*, contained clauses which made it clear that efficiency gains were to be given precedence without any necessity to weigh them against the total effects arising out of a substantial lessening of competition occurring by reason of the merger. For example, Bill C-42 read:

> (5) The Board shall not make an order under subsection (3) where it is satisfied by the parties to a merger or proposed merger to which this section applies that the merger or proposed merger has brought about or that there is a high probability that it will bring about substantial gains in efficiency, by way of savings of resources for the Canadian economy that are not reasonably attainable by means other than the merger.[82]

And, Bill C-29 provided:

> 31.73 The court shall not make an order under section 31.72
>
> *(c)* where it finds that the merger or proposed merger has brought about or is likely to bring about gains in efficiency that will result in a substantial real net saving of resources for the Canadian economy and that the gains in efficiency could not reasonably be expected to be attained if the order were made.[83] (underlining added)

But these clauses were not enacted and the text of subsection 96(1) does not provide that if substantial efficiency gains exist the merger should be allowed. Rather, the subsection requires a weighing of "efficiency gains" against the "effects of any prevention or lessening of competition that will result or is likely to result from the merger".

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[82] Bill C-42, *An Act to amend the Combines Investigation Act and to amend the Bank Act and other Acts in relation thereto or in consequence thereof*, 2d Sess., 30th Parl., 1976-77.

[83] Bill C-29, *An Act to amend the Combines Investigation Act and the Bank Act and other Acts in consequence thereof*, 2d Sess., 32d Parl., 1983-84.

A description of the various purposes served by competition law in relation to efficiency gains is found in the text entitled *Competition Law*.[84] It is noted that one traditional purpose has been to protect the consumer from being charged supra-competitive prices. While one can argue that this is insignificant from the point of view of loss to the economy as a whole, Whish notes that there is a powerful political argument for preventing such accretions of wealth at the consumer's expense. Another purpose which has traditionally been seen as served by competition law is to encourage the dispersal of power and the distribution of wealth:

> Aggregations of resources in monopolists or multinational corporations or conglomerates could be considered a threat to the whole notion of democracy, individual freedom of choice and economic opportunity. This argument has been influential in the US where for many years there was fundamental mistrust of big business, and it was under the antitrust laws that the world's largest corporation, AT and T, was eventually dismembered.[85]

A third objective of competition law is seen as that of protecting the small firm against more powerful rivals:

> Somehow the competition authorities should hold the ring and ensure that the `small guy' is given a fair chance to succeed. This idea has had a strong appeal in the US, in particular during the period when Chief Justice Warren led the Supreme Court. However it has to be appreciated that the arrest of the Darwinian struggle, whereby the most efficient succeed and the weak disappear, in order to protect small business can run directly counter to the idea of consumer welfare. It may be that competition law is used to preserve the inefficient and to stunt the performance of the efficient. Bork has been particularly scathing of the `uncritical sentimentality' in favour of the small guy in the US and in recent years US law has been developing in a noticeably less sentimental way.

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[84] *Supra*, note 34 at 12-15.

[85] *Ibid.* at 30.

> Meanwhile the current darling of the European Commission is the `small and medium sized undertaking', indicating that the little guy is still in favour on this side of the Atlantic.[86] (footnote omitted)

These objectives can run counter to the fourth objective which is that of furthering the efficiency of the economy as a whole:

> Also it is important to appreciate that economic and political fashions change and that the priority of objectives over a period can alter. In the US a fundamental change is taking place and yesterday's naked restraint of competition may turn out to be tomorrow's precondition for efficiency.[87]

With this background in mind, then, one turns to the purpose clause of the *Competition Act*. That clause makes it clear that several objectives are meant to be served by the Act. The clause states that:

> 1.1 The purpose of this Act is to maintain and encourage competition in Canada in order to promote the efficiency and adaptability of the Canadian economy, in order to expand opportunities for Canadian participation in world markets while at the same time recognizing the role of foreign competition in Canada, in order to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the Canadian economy and in order to provide consumers with competitive prices and product choices. (underlining added).

The interpretation of section 96 which both parties adopt requires a selective reading of that clause. It requires that one give precedence to the instruction that the Act be interpreted "in order to promote the efficiency ... of the

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[86] *Ibid.*

[87] *Ibid*. at 15.

Canadian economy" over the instruction that the Act be interpreted "in order to provide consumers with competitive prices". Equally, the instruction that the Act be interpreted "in order to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the Canadian economy" is accorded lesser significance. The Tribunal has not been referred to any jurisprudence which indicates that in a listing of objectives in the purpose clause of a statute that which is listed first is to be given greater weight than those which follow. Also, there is nothing in the text of the purpose section which indicates that such preference is to be given. Indeed, in debates in the House of Commons, the Minister responsible for the Act indicated that it was the fourth objective which was of overriding concern:

> The fourth but not the least objective is to provide consumers with competitive prices and product choices. As such, this objective becomes the common denominator in what we are trying to achieve. This is the ultimate objective of the Bill.[88]

Reference is made by Crampton[89] to the evidence given before the Legislative Committee on Bill C-91.[90] In that forum it was pointed out that the efficiency section was unclear because it required a balancing of two different things. The response at 11:40 reads as follows:

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[88] House of Commons Debates, 7 April 1986 at 11927.

[89] *Supra*, note 78.

[90] *Minutes of Proceedings and Evidence of the Legislative Committee on Bill C-91, Issue No. 11* (May 21, 1986) at 11:34ff.

Mr. Ouellet: I have a question to ask to the Parliamentary Secretary. As Professor Stanbury has pointed out to us, proposed section 68 contemplates a trade-off between gain and [sic] efficiency, and the lessening of competition. According to the government, which of the two is most important?

Mr. Domm: I thing it goes back to a former statement I made in response to your original motion. It is a balancing defence we are looking for. It is not a question of which one, but rather a balancing defence for the benefits against the costs.

Mr. Ouellet: Do you agree that, as Professor Stanbury indicated to us, the matters which the tribunal will have to consider under this clause are not comparable, since one involves a redistribution of income and the other involves real gain and resource savings? Because Parliament does not seem to give any guidance to the tribunal and its priorities and the way to be applied to lessening competition and gaining efficiency, it seems it would be very difficult for the tribunal to choose. It seems clear there might be some gain of efficiency in any take-over, in any merger. Is this what government feels is more important, to the detriment of lessening competition?

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Mr. Domm: The provision we are asking for provides "a simple redistribution of income shall not be considered to be a gain in efficiency."

Mr. Ouellet: In their presentation the Canadian Federation of Independent Business suggests guidelines in regard to the efficiency defence be embodied in the legislation. Why are you not giving some guidance precisely to the tribunal in this regard?

Mr. Domm: I would refer you to proposed subsection 68.(2). Proposed subsection 68.(2) directs the tribunal to consider if the gains will result in a significant increase in the real value of exports or substitution of domestic products or importer producers.

It is to be noted that the answers which were given relate to a determination of what should be considered as an efficiency gain and not to a clarification of what such gains, however they might be defined, should be balanced against.

The Tribunal is not unaware of the debate which has raged south of the border as to whether allocative efficiency should be the only goal of

merger policy.[91] The debate in the United States is well described in *Horizontal Mergers: Law and Policy*.[92] It is useful to quote a summary set out therein of the various positions relating to efficiencies:

> *Absolute Defense*. Muris may be the leading proponent of an absolute efficiencies defense. Although he concedes that a full efficiencies defense would "somewhat complicate merger proceedings and economies can not always be demonstrated," Muris nevertheless believes that merger law must be based on economic theory and that that premise dictates consideration of efficiencies.
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> *Partial Defense*. Some commentators believe that efficiencies ought to be considered on a case-by-case basis, but suggest that the scope of an efficiencies defense may be limited to minimize the extent of judicial resources necessary to resolve such claims. Areeda and Turner would limit the defense to certain types of efficiencies (i.e., plant size and plant specialization where there is product complementarity) which they feel are most likely to result in significant cost savings. Former FTC Chairman Miller similarly would recognize an efficiencies defense, but only for efficiencies related to economies of scale.
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> Sullivan also favors a partial efficiencies defense, but he would limit it according to an evidentiary standard rather than by types of efficiencies:
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> > An alternative, not leading the Court into an unbearably complex or value laden area of judgment, would be to say that where cost saving efficiencies are clear, and arise in a context where market forces will oblige the seller to pass them on to consumers, and where competitive harm is only speculative ... the wise course is to risk the possible social harm for the certain benefit. Even if the Court is not ready to weigh the social benefit of efficiencies against the social harm of competitive injury when both seem similarly likely or certain to eventuate, it might nevertheless value a significant and likely social benefit higher than a much more doubtful harm.
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> Similarly, some commentators would require that claimed efficiencies be of a certain minimum size before being subject to litigation.

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[91] A.A. Fisher & R.H. Lande, "Efficiency Considerations in Merger Enforcement" (1983) 71 Calif. L. Rev. 1582; H. Hovenkamp, *supra*, note 8 at 41-42.

[92] *Supra*, note 9 at 219-32.

In an effort to integrate efficiency considerations with traditional antitrust concerns, Rogers writes that "efficiencies are relevant as a procompetitive factor only when they produce a more competitive market". This condition is likely to be satisfied, he suggests, where a merger involves two moderate-sized firms in a market dominated by larger firms with identifiable efficiency advantages. A corollary is that efficiencies in other situations may make a market less rather than more competitive and therefore should not be considered a defense in those circumstances.

Prosecutorial Discretion. One method for accommodating efficiencies without placing the issue squarely before the courts is to allow the enforcement agencies to consider efficiencies in deciding whether to challenge a transaction. Under this approach, efficiency claims would not be entertained once a suit is brought. Williamson suggests that enforcement authorities should decline to bring cases in which "a reasonably plausible showing of real economies can be made," but he do[es] not think it feasible or rewarding for the courts to entertain explicitly an economies defense involving a full-blown trade-off assessment. This approach is outlined in the FTC Statement and, apparently, in the 1984 Merger Guidelines.

One could expect, however, to see parties attempt to urge district courts to revisit the efficiencies issue when the prosecutor decides that the claim is not sufficient to justify the merger. It has been suggested, for example, that parties will present evidence of efficiencies to the courts in any event and may even argue that it would be arbitrary and capricious for the enforcement authorities but not the courts to consider such evidence.

Raise Enforcement Thresholds. Other commentators, while sympathetic to the notion that efficiencies are desirable and can sometimes justify otherwise harmful mergers, believe that the costs of fully litigating a vast range of efficiency claims would impose an intolerable burden on the judicial system. Moreover, even if efficiencies could be quantified with precision, it might still be impossible to quantify a merger's competitive costs, against which the efficiencies must be balanced.

The proponents of this view generally assert that most efficiency-enhancing mergers will be permitted if the general standards under the Merger Guidelines are set at such a level as to balance market power and efficiency effects. Fisher and Lande, citing evidence of the high cost of business uncertainty and of litigating efficiency claims, conclude:

> [W]e would incorporate efficiency concerns by adjusting the Guidelines' threshold for challenging mergers and urging the government and the courts to follow them with practically no exceptions. This change would have the effect of allowing more merger efficiencies and weeding out many of the mergers

> whose effect on market power was unduly speculative, without increasing litigation and business adjustment costs excessively.
>
> The commentators who advocate setting of the general standards with efficiency goals in mind generally do not suggest specific numerical thresholds. Some of the material cited above was published prior to the 1982 Guidelines, so it is unclear how the revised standards would affect the commentators' views. For example, Areeda and Turner have supported a partial efficiencies defense because mergers with combined market shares in the 10 to 13 percent range - which would likely have been subject to challenge under the 1968 Guidelines, but not under the 1982 or 1984 Guidelines -could frequently involve efficiencies. Another observer points out that, according to a study by Scherer, firms in eleven out of twelve industries studied could achieve most if not all advantages of multiplant size with a national market share of 14 percent or less - a level unlikely to be challenged under the current Guidelines.[93] (footnotes omitted)

With respect to subsection 96(1) of the *Competition Act*, it is argued that if the words "effects of substantial lessening of competition" are not limited to deadweight loss then there will be a significant number of efficiency enhancing mergers that will not be allowed. Whether this is the case or not is not a matter which can be determined on the evidence given in this case. Certainly, one interpretation which is open on the basis of the wording of subsection 96(1) is to weigh any alleged efficiency gains against the degree of likelihood that detrimental effects (both wealth transfers and allocative inefficiency) will arise from the substantial lessening of competition. That is, in those cases where such effects are likely but not positively certain to follow, one could give more weight to efficiency gains than where the reverse is true. The likely detrimental effects of a merger may on some occasions be moderate in extent, in others they may be quite extreme. It is not unreasonable to expect that a balancing of the alleged

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[93] *Ibid.* at 229-32.

efficiency gains could be assessed by references thereto. To the extent that the efficiency gains would be likely to lead to lower prices for consumers this would likely be determinative.[94]

One other consideration arises with respect to the arguments concerning the efficiency defence. The parties both rely on the judgment that the wealth transfer is a neutral one. A question posed during argument and which will be repeated here is, is this always so. If, for example, the merging parties in question were drug companies and the relevant product market related to a life-saving drug would economists say that the wealth transfer was neutral. The Tribunal does no more than raise this as a question. Another question respecting the alleged neutrality of the wealth transfer is: if the dominant firm which charges supra-competitive prices is foreign-owned so that all the wealth transfer leaves the country, should the transfer be considered neutral? Dr. McFetridge referred to this in his affidavit and concluded that a decision that such was not neutral would be discriminatory. The Tribunal does no more than raise these questions since for the reasons expressed above it is not necessary to make a decision on them in the present context.

VII. ORDER FOR DIVESTITURE - EFFECTIVENESS

[94] For a recent discussion of such an analysis see: A.A. Fisher, F.I. Johnson & R.H. Lande, "Price Effects of Horizontal Mergers" (1989) 77 Calif. L. R. 777.

It has been argued that an order for divestiture would not be effective in this case. For an order to be effective Rothsay must respond to it by taking positive steps to ensure that it remains a vigorous competitor in the red meat rendering business. The Director assumes that Rothsay will do so. Rothsay asserts that it will not.

Since the divestiture requires the removal from Orenco of the Rothsay (Toronto) volumes which are now being processed at Orenco, this implicitly requires that Rothsay either expand its Moorefield facility or construct a new facility, for example, in Hamilton. While counsel for the Director suggested that some other arrangement might be made, for example, the continued processing of materials at Orenco under contract, it is difficult to conclude that this would be a viable long term solution. While Orenco would undoubtedly be willing to process such materials under a tolling agreement on a temporary basis if Rothsay were constructing additional facilities, it is difficult to accept that Orenco under independent management would agree to such an arrangement on a permanent basis, rather than insisting that Rothsay sell the relevant contracts to Orenco.

An order cannot now be given which will put Rothsay and Orenco back in the position in which they were pre-merger. At the time of the merger Rothsay was vigorously pursuing a solution to the expropriation of its Toronto plant. There is no reason to assume that Rothsay would not have been allowed to stay in the Toronto

location until new facilities were constructed. Mr. Kosalle, at least, is of the opinion that the solution would have been the construction of a new facility on the Hamilton Harbour Commission lands. With the merger the momentum towards that solution died.

Orenco has changed its facility so that a significant amount of the Rothsay (Toronto) volumes are being accommodated at that plant. Orenco has not purchased a hydrolyzer nor moved into the processing of poultry feathers. A divestiture of Orenco would leave all the captive materials originating from both Hillsdown's and Canada Packers Inc.'s red meat and poultry processing operations with Rothsay (Moorefield). Approximately 680 metric tonnes per week of captive red meat material are processed by Orenco. The merger of the upstream red meat and poultry processing operations of Hillsdown and Canada Packers Inc. has been approved. The merger of those operations does not raise competitive concerns. With a divestiture order the total volume of captive materials would be processed by Rothsay (Moorefield). In the absence of the expansion of Moorefield this would occupy a significant amount of available capacity.

In addition to the captive red meat materials, Maple Leaf Foods Inc., Rothsay's upstream poultry processing operation, processes 40% of the poultry processed in the province of Ontario. Since the supply of poultry materials is expected to increase, the Moorefield facility over time will be required to process

additional captive poultry materials and it is argued that it is likely to elect to concentrate on rendering poultry, both captive and non-captive, rather than compete with Orenco in providing rendering services for red meat materials. Thus, it is argued that Rothsay (Moorefield) will cease to be a vigorous competitor for red meat material in the relevant market in any event.

The Tribunal accepts the respondents' argument that the continued decline in red meat material together with other changes in the market make construction of a new plant in Hamilton less attractive now than it was in 1989-90. Insofar as Rothsay's Moorefield facility is concerned, while the Tribunal is not convinced that expansion of that facility would be impossible as a result of environmental concerns and community opposition, the question is whether Rothsay would choose to pursue that option.

If there had been no expropriation of the Toronto plant the question of the effectiveness of a divestiture order would not have arisen. In the particular circumstances of this case, however, the Tribunal doubts that an order for divestiture would be effective to preserve a significant degree of competition in the relevant market for a sufficient period of time to justify its issuance.

The Tribunal does not want to leave the impression that merely because the respondents have changed their positions in response to the merger before the

application for an interim order was brought by the Director, the Tribunal is reluctant to order divestiture. That is clearly not the case. The Tribunal's comments on the likely ineffectiveness of a divestiture order pertains only to the particular facts of this case including the particular market conditions. The Tribunal is not convinced that issuing an order which depends for its effectiveness on one of the parties constructing additional facilities in a market where there is already excess capacity and shrinking volumes would accomplish a pro-competitive result.

VIII. ORDER

FOR THESE REASONS, THE TRIBUNAL HEREBY ORDERS THAT the application for a divestiture order is denied.

DATED at Ottawa, this 9th day of March, 1992.

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

(s) B. Reed
B. Reed