CT-2019-005

THE COMPETITION TRIBUNAL

IN THE MATTER OF the *Competition Act*, R.S.C. 1985, c. C-34, as amended;

AND IN THE MATTER OF the acquisition by Parrish & Heimbecker, Limited of certain grain elevators and related assets from Louis Dreyfus Company Canada ULC;

AND IN THE MATTER OF an application by the Commissioner of Competition for one or more orders pursuant to section 92 of the *Competition Act*.

BETWEEN:

THE COMMISSIONER OF COMPETITION

Applicant

– and –

PARRISH & HEIMBECKER, LIMITED

Respondent

JOINT BOOK OF AUTHORITIES

Canadian Jurisprudence	
1.	*Commissioner of Competition v Canfor Corporation,* CT-2004-002 - Consent Agreement.
2.	*Commissioner of Competition v West Fraser Timber Co Ltd and West Fraser Mills*, CT-2004-013 - Consent Agreement.
3.	*Commissioner of Competition v. United Grain Growers Limited,* CT-2001-007 – a. Commissioner's Statement of Grounds and Material Facts and b. the Affidavit of Halldor Palsson.
4.	*Saskatchewan Wheat Pool and JRI*, CT-2005-009 – Commissioner's Statement of Grounds and Material facts
American Jurisprudence	
5.	*F.T.C. v. Whole Foods Market, Inc.*, 502 F.Supp.2d 1 (2007)
6.	*F.T.C. v. Whole Foods Market, Inc.*, 548 F.3d 1028 (2008)
7.	*U.S. v. Cargill, Inc. and Continental Grain Co.,* Civil No. 99 1875 – US Competitive Impact Statement
European Jurisprudence	
8.	EU Case No COMP/M/6756 – Norsk Hydro/ Orkla / JV, Regulation (EC) No 139/2004, dated May 13, 2013
Secondary Sources	
9.	Competition Bureau Merger Enforcement Guidelines, October 6, 2011.
10.	Competition Bureau, *Competition Bureau Reaches Agreement to Preserve Competition in Two B.C. Forestry Markets*, December 7, 2004.
11.	Competition Bureau Submission to the OECD Competition Committee *Roundtable on Monopsony and Buyer Power*, October 2008.
12.	Competition Bureau, *Acquisition of Better Beef by Cargill,* Technical Backgrounder, August 2005.
13.	Horizontal Merger Guidelines by the U.S. Department of Justice and the Federal Trade Commissioner, issued August 19, 2010
14.	Michael Trebilcock, Ralph Winter, Paul Collins and Edward Iacobucci, *The Law and Economics of Canadian Competition Policy*, (Toronto: University of Toronto Press, 2003).

PUBLIC VERSION
CT-2004-002

COMPETITION TRIBUNAL

IN THE MATTER OF the *Competition Act*, R.S.C. 1985 c. C-34, as amended;

AND IN THE MATTER OF the acquisition of Slocan Forest Products Ltd. by Canfor Corporation;

AND IN THE MATTER OF the filing and registration of a consent agreement pursuant to section 105 of the *Competition Act*,

COMPETITION TRIBUNAL
TRIBUNAL DE LA CONCURRENCE
P
R
O
D
U
I
T
MAR 31 2004
REGISTRAR – REGISTRAIRE
OTTAWA, ONT. 0001B

BETWEEN:

THE COMMISSIONER OF COMPETITION

Applicant

-and-

Registry of the Competition Tribunal
Greffe du Tribunal de la concurrence
REGISTERED / ENREGISTRÉ
MAR 31 2004
FOR REGISTRAR
POUR REGISTRAIRE

CANFOR CORPORATION

Respondent

P. LAVOIE

CONSENT AGREEMENT IN RELATION TO THE ACQUISITION BY CANFOR CORPORATION OF SLOCAN FOREST PRODUCTS LTD.

WHEREAS Canfor Corporation ("Canfor") proposes to acquire all of the shares of Slocan Forest Products Ltd. ("Slocan") pursuant to a plan of arrangement under the *Company Act* (British Columbia) or successor legislation thereto (the "Transaction");

AND WHEREAS the Commissioner of Competition, having completed her review of the Transaction, has concluded that the Transaction, if substantially completed, is likely to substantially lessen competition in and around Prince George, British Columbia in respect of the purchase of logs; supply of inputs to re-manufacturers and sale and supply of wood chips;

AND WHEREAS the Commissioner has alleged certain material facts and Canfor does not agree with the facts alleged and does not admit to any substantial lessening or prevention of competition in any relevant market, but, for the purpose of this Consent Agreement and any proceedings related thereto including any proceeding pursuant to section 106 of the *Competition Act* R.S.C. 1985 c.c-34 as amended (the "Act"), does not contest the Commissioner's conclusions based on those facts ;

AND WHEREAS the Commissioner declares herself satisfied that the actions required to be taken by Canfor pursuant to this Consent Agreement will ensure that the Transaction does not prevent or lessen competition substantially in any relevant market;

AND WHEREAS with the execution of this Consent Agreement, the Commissioner will not oppose the Transaction, in whole or in part, pursuant to sections 92, 100 or 104 of the Act.

NOW THEREFORE Canfor and the Commissioner have agreed to the terms of this Consent Agreement as follows:

Definitions

1. For the purposes of this Consent Agreement, the following capitalized terms have the following meanings:

   (a) "Affiliate" has the meaning given to it in subsection 2(2) of the Act;

   (b) "Associated Tenure" means an agreement as that term is defined in section 53 of the *Forest Act* to harvest standing timber in the Prince George Timber Supply Area, the allowable annual cut, operating areas and timber profile of which shall:

      (i) within the Initial Divestiture Period, be negotiated between the Purchaser (as hereinafter defined) and Canfor; or

      (ii) within the Trustee Divestiture Period shall be negotiated by the Trustee to a maximum allowable annual cut as set out in, and in such operating areas and with such timber profile as generally described in, the attached Confidential Schedule "A" to this Consent Agreement;

   (c) **[CONFIDENTIAL]**

   (d) "Commissioner" means the Commissioner of Competition appointed pursuant to section 7 of the Act;

   (e) "Confidential Information" means any information pertaining to the operation and business of the FSJ Mill including, without limitation, all manufacturing, operations, financial information, operating costs and revenues, together with any information relating to the FSJ Mill owned by, or in the possession or control of Canfor that is not independently known to Persons other than Canfor;

   (f) "Consent Agreement" means this Consent Agreement entered into by Canfor and the Commissioner together with all Schedules attached hereto;

   (g) "Divest" means to implement a Divestiture;

   (h) "Divestiture" means the sale, transfer, assignment or other disposal pursuant to which Canfor shall have no further direct or indirect interest in any asset to be divested, except as permitted herein or upon the consent of the Commissioner;

   (i) **[CONFIDENTIAL]**

(j) "*Forest Act*" means the *Forest Act* (British Columbia) [R.S.B.C. 1996] Chapter 157 as same may be amended, or any successor legislation thereto;

(k) "FSJ Mill" means the Canfor sawmill located at Fort St. James, British Columbia;

(l) "Initial Divestiture Period" means the Initial Divestiture Period specified in Confidential Schedule "B" to this Consent Agreement, together with any extensions to such period;

(m) **[CONFIDENTIAL]**

(n) "Person" means any individual, partnership, firm, corporation, association, trust, unincorporated organization or other entity;

(o) "Prince George Timber Supply Area" means the timber supply area comprised of the Prince George, Vanderhoof and Fort St. James forest districts established by the Minister of Forests (British Columbia);

(p) "Purchaser" has the meaning given to it in paragraph 3;

(q) "Transaction" has the meaning given to it in the first Recital to this Consent Agreement;

(r) "Tribunal" means the Competition Tribunal established by the *Competition Tribunal Act*;

(s) "Trustee" means **[CONFIDENTIAL]** and any replacement of such Trustee pursuant to paragraph 14(p); and

(t) "Trustee Divestiture Period" means the Trustee Divestiture Period specified in Confidential Schedule "C" to this Consent Agreement, together with any extensions to such period.

Application

2. The provisions of this Consent Agreement shall apply to:

(a) Canfor, including each Affiliate or any other Person controlled by Canfor and each officer, director, employee, or other Person acting for or on behalf of Canfor with respect to any of the matters referred to in this Consent Agreement, and any successors and assigns of Canfor; and all other Persons acting in concert or participating with any successor(s) or assign(s) in respect of the matters referred to in this Consent Agreement who shall have received actual notice of this Consent Agreement;

(b) Until the completion of the Transaction, Slocan, including each Affiliate or any other Person controlled by Slocan and each officer, director, employee, or other Person acting for or on behalf of Slocan with respect to any of the matters referred to in this Consent Agreement, and any successors and assigns of Slocan; and all other Persons acting in concert or participating with any successor(s) or assign(s) in respect of the matters referred to in this Consent Agreement who shall have received actual notice of this Consent Agreement;

(c) the Commissioner; and

(d) the Trustee (if any), or any substitute thereof appointed pursuant to this Consent Agreement, and each employee, agent, or other Person acting for or on behalf of the Trustee.

Divestiture

3. Canfor will use reasonable commercial efforts to Divest to an independent purchaser ("Purchaser"), within the Initial Divestiture Period, all of its right, title, control and interest in and to the FSJ Mill including all assets used in the operation of the FSJ Mill including, but not limited to, all assets used solely in the operation of the FSJ Mill, namely the equipment on the mill site owned or leased by Canfor, all inventories of logs, lumber and materials, and all information in books and records relating to the foregoing (excluding cash or accounts receivable) together with Associated Tenure, and contractual arrangements such that Canfor does not, directly or indirectly, retain any right, title, control or interest in and to the FSJ Mill assets in a manner inconsistent with this Consent Agreement except as permitted upon consent of the Commissioner as provided for herein.

4. Any Divestiture **[CONFIDENTIAL]** is subject to the prior approval of the Commissioner in accordance with the terms of this Consent Agreement, such approval not to be unreasonably withheld or delayed.

5. **[CONFIDENTIAL]**

6. Divestiture of the FSJ Mill, whether by Canfor or the Trustee, shall be completed on the following terms:

   (a) by way of disposition of the FSJ Mill for use as a going concern;

   (b) to one or more Purchasers who:

      (i) shall use the FSJ Mill for the same purpose for which it was used prior to the Transaction; and

      (ii) shall have the managerial, operational and financial capability to operate the FSJ Mill, provided that nothing in this paragraph 6(b)(ii) shall imply that a Purchaser is not a *bona fide* purchaser merely because such Purchaser requires certain post-Divestiture arrangements with Canfor or others following the Divestiture pursuant to paragraph 24, and subject to the Commissioner's approval thereof.

7. Any Person making a *bona fide* inquiry of Canfor or the Trustee regarding the possible purchase by that Person or its principal of the FSJ Mill shall be notified that the sale is being made pursuant to this Consent Agreement and shall be

provided with a copy of this Consent Agreement, with the exception of the provisions hereof which are confidential and the attached confidential Schedules.

8. Subject to paragraph 9 below, any prospective Purchaser who demonstrates, in the reasonable opinion of Canfor, or the Trustee, as applicable, its *bona fide* interest in purchasing the FSJ Mill, shall:

   (a) be furnished with all pertinent information regarding the FSJ Mill within fourteen (14) days of a request therefor; and

   (b) be permitted to make such reasonable inspection of the FSJ Mill and of all financial, operational or other non-privileged documents and information which relate solely to the FSJ Mill and which may be relevant to the Divestiture, except for any documents which shall at the time of request for the inspection of such documents have been made the subject of an order of confidentiality of the Tribunal.

9. Access by a prospective Purchaser to the information and assets identified in paragraph 8 of this Consent Agreement shall be conditional on the execution of a customary confidentiality agreement containing, among other things, non-solicitation terms relating to personnel and suppliers.

10. Canfor shall promptly commence the Divestiture process and shall use all reasonable commercial efforts to effect any Divestiture for such price and on such terms as are most favourable to Canfor.

11. Canfor shall during the Initial Divestiture Period, within fourteen (14) days following receipt of a written request of the Commissioner or her representative, file a report with the Commissioner describing the progress of the Divestiture process. Notwithstanding the foregoing, Canfor will promptly notify the Commissioner in writing of any negotiations with a prospective Purchaser that may in the reasonable opinion of Canfor, lead to a sale and shall forward copies to the Commissioner of any legal agreement which it signs with a prospective Purchaser of the FSJ Mill.

12. If, prior to the expiry of the Initial Divestiture Period, Canfor has entered into an agreement in principle with a prospective Purchaser to purchase the FSJ Mill, the time for effecting the Divestiture shall be extended by a period that is reasonable in the circumstances within which time the Divestiture must be completed, such period not to exceed six (6) months. If the Divestiture has not been completed within the time specified in this paragraph, or as otherwise provided for in paragraph 15, the provisions of paragraph 14 will apply.

13. If the transfer of any Associated Tenure is negotiated with a Purchaser as part of the Divestiture of the FSJ Mill, Canfor will request, pursuant to the provisions of the *Forest Act*, for a subdivision of one or more forest licenses to facilitate the transfer of such Associated Tenure to a Purchaser.

<u>Trustee Sale</u>

14. Subject to the provisions of this Consent Agreement, if the Divestiture of the FSJ Mill **[CONFIDENTIAL]** is not completed within the Initial Divestiture Period, the Commissioner shall appoint the Trustee to effect the sale of the FSJ Mill as a going concern pursuant to the provisions of paragraph 6 **[CONFIDENTIAL]** by the Trustee pursuant to the following terms:

    (a) the Trustee shall execute a confidentiality agreement satisfactory to Canfor and the Commissioner and shall not communicate any Confidential Information **[CONFIDENTIAL]** except to the extent reasonably required to effect the Divestiture.

    (b) **[CONFIDENTIAL]**

    (c) **[CONFIDENTIAL]**

    (d) the Trustee shall have all the powers necessary to effect the Divestiture of the FSJ Mill and Associated Tenure **[CONFIDENTIAL]** and will use all reasonable commercial efforts to realize such Divestiture; provided that the Trustee shall have no powers with respect to the management, operation or maintenance of the business or assets of the FSJ Mill **[CONFIDENTIAL]**

    (e) within such time prior to the expiry of the Initial Divestiture Period as the Trustee shall request, such period not to exceed thirty (30) days, Canfor will provide the Trustee with full and complete access, as is reasonable, to all information contained in books and records relating to the FSJ Mill and its Associated Tenure **[CONFIDENTIAL]** and, on fourteen (14) days advance written notice to Canfor, to the FSJ Mill **[CONFIDENTIAL]** and to those Canfor personnel employed in connection with, or who have a direct responsibility for, the FSJ Mill **[CONFIDENTIAL]**

    (f) a Divestiture by the Trustee shall be carried out in accordance with the provisions of this Consent Agreement.

    (g) if, prior to the expiry of the Trustee Divestiture Period, the Trustee has received from a prospective Purchaser a formal offer or other written indication of intent to purchase the FSJ Mill **[CONFIDENTIAL]** which the Trustee has accepted, the Trustee Divestiture Period shall be extended by a period that is reasonable in the circumstances within which time the Divestiture must be completed.

    (h) the Trustee shall implement a Divestiture at the price and on the terms and conditions most favourable to Canfor then reasonably available in the opinion of the Trustee. No minimum price shall apply to the sale of the FSJ Mill **[CONFIDENTIAL]**.

    (i) Canfor will use commercially reasonable efforts to assist the Trustee in realizing the Divestiture and shall execute any document and take such further actions as may be reasonably required by the Trustee in connection with such Divestiture. **[CONFIDENTIAL]**

(j) The Trustee shall have the full power and authority to retain, on usual and reasonable commercial terms, financial, legal and other professional advisors, including investment bankers, that may be reasonably necessary or advisable in advising and assisting the Trustee in implementing a Divestiture.

(k) following the Trustee's appointment, the Trustee will provide to both Canfor and the Commissioner every thirty (30) days a report satisfactory to the Commissioner containing reasonable detail on the steps being taken by the Trustee to effect the Divestiture, including but not limited to, the identity and status of negotiations with prospective Purchasers and including copies of all confidentiality and other agreements entered into by such prospective Purchasers. Either the Commissioner or Canfor may request additional information from the Trustee regarding the status of the Divestiture, and the Trustee shall respond within ten (10) days following receipt of such request.

(l) notwithstanding paragraph 14(k), the Trustee will promptly notify Canfor and the Commissioner of the commencement of any negotiations undertaken with a potential Purchaser.

(m) all direct fees and expenses reasonably and properly incurred by the Trustee in connection with the Trustee's performance of its obligations under this Consent Agreement will be paid for by Canfor out of the proceeds of the Divestiture.

(n) the net proceeds of a sale by the Trustee shall be paid to Canfor or as Canfor may direct.

(o) Canfor shall hold the Trustee harmless against any unpaid fees, losses, claims, damages or liabilities arising out of, or in connection with, the performance of the Trustee's duties under this Consent Agreement except to the extent that such liabilities, damages or claims result from the Trustee's malfeasance, negligence, bad faith or breach of this Consent Agreement.

(p) if either Canfor or the Commissioner reasonably concludes that the Trustee appointed pursuant to this Consent Agreement has ceased to act or failed to act diligently or otherwise in accordance with this Consent Agreement, the Commissioner will appoint a replacement Trustee.

Extensions of Time

15. If, in the opinion of the Commissioner, either Canfor or the Trustee, as the case may be, is using all reasonable commercial efforts to complete the Divestiture as provided for herein, the Commissioner may extend any of the time periods applicable to the Divestiture as set out herein. **[CONFIDENTIAL]**

<u>Preservation of Assets and Competition</u>

16. Subject to the provisions of this Consent Agreement and any applicable federal and provincial laws and regulations, from the date of this Consent Agreement to the Divestiture of the FSJ Mill, Canfor will not take any action or cause or permit any Affiliate or any other Person to take any action that will materially adversely affect the FSJ Mill or any part thereof so as to inhibit or delay the Divestiture as provided for in this Consent Agreement.

17. **[CONFIDENTIAL]**

18. **[CONFIDENTIAL]**

19. Except in the circumstances set out in paragraph 21, until the completion of the Divestiture of the FSJ Mill, Canfor will, with respect to the FSJ Mill:

    (a) take such steps as are reasonably necessary to maintain the competitive viability of the FSJ Mill and shall not dispose of any material assets of the FSJ Mill other than inventory in the ordinary course of business, without the prior written consent of the Commissioner, such consent not to be unreasonably withheld or delayed;

    (b) provide such physical mill maintenance, sales, managerial, administrative, operational and financial support as reasonably necessary in the ordinary course of business to promote the continued effective operation of the FSJ Mill in accordance with standards similar to those existing prior to the Closing Date;

    (c) not, without the prior written consent of the Commissioner, such consent not to be unreasonably withheld or delayed, enter into or terminate any material contract or arrangement with respect to the FSJ Mill (other than pursuant to a material breach by the other party or parties thereto entitling Canfor to terminate a material contract in accordance with its terms), make any material change to the operations of the FSJ Mill other than as contemplated herein, or terminate any current employment, salary or benefit agreements for any key management employees **[CONFIDENTIAL]** and, without limiting the generality of the foregoing, Canfor will perform its obligations under its contracts with lumber re-manufacturers in accordance with their terms; and

    (d) ensure that log purchasing for the FSJ Mill is independent from log purchasing for the rest of Canfor.

20. Without limiting the generality of the foregoing, until the implementation of a Divestiture of the FSJ Mill by Canfor or the Trustee, Canfor shall provide such sales, managerial, administrative, operational and financial support as is necessary in the ordinary course of business to promote the continued effective operation of the FSJ Mill in accordance with standards similar to those existing prior to the Transaction.

21. **[CONFIDENTIAL]**

22. In the event that the Commissioner has reason to believe, acting in good faith, that information relevant to determining or securing Canfor's compliance with its commitments under this Consent Agreement is located therein or possessed thereby, Canfor shall allow any duly authorised representative of the Commissioner, upon written request to counsel to Canfor:

    (a) upon seven (7) days' notice, to access without restraint or interference from Canfor, during office hours and in the presence of counsel to Canfor, to inspect any of its Canadian facilities and to inspect and copy all books, ledgers, accounts, correspondence, memoranda, and other records and documents in the possession or under the control of Canfor, in either case relating to any matters contained in this Consent Agreement, excluding documents that are subject to solicitor-client or other legal privilege; and

    (b) upon fourteen (14) days' notice and without restraint or interference from Canfor, to interview officers, directors, or employees of Canfor or its affiliates, who may have counsel to Canfor present, relating to any matters contained in this Consent Agreement.

Approval of Divestiture

23. A Divestiture shall be subject to the approval of the Commissioner. The Commissioner's approval shall be obtained pursuant to the procedure set out in this Consent Agreement, and based on the criteria outlined in paragraph 6 of this Consent Agreement. The Commissioner shall also take into consideration in connection with her approval of a proposed Divestiture the effect of such Divestiture on competition.

24. Subject to the consent of the Commissioner, and at the request of a prospective Purchaser, Canfor may enter into post-Divestiture arrangements with the Purchaser provided that such arrangements do not permit Canfor to influence or control, directly or indirectly, the operations or the business of the FSJ Mill **[CONFIDENTIAL]** after the Divestiture. Notwithstanding the foregoing, Canfor and the Purchaser may enter into an agreement with respect to the purchase and sale of wood chips produced at the FSJ Mill **[CONFIDENTIAL]**

25. Either Canfor or the Trustee, as the case may be, may request that the Commissioner review a prospective Purchaser. The Commissioner shall, within ten (10) days following the date of request, communicate to Canfor or the Trustee, as the case may be, any objection to a proposed Purchaser provided that a failure to provide such objection does not prejudice the Commissioner's right to object to such a proposed Purchaser following notification pursuant to the provisions of this Consent Agreement.

26. Either Canfor or the Trustee, as the case may be, shall notify the Commissioner in writing (the "Divestiture Notice") (and in the case of a proposed Divestiture by an agent, the Trustee shall concurrently notify Canfor) of the execution by a

Purchaser of any agreement in principle, in relation to a Divestiture. The Divestiture Notice will set out the particulars of the proposed Divestiture in reasonable detail.

27. Within fourteen (14) days following receipt of the Divestiture Notice, the Commissioner, and in the case of a Divestiture by the Trustee, Canfor, may request, in writing, further information and particulars regarding the Divestiture and Canfor, or the Trustee, as the case may be, will provide such further information and particulars within fourteen (14) days following receipt of such request, or such longer period as the Commissioner agrees to in writing.

28. Within fourteen (14) days following the Divestiture Notice or, where the Commissioner or Canfor requests additional information pursuant to paragraph 27, within thirty (30) days following receipt of the additional information, the Commissioner will notify Canfor and, in the case of a sale by the Trustee, the Commissioner or Canfor will notify the Trustee, in writing, of any objection to the Divestiture.

29. Notwithstanding any term of this Consent Agreement, nothing in this Consent Agreement shall be construed to abrogate the notification obligations set out in Part IX of the Act.

30. Pursuant to the Trustee's obligations set out in paragraph 14 of this Consent Agreement, Canfor may object to a Divestiture proposed by the Trustee.

31. Where neither Canfor nor the Commissioner objects within the time specified in paragraph 28, and where the criteria outlined in this Consent Agreement are met, the Divestiture may proceed subject to the provisions of Part IX of the Act, if applicable.

32. Where the Commissioner objects to the proposed Divestiture, or where Canfor, pursuant to paragraph 30 objects to the proposed Divestiture, the proposed Divestiture may only proceed with the approval of the Tribunal.

33. Where the Divestiture is able to proceed in accordance with this Consent Agreement, the Commissioner shall, within fourteen (14) days following the completion of the Divestiture, notify the Tribunal in writing that the Divestiture has taken place.

<u>Confidentiality of Sale Period</u>

34. The sale period, described in Confidential Schedules "A" and "B" to this Consent Agreement shall not be disclosed by the parties or Trustee except in the opinion of the Trustee that such disclosure is necessary to effect a Divestiture within the periods prescribed by this Consent Agreement, and only if the Trustee has: (i) first obtained from a prospective Purchaser an agreement to maintain the confidentiality of such information; and (ii) extensions of time have been sought from the Commissioner pursuant to paragraph 15 by the Trustee prior to disclosure.

General

35. Canfor and the Commissioner may mutually agree to amend this Consent Agreement in any manner pursuant to subsection 106(1) of the Act.

36. Whenever a provision of this Consent Agreement requires an approval, consent or action of the Commissioner, Canfor or the Trustee, such approval, consent or action shall be, unless otherwise expressly stated herein, not unreasonably withheld or delayed and words such as "consent" or "approval" or any action of a party indicated by the words "may" or "shall" shall be read together with the words "acting reasonably" immediately thereafter.

37. If the Commissioner's approval is sought pursuant to this Consent Agreement and such approval is not granted, or if a decision of the Commissioner is unreasonably delayed or withheld, Canfor may apply to the Tribunal for approval.

38. In the event of a dispute as to the interpretation or application of this Consent Agreement, the Commissioner, the Trustee or Canfor shall be at liberty to apply to the Tribunal for an order interpreting any of the provisions of this Consent Agreement.

39. Canfor will provide a copy of this Consent Agreement to its directors and to the directors and officers of any Affiliate of Canfor having a direct or indirect interest in the FSJ Mill **[CONFIDENTIAL]**

40. Notices and other communications required or permitted pursuant to this Consent Agreement shall be in writing and shall be delivered by courier or facsimile transmission to the persons set out in Schedule "E" to this Consent Agreement.

41. This Consent Agreement shall remain in effect until the Commissioner notifies the Tribunal in writing that the last of its requirements is fulfilled.

42. This Consent Agreement constitutes the entire agreement between the Commissioner and Canfor with respect to the subject matter hereof and supersedes all prior agreements, understandings, negotiations and discussions, whether written or oral.

43. In the event the Transaction does not substantially complete for any reason this Consent Agreement shall be null and void *ab initio*.

44. This Consent Agreement may be executed in counterpart and by facsimile and each such counterpart shall constitute an original and all of which taken together shall constitute one and the same instrument, dated as of the date set forth below.

DATED this 30th day of March, 2004.

Gaston Jorré [signed]

____

Acting Commissioner of Competition

Canfor Corporation

By:

David Calabrigo [signed]

____

CONFIDENTIAL SCHEDULE "A"

CONFIDENTIAL SCHEDULE “B”

CONFIDENTIAL SCHEDULE "C"

CONFIDENTIAL SCHEDULE "D"

SCHEDULE "E"

NOTICES

(A) To the Commissioner:

Senior Deputy Commissioner of Competition (Mergers Branch)
Competition Bureau, Industry Canada
Place du Portage, Phase I, 50 Victoria Street
Gatineau, Quebec K1A 0C9

Telephone: (819) 994-1863
Facsimile: (819) 994-0998

With a copy to

Director, Competition Law Division
Department of Justice Canada
Competition Bureau, Industry Canada
Place du Portage, Phase I, 50 Victoria Street
Gatineau, Quebec K1A 0C9

Telephone: (819) 997-3325
Facsimile: (819) 953-9267

(B) To Canfor Corporation:

Canfor Corporation
1500 – 550 Burrard St.
Vancouver, BC V6C 2C1

Attention: David Calabrigo
Telephone: 604-661-5255
Facsimile: 604-661-5435

With a copy to:
Lawson Lundell
Barristers & Solicitors
1600 – 925 West Georgia St.
Vancouver, BC V6C 3L2

Attention: Valerie Mann
Telephone: 604-685-3456
Facsimile: 604-669-1620

CT- 2004-002

THE COMPETITION TRIBUNAL

IN THE MATTER OF THE *Competition Act*, R.S.C. 1985, c. C-34, as amended;

AND IN THE MATTER OF the acquisition of Slocan Forest Products Ltd. by Canfor Corporation;

AND IN THE MATTER OF the filing and registration of a consent agreement pursuant to section 105 of the *Competition Act*.

BETWEEN:

THE COMMISSIONER OF COMPETITION

Applicant

- and -

CANFOR CORPORATION

Respondent

CONSENT

THE PARTIES hereby irrevocably consent to the registration of a consent agreement pursuant to section 105 of the *Competition Act* in the form attached hereto.

Commissioner of Competition

By: Gaston Jorré [signed]

Dated at Gatineau, Quebec, this 30th day of March, 2004

Deputy Commissioner of Competition

Competition Bureau, Industry Canada
Place du Portage, Phase 1, 50 Victoria Street
Gatineau, PQ
K1A OC9

Telephone: (819) 994-1863
Facsimile: (819) 994-0998

Canfor Corporation

By: David Calabrigo [signed]

Dated at Vancouver, British Columbia, this 30th day of March, 2004.

Counsel to Canfor Corporation

1500 - 550 Burrard St.
Vancouver, BC
V6C 2C1

Telephone: (604) 661-5255
Facsimile: (604) 661-5435

Signature witnessed by:

Dated at Vancouver, British Columbia, this 30th day of March, 2004

Julie Bradbeer [signed]

PUBLIC VERSION

CT - 2004-013

COMPETITION TRIBUNAL

IN THE MATTER OF the *Competition Act*, R.S.C. 1985 c. C-34, as amended;

AND IN THE MATTER OF the acquisition of Weldwood of Canada Limited by West Fraser Timber Co. Ltd.;

AND IN THE MATTER OF the filing and registration of a consent agreement pursuant to section 105 of the *Competition Act*;

BETWEEN:

THE COMMISSIONER OF COMPETITION

Applicant

- and -

WEST FRASER TIMBER CO. LTD.
and **WEST FRASER MILLS LTD.**

Respondents

CONSENT AGREEMENT

COMPETITION TRIBUNAL
TRIBUNAL DE LA CONCURRENCE
FILED / PRODUIT
CT-2004-013
DEC 7 2004
REGISTRAR - REGISTRAIRE
OTTAWA, ON 1(6)

PUBLIC VERSION

Registry of the Competition Tribunal
Greffe du Tribunal de la concurrence
REGISTERED / ENREGISTRÉ
DEC 7 2004
FOR REGISTRAR / POUR REGISTRAIRE

PUBLIC VERSION

CT -

COMPETITION TRIBUNAL

IN THE MATTER OF the *Competition Act*, R.S.C. 1985 c. C-34, as amended;

AND IN THE MATTER OF the acquisition of Weldwood of Canada Limited by West Fraser Timber Co. Ltd.;

AND IN THE MATTER OF the filing and registration of a consent agreement pursuant to section 105 of the *Competition Act*;

BETWEEN:

THE COMMISSIONER OF COMPETITION

Applicant

- and -

WEST FRASER TIMBER CO. LTD.
and **WEST FRASER MILLS LTD.**

Respondents

CONSENT AGREEMENT

WHEREAS West Fraser Mills Ltd. ("West Fraser"), a wholly-owned subsidiary of West Fraser Timber Co. Ltd., proposes to acquire the only outstanding share of Weldwood of Canada Limited ("Weldwood") from International Paper Company (the "Transaction");

AND WHEREAS the Commissioner of Competition (the "Commissioner") has expressed concerns that, without the specific commitments contained herein, the Transaction, if substantially completed, is likely to lessen competition substantially in the British Columbia Highway 16 Corridor and the Cariboo Area (both as defined herein) in the market for the purchase of logs and, in the Highway 16 Corridor, in the market for the supply of inputs to lumber re-manufacturers;

AND WHEREAS the Commissioner has alleged certain material facts and West Fraser does not agree with the facts alleged and does not admit to any substantial lessening or prevention of competition in any relevant market, but, for the purpose of this Consent Agreement and any proceedings related to the subject matter thereof, except as specifically noted herein, including any proceeding pursuant to section 106 of the *Competition Act* R.S.C. 1985 c.c-34 as amended (the "Act"), does not contest the Commissioner's initial conclusions based on those facts;

AND WHEREAS the Commissioner is satisfied that, subject to the terms of this Consent Agreement, the actions required to be taken by West Fraser pursuant to this Consent Agreement, once implemented, will address the Commissioner's concerns that the Transaction is likely to prevent or lessen competition substantially in any relevant geographic or product market;

AND WHEREAS the Ministry of Forests of the Province of British Columbia has represented to the Commissioner that it supports the remedies to be implemented hereunder and is prepared to take the steps necessary to give effect to the South Line Tenure Divestiture as contemplated in this Consent Agreement.

AND WHEREAS, subject to the terms of this Consent Agreement, with the execution of this Consent Agreement and subject to compliance with the terms therein by West Fraser, the Commissioner will not oppose the Transaction, in whole or in part, pursuant to sections 92, 100 or 104 of the Act.

NOW THEREFORE the Respondents and the Commissioner agree as follows:

Definitions

1. For the purposes of this Consent Agreement, the following capitalized terms have the following meanings:

(a) "**Affiliate**" has the meaning given to it in subsection 2(2) of the Act;

(b) "**Associated Tenures**" means the timber harvesting rights identified in Schedule "C";

(c) "**Babine Limited**" means Babine Forest Products Limited, a company incorporated under the laws of British Columbia;

(d) "**BFPC**" means the Babine Forest Products Company, a joint venture of West Fraser and Babine Limited, which owns, directly or indirectly, the Burns Lake Mill and the Decker Lake Mill, the Associated Tenures and other related assets as described in Confidential Schedule "D";

(e) "**Burns Lake Mill**" means the sawmill owned directly by BFPC located at Burns Lake, British Columbia;

(f) "**Cariboo Area**" encompasses the region along Highway 97 from Williams Lake to 100 Mile House, British Columbia as more fully described in Schedule "B";

(g) **"Closing Date"** means the day upon which the transactions, contemplated pursuant to the Acquisition Agreement between International Paper Company and West Fraser Timber Co. Ltd. dated the 21st day of July, 2004, are first implemented in whole or in part. The Transaction shall be deemed to be "implemented" on the Closing Date.

(h) "**Commissioner**" means the Commissioner of Competition appointed pursuant to section 7 of the Act;

(i) "**Confidential Information**" means any information pertaining to the operation and business of the Mills including, without limitation, all manufacturing, operations and financial information, operating costs and revenues, together with any information relating to the Mills owned by, or in the possession or control of Weldwood that is not independently known to Persons other than Weldwood;

(j) "**Consent Agreement**" means this Consent Agreement entered into by the Respondents and the Commissioner together with all Schedules attached hereto;

(k) **"Decker Lake Mill"** means the sawmill owned directly by DLFPL located at Decker Lake, British Columbia;

(l) "**Divest**" means to implement a Divestiture;

(m) "**Divestiture**" means a sale, transfer, assignment or other disposal pursuant to which neither of the Respondents shall have, directly or indirectly any remaining right, title, control or interest in any asset to be divested, except as permitted herein or upon the consent of the Commissioner;

(n) **"DLFPL"** means Decker Lake Forest Products Limited a company incorporated under the laws of British Columbia;

(o) "***Forest Act***" means the *Forest Act* (British Columbia) [R.S.B.C. 1996] Chapter 157 as same may be amended, or any successor legislation thereto;

(p) "**Highway 16 Corridor**" encompasses the region along Highway 16 from Smithers to Burns Lake, British Columbia as more fully described in Schedule "A";

(q) "**Initial Divestiture Period**" means the Initial Divestiture Period specified in Confidential Schedule "E" to this Consent Agreement, together with any extensions to such period;

(r) "**Mills**" means collectively the Burns Lake Mill and the Decker Lake Mill;

(s) "**Person**" means any individual, partnership, firm, corporation, association, trust, unincorporated organization, government, Crown corporation or other entity;

(t) "**Purchaser**" has the meaning given to it in paragraph 3;

(u) "**Respondents**" means West Fraser Timber Co. Ltd. and West Fraser;

(v) "**South Line Tenure**" means the timber harvesting rights located in the Cariboo Area described in Part I of Confidential Schedule "H";

(w) "**South Line Tenure Acceptable Purchaser**" means a single Purchaser, who qualifies as contemplated under Part 2 of Confidential Schedule "H" who:

> (i) has the managerial, operational and financial capacity and intention to establish new or to expand existing capacity or output in the Cariboo Area totalling not less than an additional 300,000 cubic metres of logs per year;

(ii) intends to participate in the log purchasing and processing market at such capacity as a going concern on a long term basis on or before January 5, 2008; and

(iii) is not related, directly or indirectly, to any other owner or operator of a mill facility or enterprise in the Cariboo Area with annual log processing capacity of more than 400,000 cubic metres.

(x) "**Transaction**" has the meaning given to it in the first recital to this Consent Agreement;

(y) "**Tribunal**" means the Competition Tribunal established by the *Competition Tribunal Act*, R.S.C. 1985 c. 19 (2nd Supp.) as amended;

(z) "**Trustee**" means the Trustee appointed by the Commissioner pursuant to paragraph 13 and any replacement of such Trustee pursuant to paragraph 13(n);

(aa) "**Trustee Divestiture Period**" means the Trustee Divestiture Period specified in Confidential Schedule "F" to this Consent Agreement, together with any extensions to such period; and

(bb) "**Weldwood and West Fraser Babine Interests**" means the 90% direct and indirect combined interest of Weldwood and West Fraser in the Burns Lake Mill, the Decker Lake Mill, the Associated Tenures and related assets as described in the attached Confidential Schedule "D".

Application

2. The provisions of this Consent Agreement shall apply to:

(a) each of the Respondents, including each Affiliate or any other Person controlled by either of them and each officer, director, employee, or other Person acting for or on behalf of the Respondents with respect to any of the matters referred to in this Consent Agreement, and any successors and assigns of either of them; and all other Persons acting in concert or participating with either of them or any successor(s) or assign(s) in respect of the matters referred to in this Consent Agreement;

(b) following the completion of the Transaction, Weldwood, including each Affiliate or any other Person controlled by Weldwood and each officer, director, employee, or other Person acting for or on behalf of Weldwood with respect to any of the matters referred to in this Consent Agreement, and any successors and assigns of Weldwood; and all other Persons acting in concert or participating with Weldwood or any successor(s) or assign(s) in respect of the matters referred to in this Consent Agreement;

(c) the Commissioner; and

(d) the Trustee (if any), or any substitute thereof appointed pursuant to this Consent Agreement, and each employee, agent, or other Person acting for or on behalf of the Trustee or its substitute.

Divestiture

3. West Fraser shall Divest, and shall cause Weldwood to Divest, all of its right, title, control and interest in and to

(a) the Weldwood and West Fraser Babine Interests, subject to the conditions described in Part 1 of Schedule "E", **[CONFIDENTIAL]**, and

(b) the South Line Tenure, subject to the conditions described in Part 2 of Schedule "H", to a South Line Tenure Acceptable Purchaser within the Initial Divestiture Period,

[CONFIDENTIAL].

4. Except as otherwise expressly set out in this Consent Agreement, any Divestiture is subject to the prior written approval of the Commissioner in accordance with the terms of this Consent Agreement.

5. Divestiture of the Weldwood and West Fraser Babine Interests, whether by West Fraser or the Trustee, shall be completed on the following terms:

(a) in a manner that will permit the continued operation as a going concern of the Burns Lake Mill **[CONFIDENTIAL]**;

(b) to **[CONFIDENTIAL]** Purchasers who, to the satisfaction of the Commissioner,

(i) shall own the Weldwood and West Fraser Babine Interests and intend to use the Burns Lake Mill and**[CONFIDENTIAL]**the Decker Lake Mill, for the same purpose for which Weldwood and West Fraser owned, and Weldwood managed, the Burns Lake Mill and**[CONFIDENTIAL]** the Decker Lake Mill, prior to the completion of the Transaction; and

(ii) shall have the managerial, operational and financial capability to operate the Burns Lake Mill and**[CONFIDENTIAL]** the Decker Lake Mill, in accordance with paragraphs 5(a) and 5(b)(i) above, provided that the fact that a Purchaser requires certain post-Divestiture arrangements with West Fraser or others pursuant to paragraph 20 following the Divestiture will not be considered as an indication of a lack of such capability.

6. Divestiture of the South Line Tenure by West Fraser shall be completed on the terms set out in Part 2 of Schedule "H". If a Divestiture of the South Line Tenure is completed in accordance with such terms, the requirement of West Fraser or Weldwood to Divest the South Line Tenure will be deemed satisfied.

7. Any Person making a bona fide inquiry of West Fraser or the Trustee regarding the possible purchase by that Person or its principal of the Weldwood and West Fraser Babine Interests shall be notified that the sale is being made pursuant to this Consent Agreement and shall be provided with a copy of this Consent Agreement, with the exception of the provisions hereof that are confidential and the attached confidential Schedules.

8. Subject to paragraphs 9 and 10 below, any prospective Purchaser who demonstrates, in the reasonable opinion of West Fraser, or the Trustee, as applicable, its bona fide interest in purchasing the Weldwood and West Fraser Babine Interests shall:

(a) be furnished, within fourteen (14) days of a request therefor, with all pertinent information regarding the Mills; and

(b) be permitted to make such reasonable inspection of the Mills, and of all financial, operational or other non-privileged documents and information which relate to the Mills which may be relevant to the Divestiture, except for any documents which shall at the time of request for inspection have been made the subject of an order of confidentiality by the Tribunal.

9. Access by a prospective Purchaser to the information and assets identified in paragraph 8 of this Consent Agreement shall be conditional on the execution of a customary confidentiality agreement containing, among other things, non-solicitation terms relating to personnel and suppliers prior to such prospective Purchaser completing the purchase of the Weldwood and West Fraser Babine Interests.

10. **[CONFIDENTIAL]**

11. West Fraser shall, during the Initial Divestiture Period, within fourteen (14) days following receipt of a written request of the Commissioner or her representative, file a report with the Commissioner describing the progress of the Divestiture process. Notwithstanding the foregoing, West Fraser shall promptly notify the Commissioner in writing of any negotiations with a prospective Purchaser that may, in the reasonable opinion of West Fraser, lead to a sale and shall forthwith forward copies to the Commissioner of any legal agreement(s) it signs with a prospective Purchaser of the Weldwood and West Fraser Babine Interests.

12. The Commissioner may extend the time for effecting a Divestiture by a period that is reasonable in the circumstances if, prior to the expiry of the Initial Divestiture Period, West Fraser has entered into an agreement in principle (including all material terms such as the identity of the parties, purchase price, interest to be sold and closing date, together with a good faith obligation on both parties to negotiate to finalize the sale transaction) with a prospective Purchaser to purchase the Weldwood and West Fraser Babine Interests or the South Line Tenure, as applicable. If a Divestiture has not been implemented within the Initial Divestiture Period, as reasonably extended by the Commissioner pursuant to this paragraph, or as otherwise provided for in paragraph 14 or elsewhere in this Consent Agreement, the provisions of paragraph 13 shall apply in respect of the Divestiture of the Weldwood and West Fraser Babine Interests. **[CONFIDENTIAL]**

Trustee Sale

13. Subject to the provisions of this Consent Agreement, if the Divestiture of the Weldwood and West Fraser Babine Interests is not completed within the Initial Divestiture Period, the Commissioner may appoint a Trustee to effect the sale of the Weldwood and West Fraser Babine Interests, pursuant to the provisions of paragraph 5 by the Trustee and on the following terms:

(a) the Trustee shall execute a confidentiality agreement satisfactory to West Fraser and the Commissioner and shall not communicate any Confidential Information except to the extent reasonably required to effect the Divestiture;

(b) the Trustee shall have all the powers necessary to effect the Divestiture of the Weldwood and West Fraser Babine Interests, and will use all reasonable commercial efforts to realize such Divestiture within the Trustee Divestiture Period; provided that the Trustee shall have no powers with respect to the management, operation or maintenance of the business or assets of BFPC or the Mills;

(c) within such time prior to the expiry of the Initial Divestiture Period as the Trustee shall request, such period not to exceed thirty (30) days, the Respondents shall provide the Trustee with full and complete access to all information contained in books and records relating to the Weldwood and West Fraser Babine Interests, BFPC, the Mills and the Associated Tenures**[CONFIDENTIAL]** and, on five (5) days advance written notice to West Fraser, access to each of the Mills and to those personnel of the Respondents employed in connection with, or who have a direct responsibility for, either of the Mills on terms that will ensure the Trustee's compliance with normal safety and other rules applicable to Mill visitors;

(d) the Divestiture by the Trustee shall be carried out in accordance with the provisions of this Consent Agreement;

(e) if, prior to the expiry of the Trustee Divestiture Period, the Trustee has entered into an agreement in principle (including all material terms such as the identity of the parties, purchase price, interest to be sold and closing date, together with a good faith obligation on both parties to negotiate to finalize the sale transaction) with a prospective Purchaser to purchase the Weldwood and West Fraser Babine Interests, the Trustee Divestiture Period may be extended by the Commissioner by a period that is reasonable in the circumstances, within which time the Divestiture must be implemented;

(f) the Trustee shall implement the Divestiture at the price and on the terms and conditions most favourable to West Fraser then reasonably available in the opinion of the Trustee. No minimum price shall apply to the sale of the Weldwood and West Fraser Babine Interests;

(g) West Fraser and Weldwood will use commercially reasonable efforts to assist the Trustee in realizing the Divestiture and shall execute any document and take such further actions as may be reasonably required by the Trustee in connection with the Divestiture **[CONFIDENTIAL]**;

(h) the Trustee shall have the full power and authority to retain, on usual and reasonable commercial terms, financial, legal and other professional advisors, including investment bankers, who may be reasonably necessary or advisable in advising and assisting the Trustee in implementing the Divestiture;

(i) following the Trustee's appointment, the Trustee shall provide to both West Fraser and the Commissioner every thirty (30) days a report satisfactory to the Commissioner containing reasonable detail on the steps being taken by the Trustee to effect the Divestiture, including, but not limited to, the identity and status of negotiations with prospective Purchasers and including copies of all confidentiality and other agreements entered into by such prospective Purchasers. Either the Commissioner or West Fraser may request additional information from the Trustee regarding the status of the Divestiture, and the Trustee shall respond within ten (10) days following receipt of such request;

(j) notwithstanding paragraph 13(i) above, the Trustee shall promptly notify West Fraser and the Commissioner of the commencement of any negotiations undertaken with a potential Purchaser;

(k) all direct fees and expenses reasonably and properly incurred by the Trustee in connection with the Trustee's performance of its obligations under this Consent Agreement shall be paid for by West Fraser out of the proceeds of the Divestiture;

(l) the net proceeds of a sale by the Trustee shall be paid to West Fraser or as West Fraser may direct;

(m) West Fraser shall hold the Trustee harmless against any unpaid fees, losses, claims, damages or liabilities arising out of, or in connection with, the performance of the Trustee's duties under this Consent Agreement except to the extent that such liabilities, damages or claims result from the Trustee's malfeasance, gross negligence, bad faith or breach of this Consent Agreement; and

(n) if either West Fraser or the Commissioner concludes that the Trustee appointed pursuant to this Consent Agreement has ceased to act or failed to act diligently or otherwise in accordance with this Consent Agreement, the Commissioner may appoint a replacement Trustee.

Extension of Time

14. Notwithstanding any other provision of this Consent Agreement, if, in the opinion of the Commissioner, either West Fraser or the Trustee, as the case may be, is using all reasonable commercial efforts to complete any Divestiture as provided for herein, the Commissioner may, in her sole discretion, extend any of the time periods applicable to the Divestiture as set out herein.

Maintenance of Assets Pending Divestiture

15. Subject to the provisions of this Consent Agreement and any applicable federal and provincial laws and regulations, from the date of this Consent Agreement to the Divestiture of the Weldwood and West Fraser Babine Interests, West Fraser shall not take any action or cause or permit any Affiliate or any other Person to take any action that may materially adversely affect the Mills, the Associated Tenures or any part thereof so as to inhibit or delay any Divestiture as provided for in this Consent Agreement. **[CONFIDENTIAL].**

16. Until the completion of the Divestiture of the Weldwood and West Fraser Babine Interests, West Fraser shall, with respect to the Mills:

(a) take such steps as are reasonably necessary to maintain the competitive viability of the Mills and shall not, without the prior written consent of the Commissioner, dispose of any material assets of, or related to, the Mills, other than inventory in the ordinary course of business;

(b) provide such physical mill maintenance, sales, managerial, administrative, operational and financial support as reasonably necessary in the ordinary course of business to promote the continued effective operation of the Mills in accordance with the standards applicable prior to the closing of the Transaction. Without limiting the generality of the foregoing operational and financial support includes the renewal of any material contracts pending the Divestiture(s);

(c) not, without the prior written consent of the Commissioner, enter into or terminate any material contract or arrangement with respect to the Burns Lake Mill (other than pursuant to a material breach by the other party or parties thereto entitling BFPC or DLFPL, as the case may be, to terminate a material contract in accordance with its terms, and only then with prior written notice to the Commissioner), make any material change to the operations of the Burns Lake Mill other than as contemplated herein, or terminate any current employment, salary or benefit agreements for any key management employees (being those employees described in Confidential Schedule "G") and, without limiting the generality of the foregoing, West Fraser will cause BFPC and DLFPL to perform their obligations under contracts with lumber re-manufacturers in accordance with their terms; and

(d) ensure that log purchasing for the Mills is independent from log purchasing for West Fraser's other operations.

17. **[CONFIDENTIAL]**

Inspection and Monitoring

18. In the event that the Commissioner has reason to believe, acting in good faith, that information relevant to **[CONFIDENTIAL]** determining or securing the Respondent's compliance with its commitments under this Consent Agreement is located therein or possessed thereby, the Respondent's shall allow any duly authorised representative of the Commissioner, upon written notice to counsel for the Respondents:

(a) upon seven (7) days' notice, to access without restraint or interference from the Respondents, during office hours and in the presence of counsel to the Respondents, to inspect any of its Canadian facilities and to inspect, produce and copy all books, ledgers, accounts, correspondence, memoranda, and other records in the possession or under the control of the Respondents, in either case relating to any matters contained in this Consent Agreement, excluding records that are subject to solicitor-client or other legal privilege and the Respondents will preserve and maintain such records for a period of not less than five (5) years from the date of this Consent Agreement, unless the Commissioner otherwise consents;

(b) upon fourteen (14) days' notice and without restraint or interference from the Respondents, to interview **[CONFIDENTIAL]**any officers, directors, or employees of the Respondents or their affiliates, who may have counsel to Respondents present, relating to any matters contained in this Consent Agreement but excluding any matters that are subject to solicitor-client or other legal privilege;

(c) **[CONFIDENTIAL]**; and

(d) **[CONFIDENTIAL]**.

Approval of Divestiture

19. Except as otherwise provided in this Consent Agreement, a Divestiture shall be subject to the prior written approval of the Commissioner. The Commissioner's approval shall be sought pursuant to the procedure set out in this Consent Agreement, and, with respect to the Weldwood and West Fraser Babine Interest, based on the assessment criteria outlined in paragraph 5 of this Consent Agreement. The Commissioner shall also take into consideration in connection with her approval of a proposed Divestiture the effect of such Divestiture on competition. **[CONFIDENTIAL]**

20. Subject to the prior written consent of the Commissioner, and at the request of a prospective Purchaser, the Respondents may enter into post-Divestiture arrangements with the Purchaser provided that such arrangements do not permit the Respondents to influence or control, directly or indirectly, the operations or the business (or any part thereof) of the Mills or the South Line Tenure after the Divestiture. Notwithstanding the foregoing, the Respondents may require, as a condition of the Divestiture of the Weldwood and West Fraser Babine Interests, that any or all of the Purchaser, Babine Limited or DLFPL enter into an agreement **[CONFIDENTIAL]** with respect to the purchase by West Fraser of wood chips produced at the Mills provided that such agreement does not permit the Respondents to influence or control directly or indirectly, the operations or the business (or any part thereof) of the Mills.

21. West Fraser or the Trustee, as the case may be, may request that the Commissioner review a prospective Purchaser of the Weldwood and West Fraser Babine Interests. The Commissioner shall, within ten (10) days following the date of request, communicate to West Fraser or the Trustee, as the case may be, any objection to a proposed Purchaser provided that a failure to provide such objection does not prejudice the Commissioner's right to object to such proposed Purchaser following notification pursuant to the provisions of this Consent Agreement.

22. West Fraser or the Trustee, as the case may be, shall give notice to the Commissioner (the "Divestiture Notice") (and in the case of a proposed Divestiture by the Trustee, the Trustee shall concurrently give a Divestiture Notice to West Fraser) of the execution by a Purchaser of any agreement in principle (as identified in paragraph 12 above), in relation to a proposed Divestiture. The Divestiture Notice will set out the particulars of the proposed Divestiture in reasonable detail.

23. Within fourteen (14) days following receipt of the Divestiture Notice, the Commissioner and, in the case of a Divestiture Notice given by the Trustee, West Fraser, may request further information and particulars regarding the Divestiture and West Fraser, or the Trustee, as the case may be, shall provide such further information and particulars within fourteen (14) days following receipt of such request, or such longer period as the Commissioner agrees to in writing.

24. Within fourteen (14) days following receipt of the Divestiture Notice or, where the Commissioner or West Fraser requests additional information pursuant to paragraph 23, within thirty (30) days following receipt of the additional information, the Commissioner shall notify West Fraser and, in the case of a sale by the Trustee, the Commissioner or West Fraser shall notify the Trustee of any objection to the Divestiture.

25. West Fraser may object to a Divestiture proposed by the Trustee within fourteen (14) days following receipt of the Divestiture Notice solely on the basis that the Trustee has materially failed to fulfil any of its obligations set out in paragraph 13 of this Consent Agreement.

26. Where neither the Commissioner nor West Fraser objects within the time specified in paragraphs 24 or 25 respectively, and where the criteria outlined in this Consent Agreement are met, the Divestiture may proceed subject to the provisions of Part IX of the Act, if applicable.

27. Where the Commissioner objects to the proposed Divestiture, or where West Fraser, pursuant to paragraph 25, objects to the proposed Divestiture, the proposed Divestiture may only proceed with the approval of the Tribunal.

28. Where the Divestiture is able to proceed in accordance with this Consent Agreement, West Fraser, or in the case of a Trustee Divestiture, the Trustee, shall, within fourteen (14) days following the completion of the Divestiture, notify the Tribunal in writing that the Divestiture has taken place.

29. Notwithstanding any term of this Consent Agreement, nothing in this Consent Agreement shall be construed to abrogate the notification obligations set out in Part IX of the Act.

Confidentiality of Sale Periods

30. The sale periods described in Confidential Schedules "E" and "F" to this Consent Agreement shall not be disclosed by the parties or the Trustee to a prospective Purchaser unless, in the opinion of the Trustee, such disclosure is necessary to effect a Divestiture within the periods prescribed by this Consent Agreement, and only if the Trustee has: (i) first obtained from such prospective Purchaser an agreement to maintain the confidentiality of such information; and (ii) extensions of time have been sought from the Commissioner pursuant to paragraph 14 by the Trustee prior to disclosure.

General

31. Whenever a provision of this Consent Agreement requires an approval, consent or action of the Commissioner, West Fraser or the Trustee, such approval, consent or action shall be, unless otherwise expressly stated herein, not unreasonably withheld or delayed, and words such as "consent" or "approval" or any action of a party indicated by the words "may" or "shall" shall be read together with the words "acting reasonably" immediately thereafter.

32. The Respondents and the Commissioner may agree to amend this Consent Agreement in any manner pursuant to subsection 106(1) of the Act or otherwise pursuant to this Consent Agreement.

33. The Commissioner and the Respondents may agree to extend or abridge any of the time periods for the doing of any thing specified in this Consent Agreement.

34. If the Commissioner's approval is sought pursuant to this Consent Agreement and such approval is not granted, West Fraser may apply to the Tribunal for approval.
In the event of a dispute as to the interpretation or application of this Consent Agreement, the Commissioner, the Trustee or West Fraser shall be at liberty to apply to the Tribunal for an order interpreting any of the provisions of this Consent Agreement so as to give effect to the specific terms and intent of this Consent Agreement. **[CONFIDENTIAL]**

35. West Fraser shall provide a copy of this Consent Agreement to its directors and to the directors and officers of any Affiliate of West Fraser having a direct or indirect interest in either of the Mills.

36. Notices, requests and other communications required or permitted pursuant to this Consent Agreement shall be in writing and shall be delivered by registered mail, courier or facsimile transmission to the persons set out in Schedule "I" to this Consent Agreement and shall be deemed to be received upon delivery or, in the case of facsimile transmission, on the next business day following transmission.

37. This Consent Agreement shall remain in effect until the Commissioner notifies the Tribunal in writing that the last of its requirements is fulfilled.

38. The confidential version of this Consent Agreement shall be made public once the last of the requirements of the Consent Agreement is fulfilled.

39. This Consent Agreement constitutes the entire agreement between the Commissioner and the Respondents with respect to the subject matter hereof and supersedes all prior agreements, understandings, negotiations and discussions, whether written or oral.

40. In the event that the Transaction is not implemented for any reason, this Consent Agreement shall be null and void *ab initio*.

41. This Consent Agreement may be executed in counterpart and by facsimile and each such counterpart shall constitute an original and all of which taken together shall constitute one and the same instrument, dated as of the date set forth below.

Commissioner of Competition

By:_________________________________ DATED this ____ day of December, 2004.
Sheridan Scott

West Fraser Timber Co. Ltd.

By:_____________________________ DATED this ____ day of December, 2004.
Henry H. Ketcham III

Chairman, President and Chief Executive Officer

West Fraser Mills Ltd.

By:_____________________________ DATED this ____ day of December, 2004.
Henry H. Ketcham III

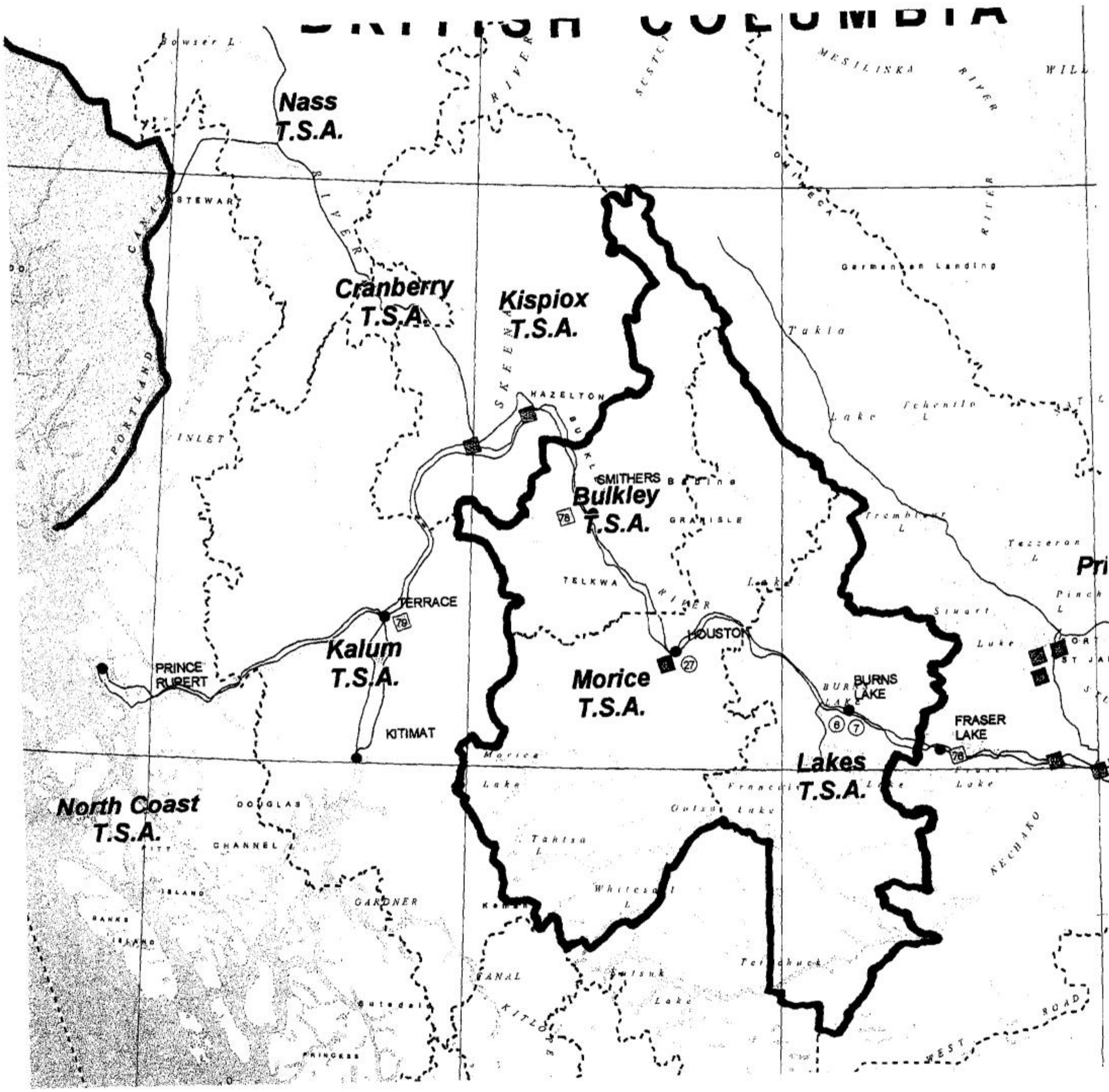
Chairman, President and Chief Executive Officer

PUBLIC VERSION

Babine and Tenure

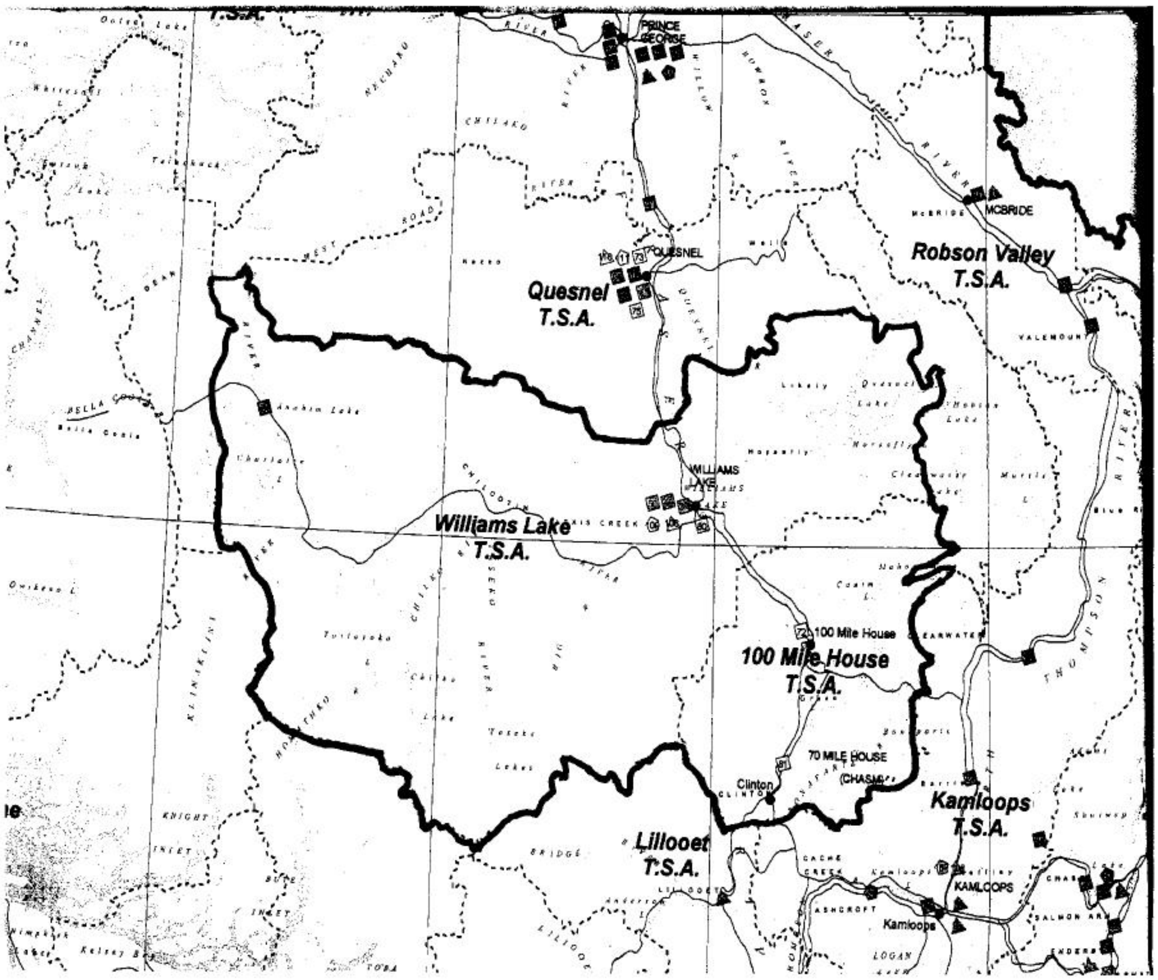
Schedule "A"

Map of Highway 16 Corridor



Schedule "B"

Map of Cariboo Area



Schedule "C"

Associated Tenure

Forest Licence A16823

Forest Licence A16825

Confidential Schedule "D"

Weldwood and West Fraser Babine Interests

[CONFIDENTIAL]

Confidential Schedule "E"

Initial Divestiture Period

[CONFIDENTIAL]

Confidential Schedule "F"

Trustee Divestiture Period

[CONFIDENTIAL]

Confidential Schedule "G"

Key Management Employees

[CONFIDENTIAL].

Confidential Schedule "H"

South Line Tenure

[CONFIDENTIAL]

Schedule "I"

Notices

(A) **To the Commissioner**:

Senior Deputy Commissioner of Competition (Mergers Branch)
Competition Bureau, Industry Canada
Place du Portage, Phase I, 50 Victoria Street
Gatineau, Quebec K1A 0C9

Telephone: (819) 994-1863
Facsimile: (819) 994-0998

With a copy to

Director, Competition Law Division
Department of Justice Canada
Competition Bureau, Industry Canada
Place du Portage, Phase I, 50 Victoria Street
Gatineau, Quebec K1A 0C9

Telephone: (819) 997-3325
Facsimile: (819) 953-9267

(B) **To West Fraser Timber Co. Ltd. and West Fraser Mills Ltd.**:

West Fraser Mills Ltd.
1000 – 1100 Melville Street
Vancouver, B.C.
V6E 4A6

Attention: Martti Solin, Chief Financial Officer

Telephone: (604) 895-2713
Facsimile: (604) 682-2962

With a copy to:

Lang Michener LLP
1500 – 1055 West Georgia Street
Vancouver, B.C.
V6E 4N7

Attention: Larry S. Hughes

Telephone: (604) 691-7429
Facsimile: (604) 893-2365

PUBLIC VERSION

CT -

SCHEDULE "J"

COMPETITION TRIBUNAL

IN THE MATTER OF the *Competition Act*, R.S.C. 1985 c. C-34, as amended;

AND IN THE MATTER OF the acquisition of Weldwood of Canada Limited by West Fraser Timber Co. Ltd.;

AND IN THE MATTER OF the filing and registration of a consent agreement pursuant to section 105 of the *Competition Act*;

BETWEEN:

THE COMMISSIONER OF COMPETITION

Applicant

- and -

WEST FRASER TIMBER CO. LTD.
and **WEST FRASER MILLS LTD.**

Respondents

CONSENT

THE PARTIES hereby irrevocably consent to the registration of a Consent Agreement pursuant to section 105 of the Competition Act, R.S.C. 1985, c. C-34, as amended, in the form to which this Schedule "J" is attached.

Commissioner of Competition

By: ______________________
Sheridan Scott
Commissioner of Competition

Dated at Gatineau, Quebec
this ____day of December, 2004.

Competition Bureau, Industry Canada
Place du Portage, Phase I, 50 Victoria Street
Gatineau, Quebec K1A 0C9

Telephone: (819) 997-5300
Facsimile: (819) 953-5013

West Fraser Timber Co. Ltd. and West Fraser Mills Ltd.

By: ______________________
Henry H. Ketcham III
Chairman, President and Chief Executive Officer

Dated at Vancouver, British Columbia this ____day of December, 2004.

1000 – 1100 Melville Street
Vancouver, B.C.
V6E 4A6
Telephone: (604) 895-2713
Facsimile: (604) 682-2962

CT -

BETWEEN

THE COMMISSIONER OF COMPETITION

Applicant

- and –

WEST FRASER TIMBER CO. LTD.
and
WEST FRASER MILLS LTD.

Respondents

CONSENT AGREEMENT

Counsel for the Commissioner of Competition

Duane E. Schippers
Melanie L. Aitken
Pamela Owen-Lafrance
Adam Newman

Department of Justice Canada
Competition Bureau, Industry Canada
Place du Portage, Phase I, 50 Victoria Street
Gatineau, Quebec K1A 0C9

Telephone: (819) 997-3325
Facsimile: (819) 953-9267

CT-2001/007

PUBLIC

THE COMPETITION TRIBUNAL

IN THE MATTER OF the *Competition Act*, R.S.C. 1985, c. C-34; as amended;

IN THE MATTER OF an Application by the Commissioner of Competition for an order under section 92 of the *Competition Act*;

AND IN THE MATTER OF the acquisition by United Grain Growers Limited of Agricore Cooperative Ltd., a company engaged in the grain handling business.

B E T W E E N:

THE COMMISSIONER OF COMPETITION

Applicant

-and-

UNITED GRAIN GROWERS LIMITED

Respondent

STATEMENT OF GROUNDS AND MATERIAL FACTS

STATEMENT OF GROUNDS AND MATERIAL FACTS

I. INTRODUCTION

1. The Commissioner of Competition (the "Commissioner") brings this Consent application pursuant to sections 92 and 105 of the *Competition Act* (the "Act") on the grounds that the acquisition by United Grain Growers Limited ("UGG") of Agricore Cooperative Ltd. ("Agricore") on November 1, 2001 (the "Acquisition") is likely to prevent or lessen competition substantially in: (1) the purchasing and handling of grain in certain local markets in Western Canada; and (2) canola oil-seed purchasing and processing in Canada. UGG and Agricore have been carrying on business as Agricore United since November 1, 2001. The Commissioner, with the consent of Agricore United, respectfully submits for approval a draft Consent Order which, if implemented, will eliminate the likely substantial lessening or prevention of competition which the Commissioner submits will otherwise be occasioned by the Acquisition. A separate application relating to certain Vancouver port terminal assets which were part of this Acquisition will also be brought pursuant to section 92 of the Act to remedy the substantial lessening or prevention of competition in the market for port terminal grain handling services alleged by the Commissioner.

2. The Commissioner alleges certain material facts and makes certain submissions in this statement. Agricore United does not contest the allegations or submissions herein for the purpose of this application, but nothing in this application or other filings shall be taken as an admission now or in the future by Agricore United of any such allegations or submissions.

II. THE PARTIES

3. The Applicant is the Commissioner, appointed under section 7 of the Act and charged with the administration of the Act.

4. The Respondent, Agricore United, which has its head office in Winnipeg, Manitoba, provides a wide range of goods and services to farmers in Western Canada and also markets agricultural commodities domestically and internationally.

5. Prior to the Acquisition, UGG which had its head office in Winnipeg, Manitoba, operated four distinct but related businesses: (1) grain handling and marketing at both the port terminal and primary grain elevator level, (2) Agro-business (crop inputs) supplies and services, (3) farm business publications and (4) livestock services.

6. Pre-merger Archer Daniels Midland Company ("ADM") had a 42% ownership position in UGG, while post merger it has a 19% interest in Agricore United which could, at ADM's option and subject to certain conditions, ultimately rise to 45%.

7. Prior to the Acquisition, Agricore, which had its head office in Winnipeg, Manitoba, provided a wide range of goods and services to farmers in Western Canada. Specifically, Agricore operated four distinct but related businesses: (1) grain handling and marketing at both the port terminal and primary grain elevator level, (2) agro-business (crop inputs) supplies and services, (3) farm business publications and (4) agri-food processing. Agricore was a one hundred percent farmer owned co-operative.

III. THE TRANSACTION

8. Pursuant to the terms of a Merger Agreement between UGG and Agricore dated July 30, 2001, UGG and Agricore agreed to merge by way of a court-approved plan of arrangement ("Plan of Arrangement") under section 192 of the *Canada Business Corporations Act.* The Plan of Arrangement provided that UGG would acquire control of all business assets of Agricore. These assets included:

   (a) whole or partial interest in port terminal facilities in Vancouver, Prince Rupert and Thunder Bay;

   (b) whole or partial interest in Western Canadian primary grain elevator facilities;

(c) agro-business interests (crop inputs supplies and services); and

(d) a 16.67% interest in CanAmera Foods Limited Partnership ("CanAmera").

9. As noted above, the transaction was completed on November 1, 2001.

IV. DETAILS OF THE INQUIRY

10. On or about June 11, 2001, the parties advised the Commissioner of the proposed merger transaction. However examination of the transaction, pursuant to section 92 of the Act, did not commence until July 30, 2001, when the matter was made public by the parties.

11. The statutory long form pre-merger notification filings of the parties pursuant to section 114 of the Act were completed on August 9, 2001.

12. An inquiry into this merger was commenced by the Commissioner on September 6, 2001, pursuant to section 10 of the Act. On the same day Bureau staff met with counsel for UGG to re-iterate that the merger raised serious competitive concerns. The Bureau's concerns had initially been expressed to UGG in a letter dated August 3, 2001.

13. The Acquisition combines the two largest grain handling companies in Alberta and Manitoba and results in the merged entity, Agricore United, having high market shares in primary elevator grain handling, in excess of 50% by capacity, in certain markets across Manitoba and Alberta.

14. With regard to the markets for canola seed purchasing and processing, pursuant to the Acquisition, Agricore United now has what was formerly Agricore's partial interest in CanAmera, a large domestic oil seed processor. ADM is a major shareholder in Agricore United and is also a major domestic oil seed processor. Through its Board representation and the Grain Operations Committee, ADM could receive competitive information concerning the operations of CanAmera as well as have the opportunity to influence CanAmera and take competitive advantage of commercially sensitive information which could result in a

substantial lessening of competition for canola purchasing and processing. Combined, ADM and CanAmera have approximately a 65% share of the canola seed purchasing and processing markets in Canada.

15. The preliminary examination and the Inquiry into the proposed transaction has included the following:

(a) a review of long-form notification information provided by UGG and Agricore under section 114 of the Act;

(b) a review of information provided voluntarily by UGG and Agricore, including competitive analyses;

(c) members of the investigative team met with and obtained information from competitors and government agencies in Western Canada, as well as touring both primary and port grain handling facilities;

(d) over 30 interviews, either in person or by telephone, with market participants, including customers, farmers, competitors, suppliers and government departments and agencies;

(e) a review of written submissions and reports from various third parties, including market participants;

(f) meetings and discussions with UGG counsel as well as representatives of both UGG and Agricore, either in-person or by telephone, to provide and obtain information about the proposed transaction and to discuss emerging issues;

(g) through the Federal Court of Canada, the issuance of orders for the production of records and written return of information to the parties to the merger;

(h) through the Federal Court of Canada, the issuance of orders for the production of records and/or written return of information to 18 third-party competitors in, or suppliers to, the Western Canadian grain-handling industry; and

(i) telephone discussions with representatives of the US Federal Trade Commission who had reviewed mergers in the grain handling industry in the United States.

16. Concerns expressed through the Commissioner's market contacts regarding the merger include:

(a) the likelihood of a substantial increase in the handling costs of grain at primary elevators in local markets with high post-merger market shares;

(b) the likelihood of a substantial increase in farmers' transportation costs realized through a decrease in hauling allowances offered to farmers for the delivery of grain to primary elevators in local markets with high post-merger market shares;

(c) the likelihood of a substantial decrease in the prices offered for non-Canadian Wheat Board grains at primary elevators in local markets with high post-merger market shares;

(d) the likelihood of a substantial increase in the handling costs of grain at port terminal facilities at the Port of Vancouver realized in part through a reduction in the diversion premiums offered to third party grain handling companies for port terminal grain deliveries;

(e) the likelihood of a substantial increase in the price of products derived from canola oil seed processing; and

(f) the likelihood of a substantial decrease in the prices offered for canola seed.

V. COMPETITIVE EFFECTS OF THE MERGER

SUMMARY

17. The Commissioner states that the acquisition of Agricore by UGG is likely to substantially lessen or prevent competition in the following markets:

(a) certain local primary grain handling services in certain areas of Alberta and Manitoba;

(b) port terminal grain handling services in Vancouver, British Columbia; and

(c) canola seed purchasing and processing in Canada.

A. PRIMARY GRAIN ELEVATORS

INDUSTRY OVERVIEW

Introduction

18. The grain industry in Western Canada has a number of elements and various participants. They include:

(a) farmers, who produce grain;

(b) grain handling companies such as Agricore United (and prior to the Acquisition, UGG and Agricore) who purchase grain from farmers, either as agents of the Canadian Wheat Board ("CWB") or on their own account, at the grain handling companies' primary grain elevators which are located across the Prairies. There are two kinds of primary elevators - traditional wooden elevators and high through-put elevators ("HTP"). HTPs have substantially greater capacity than traditional elevators. Each of these two types of elevators is described in greater detail below;

(c) the CWB, which is, by law, the only purchaser of wheat and barley, that is either to be exported from Canada or for domestic human consumption. Grain meeting that description is referred to as "CWB Grain", all other grain is referred to as "non-CWB grain." (hereinafter, where no distinction is required between CWB grain and non-CWB grain, it will be referred to simply as "grain"). Grain handling companies merchandise all non-CWB grain;

(d) the railways (i.e., Canadian National Railway and the Canadian Pacific Railway) both of which transport CWB and non-CWB grain from primary elevators to, among other places, port terminals located in Vancouver, Prince Rupert and Thunder Bay;

(e) port terminals, where grain from the Prairies is delivered for storage, in some cases "cleaning," and ultimately, for shipping; and

(f) vessels onto which grain is loaded for export.

19. The grain industry in Western Canada comprises production regions in the three Prairie Provinces and the Peace River region, which is an area that traverses Northern Alberta and British Columbia.

20. As noted above, grain handling companies, including Agricore United (and prior to the Acquisition, UGG and Agricore), purchase grain from farmers either on their own account or as agents of the CWB.

21. Grain handling begins when a producer's grain is transported from the farm to a primary elevator where the grain is weighed, graded and dockage (i.e., foreign material in the grain such as dirt and straw) is assessed. At a primary elevator, grain handling comprises receiving, grading, possibly cleaning, elevation, storage and loading grain onto rail cars. The farmer is then issued a cheque for the grain delivered, based upon the then current market price for the grade, less charges levied for delivery (if made by the grain company), elevation, dockage and cleaning (if applicable).

22. Elevators are licensed by their static storage capacity in tonnes. The amount of grain received at a given elevator is referred to as that elevator's handle. The number of times an elevator ships or handles the equivalent of its total storage capacity in a year is referred to as the number of "turns" or the "turn ratio." In 1992-93, the average turn ratio for primary elevators was 5. That figure increased to 5.92 in 1996-97, but then declined to approximately 5.5 for 1999-00. In a 1999 study, Trimac Consulting Services Ltd. estimated that in 1998-99, the 186 HTPs for which it had data averaged 7.3 turns, with approximately 10% achieving more than 20 turns.

23. Between 1970 and 2001, the number of primary grain elevators decreased from approximately 5,000 to less than 700 and in that same period primary elevator storage capacity decreased from approximately 11 million tonnes to approximately 6 million tonnes.

24. Pre-merger, the principal grain handling companies in Canada were: Agricore, UGG, Saskatchewan Wheat Pool ("SWP"), Pioneer Grain [the grain handling arm of James Richardson International ("JRI")], Cargill Limited ("Cargill"), N.M. Paterson & Sons Limited ("Paterson"), Louis Dreyfus Canada Ltd. ("Louis Dreyfus") and Parrish & Heimbecker, Limited ("P&H"). The table below depicts the breakdown of elevators owned by the various grain handling companies:

Grain Co	**Storage (tonnes)**	**% Storage**	**Elevators**	**% Elevators**
Agricore	1,432,340	22.9	207	30.4
UGG	751,020	12.0	87	12.8
SWP	1,517,200	24.2	151	22.2
Pioneer Grain	561,740	9.0	78	11.5
Cargill	479,430	7.6	45	6.6
Paterson	290,040	4.6	48	7.0
Louis Dreyfus	259,860	4.2	11	1.6
P&H	251,110	4.0	23	3.4
Others	717,990	11.5	31	4.5
Total	**6,260,730**	**100**	**681**	**100**

Inland Terminals

25. There are ten farmer owned and operated inland terminals, most of which are located in Saskatchewan. These facilities, which are included in the "others" category in the table above, provide grain handling services and are in direct competition with the major grain handling companies. However most of these inland terminals have some form of affiliation with a major grain handling company.

Producer Cars

26. In addition to grain-handling companies, farmers also have the option to use "producer cars" to ship their grain to port. By using a producer car, farmers save on elevation fees which could amount to approximately $1,000 on a carload of grain. However these facilities are not licensed elevators and therefore they do not provide all of the services of a grain handling elevator such as blending and in some cases cleaning. Historically, only approximately one percent of all grain produced in Western Canada has been shipped by producer cars.

Regulatory Environment

27. The grain handling industry is regulated by the Canadian Grain Commission ("CGC") and the Canadian Wheat Board ("CWB") pursuant to the *Canada Grain Act* and the *Canadian Wheat Board Act*, respectively.

28. The CGC is responsible for ensuring that grain produced in Canada meets certain quality standards. CGC inspectors monitor grain quality and enforce standards in respect of the grain delivered to primary elevators and port terminals.

29. The CWB is by law the sole purchaser and seller of CWB grains (i.e., wheat and barley for export and domestic human consumption). Grain handling companies purchase CWB grains from farmers as agents of the CWB at prices fixed periodically by the CWB. The majority of all non-CWB grains (i.e., grains such as canola, peas and lentils) are purchased at primary elevators by grain handling companies on their own accounts at market prices.

Changes in the Industry

30. The grain handling industry has undergone significant structural and regulatory changes in recent years. Many older, wooden, primary elevators have been closed and in their place HTP elevators have been constructed.

31. In 1980 the average primary elevator in Western Canada had about 3,500 tonnes of storage and about 10 rail car spots. By comparison an HTP typically has 15,000 to 40,000 tonnes of storage and 50 to100 rail car "spots." The term "spot" refers to the capacity of a facility to accommodate rail cars at a given time. For example, a facility with a 50 car "spot" could accommodate 50 rail cars at one time.

32. It is generally accepted in the industry, with certain limited exceptions, that the storage space for a given elevator should be approximately four times the total capacity of the rail cars that fill that elevator's car spot. One rail car holds approximately 90 tonnes of grain. Therefore, for example, an elevator with a 25 car spot loading 2,250 (90 x 25) tonnes of grain at one time would require approximately 9,000 tonnes of storage. In keeping with the foregoing, an elevator with a 50 car spot would require approximately 18,000 tonnes of storage space and a 100 car spot about 36,000 tonnes.

33. HTP elevators invariably have a larger number of rail car spots and are capable of handling much greater volumes of grain than traditional primary elevators. HTPs also draw grain from a larger area than the traditional primary elevators.

34. The incentives to build new HTP primary elevators are driven by the commodity mix in the draw area and the Multi Car Incentive ("MCI") rates offered by the railways. MCI rates are offered by railways to grain handling companies based on their ability to provide, within a set period of time following the delivery of empty rail cars, loaded blocks of 25, 50 and 100 rail cars for transport from individual elevators. In order to obtain the MCI rate, the loaded block of cars must also be unloaded within a fixed period of time. Since the supply of grain cars can be a bottleneck in the system the loading and unloading time constraints are

intended to expedite the handling of rail cars so as to minimize their turnaround time. The MCI rate ranges from $1/ tonne to $6/tonne.

35. Other structural changes to the industry include the abandonment of certain secondary rail-lines, a process that has been both hastened by and contributed to, the closure of a number of older primary elevators. These changes have resulted in a grain-handling network, which, in economic terms, is more efficient (i.e., the cost of transporting grain from the grain elevator to port terminals has been reduced). The logistics of handling and transportation from primary elevator to port terminal to vessel position is referred to as "pipeline management" in the grain handling industry.

CWB Business and Grain Car Allocation

36. The CWB recently adopted a tendering system pursuant to which grain handling companies can tender to supply grain and ship to a specified destination. Rail cars come with successful tenders. During the current crop year, the CWB will tender a minimum of 25% of its grain handling requirement to grain handling companies, rising to a minimum of 50% for the 2002-03 crop year. The allocation of rail cars for CWB non-tendered requirements among the grain handling companies is based on: (1) an 18-week running average of CWB grain through-put at each primary elevator; and (2) the balance of outstanding CWB quota from farmers who last delivered to the grain company's elevators and are assumed to continue to do so.

Transportation

37. As noted above, incentives in the form of rebates are sometimes offered by grain handling companies to farmers as a means of encouraging them to transport grain significant distances to the relevant company's primary elevators. Most of the grain that is delivered to primary grain elevators is then transported via rail to domestic users **(e.g. at flour mills, barley malters, feed mills, feed lots and oilseed crushers)**, US consumers or port terminals for export to other countries.

38. A key factor in ongoing rationalization of traditional primary grain elevators, is the adoption of MCI rates by the railways (described in paragraph 34 above). MCI rates ($1-$6/ tonne) are a substantial fraction of the rail rate to Vancouver, which ranges from $28-$45/tonne depending on the point of origin in Western Canada.

RELEVANT PRODUCT MARKET

39. The relevant product market for the primary grain elevator portion of this application is the purchasing and handling of grain.

RELEVANT GEOGRAPHIC MARKET

40. The relevant geographic markets for the primary grain elevator portion of this application are the local draw areas for each relevant elevator. To calculate market shares the Commissioner used 'draw areas' for Agricore's 38 HTP elevators.

INDUSTRY CONCENTRATION

41. UGG and Agricore are two of a small number of grain handling companies competing to purchase and handle grain in the following local geographic markets:

(a) the draw areas for primary elevators in the vicinity of the Agricore HTP at Dauphin, Manitoba;

(b) the two draw areas for primary elevators centred around Agricore's HTPs at Star and Legacy Junction, Alberta (Edmonton area). The draw area for the Agricore HTP at Starr includes primary elevators at Westlock and Gaudin (near Fort Saskatchewan). The draw area for the Agricore HTP at Legacy Junction includes primary elevators at Killam and Bawlf; and

(c) the draw areas for primary elevators in the vicinity of the Agricore HTP at Rycroft, Alberta (Peace River Area).

42. In this application the Commissioner is not alleging any likely substantial prevention or lessening of competition in any local geographic markets for the purchase and handling of grain, other than those referred to in the foregoing paragraph.

43. A combination of UGG and Agricore substantially increased concentration in already highly concentrated grain purchasing and handling markets.

44. In the draw areas for primary elevators in the vicinity of Dauphin, Manitoba and in the Edmonton area, the post-merger market share of Agricore United is approximately 50% to 55%, while in the Peace River Region the post-merger market share of Agricore United is approximately 60% to 65%.

SECTION 93 FACTORS

Acceptable Substitutes

45. The Commissioner concluded that there are no acceptable substitutes for primary grain elevator purchasing and handling services. While there are other facilities that can legally receive grain, such as process elevators (e.g. at flour mills, barley malters, feed mills, feed lots and oilseed crushers), the vast majority of the grain received at such facilities is sourced directly from primary grain elevators and not from farmers' operations.

46. Primary grain elevators located in the US are not potential substitutes for primary grain elevator services in Canada in view of the prohibitive transportation costs associated with shipping grain from the geographic markets of Peace River, Edmonton or Dauphin over the US border and on to US primary elevators.

Barriers to Entry

47. The Commissioner concluded that the barriers to entry into primary grain elevator handling services are high because of sunk costs.

48. The capital costs for construction of a new HTP elevator facility are estimated to be in the

range of about $10-$15 million, depending on the configuration adopted and the size of the storage built. New elevators are usually built to load 50 or 100 rail cars and therefore qualify for railway MCI rebates.

49. There are few, if any, economically viable possible alternative uses for an HTP grain elevator other than grain handling and storage. The capital invested in a new grain elevator is therefore almost entirely sunk cost.

50. The only significant entry in Western Canada in recent years is by Louis Dreyfus. However, the existing capacity of incumbent grain companies is more than sufficient to handle all grain crops grown in Western Canada. Further, existing excess capacity of incumbent grain companies is a barrier to entry because it represents a sunk cost.

51. An operator of a primary elevator also requires access to port terminals on commercially competitive terms.

52. Regulation is not a significant barrier to entry. The approval and construction of a new primary elevator facility can be completed in about one year.

Removal of a Vigorous and Effective Competitor

53. Agricore has been a strong competitor to UGG in providing primary grain elevator handling services in local markets in the areas of Peace River, Edmonton and Dauphin.

54. In the relevant markets, the acquisition of Agricore by UGG will result in substantially less grain handling choice for farmers, in the absence of the Draft Consent Order ("DCO"). This will allow Agricore United to exercise market power, resulting in higher handling fees and lower grain prices.

Effective Remaining Competition

55. The Commissioner concluded that if Agricore United is permitted to retain all the Agricore and UGG primary grain elevators in the affected areas of Peace River, Edmonton and Dauphin, the remaining companies will not be effective competitors for the purposes of eliminating the substantial lessening of competition. UGG and Agricore were two of a small number of grain handling companies competing to purchase and handle grain in those areas. Without the divestitures contemplated in the DCO filed by the Commissioner as part of his Application herein, the remaining third party grain-handling companies cannot be relied upon to prevent the substantial lessening of competition arising from this merger.

Foreign Competition

56. US primary grain elevator facilities do not compete in the affected local markets.

ANTI-COMPETITIVE EFFECTS

57. The Commissioner concluded that it is unlikely that UGG's exercise of market power will be prevented by new entry or by farmers transporting their products to more distant markets, or by any other countervailing competitive force. It is also the view of the Commissioner that it is unlikely that Agricore United's exercise of market power in any of the relevant geographic markets would be thwarted by significantly increased purchases of grains by processors or other buyers. The purchase decisions of these buyers are based on factors other than small but significant changes in grain prices, such as supply and demand conditions in their selling markets. Without the remedy contemplated in the DCO the Acquisition would result in substantial lessening of competition for a significant period of time.

B. CANOLA PURCHASING AND PROCESSING

OWNERSHIP STRUCTURE

58. Pursuant to the Acquisition, UGG acquired Agricore's interest in CanAmera which is a leading Canadian manufacturer and marketer of canola oil, and, is one of the largest canola processors in Canada. By virtue of its interest in CanAmera, Agricore (and now Agricore United), could nominate a representative to sit on CanAmera's Board of Directors.

59. Agricore United has 16.67% interest in CanAmera. SWP has a 33.3% interest and CSY Agri-Processing, Inc. and its subsidiary Central Soya Company, Inc. effectively hold the remaining 50%.

60. The actual governance of CanAmera is administered through CF Edible Oils Inc. As a result of its shareholder interest, Agricore's CEO has traditionally been one member of the six person CF Edible Oils Inc. Board and Agricore has had an observer at certain committee meetings where detailed operational information is provided, discussed and commercial decisions are taken.

61. ADM is also a major canola oil seed processor and is a direct competitor with CanAmera. Pre-merger ADM had a 42% ownership position in UGG while post merger it holds 19% of the common shares of Agricore United which could, at ADM's option and subject to certain conditions, ultimately rise to 45%. ADM also has the right to nominate two representatives to the Agricore United Board of Directors. ADM also has the right to nominate one of four members to a Grain Operations Committee established by UGG. Further, the agreement establishing that Committee provides that ADM shall have "...substantial influence over the operating units of UGG that procure, transport and market grain...".

62. Through its Board representation and the Grain Operations Committee, ADM could receive competitive information concerning the operations of CanAmera as well as have the opportunity to take competitive advantage of commercially sensitive information which

could result in a substantial lessening of competition for canola seed purchasing and processing.

INDUSTRY OVERVIEW

63. Canola seed processing results in two products: (1) a dry protein meal used in livestock and pet feed and; (2) a canola vegetable oil used as a major ingredient in numerous food products. As described below, the processors purchase seed from grain handling companies, who themselves have purchased it from farmers.

64. Canola seed processors generally have a limited amount of storage capacity and therefore tend to deal with grain handling companies who have an efficient and responsive delivery system. While direct purchases by processors from the farmers are utilized, the logistics of timely and efficient delivery make direct sourcing a minor proportion of their requirements.

65. CanAmera is viewed as a dominant participant in the North American canola processing industry. Together CanAmera and ADM account for 65% to 80% of the North American canola processing market. Other significant participants in the market include JRI and Cargill. JRI operates its canola processing business through its subsidiary, Canbra Foods Ltd.

66. CanAmera operations consist of:

(a) a soya bean and canola crushing plant in Hamilton, Ontario;

(b) canola crushing plants at Fort Saskatchewan, Alberta; Nipawin, Saskatchewan; and Harrowby and Altona, Manitoba;

(c) edible oil refineries at Toronto, Ontario; Montreal, Quebec; Nipawin, Saskatchewan; Altona, Manitoba; and at Wainwright, Alberta; and

(d) packaging plants in Oakville, Ontario and Edmonton, Alberta.

67. ADM has oilseed processing facilities at Lloydminster, Alberta; Windsor, Ontario and Velva, North Dakota.

RELEVANT PRODUCT MARKET

68. Canola purchasing and processing are the relevant product markets. Canola differs from other types of grains in terms of customer uses and pricing.

69. Canola processing which involves crushing, extraction and refining, is a capital intensive industry. Canola processing results in two products: (1) a dry protein meal used in livestock and pet feed and (2) a canola vegetable oil which is refined and then used in salad dressings, margarine, cookies and other types of bakery products.

70. Canadian oil seed processors purchase just under 40% of total Canadian canola seed production, the balance is exported primarily to the US, Mexico, Japan and China.

71. ADM is a leading exporter of Canadian grown canola. Post-merger ADM's share of total Canadian canola exports will be approximately 50%. ADM's significant position in both domestic and foreign canola purchases makes it unlikely that a small but significant price decrease by domestic canola crushers would be defeated by an increase in canola exports.

72. Canola oil is Canada's most popular all-purpose vegetable oil. In fact, Canadians are the largest per capita consumers of canola oil in the world. This is due in large part to the perceived health benefits associated with its use, as compared to other oils. Canola oil is often recommended by nutrition experts over other oils as it has the lowest level of saturated fat.

73. Canada is one of the largest producers of canola oil in the world. Canola oil accounts for approximately 78% of total Canadian production of edible oils, including approximately 88% of salad and cooking oils, 71% of shortening oils, and 53% of margarine oils.

RELEVANT GEOGRAPHIC MARKET

74. Canola seed production requires a climate with cool nights, therefore the crop is primarily grown in the northern regions of the US and in Canada. For this reason canola processors are located in these same regions.

75. Canola processors purchase the bulk of their canola seed requirements from grain handling companies. The geographic market for grain handling companies is local. Some of the grain handling companies are integrated into canola processing (i.e. Cargill and JRI) while UGG, Agricore and SWP have either equity or contractual ties to ADM or CanAmera.

76. In respect of canola processing the geographic market is regional encompassing the major grain growing regions in Western Canada and the Northwestern US. The major competitors in the canola processing industry have plants located in both the US and Canada.

77. Since canola oil is a major food product and a major ingredient in other food products, a key component of the canola processing business is to have plants situated in various locations to effectively service the food industry.

INDUSTRY CONCENTRATION

78. CanAmera and ADM are the dominant suppliers in the market for canola processing services in North America. In respect of canola oil processing, CanAmera and ADM account for at least 46% and 22% of the North American market, respectively. Cargill and JRI are the only other two major participants in this market and would account for approximately 20% and 12% of the market, respectively. These same market shares are reflective of the situation that exists in Canada. There is only one other competitor, a small farmer's co-operative canola processor located in Montana which would represent an insignificant share of the market.

SECTION 93 FACTORS

Acceptable Substitutes

79. Soya bean oil, which like canola oil is extracted through crushing, is substitutable for canola oil in some applications. Canola oil sells at a premium over soya bean oil. Each oil has its own distinct nutrient and fatty acid components. For example, as noted above, canola is recognized as having the lowest level of saturated fat as compared to all other oils and, as such, is viewed by many as a more healthy oil alternative. The use of each of these two oils therefore depends on the desired benefits and functionality required.

80. Other edible oil products include, olive oil, corn oil, palm oil, sunflower oil and peanut oil, all of which have higher levels of saturated fat than canola oil and are priced differently than canola oil. In addition, the use of peanut oil in North America has declined significantly in recent years due to common concerns relating to food allergies and its serious consequences on health, particularly among children.

Barriers to Entry

81. The barriers to entry into the canola processing market are high and include the following:

(a) significant sunk costs for required multiple plant locations;

(b) excess capacity in the market; and

(c) specialized knowledge for operations and commodity trading.

Remaining Competition

82. The dominant industry participants in canola processing in North America are ADM and CanAmera. Cargill and JRI together represent less than 35% of the market.

Foreign Competition

83. CanAmera, ADM, Cargill and JRI are the only major canola processors in North America. US plants are located in North Dakota, Montana and Minnesota. There is no foreign competition which originates from outside the US and Canada.

84. As noted above, canola oil and canola meal which are processed in Canada are sold in both Canada and the US. However, while canola meal is processed in the US and sold into Canada, little if any canola oil is processed in the US and sold into Canada.

ANTI-COMPETITIVE EFFECTS

85. The acquisition by UGG of Agricore's interest in CanAmera will likely result in a substantial lessening or prevention of competition in the canola purchasing and processing market.

86. CanAmera and ADM are the largest canola processors in North America. Together they account for approximately 65% of the canola oil processing market both in Canada and the US. Absent some safeguard, the Acquisition could result in ADM being in a position to receive commercially sensitive information concerning the operations of CanAmera and, indirectly, being able to influence the output pricing decisions of CanAmera. These circumstances would likely result in a substantial lessening of competition for canola purchasing and processing.

87. This transaction will reinforce ADM's already significant position with respect to both domestic and export purchases of canola seed and would likely result in lower prices being offered to canola seed producers. ADM would be in a position to substantially lessen competition by influencing canola seed prices, grade assessment, trucking allowances and other terms.

VI. RELIEF SOUGHT

PRIMARY GRAIN ELEVATORS

88. The Commissioner requests an Order or Orders pursuant to section 92 of the Act requiring the Respondent to divest:

   (a) the UGG elevator at Dutton Siding, Manitoba;

   (b) the UGG elevator at Gaudin, Alberta;

   (c) the UGG elevator at Killam, Alberta;

   (d) the Agricore elevator at Westlock, Alberta;

   (e) the Agricore elevator at Bawlf, Alberta; and

   (f) at the Respondent's option, either the Agricore elevator at Rycroft, Alberta or the UGG elevator at Rycroft, Alberta and the UGG elevator at Falher, Alberta.

CANOLA PURCHASING AND PROCESSING

89. The Commissioner requests an Order or Orders pursuant to section 92 of the Act requiring the Respondent to:

   (a) maintain all non-public information regarding CanAmera, obtained as a result of Agricore United's shareholdings in CanAmera, confidential and separate from ADM (including the ADM nominees to the Agricore United board of directors).

   (b) not appoint any director, officer or employee of ADM as a nominee to the board of directors of CanAmera.

(c) exclude canola processing from the scope of the Agricore United Grain Operations Committee's mandate.

90. The restrictions set out in 89(a) to 89(c) shall remain in effect so long as Agricore United is entitled either to elect a representative to the Board of Directors of CanAmera or holds a greater than 10% interest in CanAmera, but in any event, not beyond November 1, 2011.

VII. CONCLUSION

91. The Commissioner concludes that the Acquisition would result in a likely substantial lessening or prevention of competition in a number of relevant markets. Nevertheless, it is submitted that each likely substantial lessening or prevention of competition identified by the Commissioner will be eliminated by the DCO as more fully explained in the Consent Order Impact Statement filed with the Commissioner's Application.

92. The Commissioner therefore seeks, pursuant to subsections 92(1)(e) and section 105 of the Act, the issuance of an Order on the same terms and conditions as are set out in the DCO.

CT-2001/007

PUBLIC

THE COMPETITION TRIBUNAL

IN THE MATTER OF the *Competition Act*, R.S.C. 1985, c. C-34; as amended;

IN THE MATTER OF an Application by the Commissioner of Competition for an order under section 92 of the *Competition Act*;

AND IN THE MATTER OF the acquisition by United Grain Growers Limited of Agricore Cooperative Ltd., a company engaged in the grain handling business.

B E T W E E N:

THE COMMISSIONER OF COMPETITION

Applicant

-and-

UNITED GRAIN GROWERS LIMITED

Respondent

COMPETITION TRIBUNAL
TRIBUNAL DE LA CONCURRENCE
DEC 17 2001
OTTAWA, ONT.
1(cl)

AFFIDAVIT OF HALLDOR P. PALSSON

1. I, Halldor P. Palsson, of the City of Ottawa, in the District of Ottawa-Carleton, in the Province of Ontario, Public Servant, MAKE OATH AND SAY:

2. I am a senior economist in the Enforcement Economics Division of the Competition Bureau at Industry Canada. I was assigned to be the investigative economist in the above captioned matter. In the course of my duties I analyzed the competitive process in the grain-handling industry in local markets in Western Canada and in certain canola seed purchasing and

processing markets. Counsel for the Commissioner of Competition asked me to undertake an economic analysis of how UGG and Agricore interact in these local markets in Western Canada. Attached hereto as Exhibit "A" is a true copy of the Report prepared pursuant to the aforesaid request.

3. I have a Ph.D. in economics and my area of specialization is industrial organization. I have studied issues of competition and market power in a number of industries. Included as Appendix "A" to the aforesaid Report is a true copy of my Curriculum Vitae.

SWORN BEFORE ME, at the City of Hull,)
in the Province of Quebec,)
this 10th day of December 2001.)
)

Josée Brunet

COMMISSIONER OF OATHS

Commissaire à l'assermentation
JOSÉE BRUNET
96746
District Judiciaire de Hull, QC

Halldor P. Palsson

HALLDOR P. PALSSON

THIS IS EXHIBIT A TO THE AFFIDAVIT OF HALLDOR P. PALSSON
SWORN BEFORE ME THIS 10th DAY OF December 20 01
Brunet
COMMISSIONER FOR OATHS

Commissaire à l'assermentation
JOSÉE BRUNET
96 746
District Judiciaire de Hull, QC

Exhibit "A"-PUBLIC

Report by Halldor P. Palsson, Ph.D.

December 10th, 2001

Qualifications and Introduction

1. I have been an economist with the Economic Policy and Enforcement Division of the Competition Bureau (the "Bureau") since 1992. In my position I am responsible for providing economic analysis of cases at the Competition Bureau, including, in this case, the likely competitive impact in Canada of the acquisition by United Grain Growers ("UGG") of Agricore Cooperative Ltd. ("Agricore") (the "Acquisition").

2. I have a Ph.D. in economics and my area of specialization is industrial organization economics. I have studied issues of competition and market power in a number of industries including, most recently, the cement industry. A copy of my C.V. is attached hereto as Appendix "A".

3. In conducting my analysis in this case, I examined: (1) the records of the Mergers Branch of the Competition Bureau pertaining to its review of the Acquisition, and (2) economic literature relevant to the grain industry. In addition, I participated with Bureau competition law officers in meetings and interviews with several industry participants and consulted with Dr. Daryl F. Kraft and Mr. John DePape, who did work on behalf of the Bureau which is more fully described below. These sources have been used to form my opinions and draw my conclusions on how markets relevant to these products operate in Western Canada.

4. In analyzing the competitive effects of the Acquisition, I proceeded in four steps. First, I defined the relevant product and geographic markets, having particular regard to features of market supply, as well as demand. Second, I examined the position of Agricore United in

the relevant markets. Third, I examined the likely impact on competition of the Acquisition, and, in particular, the likely effect on prices if Agricore were to, in effect, exit from the market as a competitive alternative as a result of the Acquisition. Finally, I considered possible remedies.

5. Pursuant to the terms of a Merger Agreement between UGG and Agricore dated July 30, 2001, UGG and Agricore agreed to merge by way of a court-approved plan of arrangement ("Plan of Arrangement") under section 192 of the *Canada Business Corporations Act*. The Plan of Arrangement provided that UGG would acquire control of all business assets of Agricore. These assets included:

(a) whole or partial interests in Port Terminal facilities in Vancouver, Prince Rupert and Thunder Bay;

(b) whole or partial interests in Western Canadian Primary Grain Elevator facilities;

(c) Agro-business interests (crop inputs supplies and services); and

(d) a 16.67% interest in CanAmera Foods Limited Partnership ("CanAmera").

6. The Acquisition was completed on November 1, 2001 and as of that date UGG and Agricore have been carrying on business as Agricore United.

A. Primary Grain Elevators

I. Industry Overview

Introduction

7. Pursuant to the Acquisition, UGG acquired all of Agricore's primary grain elevator assets.

8. The grain industry in Western Canada has a number of elements and various participants.

They include:

(a) farmers, who produce grain;

(b) grain handling companies such as Agricore United (and prior to the Acquisition, UGG and Agricore) who purchase grain from farmers, either as agents of the Canadian Wheat Board ("CWB") or on their own account, at the grain handling companies' primary grain elevators which are located across the Prairies. There are two kinds of primary elevators - traditional wooden elevators and high through-put elevators ("HTP"). HTPs have substantially greater capacity than traditional elevators. Each of these two types of elevators is described in greater detail below;

(c) the CWB, which is, by law, the only purchaser of wheat and barley, that is either to be exported from Canada or for domestic human consumption. Grain meeting that description is referred to as "CWB Grain" - all other grain is referred to as "non-CWB grain." (hereinafter, where no distinction is required between CWB grain and non-CWB grain, it will be referred to simply as "grain"). Grain handling companies merchandise all non-CWB grain that they purchase;

(d) the railways (i.e., Canadian National Railway and the Canadian Pacific Railway) both of which transport CWB and non-CWB grain from primary elevators to, among other places, port terminals located in Vancouver, Prince Rupert and Thunder Bay;

(e) port terminals, where grain from the Prairies is delivered for storage, in some cases "cleaning," and ultimately, for shipping; and

(f) vessels onto which grain is loaded for export.

9. The grain industry in Western Canada comprises production regions in the three Prairie Provinces and the Peace River region, which is an area that traverses Northern Alberta and British Columbia.

10. As noted above, grain handling companies, including Agricore United (and prior to the

Acquisition, UGG and Agricore), purchase grain from farmers either on their own account or as agents of the CWB.

11. Grain handling begins when a producer's grain is transported from the farm to a primary elevator where the grain is weighed, graded and dockage (i.e., foreign material in the grain such as dirt and straw) is assessed. At a primary elevator, grain handling comprises receiving, grading, possibly cleaning, elevation, storage and loading grain onto rail cars. The farmer is then issued a cheque for the grain delivered, based upon the then current market price for the grade, less charges levied for delivery (if made by the grain company), elevation, dockage and cleaning (if applicable).

12. Elevators are licensed by their static storage capacity in tonnes. The amount of grain received at a given elevator is referred to as that elevator's handle. The number of times an elevator ships or handles the equivalent of its total storage capacity in a year is referred to as the number of "turns" or the "turn ratio." In 1992-93, the average turn ratio for primary elevators was 5. That figure increased to 5.92 in 1996-97, but then declined to approximately 5.5 for 1999-00. In a 1999 study, Trimac Consulting Services Ltd. estimated that in 1998-99, the 186 HTPs for which it had data averaged 7.3 turns, with approximately 10% achieving more than 20 turns.

13. According to the Grain Handling Infrastructure Rationalization Study (1998), Western Canadian primary elevator storage capacity peaked in 1970 at about 11 million tonnes. The number of elevators, delivery points (stations where more than one elevator could be located) and storage capacity has declined sharply over the years.

Crop Year	Primary Elevators	Delivery Points	Storage Capacity (tonnes)
1970	4,947	1,899	11,000,000
1992-93	1,500	967	7,200,000
1997-98	1,027	811	6,600,000
2000-01	681	N/A	6,260,730

14. As of July 11, 2001 there were 681 licensed primary elevators still in operation across Western Canada. Pre-merger, the principal grain handling companies in Canada were: Agricore, UGG, Saskatchewan Wheat Pool ("SWP"), Pioneer Grain (the grain handling arm of James Richardson International ("JRI")), Cargill Limited ("Cargill"), N.M. Paterson & Sons Limited ("Paterson"), Louis Dreyfus Canada Ltd. ("Louis Dreyfus") and Parrish & Heimbecker, Limited ("P&H"). The table below depicts the breakdown of elevators owned by the various grain handling companies:

Grain Co	Storage (tonnes)	% Storage	Elevators	% Elevators
Agricore	1,432,340	22.9	207	30.4
UGG	751,020	12.0	87	12.8
SWP	1,517,200	24.2	151	22.2
Pioneer Grain	561,740	9.0	78	11.5
Cargill	479,430	7.6	45	6.6
Paterson	290,040	4.6	48	7.0
Louis Dreyfus	259,860	4.2	11	1.6
P&H	251,110	4.0	23	3.4
Others	717,990	11.5	31	4.5
Total	**6,260,730**	**100**	**681**	**100**

Inland Terminals

15. There are ten farmer owned and operated inland terminals, most of which are located in Saskatchewan. These facilities, which are included in the "others" category in the table above, provide grain handling services and are in direct competition with the major grain handling companies. However it should be noted that most of these inland terminals have some form of affiliation with a major grain handling company.

Producer Cars

16. In addition to grain-handling companies, farmers also have the option to use "producer cars" to ship their grain to port. Provided that a farmer has sufficient quota left on his delivery

contract with the CWB (which is entered into each crop year and uses an acreage quota system, based on CWB sales), he or she can apply to the Canadian Grain Commission ("CGC") for a producer car. By using a producer car, farmers save on elevation fees which could amount to approximately $1,000 on a carload of grain. Historically, farmers have filled producer cars one at a time, using an auger system to transfer the grain from a truck to a grain car. Recently, however, in an attempt to obtain a Multi-Car Incentive ("MCI") rebate (as described below in paragraph 24), a group of farmers have invested in a 25 car siding with approximately 3,000 tonnes of condominium storage (i.e. the farmer owns the grain and merely stores it on site). However these facilities are not licensed elevators and therefore they do not provide all of the services of a grain handling elevator such as blending and in some cases cleaning. Historically, only approximately one percent of all grain produced in Western Canada has been shipped by producer cars, however in light of recent developments to ship multi-car producer cars, it is anticipated that producer car shipments could double or triple.

Regulatory Environment

17. The grain handling industry is regulated by the CGC and the CWB pursuant to the *Canada Grain Act* and the *Canadian Wheat Board Act*, respectively.

18. The CGC is responsible for ensuring that grain produced in Canada meets certain quality standards. CGC inspectors monitor grain quality and enforce standards in respect of the grain delivered to primary elevators and port terminals.

19. The CWB is by law the sole purchaser and seller of CWB grains (i.e., wheat and barley for export and domestic human consumption). Grain handling companies purchase CWB grains from farmers as agents of the CWB at prices fixed periodically by the CWB. The majority of all non-CWB grains (i.e., grains such as canola, peas and lentils) are purchased at primary elevators by grain handling companies at market prices.

Changes in the Industry

20. The grain handling industry has undergone significant structural and regulatory changes in recent years. Many older, wooden, primary elevators have been closed and in their place, HTP elevators have been constructed.

21. In 1980 the average primary elevator in Western Canada had about 3,500 tonnes of storage and about 10 rail car spots. By comparison an HTP typically has 15,000 to 40,000 tonnes of storage and 50 to100 rail car "spots." The term "spot" refers to the capacity of a facility to accommodate rail cars at a given time. For example, a facility with a 50 car "spot" could accommodate 50 rail cars at one time.

22. It is generally accepted in the industry, with certain limited exceptions, that the storage space for a given elevator should be approximately four times the total capacity of the rail cars that fill that elevator's car spot. One rail car holds approximately 90 tonnes of grain. Therefore, for example, an elevator with a 25 car spot loading 2,250 (90 x 25) tonnes of grain at one time would require approximately 9,000 tonnes of storage. In keeping with the foregoing, an elevator with a 50 car spot would require approximately 18,000 tonnes of storage space and a 100 car spot about 36,000 tonnes.

23. HTP elevators invariably have a larger number of rail car spots and are capable of handling much greater volumes of grain than traditional primary elevators. HTPs also have to draw grain from a larger area than the traditional primary elevators.

24. The incentives to build new HTP primary elevators are best understood by examining the basic economics of primary elevators. The commodity mix in the draw area and the MCI rebates offered by the railways drives the operation of a primary elevator. MCI rebates are offered by railways to grain handling companies based on their ability to provide, within a set period of time following the delivery of empty rail cars, loaded blocks of 25, 50 and 100 rail cars for transport from individual elevators. In order to obtain the rebate, the loaded

block of cars, whether 25, 50 or 100, must also be unloaded within a fixed period of time. Since the supply of grain cars can be a bottleneck in the system, the loading and unloading time constraints are intended to expedite the handling of rail cars so as to minimize their turnaround time. The MCI rebate scheme is set out in the following table.

Rail Incentives		**Incentive Conditions**	
Rail Car Block	**Rail Incentive**	**Load Time**	**Unload Time**
25 to 49	$1 per tonne	10 Hours	48 Hours
50 to 99	$4 per tonne	10 Hours	48 Hours
100	$6 per tonne	24 Hours	48 Hours

25. To illustrate certain differences in the economics of HTP and traditional primary elevators, I constructed an example, based on information I obtained from interviews with, and submissions from, industry participants depicting how major revenue and cost components of each type of facility are viewed by the industry.

26. In my example, the tariff on CWB wheat is assumed to be $12.25 per tonne and trucking costs to move the grain from a farm to a primary elevator are assumed to be $3.50 to $4.00 per tonne. Trucking costs are somewhat lower for smaller elevators since they generally draw grain from the immediate vicinity of the elevator. The average discounted cost of elevation services on CWB wheat to producers is $8.25 to $8.75 per tonne (i.e., tariff less net trucking costs). Operators of HTP elevators tend to offer greater trucking incentives in the form of rebates to farmers and, because of their relatively high number of car spots, are able to obtain higher MCI revenues from the railways. An HTP generally has lower variable cost because it is more efficient than older elevators. Although fixed costs tend to be higher for HTPs on a per tonne basis, they are similar to traditional elevators since they handle a greater volume. For illustrative purposes, a comparison of the typical revenue and cost per tonne for traditional and HTP primary elevators, operating at average levels, is set out in the following table.

	Small Elevator <25 cars ($ per tonne)	New HTP >100 ($ per tonne)	Range of Opinion ($ per tonne)
Tariff CWB Wheat	$12.25	$12.25	
Net Trucking	(3.50)	(4.00)	$0-$5.00
Variable Cost	(3.25)	(2.75)	2.00-4.00
Rail Rebate	0	4.00	0-6.00
Cleaning Margin	0	3.50	0-3.50
Gross Margin	**$5.50**	**$13.00**	
Fixed Cost	(4.00)	(4.00)	2.00-5.00
Depreciation	(1.25)	(3.50)	1.00-7.00
Margin	$0.25	$5.50	

27. Other structural changes to the industry include the abandonment of certain secondary rail-lines by the railways, a process that has been both hastened by, and contributed to, the closure of a number of older primary elevators. These changes have resulted in a grain-handling network, which, in economic terms, is more efficient (i.e., the cost of transporting grain from the grain elevator to port terminals has been reduced). The logistics of handling and transportation from primary elevator to port terminal to vessel position is referred to as "pipeline management" in the grain handling industry.

CWB Business and Grain Car Allocation

28. The CWB recently adopted a tendering system pursuant to which grain handling companies can tender to supply grain and ship to a specified destination. Rail cars come with successful tenders. During the current crop year, the CWB will tender a minimum of 25% of its grain handling requirement to grain handling companies, rising to a minimum of 50% for the 2002-03 crop year. The allocation of rail cars for CWB non-tendered requirements among the grain handling companies is based on: (1) an 18-week running average of CWB grain through-put at each primary elevator; and (2) the balance of outstanding CWB quota from farmers who last delivered to the grain company's elevators and are assumed to continue to do so.

Transportation

29. As noted above, incentives in the form of rebates are sometimes offered by grain handling companies to farmers as a means of encouraging them to transport grain significant distances to the relevant company's primary elevators. Most of the grain that is delivered to primary grain elevators is then transported via rail to domestic users **(e.g. at flour mills, barley malters, feed mills, feed lots and oilseed crushers)**, US consumers or port terminals for export to other countries.

30. A key factor in ongoing rationalization of traditional primary grain elevators, is the adoption of MCI rates by the railways (described in paragraph 24 above). MCI rates which range from $1-$6/tonne are a substantial fraction of the rail rate to Vancouver, which typically ranges from $28-$45/tonne depending on the point of origin in Western Canada.

II. Relevant Product Market

31. The major grain crops in Western Canada are wheat, canola and barley, which together account for about 90% of the total grain production. Other crops grown in Western Canada are flax, oats, rye and specialty crops which include canary and mustard seed, lentils and field peas.

32. The purchasing and handling of grain is a candidate relevant product market. In performing my review in this case, I considered smaller product markets. For example, I considered whether CWB grain and non-CWB grain should be considered two separate product markets for the following reasons. First, the distinction between CWB grain and non-CWB grain is important because the grain handling companies purchase CWB grain as agents of the CWB, whereas they purchase non-CWB grain on their own account. Thus, the handling services for milling wheat, durum wheat, malting barley and feed grains delivered for the CWB's account or CWB grain is a candidate relevant product market. Second, the grain handling companies, not the CWB, market and sell non-CWB grains, such as canola, feed barley and

feed wheat and other grains (e.g. mustard and canary seed, flax, oats, rye, peas, lentils and dry beans).

33. Notwithstanding the CWB/ non-CWB distinction, the firms in the industry define themselves around purchasing and handling all types of grain and their primary elevators receive, store and ship grain in bulk. Grain handling companies have considerable flexibility to move from one grain crop to another.

34. In view of the foregoing, I concluded that the product market in this case should be defined as the purchasing and handling of grain. In summary, this best accords with trade views and practices in light of the fact that every company handles most types of grain. In addition, production substitutability is high in that primary elevators generally handle both CWB and non-CWB grains. The production facilities for handling different types of grain are essentially the same.

35. The purchasing and handling of grain is a distinct product market without practical substitutes. The purchasing and handling of grain differs from the purchasing and handling of all other agricultural commodities in their physical characteristics, means of production, uses, and pricing.

36. On the supply side, farmers are tied to grains. Due to the length of growing seasons, and the suitability of grains to certain climates and regions, it is my view that grain farmers would not switch to the production of other agricultural commodities in sufficient numbers to prevent a small but significant decrease in price they obtain for their grain products.

37. In my opinion, the purchasing and handling of grain constitutes the relevant product market within the meaning of the *Competition Act* (the "Act").

III. Relevant Geographic Market

38. Grain flows from producers on their farms to primary elevators, from which it moves by rail to domestic or US purchasers or to port terminals for export to other countries.

39. Farmers typically haul grain by truck to nearby primary elevators. Delivery of grain from the farm to elevators is a relatively costly and time consuming exercise. As a result, farmers generally sell and deliver their grain within a limited geographic area surrounding their farms.

40. Grain trading companies generally purchase grain from farmers at primary elevators. The geographic area from which a primary elevator receives grain is limited by transportation costs and is known as the "draw area" for that facility. The size of the draw area for any given primary elevator varies depending on factors such as the crop yield and the number and location of competing grain elevators. Draw areas expand and contract in response to normal economic fluctuations in crop supply, crop demand, and transportation costs.

41. In its 1997 review of the proposed acquisition of UGG by the Alberta Wheat Pool and the Manitoba Pool Elevators, the Bureau concluded that draw areas for UGG's primary elevators were a 30 mile radius around each UGG elevator in Alberta and Manitoba.

42. In connection with the Commissioner's inquiry in this case, UGG submitted market share data based on 60 and 90 mile circles around UGG HTP facilities.

43. UGG arrived at these figures through the analysis of their hauling data. UGG compared the average delivery distance of a grain delivery in the 1996-97 crop year to the average distance for the 1999-00 crop year and found that it had doubled to [ ] kilometres. UGG's data indicates that 59% of deliveries to their primary elevators are made from within [ ] miles (approximately [ ] kilometres) of any given elevator. In addition, UGG found that 82% of all deliveries were within [ ] kilometres or approximately [ ] miles of the elevator.

44. To assist it in this matter, the Competition Bureau hired Dr. Daryl F. Kraft, the Head of the Department of Agribusiness and Agricultural Economics at the University of Manitoba. Dr. Kraft was assisted by Mr. John DePape, a grain handling consultant.

45. Dr. Kraft and Mr. DePape used Census Consolidated Subdivision ("CCS") areas as defined by Statistics Canada as a starting point for their review. Dr. Kraft and Mr. DePape used a 30 mile radius as the draw area for elevators with less than 50 car spots. For larger elevators with 50 or more car spots, they assumed that 70% of their draw was from within 30 miles and 30% from 30-60 miles. This reflects the ability of operators of larger facilities to draw grain from greater distances as a result of being able to obtain MCI rates from the railways, part of which, in turn, can be offered to farmers as trucking incentives. Any elevator that cut into a CCS was assigned a market share in the CCS in proportion with its reach. This was done to capture the market presence of elevators that are just outside a given circle, that may draw from inside that circle. With these modifications the market shares assigned to companies by Dr. Kraft and Mr. DePape were similar to those calculated by UGG for their HTP elevators.

46. I also asked Dr. Kraft and Mr. DePape to do a local market analysis on all Agricore HTP elevators as these are the grain handling competitive alternatives which would be eliminated as a competitive alternative as a result of the Acquisition. Post-merger market shares, based on capacity were calculated in a 60 mile radius surrounding each of Agricore's 38 HTP elevators.

47. In examining the issue of geographic market definition, I also reviewed submissions from grain companies and the CWB. The grain companies were in general agreement that sourcing grain much beyond 100 kilometres on a regular basis was not possible in light of trucking costs. However, if a specific type or grade of grain was required to complete a particular rail shipment, sourcing it beyond 100 kilometres was an option.

48. Based on the submissions of UGG, the review of Dr. Kraft and Mr. DePape and industry interviews, I conclude that as a general rule the draw area for primary elevators is typically a radius of 50 to 100 kilometres.

49. For many primary elevators, draw areas overlap. Prior to the Acquisition, UGG and Agricore operated a number of primary elevators that had overlapping draw areas. They therefore competed with one another for the purchase and handling of grains from the same producers.

50. In some of these overlapping draw areas, UGG and Agricore were two of a small number of competing grain handling companies. If Agricore United were permitted to retain Agricore's facilities in these local or primary draw areas, in my opinion, it would be in a position to unilaterally decrease prices paid to farmers because transportation costs would preclude them from selling to purchasers outside the draw areas in sufficient quantities to prevent the price decrease.

51. In my opinion, focusing the local market analysis on Agricore's elevators is appropriate since these were the alternative purchasers of grain that were eliminated as a competitive alternative as a result of the merger. It is also my opinion that each such draw area for a primary elevator is a relevant geographic market within the meaning of the Act.

IV. Industry Concentration

52. UGG and Agricore are two of a small number of grain handling companies competing to purchase and handle grain in the following local geographic markets:

(a) **the draw areas for primary elevators in the vicinity of the Agricore HTP at Dauphin, Manitoba;**

(b) the two draw areas for primary elevators centred around Agricore's HTPs at Star and Legacy Junction, Alberta (Edmonton area). The draw area for the Agricore HTP at Star includes primary elevators at Westlock and Gaudin (near Fort Saskatchewan). The draw area for the Agricore HTP at Legacy Junction includes primary elevators at Killam and Bawlf; and

(c) the draw areas for primary elevators in the vicinity of the Agricore HTP at Rycroft, Alberta (Peace River Area).

53. A combination of UGG and Agricore substantially increased concentration in already highly concentrated grain purchasing and handling markets.

54. In the draw areas for primary elevators in the vicinity of Dauphin, Manitoba and in the Edmonton area, the post-merger market share of Agricore United is approximately 50% to 55%, while in the Peace River Region, the post-merger market share of Agricore United is approximately 60% to 65%.

V. Section 93 Factors

Acceptable Substitutes

55. In my view there are no acceptable substitutes for primary grain elevator purchasing and handling services. While there are other facilities that can legally receive grain, such as process elevators (e.g. at flour mills and barley malters), the vast majority of the grain

received at such facilities is sourced directly from primary grain elevators and not from farmers' operations. In my opinion producer cars cannot effectively compete with grain handling companies since they do not provide all of the services of a grain handling elevator such as blending, cleaning or storage.

56. Primary grain elevators located in the US are not potential substitutes for primary grain elevator services in Canada in view of the prohibitive transportation costs associated with shipping grain from the geographic markets of Peace River, Edmonton or Dauphin over the US border and on to US primary elevators.

Barriers to Entry

57. In my opinion the barriers to entry into primary grain elevator handling services are high because of sunk costs.

58. The capital costs for construction of a new HTP elevator facility are estimated to be in the range of about $10-$15 million, depending on the configuration adopted and the size of the storage built. New elevators are usually built to load 50 or 100 rail cars and therefore qualify for railway MCI rebates.

59. There are few, if any, economically viable possible alternative uses for an HTP grain elevator other than grain handling and storage. For smaller older primary elevators the cost of demolition is estimated to range from $30,000-$100,000 while the net salvage value of a new HTP is about $1 million. The capital invested in a new grain elevator is therefore almost entirely sunk cost.

60. In my opinion the existing capacity of incumbent grain companies is more than sufficient to handle all grain crops grown in Western Canada. In my opinion, existing excess capacity of incumbent grain companies is a barrier to entry because it represents a sunk cost.

61. An operator of a primary elevator also requires access to port terminals on commercially

competitive terms.

62. Regulation is not a significant barrier to entry. The approval and construction of a new primary elevator facility can be completed in about one year.

Removal of a Vigorous and Effective Competitor

63. Agricore has been a strong competitor to UGG in providing primary grain elevator handling services in local markets in the areas of Peace River, Edmonton and Dauphin.

64. In the relevant markets, the acquisition of Agricore by UGG will result in significantly less grain handling choice for farmers. This will allow Agricore United to exercise market power, resulting in higher handling fees and lower grain prices.

Effective Remaining Competition

65. In my opinion if Agricore United is permitted to retain all the Agricore and UGG primary grain elevators in the affected areas of Peace River, Edmonton and Dauphin, the remaining companies will not be effective competitors for the purposes of eliminating the substantial lessening of competition. UGG and Agricore were two of a small number of grain handling companies competing to purchase and handle grain in those areas. In my view, without the divestitures contemplated in the Draft Consent Order ("DCO") filed by the Commissioner as part of his Application herein, the remaining third party grain-handling companies cannot be relied upon to prevent the substantial lessening of competition arising from this merger.

Foreign Competition

66. For the reasons set out in paragraph 56 above, US primary grain elevator facilities do not compete in the affected local markets.

VI. Anti-competitive Effects

67. In my opinion it is unlikely that UGG's exercise of market power will be prevented by: (1) new entry, (2) farmers transporting their products to more distant markets, or (3) any other countervailing competitive force. It is also my opinion that it is unlikely that Agricore United's exercise of market power in any of the relevant geographic markets would be thwarted by significantly increased purchases of grains by processors or other buyers. The purchase decisions of these buyers are based on factors other than small but significant changes in grain prices, such as supply and demand conditions in their selling markets. In my opinion, without the remedy contemplated in the DCO the Acquisition would result in substantial lessening of competition for a significant period of time.

VII. Remedy

68. The DCO agreed to by the Commissioner and UGG contemplates the divestitures set out in Schedule "A" of the DCO. The primary elevator assets to be divested are situated in the following local market areas:

(a) in the vicinity of Dauphin Manitoba,

(b) in the vicinity of Agricore's HTP at Star which includes primary elevators at Westlock and Gaudin (near Fort Saskatchewan) and in the vicinity of Agricore's HTP at Legacy Junction which includes primary elevators at Killam and Bawlf; and

(c) in the vicinities of Rycroft and Fahler, Alberta.

69. In my opinion these divestitures will remove the substantial lessening of competition arising from this transaction in these local markets.

VIII. Alternatives to the Settlement

70. As an alternative to the DCO, contested litigation was considered as a means of seeking

divestitures in the relevant markets. However, I believe that the proposed divestitures should result in sales of the relevant primary elevators to effective competitors to prevent any possible exercise of market power in the markets concerned. I also believe the DCO provides a timelier and more certain outcome for Agricore United and producers of grain.

B. CANOLA PROCESSING

I. Ownership Structure

71. Pursuant to the Acquisition, UGG acquired Agricore's interest in CanAmera which is a leading Canadian manufacturer and marketer of canola oil, and, is one of the largest canola processors in Canada. By virtue of its interest in CanAmera, Agricore (and now Agricore United), could nominate a representative to sit on CanAmera's Board of Directors.

72. Agricore United has 16.67% interest in CanAmera. SWP has a 33.3% interest and CSY Agri-Processing, Inc. and its subsidiary Central Soya Company, Inc. effectively hold the remaining 50%.

73. The actual governance of CanAmera is administered through CF Edible Oils Inc. As a result of its shareholder interest, Agricore's CEO has traditionally been one member of the six person CF Edible Oils Inc. Board and Agricore has had an observer at certain committee meetings where detailed operational information is provided, discussed and commercial decisions are taken.

74. Archer Daniels Midland Company Ltd. ("ADM") is also a major canola oil seed processor and is a direct competitor with CanAmera. Pre-merger ADM had a 42% ownership position in UGG while post merger it holds 19% of the common shares of Agricore United which could, at ADM's option and subject to certain conditions, ultimately rise to 45%. ADM also has the right to nominate two representatives to the Agricore United Board of Directors. ADM also has the right to nominate one of four members to a Grain Operations Committee established by UGG. Further, the agreement establishing that Committee provides that ADM

shall have "...substantial influence over the operating units of UGG that procure, transport and market grain...".

75. Through its Board representation and the Grain Operations Committee, ADM could receive competitive information concerning the operations of CanAmera as well as have the opportunity to influence CanAmera and take competitive advantage of commercially sensitive information which could result in a substantial lessening of competition for canola purchasing and processing.

II. Industry Overview

76. Canola seed processing results in two products: (1) a dry protein meal used in livestock and pet feed; and (2) a canola vegetable oil used as a major ingredient in numerous food products. As described below, the crushers purchase seed from grain handling companies, who themselves have purchased it from farmers.

77. Canola seed processors generally have a limited amount of storage capacity and therefore they tend to deal with grain handling companies who have an efficient and responsive delivery system. While direct purchases by processors from the farmers are utilized, the logistics of timely and efficient delivery make direct sourcing a minor proportion of their requirements.

78. CanAmera is viewed as a dominant participant in the North American canola processing industry. Together CanAmera and ADM account for approximately 65% of the North American canola processing market. Other significant participants in the market include Cargill and JRI which operates its canola processing business through its subsidiary, Canbra Foods Ltd.

79. CanAmera operations consist of:

(a) a soya bean and canola crushing plant in Hamilton, Ontario;

(b) canola crushing plants at Fort Saskatchewan, Alberta; Nipawin, Saskatchewan; and Harrowby and Altona, Manitoba;

(c) edible oil refineries at Toronto, Ontario; Montreal, Quebec; Nipawin, Saskatchewan; Altona, Manitoba; and at Wainwright, Alberta; and

(d) packaging plants in Oakville, Ontario; and Edmonton, Alberta.

80. ADM has oilseed processing facilities at Lloydminster, Alberta; Windsor, Ontario and Velva, North Dakota.

III. Relevant Product Market

81. Canola purchasing and canola processing are relevant product markets. Canola differs from other types of grains in terms of customary uses and pricing.

82. Canola processing, which includes crushing, extraction and refining is a capital intensive industry. Canola seed processing results in two products, a dry protein meal used in livestock and pet feed and a canola vegetable oil which is used in salad dressings, margarine, cookies and other types of bakery products. Canola processing consists of crushing canola seed to extract a crude oil and further refining it into an edible vegetable oil. Canola meal is the solid portion of the canola seed remaining after the oil is removed.

83. Canadian crushers purchase just under 40% of total Canadian canola seed production, the balance is exported, primarily to the US, Mexico, Japan and China.

84. ADM is a leading exporter of Canadian grown canola. ADM's share of total Canadian canola seed exports is approximately 50%. ADM's significant position in both domestic and foreign canola purchases makes it unlikely that a small but significant price decrease by domestic canola crushers would be defeated by an increase in canola exports.

85. Canola oil is Canada's most popular all-purpose vegetable oil. This is due in large part to

the perceived health benefits associated with its use, as compared to other oils. Canola oil is often recommended by nutrition experts over other oils as it has the lowest level of saturated fat.

86. Canadians are the largest per capita consumers of canola oil in the world. Canola oil accounts for approximately 78% of total Canadian production of edible oils, including approximately 88% of salad and cooking oils, 71% of shortening oils, and 53% of margarine oils.

IV. Relevant Geographic Market

87. Canola seed production requires a climate with cool nights, therefore the crop is primarily grown in the northern regions of the US and in Canada. For this reason canola processors are located in these same regions.

88. Canola processors purchase the bulk of their canola seed requirements from grain handling companies. The geographic market for grain handling companies is local as discussed in Section 'A' which deals with primary grain elevators. Some of the grain handling companies are integrated into canola processing (i.e., Cargill and JRI) while UGG, Agricore and SWP have either equity or contractual ties to ADM or CanAmera.

89. In respect of canola processing, it is my opinion that the geographic market is regional encompassing the major grain growing regions in Western Canada and the Northwestern US. This is also reflected in the processing plant locations. The major competitors in the canola processing industry have plants located in both the US and Canada.

90. The sales of processed canola products from both Canada and the US are distributed throughout North America establishing that the geographic market for the outputs from canola processing is large, often North American.

91. Since canola oil is a major food product and a major ingredient in other food products, a key

component of the canola processing business is to have plants situated in various locations to effectively service the food industry.

V. Industry Concentration

92. CanAmera and ADM are the dominant suppliers in the market for canola processing services in North America. In respect of canola oil processing, CanAmera and ADM account for at least 46% and 22% of the North American market, respectively. Cargill and JRI are the only other two major participants in this market and would account for approximately 20% and 12% of the market, respectively. These same market shares are reflective of the situation that exists in Canada. There is only one other competitor, a small farmer's co-operative canola processor located in Montana which would represent an insignificant share of the market.

VI. Section 93 Factors

Acceptable Substitutes

93. Soya bean oil, which like canola oil is extracted through crushing, is substitutable for canola oil in some applications. Canola oil sells at a premium over soya bean oil. Each oil has its own distinct nutrient and fatty acid components. For example, as noted above canola is recognized as having the lowest level of saturated fat as compared to all other oils and, as such, is viewed by many as a more healthy oil alternative. The use of each of these two oils therefore depends on the desired benefits and functionality required.

94. Other edible oil products include, olive oil, corn oil, palm oil, sunflower oil and peanut oil, all of which have higher levels of saturated fat than canola oil and are priced differently than canola oil. In addition, the use of peanut oil in North America has declined significantly in recent years due to common concerns relating to food allergies and its serious consequences on health, particularly among children.

Barriers to Entry

95. The barriers to entry into the canola processing and purchasing market are high and include the following:

    (a) significant sunk costs for required multiple plant locations;

    (b) excess capacity in the market; and

    (c) specialized knowledge for operations and commodity trading.

Remaining Competition

96. The dominant industry participants in canola processing in North America are ADM and CanAmera. Cargill and JRI together represent less than 35% of the market.

Foreign Competition

97. CanAmera, ADM, Cargill and JRI are the only major canola processors in North America. US plants are located in North Dakota, Montana and Minnesota. There is no foreign competition which originates from outside the US and Canada.

98. As noted above, canola oil and canola meal which are processed in Canada are sold in both Canada and the US. However, while canola meal is processed in the US and sold into Canada, little if any canola oil is processed in the US and sold into Canada.

VII. Anti-Competitive Effects

99. This transaction will reinforce ADM's already significant position with respect to both domestic and export purchases of canola seed which in my view would likely result in lower prices being offered to canola seed producers. ADM would be in a position to substantially lessen competition by influencing canola seed prices, grade assessment, trucking allowances and other terms.

100. CanAmera and ADM are the largest canola processors in North America. Together they account for approximately 65% of the canola oil processing market both in Canada and the US. Absent some safeguard, the Acquisition could result in ADM being in a position to receive commercially sensitive information concerning the operations of CanAmera and, indirectly, being able to influence the output pricing decisions of CanAmera. These circumstances would in my opinion, likely result in a substantial lessening of competition for canola purchasing and processing.

VIII. Remedy

101. The DCO agreed to by the Commissioner and UGG provides that Agricore United shall keep all non-public information it receives regarding CanAmera, which is obtained as a result of Agricore United's direct or indirect shareholdings in CanAmera, confidential and separate from ADM (including the ADM nominee's to Agricore United's Board of Directors). The DCO also provides that Agricore United shall not appoint any director, officer or employee of ADM as a nominee to CanAmera's Board of Directors. Finally, Agricore United's Grain Operations Committee shall exclude canola seed processing from the scope of its mandate.

102. In my opinion these remedies will remove the substantial lessening of competition arising from this transaction in the canola purchasing and processing markets.

IX. Alternatives to the Settlement

103. As an alternative to the DCO, contested litigation was considered with a view to seeking divestiture of UGG's shares in CanAmera. However, I believe that the safeguards proposed in the DCO should result in ADM being unable gain access to information which would likely increase its ability to exercise market power in the relevant markets.

THIS IS ~~EXHIBIT~~ Appendix A TO THE AFFIDAVIT OF HALLDOR P. PALSON
SWORN BEFORE ME THIS 10th DAY OF December 2021
Josée Brunet
COMMISSIONER FOR OATHS

Commissaire à l'assermentation
JOSÉE BRUNET
96 746
District Judiciaire de Hull, QC

APPENDIX "A"

CURRICULUM VITAE

Name:	Halldor P. Palsson
Address:	633 Island Park Cr. Ottawa, Ontario K1Y 3P4
E-mail:	palsson.halldor@ic.gc.ca
Phone:	Office (819) 953-4256 Fax (819) 953-6400 Home (613) 728-0577

POST SECONDARY EDUCATION:

1991 — Ph.D. in Economics, Carleton University, Ottawa, Ontario, Canada.

Thesis Title: Population Dynamics and Extinction: An Application to the Fin Whale Stock Off Iceland.

Fields of Specialization: Industrial Organization, and Public Finance.

1982 — M.A. in Economics, University of Waterloo, Waterloo, Ontario.

1980 — B.B.A. Honours in Business Administration with an Economics Minor. Wilfrid Laurier University, Waterloo, Ontario.

PROFESSIONAL EMPLOYMENT:

Apr 92 to present — Industry Canada, Competition Bureau, Economic Policy & Enforcement (ES-05). Responsible for providing economic advice and analysis in support of competition investigations and court cases. This includes litigation support, the supervision of contracts with outside experts and support staff and testifying. Participate in the settlement of cases through negotiations with private sector corporations. Develop interventions to Federal and Provincial regulatory bodies and legislative committees on competition matters. Other duties include research on competition policy and related issues.

Feb. 88 to Apr. 92	Department of Fisheries and Oceans, Ottawa, Economic Analysis and Statistics Division, Economic and Commercial Analysis Directorate. (ES-02 to ES-04) Developed the economic arguments for the Canada-France Maritime Boundary Arbitration case over St. Pierre and Miquelon. Completed a review of factory freezer trawler policy. Designed and implemented projects on the effectiveness of fishery regulation enforcement to structure requests to central agencies for more resources for DFO. Represented DFO at the OECD fisheries committee and liaised with the U.S. Department of Commerce on methodologies to calculate producer subsidy equivalents for fishing industries. Conducted research on fisheries management regimes and related work on property rights versus effort regulation. Designed and supervised projects for junior economic staff and summer students.
Oct 87 to Feb. 88	Revenue Canada Taxation, Ottawa, Forecaster, Forecasting and Research Section, Finance Directorate. (ES-03) Worked on the Ideal Tax Administration project on the effectiveness and need for additional auditors for tax enforcement purposes. The economics of crime literature as it relates to tax evasion was surveyed and applied to Canadian tax evasion. Previous work on tax compliance and estimates of tax evasion generated within Revenue Canada were critically reviewed and further studies proposed.
May to Sept 1986	Department of Fisheries and Oceans, Ottawa, Economic Analysis and Statistics Division, Economic and Commercial Analysis Directorate. Completed a cost benefit study of the factory freezer trawler policy for Canada. Supervised the in-house data work for a model of the fishing industry that was built by outside consultants.
May to Sept 1985	Department of Fisheries and Oceans, Ottawa, Economic Analysis and Statistics Division, Economic and Commercial Analysis Directorate. Worked on a final demand model for groundfish in the United States market. Conducted a study of the Icelandic fishing industry and the role of government subsidies on the industry.
June 1983 to June 1984	Research assistant to Professor Kanta Marwah Carleton University. The estimation and simulation of various foreign exchange models

were the main tasks.

Sept 1981 to 1982	Research assistant to Professor Jim Brox Department of Economics, University of Waterloo. Duties were computer work and data management for Canadian macro models and tutoring the 4th year forecasting class in Troll.
Feb to Sept 1981	Project Accountant for Eaglebrook Investments Ltd of Toronto. Had responsibility for the day-to-day financial management of four residential developments in Pickering.

EXPERT WITNESS TESTIMONY:

1. Qualified as an expert economist witness in the analysis of industry structure and market competition before the Canadian International Trade Tribunal (CITT) in: Dumping of Refined Sugar Originating from the United States, Denmark, Germany, Netherlands etc. February 1996. My expert report was Appendix I: **An Analysis of the Price Impact of Dumping Duties on the Canadian Refined Sugar Market**. Counsel was Mr. James Sutton of the Department of Justice.

2. Qualified as an expert economist witness at the CITT in Certain Prepared Baby Foods Originating in or Exported from the United States of America, September 1998. My export report was: **Exhibit "C"** to the submission of the Director of Investigation and Research, August 10, 1998. Counsel were Mr. Simon V. Potter and Brenda C. Swick-Martin of Ogilvy Renault.

3. Qualified as an expert witness at the CITT in the matter of the Review of Dumping of Refined Sugar Originating from the United States, Denmark, Germany, Netherlands etc. My expert report was Exhibit J-3 Review RR-99-006 (Refined Sugar): **The Impact of Dumping Duties on the Canadian Refined Sugar market 1995 to 2000**. September 2000. Counsel was Ms. Josephine Palumbo of the Department of Justice.

4. The Commissioner of Competition and Lafarge S.A Application for a Consent Order. Affidavit and Report of Halldor P. Palsson Ph.D., June 14, 2001.

OTHER SKILLS:	Good computer skills and knowledge of econometric packages for PCs.
	Languages: Icelandic (native), French (BBB), Danish and some Spanish.

PUBLICATIONS:

Kleit, Andrew N. and Palsson H. **(1999)** Horizontal Concentration and Anticompetitive Behaviour in the Central Canadian Cement Industry: Testing Arbitrage Cost Hypothesis, the **International Journal of Industrial Organization**, Vol 17, (1999) pp. 1189-1202.

Kleit, Andrew N. and Palsson, H. **(1996)** Is There Anticompetitive Behaviour in the Central Canadian Cement Industry?: Testing Arbitrage Cost Hypothesis, **Canadian Journal of Economics**, Vol XXIX, No 2 (May, 1996) pp. 343-356.

Lane, D. E. and Palsson, H. P. **(1996)** Stock Rebuilding Strategies Under Uncertainty: The Case for "Sentinel Fisheries". pp. 61-90 in D.V. Gordon and G.R. Munro [ed.] **Fisheries and Uncertainty: A Precautionary Approach to Resource Management**, University of Calgary Press, 1996.

Lane, D. E. and Palsson, H. P. **(1994)** Stock Rebuilding Strategies Under Uncertainty: The Case for "Sentinel Fisheries". **Canadian Journal of Economics**, Special Issue, Part I, Vol. XXIX (April 1996) pp. S151-S156.

Palsson, H., Lane, D.E. and Kaufmann, B.**(1993)** Bioeconomic methods for determining TACs. pp. 357-369. In S.J. Smith, J. J. Hunt and D. Rivard [ed.] Risk evaluation and biological reference points for fisheries management. **Can. Spec. Publ. Fish. Aquat. Sci. 120.**

R.W. Crowley and Palsson, H. **(1992)** Rights Based Fishing in Canada, **Marine Resource Economics** Vol. 7, No 2, (September) pp. 1-21

R.W. Crowley and Palsson, H.**(1992)** "Modeling Offshore Fishery Regulation Enforcement In Canada" **American Journal of Mathematical and Management Sciences**, Vol 12, No 1-2, pp. 153-190.

Edwin G. West and Palsson, H. **(1988)** Parental Choice of School Characteristics: Estimation Using State-Wide Data, **Economic Inquiry**, Vol. XXVI pp. 725-740

K. Marwah and Palsson, H.(1988)"Direct Interventions, Interest Rate Shocks and Monetary Disturbances in the Canadian Foreign Exchange Market: A Simulation Study", Ch 20 in Homa Motamen (ed) **Economic Modelling in the OECD Countries** (Chapman and Hall, London 1988) pp. 407-455

K. Marwah and Palsson, H. (1988) The Tracks of the Managed Exchange Rate of the Indian Rupee with Monetary Shocks and External Disturbances, in M. Dutta (ed) **Asian Industrialization**: Changing Economic Structures. (JAI Press Inc., Greenwich, Conn.).

TEACHING EXPERIENCE:

Winters 1993-95	Government Policy Toward Business 330A, a third year course in industrial organization and competition law. Economic analysis of post-1986 Canadian competition law cases were emphasized.
Fall 1990	Microeconomics for public administration students, Carleton University.
1985-1987	Sessional lecturer at Carleton University, Ottawa, Ontario.
Winter 1987	Intermediate Macroeconomics, 212 a second year course, two sections. Closed economy macro with emphasis on consumption, investment and the demand for money.
Summer 1986	Intermediate Macroeconomics. Economics 213 is an introduction to policy and the open economy.
Winter 1986	Intermediate Macroeconomics and Microeconomics.
Fall 1985	Intermediate to Microeconomics.

MEMBERSHIPS:

Canadian Economics Association.
Resource Modeling Association.
Scientific Committee of the International Whaling Commission 1991-92.

Other:

Vice President of the Chess Federation of Canada	2000-2001
Secretary of the Chess Federation of Canada	1999-2000

PUBLIC

THE COMPETITION TRIBUNAL

IN THE MATTER OF the *Competition Act*, R.S. 1985, c. C-34, as amended;

IN THE MATTER OF an application by the Commissioner of Competition under section 92 of the *Competition Act*;

AND IN THE MATTER OF a joint venture between Saskatchewan Wheat Pool Inc. and James Richardson International Limited in respect of port terminal grain handling in the Port Vancouver.

BETWEEN:

Amended version original filed November 10. 2005

THE COMMISSIONER OF COMPETITION

Applicant

- AND -

SASKATCHEWAN WHEAT POOL INC.,

JAMES RICHARDSON INTERNATIONAL LIMITED

6362681 CANADA LTD. AND 6362699 CANADA LTD.

Respondents

STATEMENT OF GROUNDS AND MATERIAL FACTS

I. INTRODUCTION

1. The Respondents each own a port terminal grain handling facility in the Port of Vancouver. There are three other port terminal grain handling facilities in Vancouver. One firm owns two and co-owns a third and another firm owns the remaining half interest in one facility.

2. If the Respondents are permitted to enter into their proposed joint venture (the "proposed JV") this will substantially lessen the competitive options available to non-integrated grain companies and to the Canadian Wheat Board ("CWB"), thus negatively impacting Canadian grain farmers.

3. Accordingly, the proposed JV will likely result in a substantial lessening or prevention of competition in the Canadian west coast port terminal grain handling services market by causing or allowing:

   the proposed JV to have an ability and incentive to increase the tariffs for port terminal grain handling services at Vancouver and Prince Rupert charged to:

      i. the CWB for the handling of CWB grain; and to

      ii. Non-Integrated Graincos for the handling of non-CWB grain;

   (b) the proposed JV to have an ability and incentive to reduce or eliminate the diversion premiums paid to Non-Integrated Graincos to induce shipment of their grain volumes (CWB and non-CWB grain) to the integrated companies' competing port grain terminals at Vancouver; and,

   (c) the proposed JV to have an incentive to increase the difficulties for Non-Integrated Graincos in obtaining terminal authorization and ready access to port terminal grain handling services, particularly during periods of high demand for such services.

4. In addition, because of the vertical relationship between port terminal grain handling service markets and primary grain elevator markets, the above noted substantial prevention or lessening of competition caused by the proposed JV is also likely to have anti-competitive effects in many local primary grain handling markets across the Prairies. Greater difficulties in obtaining ready access to port terminal grain handing services and the reduction or elimination of diversion premiums, or the increase in port terminal tariffs, will increase the costs of Non-Integrated Graincos , thereby limiting their ability and incentive to compete for grain originations in country.

5. Therefore, the Commissioner of Competition ("Commissioner") seeks an Order prohibiting the proposed JV or such other relief as the Tribunal considers appropriate to address the substantial lessening or prevention of competition which is likely to result from the Respondents' proposed JV.

II. DEFINITIONS

6. For the purposes of this application, the following capitalized terms have the following meaning:

   (a) "Act" means the *Competition Act.*

   (b) "AU" means Agricore United

   (c) "Cargill" means Cargill Limited

(d) "CGC" means the Canadian Grain Commission

(e) "CN" means the Canadian National Railway

(f) "Commissioner" means the Commissioner of Competition

(g) "CP" means the Canadian Pacific Railway

(h) "crop year" means the period commencing on August 1 in any year and terminating on July 31 in the next year

(i) "CWB" means the Canadian Wheat Board

(j) "CWB grain" means wheat and barley for export and for domestic human consumption

(k) "Diversion premium" means a premium paid by Integrated Graincos to Non-Integrated Graincos in order to attract that grain to the Integrated Grainco's port terminal.

(l) "Graincos" means grain companies

(m) "Hold Separate" means the Consent Interim Agreement registered with the Competition Tribunal.

(n) "Integrated Grainco" means a grain company which owns both primary elevators and a port terminal elevator on the west coast.

(o) "JV Agreements" means the series of agreements between SWP, JRI, 6362681

Canada Ltd. and 6362699 Canada Ltd. creating a joint venture for the joint operation and marketing of their Vancouver port terminal facilities.

(p) “JRI” means James Richardson International Limited

(q) “Non-CWB grains” means canola, lentils, peas, and other specialty crops.

(r) “Non-Integrated Grainco” means a grain company which may own a primary elevator but does not own a port terminal on the west coast.

(s) “Pacific” means Pacific Elevators Limited

(t) “Parties” means SWP, JRI, 6362681 Canada Ltd. and 6362699 Canada Ltd.

(u) “Port terminal” means an elevator located in a port, the principal uses of which are the receiving of grain on or after the official inspection and official weighing of the grain and the cleaning, storing and treating of the grain before it is moved forward.

(v) “PRG” means Prince Rupert Grain Ltd.

(w) “Primary grain elevator” means an elevator the principle use of which is the receiving of grain directly from producers for storage or forwarding or both.

(x) “ JV” means the proposed joint venture between SWP and JRI for the joint operation and marketing of their Vancouver port terminal elevators.

(y) “SWP” means Saskatchewan Wheat Pool Inc.

(z) "UGG" means the United Grain Growers Limited.

III. THE PARTIES

7. The Applicant is the Commissioner, appointed under section 7 of the Act and charged with the administration of the *Competition Act* ("the Act").

8. The Respondent, SWP, a publicly traded agri-business cooperative, has its head office in Regina, Saskatchewan. It provides a wide range of goods and services to farmers and to other grain handling companies in western Canada and also markets agricultural commodities domestically and internationally. SWP operates businesses in three distinct but related areas: (1) grain handling and marketing at both the port terminal and primary grain elevator levels, (2) agri-business (crop inputs) supplies and services and (3) agri-food processing. SWP operates 45 primary grain elevators in the Prairies and owns port terminals at Vancouver and Thunder Bay and an interest in a port terminal at Prince Rupert, British Columbia.

9. The Respondent, JRI, has its head office in Winnipeg, Manitoba, and is a subsidiary of James Richardson & Sons Limited, a privately owned corporation. Through various subsidiaries and affiliates, JRI operates businesses in: (1) grain handling and marketing at both the port terminal and primary grain elevator levels, (2) agri-business (crop inputs) supplies and services and (3) agri-food processing. JRI operates 66 primary grain

elevators in the Prairies and owns and operates port terminal facilities at Vancouver, Thunder Bay, Port Stanley and Hamilton and an interest in a port terminal at Prince Rupert, British Columbia.

10. Both SWP and JRI provide port terminal grain handling services at Vancouver and Thunder Bay. JRI's facilities in Hamilton and Port Stanley service their local areas.

IV. THE PROPOSED JOINT VENTURE

11. SWP and JRI, together with their affiliates, 6362681 Canada Ltd. and 6362699 Canada Ltd. ("the Parties"), have entered into a series of agreements[1] (collectively, the "JV Agreements"), dated April 6, 2005, creating a joint venture for the joint operation of their Vancouver port terminal facilities as well as the marketing of port terminal grain handling services to Non-Integrated Graincos.

12. SWP and JRI will each continue to own their respective facilities at Vancouver. However, the JV Agreements provide that a new business corporation, owned equally by SWP and JRI, would be established to act as a joint venture operator and agent for the parties. The JV operator would manage the operation of the Parties' Vancouver port terminals together, as if they were one terminal. The JV operator would also market the grain handling services offered at these terminals to Non-Integrated Graincos.

---

[1] A Shareholders' Agreement between SW P, JRI and 6362681 Canada Limited.; a Shareholders' Agreement between SW P, JRI and 6362699 Canada Limited.; and a Co-Production and Facility Management Agreement between SWP, JRI and 6362699 Canada Limited.

13. The Parties would continue to own and independently control all their remaining business assets including their respective:

    (a) whole or partial interests in primary grain elevator facilities;

    (b) whole or partial interests in port terminal facilities (including Prince Rupert and Thunder Bay); and

    (c) whole or partial agri-business interests (crop input supplies and services, etc.).

14. The Parties entered into a Consent Interim Agreement ("Hold Separate") with the Commissioner, which was registered with the Competition Tribunal on July 5, 2005, requiring the Parties to implement a Hold Separate relating to the marketing component of the proposed JV, pending the completion of the merger review by the Commissioner. The Hold Separate has been extended and is due to expire on November 10, 2005.

V. INDUSTRY OVERVIEW

15. The grain industry in Western Canada has a number of elements and various participants. They include:

    (a) Farmers, who produce grain; the vast majority of their grain for export is delivered to primary elevators located within a limited geographic area surrounding their farm;

(b) The CWB is by law the sole marketer of wheat and barley for export and domestic human consumption. These grains are referred to as "CWB grains". Wheat and barley sold for non-human consumption in Canada (e.g. livestock feed or ethanol production) are traded outside the jurisdiction of the CWB;

(c) Grain companies purchase grain at primary grain elevators from farmers. When purchasing CWB grain they act as agents for the CWB. The majority of all non-CWB grains (i.e., canola, lentils, peas, etc.) are purchased at primary grain elevators from farmers by grain handling companies on their own account at market prices. At primary elevators, the grain is elevated, graded, and segregated and may be cleaned, dried, blended and stored. Grain companies with ownership interests in both primary grain elevators and port terminals in Vancouver and Prince Rupert are hereinafter called "Integrated Graincos". Grain companies who do not own a port terminal in Vancouver or Prince Rupert are hereinafter called "Non-Integrated Graincos". SWP and JRI are thus Integrated Graincos;

(d) The railways (i.e., Canadian National Railway and the Canadian Pacific Railway) transport CWB and non-CWB grain from primary grain elevators to, among other places, port terminals located in Vancouver, Prince Rupert (only connected to CN), and Thunder Bay. Rail transportation charges account for about half the costs of handling and transporting grain destined for off-shore markets. The logistics (including incentives and disincentives) relating to the allocation and delivery by rail are complex and have an important impact on the competitive dynamic of the grain handling industry;

(e) Port terminals receive grain from the Prairies and earn fees for storage, elevation and, if necessary, blending and cleaning; and

(f) Ocean-going vessels onto which grain is loaded for export.

16. Integrated and Non-Integrated Graincos compete in purchasing farmers' CWB and non-CWB grains via their primary grain elevators. They do this through various activities, including pricing (discounts on service charges), grade promotions and by bundling trucking services with crop inputs. Non-Integrated Graincos require competitive access to west coast port terminals owned by Integrated Graincos in order to get their grain to market.

17. As Integrated Graincos earn revenue for elevating, storing, blending and cleaning wheat at their port terminals, they may seek to increase the volume of grain handled at their port terminals by offering financial inducements commonly referred to as "diversion

premiums”, a per tonne payment to Non-Integrated Graincos, paid in return for the Non-Integrated Graincos shipping their grain to the Integrated Graincos’ port terminal.

18. These diversion premiums are confidential and set out in grain handling contracts, the majority of which are between [CONFIDENTIAL] years in duration. They generally range from approximately $ [CONFIDENTIAL] to $ [CONFIDENTIAL] per tonne. The Non-Integrated Graincos receive diversion premium payments on both CWB and non CWB grains. The grain handling contracts also provide Non-Integrated Graincos contractual rights of access to port terminal.

19. For Non-Integrated Graincos to compete effectively with Integrated Graincos, it is essential that they have regular and predictable access to port terminal services.

Regulatory Environment

20. Aspects of the grain handling industry are regulated by the Canadian Grain Commission ("CGC") and the CWB pursuant to the *Canada Grain Act* and the *Canadian Wheat Board Act*, respectively.

Canadian Grain Commission

21. The CGC is responsible for establishing grain standards for grain sold domestically and for export. CGC inspectors monitor grain quality and assign official grades in respect of the grain delivered to port grain terminals. In order to respond to different customer

demands for specific quality characteristics of grain (primarily wheat) the CGC has, pursuant to section 16 of the *Canada Grain Act*, established in recent years an increasing number of grain "segregations", currently many hundreds, each of which is generally handled and stored separately. Segregations are made on the basis of factors such as the type of grain, the grade of grain and its protein content.

22. Pursuant to section 50 of the *Canada Grain Act,* tariffs for each service offered at any port terminal must be filed annually with the CGC and are publicly posted. Amended tariffs can also be filed during the year. However, the CGC is not required to approve the tariffs before they come into force and there is no complaint mechanism under the *Canada Grain Act* which permits shippers to challenge tariffs filed with the CGC. The CGC does not have any regulatory oversight relating to the payment of diversion premiums.

23. Pursuant to subsection 69(1) of the *Canada Grain Act*, licensed terminal elevators, including port terminals at the Port of Vancouver, are required to "receive into the elevator all grain so lawfully offered for which there is, in the elevator, available storage accommodation of the type required by the person by whom the grain is offered." Subsection 69(2) of that Act empowers the CGC to require the operator of a licensed terminal elevator to receive grain offered for storage or transfer at the elevator. However, in practice storage accommodation availability or refusal of terminal authorization is sometimes an issue and is not monitored by the CGC.

Canadian Wheat Board

24. The CWB is a farmer controlled marketing organization, incorporated pursuant to the provisions of the *Canadian Wheat Board Act*. It has exclusive jurisdiction over the purchase and sale of wheat and barley grown in western Canada and intended for export or domestic human consumption. All the sales revenue earned by the CWB, after deducting operating costs, is returned to the approximately 85,000 producers of CWB grains.

25. The CWB does not own any grain handling facilities in Canada, and it therefore relies on grain handling services and the facilities provided by both integrated and non-integrated companies. Port terminal grain handling services in the Port of Vancouver are essential to its operations.

Terminal Authorization

26. In order to obtain access to rail cars, the primary grain elevator operator must first obtain a port grain terminal authorization from a port grain terminal. Terminal authorizations to transport product to port may be denied if the port grain terminal is unable to accommodate further "unloads" of grain. The ability of port grain terminals to receive more grain relative to demand is subject to a number of variables such as seasonality, crop yield and vessel arrivals. The railway delivers rail cars to the terminal specified in the terminal authorization. However, in unforseen circumstances when the authorized

terminal cannot accept the grain, alternate arrangements may need to be made to have the grain delivered to another terminal.

VI. MARKET DEFINITIONS

Product Market

27. The relevant product market is port terminal grain handling services.

28. Port terminal grain handling services are a distinct product market without practical substitutes for the shipment of grain to international customers. The primary function of a Port grain terminal is the handling of grain for offshore exports. This can include elevation, cleaning, segregation, drying, storage, grading, blending and loading onto a vessel. Port grain terminals differ significantly from other port loading facilities in their physical characteristics, means of production, uses and pricing.

29. Grain is sometimes exported using shipping containers. There are a number of limitations on the use of containers including blending and grading issues, the availability of containers and container yard capacity. Transportation by containers represents only a small percentage of total grain exports.

30. Grain can also be transported by rail and then loaded directly from the rail car onto a waiting ship. This is usually referred to as a "direct hit" shipment. This requires extremely precise logistics including "just in time delivery" and vessel availability. This

method of shipping grain is only used for extremely small volumes and is not an acceptable substitute to port grain terminals because of the precise logistics required.

31. Vancouver Wharves operates a bulk handling terminal at the Port of Vancouver that handles grain and a variety of other commodities. With respect to grain products, it primarily handles specialty crops. However, Vancouver Wharves currently has no grain cleaning equipment. Vancouver Wharves only has 25,000 tonnes of licensed grain storage capacity, or approximately 2.7% of the licenced grain storage capacity at the Port of Vancouver compared to SWP's capacity of 237,240 tonnes and JRI's capacity of 108,000.

Geographic Market

32. Grain from western Canada that is to be exported outside of North America is shipped by rail to ports at Vancouver, British Columbia; Prince Rupert, British Columbia; Thunder Bay, Ontario; and Churchill, Manitoba. Canadian west coast ports are particularly well positioned for moving grain from the Prairies to Asia. In recent years, approximately 95% of all the bulk grain from western Canada destined for Asia has passed through the ports of Vancouver and Prince Rupert.

33. The draw areas for port terminals are determined primarily by relative freight and handling costs as between different routes/ports and the location of export demand. The dividing line between east and west for moving grain has tended to shift eastward in

recent years in response to the increase in demand from Asian countries. In certain circumstances, the CWB and grain companies ship grain to Vancouver from as far away as Manitoba.

34. Since the mid-1980s, Canada's traditional grain markets have shifted from Europe to Asia, which has resulted in a larger portion of export grain shipments going through the two Canadian west coast ports (Vancouver and Prince Rupert), as opposed to Thunder Bay and Churchill. In the 1984-85 crop year, the two Canadian west coast ports together accounted for less than 45 % of all the grain going through these four ports. In the 2003-04 crop year, Canadian west coast ports handled approximately 84 % of all the grain volume being exported through those same four ports.

35. Effective May 1, 2005, CN reduced its single car published rates for grain originating in western Canada and destined to Prince Rupert, making these rates equal to the published rates to Vancouver for all export grain movements in covered hopper cars. Since the Port of Prince Rupert is now rail cost competitive with the Port of Vancouver in relation to CN movements of grain, these two ports are now arguably within the same relevant geographic market.

VII. COMPETITIVE ANALYSIS

Canadian West Coast Port Terminals

36. On the West Coast, there are five port terminals in Vancouver and one at Prince Rupert. In Vancouver, the terminals are as follows:

(a) SWP terminal, with a licensed storage capacity of 237,240 tonnes, is wholly owned and operated by SWP;

(b) JRI terminal, with licensed storage capacity of 108,000 tonnes, is wholly owned and operated by JRI;

(c) Cascadia terminal, with 282,830 tonnes of licensed storage capacity. Cargill Limited ("Cargill") and Agricore United ("AU") each own 50% of Cascadia;

(d) Pacific Elevators Limited terminal ("Pacific") with 199,150 tonnes of licensed storage capacity. AU is the sole shareholder of Pacific, which owns and operates this terminal. SWP sold its 30% interest in Pacific in October 2002; and

(e) UGG terminal, with licensed storage capacity of 102,070 tonnes, is presently wholly owned and operated by AU[2].

Appendix "A" to this Statement identifies the locations of the foregoing port grain terminals in relation to the Greater Vancouver Region.

[2] The Consent Agreement requiring a divestiture of this terminal is currently being challenged by AU through an application filed with the Competition Tribunal on August 12, 2005, pursuant to section 106 of the *Competition Act*.

The Prince Rupert Grain Ltd. ("PRG") terminal, with licensed storage capacity of 209,510 tonnes, is operated under a co-tenancy agreement wherein as of August 1, 2004, AU had a 45.3 % interest, SWP had a 24.0 % interest, Cargill had a 15.8 % interest and JRI had a 14.9 % interest. The PRG terminal handles almost exclusively CWB grain. In recent years, it has only been open a portion of the year. It is currently planning to be open year round. It should be noted that all the owners of PRG have an equity interest in Vancouver terminals and earn greater revenues on grain moving through their Vancouver facilities where they are not required to share revenues with a number of other facility owners.

MARKET SHARES

37. The current capacity and receipts for the 5 Vancouver grain terminals is as follows:

Port Terminal Grain Handling Services at Vancouver (2003-2004 crop year)

Terminals	Ownership Interest	Receipts at Terminals		Storage Capacity	
		Tonnes	Share	Tonnes	Share
Cascadia	50% - AU 50% - Cargill	3347147	37%	282830	30.4%
UGG	100% AU	1039878	11%	102070	11%
Pacific	100% AU	510779	6%	199150	21.4%
SWP	**100% - SWP**	**2548888**	**28%**	**237240**	**25.5%**
JRI	**100% - JRI**	**1597344**	**18%**	**108000**	**11.6%**
Total		9044036	100%	929290	100%
Combined SWP/JRI		**4146232**	**46%**	**345240**	**37.1%**

38. SWP and JRI combined control 37% of the licensed storage capacity of grain terminals at the Port of Vancouver. In 2003-2004, SWP and JRI received 46% of the grain handled by the Vancouver port grain terminals.

39. In addition to the 929,290 tonnes of capacity provided by the Vancouver Port grain terminals, the PRG terminal has 209,510 tonnes of licensed storage capacity. However, PRG is not an independent competitor as it is owned jointly by all the current owners of the Vancouver port grain terminals. It should also be noted that the combined SWP and JRI ownership interest of PRG is 38.9%, a level almost equivalent to their combined share of the overall capacity of Vancouver port grain terminals.

40. The pre-JV Herfindahl-Hirschman Index ("HHI") for port terminal grain handling services in Vancouver is approximately 4024. The proposed JV would increase the HHI by over 1000 points to approximately 5032.[3]

Barriers to Entry

41. The barriers to entry to constructing a new port terminal in Vancouver are very high.

42. Capital costs for construction of a new port terminal elevator facility are high and would involve significant sunk costs. The numerous wheat segregations established by the CGC in response to demands for specific protein content and other quality measures, impose a

[3] These numbers are based on receipts (volume handled), with AU being the current owner of the UGG terminal and also having control of the Cascadia terminal.

need for considerable storage capacity which is costly to construct.

43. There is little or no land available upon which a new port terminal could be built in the port of Vancouver. Although Roberts Bank (located south of Vancouver) was, at one time, considered as a possible location for a grain handling terminal, its poor soil conditions would have significantly increased the cost of construction. Concern has also been raised over the potential for grain contamination from the nearby coal terminal.

44. As a result of the lack of suitable land in the port of Vancouver and the need for rail link access and ocean vessel berth access, the potential for entry of a new port terminal is very unlikely in the foreseeable future.

45. Entry of a new competitor in the market for port terminal grain handling services in Vancouver would likely, in the short term, only be possible through the acquisition of an existing terminal. Pursuant to a Consent Agreement between the Commissioner and UGG filed with the Competition Tribunal on October 17, 2002, AU was required to divest either the Pacific or the UGG port terminal to an arm's length purchaser. AU subsequently elected to divest the UGG port terminal. However, on August 12, 2005, AU filed an application to the Competition Tribunal seeking to rescind this obligation. If successful, this would relieve AU of the obligation to divest the terminal to a third party. The Commissioner is opposing this application. Until the Competition Tribunal disposes of the matter, it is not possible to know whether there is likely to be a sale of the UGG port terminal.

Removal of a Vigorous and Effective Competitor

46. In the context of a highly concentrated market JRI and SWP have been alternative providers of grain handling services for Non-Integrated Graincos at the Port of Vancouver. In recent years, certain large Non-Integrated Graincos have transferred their shipment volumes between the two.

47. Through the elimination of this competition, the proposed JV will result in less choice for Non-Integrated Graincos in shipping their grain. This would allow SWP-JRI to exercise market power, with the ability and incentive to introduce higher handling fees and lower diversion premiums.

Effective Remaining Competition

48. If SWP and JRI are permitted to implement the proposed JV, the only remaining effective competitor will be AU which owns the Pacific port terminal, the UGG port terminal, and a 50% interest in the Cascadia port terminal. The other 50% interest in Cascadia is owned by Cargill. The joint terminal ownership renders Cargill a less than effective competitor with respect to soliciting grain volume from Non-Integrated Graincos. **[CONFIDENTIAL]**

49. Therefore the proposed JV would increase concentration in an already concentrated market and, in the current market likely create, in effect, a duopoly in the supply of port terminal grain handling services at Vancouver and Prince Rupert. Even if AU is required by the Tribunal to divest the UGG port terminal, it would be necessary to assess at that time the

degree to which the purchaser would discipline the market power otherwise accumulated by the proposed JV.

50. PRG is not an effective competitor to the Vancouver port terminals for a number of reasons.

51. Because PRG is owned jointly by all of the Vancouver port terminal operators, there is considerably less incentive for it to compete vigorously against Vancouver port terminals. **[CONFIDENTIAL]**

52. Prince Rupert is only connected to the CN rail network, with CP originating grain shipments accounting for about half of all grain volume going to Vancouver. For grain originating on the CP rail network, it would be necessary to interchange the traffic between the two railways in order to ship to Prince Rupert. There have been no interchange movements of grain to Prince Rupert in recent years except during the lock-out in Vancouver in the fall of 2002, at which time CP cars were shipped to Prince Rupert.[4]

53. Furthermore, CP's current published rates to Prince Rupert are approximately 15% higher than its rates to Vancouver. Similarly, CP has published rates for the movement of grain from western Canada to Prince Rupert that are approximately 12 % higher than CN's published rates for the same originations. Clearly, Prince Rupert is not an alternative to

---

[4] Like PRG, the SWP and JRI terminals are only connected directly to the CN line. However, in this case, due to provisions of the *Canada Transportation Act,* it is economically feasible to deliver grain originating on a CP line to the North Shore port terminals via the Vancouver CN line.

Vancouver for all CP originating shipments of grain.

54. PRG is not configured to clean canola, the major non-CWB grain. During the last 20 years, PRG has handled an insignificant volume of non-CWB grain. The only exception was in the 2002-03 crop year when non-CWB grain accounted for 19% of all the grain volume handled by PRG. This was an unusual year, since there was a lock-out that took place in Vancouver during the Fall of 2002.

55. For all these reasons, the PRG port terminal is not an effective remaining competitor.

Foreign Competition

56. US port terminals in the Pacific North-West are not a close substitute for port grain terminal services at Canadian west coast ports. Rail rates are approximately $12 per tonne, or 37%, higher from western Canada to Portland or Seattle as compared to Vancouver.

Competitive effects

57. As noted above, the market for port terminal grain handling services is already highly concentrated. The proposed JV would effectively create an even more highly concentrated market and, possibly, a duopoly. The proposed JV is likely to reduce even further the level of effective competition in the relevant market, specifically, it will give rise to both unilateral and coordinated effects.

Unilateral Effects

58. A unilateral exercise of market power occurs where the merged entity can profitably sustain a material price increase without discipline from competitive responses by rivals. Factors indicating that unilateral exercise of market power is likely, in the case of the prroposed JV, include:

- The proposed JV would remove a service provider to whom buyers would otherwise turn in response to a price increase. As noted in paragraph 47 and 48 above, SWP and JRI have been alternative providers of grain handling services for Non-Integrated Graincos.

- The only significant remaining competitor is AU, which has a large market share. Because of its large market share AU has a reduced incentive to compete in response to a post-merger price increase.

59. As a result, it is likely that the proposed JV will increase the incentive to raise tariffs, reduce or eliminate diversion premiums, and reduce the incentive to provide timely terminal authorization and access to port terminal grain handling services.

<u>Coordinated Effects</u>

60. A merger results in coordinated effects when a group of firms is able to profitably coordinate its behaviour because of each firm's accommodating responses to the conduct of others. Market conditions are likely to allow coordinated behaviour in the west coast port terminal grain handling services market, which would be exacerbated if the proposed

JV is allowed.

61. The proposed JV changes the competitive dynamic by reducing the number of players in the market. As a result, firms in the market may find it easier and less costly to:

- raise tariff rates towards levels that would occur in a monopoly market;
- eliminate diversion premiums as a monopoly provider would; and
- reduce the timeliness of access in order to dampen competition from Non-Integrated Graincos in primary grain elevator markets.

Anti-competitive Effects

<u>SLC in Port Terminal Grain Handling Services</u>

62. The proposed JV between SWP and JRI at the Port of Vancouver is likely to prevent or lessen, competition substantially in the market for Canadian west coast port terminal grain handling services.

63. If SWP and JRI are permitted to proceed with their proposed JV, they will likely be able to exercise market power in the provision of grain handling services at the Port of Vancouver. The proposed JV would likely enable them to unilaterally increase prices charged to buyers of Vancouver port terminal grain handling services and/or lower diversion premiums paid to Non-Integrated Graincos. It is also likely to result in a

substantial lessening of competition by allowing the only two remaining firms with complete control of port grain terminal facilities in Vancouver to assume a position in which they can increase prices and/or reduce diversion premiums.

<u>Impact on Primary Grain Elevator Markets</u>

64. Farmers currently benefit from the fact that both Integrated and Non-Integrated Graincos compete in many primary grain elevator markets. If Non-Integrated Graincos experience greater difficulties in obtaining ready access to port terminal grain handling services or diversion premiums are reduced or eliminated, their per unit operating costs will be increased. This would reduce the incentive and ability for them to compete in primary grain elevator markets. That is, more concentration in the port terminal grain handling services market will likely lead to increased concentration in primary grain elevator markets.

65. An increase in concentration in primary grain elevator markets would likely result in a reduction in various competitive activities that benefit farmers, including pricing (discounts on service charges), grade promotions and the bundling of trucking services with crop inputs. It would also likely put upward pressure on tariffs in primary grain elevator markets, thereby increasing costs to the CWB and consequently reduce payments to grain farmers.

VIII. RELIEF SOUGHT

The Commissioner requests the following relief:

a) an Order or Orders against the Respondents pursuant to section 92 of the *Competition Act* dissolving the proposed JV, to the extent that it has taken effect;

b) an Order or Orders against the Respondents pursuant to section 92 of the *Competition Act* dissolving the proposed JV;

c) such further and other orders as may be appropriate.

IX. PROCEDURAL

The Commissioner requests that the hearing of this application be held in Ottawa, Ontario.

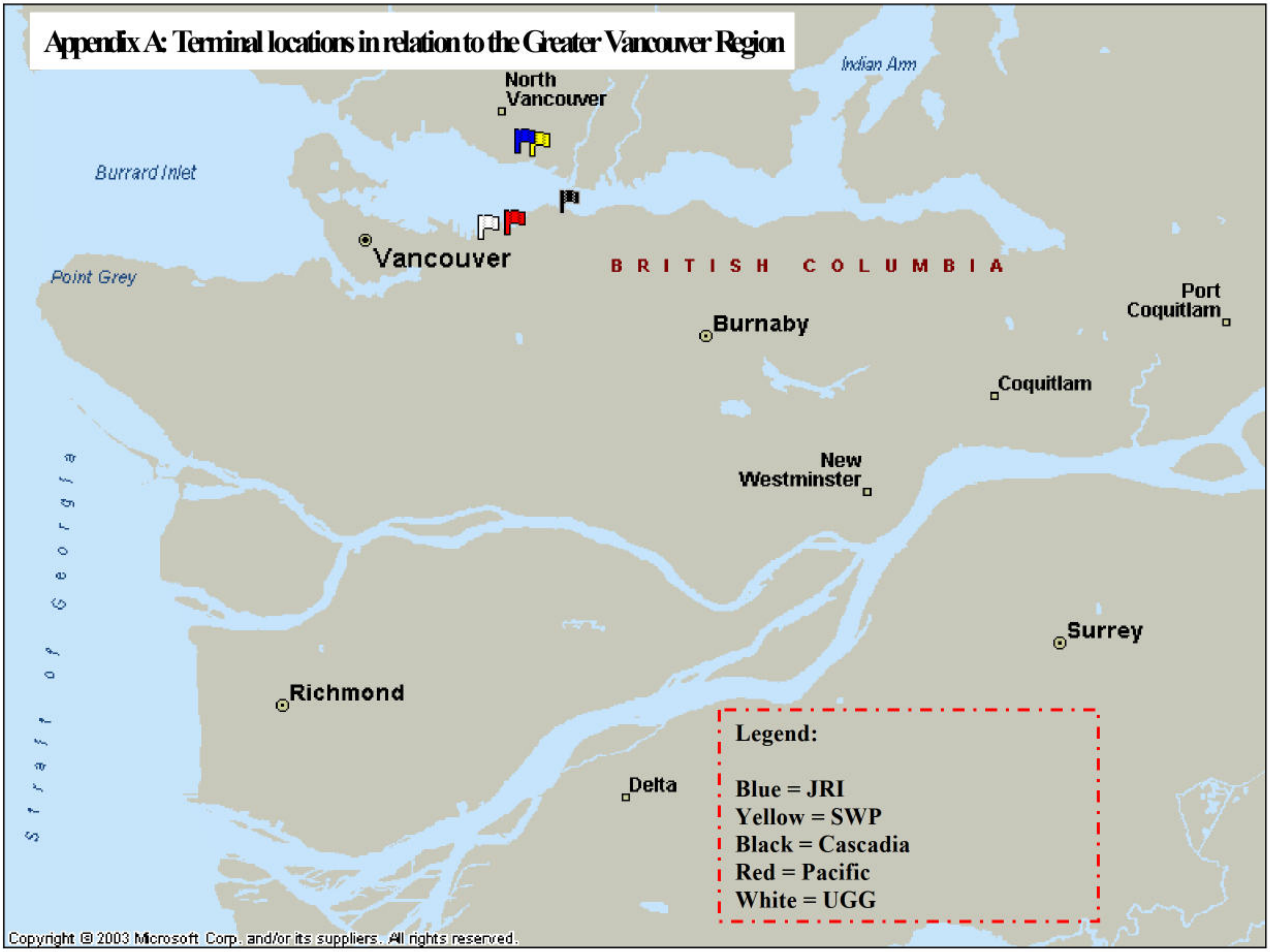
For purposes of this application, service of all documents on the Commissioner can be served on:

Mr. Jonathan Chaplan
Mr. André Brantz
Ms. Valérie Chénard
Department of Justice
Competition Law Division
50 Victoria Street
Place du Portage
Phase I, 22nd Floor
Hull, Quebec
KIA 0C9
Telephone (819) 953-3895
Facsimile (819) 953-9267

Counsel for the Commissioner of Competition

DATED at Gatineau, Quebec this 10th day of November, 2005.

Sheridan Scott Q, .C.
Commissioner of Competition
Place du Portage, Phase 1
21st Floor - 50 Victoria Street
Hull, Quebec
KIA OC9



Appendix A: Terminal locations in relation to the Greater Vancouver Region
Indian Arm
North Vancouver
Burrard Inlet
Vancouver
Point Grey
BRITISH COLUMBIA
Port Coquitlam
Burnaby
Coquitlam
New Westminster
Strait of Georgia
Surrey
Richmond
Delta
Legend:
Blue = JRI
Yellow = SWP
Black = Cascadia
Red = Pacific
White = UGG
Copyright © 2003 Microsoft Corp. and/or its suppliers. All rights reserved.


Appendix A: Terminal locations in relation to the Greater Vancouver Region
Indian Arm
North Vancouver
Burrard Inlet
Vancouver
Point Grey
BRITISH COLUMBIA
Port Coquitlam
Burnaby
Strait of Georgia
Richmond
Delta
Legend:
Blue = JRI
Yellow = SWP
Black = Cascadia
Red = Pacific
White = UGG
Copyright © 2003 Microsoft Corp. and/or its suppliers. All rights reserved.

502 F.Supp.2d 1
United States District Court,
District of Columbia.

FEDERAL TRADE COMMISSION, Plaintiff,
v.
WHOLE FOODS MARKET, INC., and Wild Oats Markets, Inc., Defendants.

Civil Action No. 07–1021(PLF).
|
Aug. 16, 2007.

Synopsis
Background: Federal Trade Commission (FTC) filed lawsuit seeking to enjoin largest operator of premium natural and organic supermarkets (PNOS) from acquiring closest competitor during the pendency of an administrative proceeding to be commenced by the FTC pursuant to Clayton Act and the Federal Trade Commission Act (FTCA). FTC moved for a preliminary injunction.

Holdings: The District Court, Paul L. Friedman, J., held that:

relevant product market was not the PNOS supermarkets, but rather, all supermarkets, and

FTC failed to show likelihood that it could prove that proposed acquisition could substantially lessen competition or tend to create a monopoly.

Motion denied.

Attorneys and Law Firms

***3** Michael Bloom, Amanda L. Wait, Catharine Mary Moscatelli, Eric Matthew Sprague, Marilyn E. Kerst, Matthew James Reilly, Reid Brian Horwitz, Thomas H. Brock, Thomas J. Lang, Federal Trade Commission, Washington, DC, for Plaintiff.

Alden Lewis Atkins, John Martin Faust, John David Taurman, Neil W. Imus, Vinson & Elkins, LLP, Paul H. Friedman, Rebecca Powers Dick, James A. Fishkin, Jeffrey W. Brennan, Michael D. Farber, Paul T. Denis, Dechert LLP, Gary Alan MacDonald, Skadden, Arps, Slate, Meagher & Flom, LLP, Washington, DC, Clifford Hank Aronson, Matthew P. Hendrickson, Thomas Pak, Skadden, Arps, Slate, Meagher & Flom, LLP, New York, NY, Terrence J. Wallock, Law Office of Terrence J. Wallock, Corona Del Mar, CA, for Defendants.

PUBLIC VERSION

PAUL L. FRIEDMAN, District Judge.

OPINION

This matter is before the Court on plaintiff's motion for a preliminary injunction.[1] Plaintiff, the Federal Trade Commission ("FTC"), filed this lawsuit on June 6, 2007 seeking to enjoin defendant Whole Foods Market, Inc. from acquiring defendant Wild Oats Markets, Inc. during the pendency of an administrative proceeding to be commenced by the FTC pursuant to Sections 7 and 11 of the Clayton Act, 15 U.S.C. §§ 18, 21, and Section 5(b) of the Federal Trade Commission Act ("FTCA"), 15 U.S.C. § 45(b). *See* Complaint at 2, 6.[2] The FTC believes that the acquisition of Wild Oats by Whole Foods "would violate Section 7 of the Clayton Act and Section 5 of the Federal Trade Commission Act because ***4** [it] may substantially lessen competition and/or tend to create a monopoly in the operation of premium natural and organic supermarkets across the United States." Complaint ¶ 15.

This lawsuit has been litigated on a very fast track. Fact discovery took place in the space of 30 days, expert reports were exchanged three days after the close of fact discovery, and rebuttal expert reports and expert depositions took place within nine days thereafter. Initial briefs were filed two days later and reply briefs five days after that. The Court held a two-day hearing six days later. The parties' respective economists, Dr. Kevin M. Murphy and Dr. David T. Scheffman, Jr., were examined by counsel and by the Court on July 31, 2007, and counsel presented their final arguments on the record in Court on August 1, 2007.

The evidence presented by the parties consists of: (1) transcripts of the testimony of 13 lay witnesses taken by the FTC at investigational hearings before it filed suit; (2) transcripts of the deposition testimony of 22 lay witnesses and five expert witnesses taken after suit was filed;[3] (3) the declarations of 16 lay witnesses submitted by defendants and of one lay witness submitted by plaintiff;[4] (4) the expert reports (and exhibits thereto) of five expert witnesses; (5) 19 volumes of exhibits submitted by plaintiff, consisting of approximately a total of 700 exhibits; (6) 27 volumes of exhibits submitted by defendants, consisting of 811 exhibits; and (7) the examination and cross-examination of two of the expert witnesses in Court—Dr. Kevin M. Murphy and Dr. David T. Scheffman, Jr. The Court has also considered the written and oral arguments presented by counsel and the exhibits and demonstrative exhibits used in connection with their arguments.

The fast track on which this litigation has proceeded has put immense pressure on counsel for the parties and their teams who, despite these pressures, have all acted professionally, civilly, effectively, and in a timely manner in presenting their evidence and argument. Unfortunately, the Court, too, has had to act under severe time constraints (and with fewer resources than counsel has had) in evaluating the evidence and arguments, reaching its decision and attempting quickly to articulate that decision in a reasonably thorough and comprehensible opinion—so as to provide the losing side (as the Court promised it would) sufficient time to proceed promptly to the court of appeals for a decision before the consummation of the proposed merger, scheduled for August 31, 2007.

For the reasons set forth in this Opinion, the Court will deny plaintiff's motion for a preliminary injunction.

I. BACKGROUND

Defendant Whole Foods Market, Inc. ("Whole Foods") is a Texas corporation which opened its first store in 1980. Whole Foods operates approximately 194 stores in North America and the United Kingdom. Defendant Wild Oats Markets, ***5** Inc. ("Wild Oats") is a Delaware corporation founded in 1987 and headquartered in Colorado. Wild Oats operates approximately 110 stores in the United States and Canada. Both firms are engaged in the business of selling grocery products, with an emphasis on natural and organic foods. In February 2007, the defendants announced that Whole Foods planned to acquire Wild Oats, and the two companies entered into a formal merger agreement on February 21, 2007.

The FTC alleges that the "operation of premium natural and organic supermarkets is a distinct 'line of commerce' within the meaning of Section 7 of the Clayton Act." Complaint ¶ 34. The FTC further alleges that Whole Foods and Wild Oats are "the only two nationwide operators of premium natural and organic supermarkets in the United States[,]" and "are one another's closest competitor in twenty-one geographic markets." *Id.* ¶¶ 37–38. According to the FTC, "[c]onsumers in those markets have reaped price and non-price benefits of competition between Whole Foods and Wild Oats." *Id.* ¶ 38. "[T]hose benefits will be lost if the acquisition occurs in the markets where the two currently compete and they will not occur in those markets where each is planning to expand." *Id.* ¶ 42.

II. LEGAL FRAMEWORK

Section 13(b) of the Federal Trade Commission Act provides:

> Whenever the Commission has reason to believe ... that any person, partnership, or corporation is violating, or is about to violate, any provision of law enforced by the Federal Trade Commission, and ... that the enjoining thereof pending the issuance of a complaint by the Commission and until such complaint is dismissed by the Commission or set aside by the court on review, or until the order of the Commission made thereon has become final, would be in the interest of the public ... the Commission ... may bring suit in a district court of the United States to enjoin any such act or practice.

15 U.S.C. § 53(b). "Upon a proper showing that, weighing the equities and considering the Commission's likelihood of ultimate success, such action would be in the public interest, and after notice to the defendant, a temporary restraining order or a preliminary injunction may be granted...." *Id.; see also FTC v. Libbey, Inc.,* 211 F.Supp.2d 34, 43 (D.D.C.2002). In contrast to the four-part equity standard for the granting of a preliminary injunction in other contexts, "[i]n deciding whether to grant preliminary injunctive relief under section 13(b), the court evaluates whether it is in the public interest to enjoin the proposed merger." *FTC v. H.J. Heinz Co.,* 246 F.3d 708, 713 (D.C.Cir.2001). "This standard is broader than the traditional equity standard that is normally applicable to requests for injunctive relief and is consistent with Congress' intention that injunctive relief be broadly available to the FTC." *FTC v. Libbey, Inc.,* 211 F.Supp.2d at 44 (quoting and citing *FTC v. Weyerhaeuser,* 665 F.2d 1072, 1080–81 (D.C.Cir.1981)) (internal quotations omitted).

"The FTC is not required to *establish* that the proposed merger would in fact violate section 7 of the Clayton Act." *FTC v. H.J. Heinz Co.,* 246 F.3d at 713 (emphasis in original) (citing *FTC v. Staples, Inc.,* 970 F.Supp. 1066, 1071 (D.D.C.1997) and *FTC v. Food Town Stores, Inc.,* 539 F.2d 1339, 1342 (4th Cir.1976) ("The district court is not authorized to determine whether the antitrust laws have been or are about to be violated. That adjudicatory function is vested in the FTC in the first instance.")); *see also FTC v. Swedish* ***6** *Match,* 131 F.Supp.2d 151, 155 (D.D.C.2000). It is required only to show that it is "likely" to succeed in showing under Section 7 of the Clayton Act that the proposed merger "may substantially lessen competition" or "tend to create a monopoly." 15 U.S.C. § 18; *see also FTC v. H.J. Heinz Co.,* 246 F.3d at 714; *FTC v. Libbey, Inc.,* 211 F.Supp.2d at 44; *FTC v. Staples, Inc.,* 970 F.Supp. at 1071 (citing cases). The FTC must show a "reasonable probability" that the proposed merger may substantially lessen competition in the future. *See FTC v. Arch Coal, Inc.,* 329 F.Supp.2d 109, 116 (D.D.C.2004); *FTC v. Swedish Match,* 131 F.Supp.2d at 156; *FTC v. Staples, Inc.,* 970 F.Supp. at 1072 (citing cases). "[T]he FTC's burden is not insubstantial, and '[a] showing of fair or tenable chance of success on the merits will not suffice for injunctive relief.' " *FTC v. Arch Coal, Inc.,* 329 F.Supp.2d at 116 (quoting *FTC v. Tenet Health Care Corp.,* 186 F.3d 1045, 1051 (8th Cir.1999)).

To meet its burden to establish its likelihood of success on the merits, the FTC may raise questions "going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC in the first instance and ultimately by the Court of Appeals." *FTC v. H.J. Heinz Co.,* 246 F.3d at 714–15 (citing, *inter alia, FTC v. Beatrice Foods Co.,* 587 F.2d 1225, 1229 (D.C.Cir.1978); *FTC v. Staples, Inc.,* 970 F.Supp. at 1071: *FTC v. Warner Communications, Inc.,* 742 F.2d 1156, 1162 (9th Cir.1984)) (internal quotations omitted). "[T]he FTC does not have to prove ... that the proposed merger will in fact violate Section 7 of the Clayton Act because the Congress used the words *may* be substantially to lessen competition ... to indicate that its concern was with probabilities, not certainties." *FTC v. Libbey, Inc.,* 211 F.Supp.2d at 44 (internal quotations and citations omitted); *see also FTC v. Staples, Inc.,* 970 F.Supp. at 1071 ("The FTC is not required to prove, nor is the Court required to find, that the proposed merger would in fact violate Section 7 of the Clayton Act.... The determination of whether the acquisition actually violates the antitrust laws is reserved for the Commission and is, therefore, not before this Court.").

"Merger enforcement, like other areas of antitrust, is directed at market power. It shares with the law of monopolization a degree of schizophrenia: an aversion to potent power that heightens risk of abuse; and tolerance of that degree of power required to attain economic benefits." *FTC v. H.J. Heinz Co.,* 246 F.3d at 713 (internal citations omitted). The Congress therefore has empowered the FTC "to weed out those mergers whose effect 'may be substantially to lessen competition from those that enhance competition.' " *Id.* (internal citations omitted). With respect to Section 7 of the Clayton Act, the D.C. Circuit has explained:

> Section 7 of the Clayton Act prohibits acquisitions ... "where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly." 15 U.S.C. § 18; *see United States v. Philadelphia Nat'l Bank,* 374 U.S. 321, 355, 83 S.Ct. 1715, 10 L.Ed.2d 915 (1963) ("The statutory test is whether the effect of the merger 'may be substantially to lessen competition' 'in any line of commerce in any section of the country.' "). The "Congress used the words '*may* be substantially to lessen competition' (emphasis supplied), to indicate that its concern was with probabilities, not certainties." ***7** *Brown Shoe Co. v. United States,* 370 U.S. 294, 323, 82 S.Ct. 1502, 8 L.Ed.2d 510 (1962) (emphasis original); *see* S.Rep. No. 1775, at 6 (1950), U.S.Code Cong. & Admin. News [1950] at 4293, 4298 ("The use of these words ["may be"] means that the bill, if enacted, would not apply to the mere possibility but only to the reasonable probability of the pr[o]scribed effect....").

FTC v. H.J. Heinz Co., 246 F.3d at 713 (parallel citations omitted) (brackets in original).

To reiterate, Section 7 deals "in probabilities, not ephemeral possibilities." *FTC v. Arch Coal, Inc.,* 329 F.Supp.2d at 115; *see also United States v. Sungard Data Systems,* 172 F.Supp.2d 172, 180 (D.D.C.2001). "To determine whether the FTC has met its burden of establishing a prima facie case that the proposed acquisition in this matter may violate the antitrust laws, this court must initially analyze the likely anti-competitive effects the merger would have." *FTC v. Libbey, Inc.,* 211 F.Supp.2d at 44–45 (internal quotations and citations omitted) (citing *FTC v. Staples, Inc.,* 970 F.Supp. at 1072–73); *see also FTC v. Swedish Match,* 131 F.Supp.2d at 156. "Analysis of the likely competitive effects of a merger requires determinations of (1) the relevant product market in which to assess the transaction, (2) the geographic market in which to assess the transaction, and (3) the transaction's probable effect on competition in the relevant product and geographic markets." *FTC v. Arch Coal, Inc.,* 329 F.Supp.2d at 117.

As Chief Judge Hogan has noted, "[a]s with many antitrust cases, the definition of the relevant product market in this case is crucial. In fact, to a great extent, this case hinges on the proper definition of the relevant product market." *FTC v. Staples, Inc.,* 970 F.Supp. at 1073; *see also FTC v. Swedish Match,* 131 F.Supp.2d at 156. The general rule when determining a relevant product market is that "[t]he outer boundaries of a product market are determined by the reasonable interchangeability of use [by consumers] or the cross-elasticity of demand between the product itself and substitutes for it." *Brown Shoe Co. v. United States,* 370 U.S. 294, 325, 82 S.Ct. 1502, 8 L.Ed.2d 510 (1962).

> Interchangeability of use and cross-elasticity of demand look to the availability of substitute commodities, i.e. whether there are other products offered to consumers which are similar in character or use to the product or products in question, as well as how far buyers will go to substitute one commodity for another. *E.I. du Pont de Nemours,* 351 U.S. [377, 393, 76 S.Ct. 994, 100 L.Ed. 1264 (1956)]. In other words, the general question is "whether two products can be used for the same purpose, and if so, whether and to what extent purchasers are willing to substitute one for the other." *Hayden Pub. Co. v. Cox Broadcasting Corp.,* 730 F.2d 64, 70 n. 8 (2d Cir.1984).

FTC v. Staples, Inc., 970 F.Supp. at 1074 (parallel citations omitted); *see also United States v. Sungard Data Systems,* 172 F.Supp.2d at 182; *FTC v. Swedish Match,* 131 F.Supp.2d at 157.

In addition to cross-elasticity of demand, courts also consider "practical indicia" such as "industry or public recognition of the [ ] market as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes and specialized vendors" when defining the relevant market. *Brown Shoe Co. v. United States,* 370 U.S. at 325, 82 S.Ct. 1502.[5] Courts do not ***8** apply these factors rigidly or exclusively, but rather use them as "practical aids" to ensure that the market definition comports with business reality. *FTC v. Swedish Match,* 131 F.Supp.2d at 159. Judge Bates has explained:

> "[O]nly examination of the particular market—its structure, history, and probable future—can provide the appropriate setting for judging the probable anticompetitive effects of the merger." Hence, antitrust theory and speculation cannot trump facts, and even Section 13(b) cases must be resolved on the basis of the record evidence relating to the market and its probable future.
>
> *FTC v. Arch Coal, Inc.,* 329 F.Supp.2d at 116–17 (internal citations omitted).

In this case, if the relevant product market is, as the FTC alleges, a product market of "premium natural and organic supermarkets" consisting only of the two defendants and two other non-national firms, there can be little doubt that the acquisition of the second largest firm in the market by the largest firm in the market will tend to harm competition in that market. If, on the other hand, the defendants are merely differentiated firms operating within the larger relevant product market of "supermarkets," the proposed merger will not tend to harm competition. As in *Staples,* "this case hinges"—almost entirely—"on the proper definition of the relevant product market." *FTC v. Staples, Inc.,* 970 F.Supp. at 1073.

The government also has the burden of proving the relevant geographic market. *FTC v. Tenet Health Corp.,* 186 F.3d at 1052. "A geographic market is that geographic area to which consumers can practically turn for alternative sources of the product and in which the antitrust defendant faces competition." *FTC v. Staples, Inc.,* 970 F.Supp. at 1073 (internal quotations omitted). It is the geographic area that would be adversely affected by the proposed acquisition. *United States v. Philadelphia Nat'l Bank,* 374 U.S. 321, 357–58, 83 S.Ct. 1715, 10 L.Ed.2d 915 (1963). As Judge Bates put it in *Arch Coal:*

> The relevant geographic market in which to examine the effects of a merger is "the region in which the seller operates, and to which the purchaser can practicably turn for supplies." *FTC v. Cardinal Health, Inc.,* 12 F.Supp.2d 34, 49 (D.D.C.1998) (citing *Tampa Elec. Co. v. Nashville Coal Co.,* 365 U.S. 320, 81 S.Ct. 623, 5 L.Ed.2d 580 (1961)). The Supreme Court has emphasized that the relevant geographic market must both "correspond to the commercial realities of the industry and be economically significant." *Brown Shoe [Co. v. United States],* 370 U.S. at 336–37[, 82 S.Ct. 1502] (internal citations omitted). The *Merger Guidelines* also provide guidance for determining the relevant geographic market. The geographic market should be delineated as "a region such that a hypothetical monopolist that was the only present or future producer of the relevant product at locations in that region would

> profitably impose at least a 'small but significant and nontransitory' increase in price, holding constant the terms of sale for all products produced elsewhere." *Merger Guidelines* § 1.21. If buyers would respond to the SSNIP by shifting to products produced outside the proposed geographic market, and this shift were sufficient to render the SSNIP unprofitable, then the proposed geographic market would be too narrow. *Id.*

***9** *FTC v. Arch Coal, Inc.,* 329 F.Supp.2d at 123 (parallel citations omitted). If the FTC shows that the merger may lessen competition in any one of the alleged geographic markets, it is entitled to injunctive relief. *See* 15 U.S.C. § 18.

After the relevant product and geographic markets have been established, the ultimate question under Section 7 of the Clayton Act is whether the proposed merger will have anticompetitive effect within those markets—that is, whether the effect of the merger "may be substantially to lessen competition" in the relevant market. 15 U.S.C. § 18. As the Supreme Court has noted, "clearly, this is not the kind of question which is susceptible of a ready and precise answer in most cases. It requires not merely an appraisal of the immediate impact upon competition, but a prediction of its impact upon competitive conditions in the future...." *United States v. Philadelphia Nat'l Bank,* 374 U.S. at 362, 83 S.Ct. 1715; *see Brown Shoe Co. v. United States,* 370 U.S. at 317, 82 S.Ct. 1502 (focus is on arresting anticompetitive mergers "in their incipiency"); *id.* at 323, 82 S.Ct. 1502 (Section 7 "deals in probabilities, not certainties"). "By focusing on the future, section 7 gives a court the uncertain task of assessing probabilities." *United States v. Baker Hughes Inc.,* 908 F.2d 981, 991 (D.C.Cir.1990).

The "law allows both sides to make competing predictions about a transaction's effects." *United States v. Baker Hughes Inc.,* 908 F.2d at 991. It does so by "shifting the burden of producing evidence." *Id.* As the D.C. Circuit has explained:

> In *United States v. Baker Hughes Inc.,* 908 F.2d 981, 982–83 (D.C.Cir.1990), [the D.C. Circuit] explained the analytical approach by which the government establishes a section 7 violation. First the government must show that the merger would produce "a firm controlling an undue percentage share of the relevant market, and would result in a significant increase in the concentration of firms in that market." [*United States v.] Philadelphia Nat'l Bank,* 374 U.S. at 363[, 83 S.Ct. 1715]. Such a showing establishes a "presumption" that the merger will substantially lessen competition. *See [United States v.] Baker Hughes [Inc.],* 908 F.2d at 982. To rebut the presumption, the defendants must produce evidence that "shows that the market-share statistics give an inaccurate account of the merger's probable effects on competition" in the relevant market. *United States v. Citizens & S. Nat'l Bank,* 422 U.S. 86, 120, 95 S.Ct. 2099, 45 L.Ed.2d 41 (1975). "If the defendant successfully rebuts the presumption of illegality, the burden of producing additional evidence of anticompetitive effect shifts to the government, and merges with the ultimate burden of persuasion, which remains with the government at all times." *Baker Hughes Inc.,* 908 F.2d at 983; *see also Kaiser Aluminum [and Chemical Corp. v. FTC],* 652 F.2d [1324,] 1340 & n. 12 [(7th Cir.1981)].

FTC v. H.J. Heinz Co., 246 F.3d at 715 (brackets, footnotes and parallel citations omitted).

The FTC generally can establish a *prima facie* case of anticompetitive effect by showing that "the merged entity will have a significant percentage of the relevant market." *FTC v. Swedish Match,* 131 F.Supp.2d at 166. In addition to market share, courts also must examine "market concentration and its increase as a result of the proposed acquisition." *Id.* As noted, the defendants can then rebut the presumption of anticompetitive effect by showing that the statistical data doesn't reflect reality in the relevant market. One factor that is an important consideration when analyzing possible anti-competitive ***10** effects is whether the acquisition "would result in the elimination of a particularly aggressive competitor in a highly concentrated market ..." *FTC v. Libbey, Inc.,* 211 F.Supp.2d at 47 (quoting *FTC v. Staples, Inc.,* 970 F.Supp. at 1083 (citation omitted)).

III. WHOLE FOODS, WILD OATS, AND THE PROPOSED MERGER

A. Whole Foods and Wild Oats

Whole Foods first opened its doors in 1980. Today it operates 194 stores in the United States, with a broad array of conventional, natural, organic, gourmet, prepared and specialty product offerings. Sud Decl. ¶¶ 14, 16, 17, 18. It also operates three stores in Canada; and six stores in the United Kingdom. PX01302 at 004; *see also* PX00011 at 003. Whole Foods currently employs over 39,000 people across its U.S. stores. DX 457 (Whole Foods 2006 10–K). Its operations in the United States are divided into eleven regions. Each region is headed by a regional president. Each regional president reports to one of the two Whole Foods' Co–Presidents and Chief Operating Officers.

Over two decades, Whole Foods has expanded by opening new stores and by acquiring several other premium natural and organic supermarkets: Blue Bonnet Natural Foods Grocery in 1984, Whole Food Company in 1988, Wellspring Grocery in 1991, Bread & Circus in 1992, Mrs. Gooch's in 1993, Bread of Life (San Francisco) in 1995, Unicorn Village in 1995, Oak Street Market in 1995, Fresh Fields in 1996, Granary Market in 1997, Bread of Life (Florida) in 1995, Merchant of Vino in 1997, Nature's Heartland in 1999, Food 4 Thought Natural Food Market and Deli in 2000, Harry's Farmers Market in 2001, and Whole Grocer in 2006. Murphy Report ¶ 25; JX 40 at 32–33:23–5 (Chamberlain Dep.).

Most competitive decisions at Whole Foods—including decisions with respect to pricing—are made at the regional level under the supervision of Whole Foods' regional presidents. Sud Decl. ¶¶ 7–9; Allshouse Decl. ¶ 5; Besancon Decl. ¶ 2; Bradley Decl. ¶¶ 1–3; Lannon Decl. ¶ 4; Megahan ¶ 23; Meyer Decl. ¶ 3; Paradise Decl. ¶ 4; JX 41 at 51–52 (Foster I.H.).

Whole Foods has articulated five "Core Values" that it emphasizes "reflect what is truly important to us as an organization." Among these is "selling the highest quality natural and organic products available." PX01302 at 006. Its stores typically stock around 30,000 stock keeping units ("SKUs") of natural and organic products. PX00182 at 004; PX01333 at 003. Whole Foods has evolved from a health food store into a supermarket. Whole Foods' new stores typically range in size between 50,000 and 60,000 square feet. DX 457 (2006 Whole Foods 10–K). Its 92 stores in development average 54,500 square feet. Sud Decl. ¶ 18. Whole Foods currently operates four stores in excess of 65,000 square feet and has an additional 17 stores of that size in development. DX 457. Whole Foods' stores now carry a wide variety of conventional products, everyday value private label items, and premium and gourmet offerings. Many of these items are not organic, including more than half of the produce Whole Foods sells and a significant portion of its prepared foods, bakery, and specialty items. Sud Decl. ¶¶ 17, 25.

Wild Oats is headquartered in Boulder, Colorado and operates 115 stores in the United States, under three different banners: Wild Oats Marketplace (nationwide), Henry's Farmers Market (in Southern California), and Sun Harvest (in Texas). DX 494 at 3 (2006 Wild Oats 10–K). It ***11** also has stores in British Columbia, Canada, under the name Capers Community Market. PX00613 at 005, 027; PX2705. Wild Oats says it is committed to selling the "best variety of high-quality products made with wholesome ingredients." PX00601 at 003. Wild Oats sells a large array of natural and organic products that appeal to "health-conscious shoppers," and include "dry groceries, produce, meat, poultry, seafood, dairy, frozen, prepared foods, bakery" offered in a manner "that emphasizes customer service." PX00613 at 005.

Wild Oats has expanded over the past two decades by opening new stores and acquiring several other premium and organic supermarkets: Alfalfa's Markets in 1996, Henry's Marketplace stores in 1999, Sun Harvest stores in 1999, and Natures stores in 1999. PX04449 at 047; PX04449 at 002. The average square footage of Wild Oats' stores today are less than 25,000 square feet. DX 807 (Wild Oats Response to Spec. 2 of FTC's Second Request).

B. The Proposed Merger and the FTC's Response

On February 21, 2007, Whole Foods and Wild Oats executed an Agreement and Plan of Merger ("Agreement"), pursuant to which Whole Foods would commence a tender offer for all of Wild Oats stock at a price of $18.50 per share. DX 811 (Agreement and Plan of Merger). At this share price, the total price of the transaction would be approximately $565 million.[6] The parties have agreed to close the transaction contemplated by the Agreement on or before August 31, 2007. Sud Decl. ¶ 45. After the merger, Whole Foods plans to close a number of Wild Oats stores. Murphy Report ¶ 22.4. It also will sell off all 35 Henry's and Sun Harvest stores (located in California and Texas) to be acquired from Wild Oats. PX00329.

On February 26, 2007, Whole Foods filed its Premerger Notification and Report Forms with the Federal Trade Commission and the Department of Justice. On June 5, 2007, the FTC authorized its staff to seek both a temporary restraining order and a preliminary injunction to prevent Whole Foods from acquiring Wild Oats pending the outcome of an administrative trial under Section 7 of the Clayton Act and Section 5 of the Federal Trade Commission Act.

On June 6, 2007, the FTC filed a complaint in this Court seeking a temporary restraining order and preliminary injunction to halt the transaction pending an administrative trial on the merits. On June 7, 2007, with the consent of the parties, the Court entered a temporary restraining order to delay completion of the transaction until the Court could rule on the motion for a preliminary injunction.

IV. THE EXPERT WITNESSES

The Federal Trade Commission proffered two expert witnesses: Dr. Kevin M. Murphy, an economist, and Dr. Kent Van Liere, a sociologist. The defendants proffered three expert witnesses: Dr. David T. Scheffman, Jr., an economist; Dr. John L. Stanton, an expert in food marketing; and Ms. Kellyanne Conway, a polling expert.

Dr. Murphy is the George J. Stigler Distinguished Service Professor of Economics at the University of Chicago Graduate School of Business. PX02878 at 002. Dr. Murphy has a doctorate degree in economics from the University of Chicago. His undergraduate degree from UCLA is ***12** also in economics. *Id.* at 006. He teaches courses and publishes "in a variety of areas in economics." *Id.* Dr. Murphy has consulted in the area of antitrust for over 20 years. He has worked on over 50 antitrust cases. PX02878 at 007.

Dr. Murphy is a Fellow of the Econometric Society and is a member of the American Academy of Arts and Sciences. PX02878 at 007. In 1997, he was awarded the John Bates Clark medal for economics. *Id.* In 2005, Dr. Murphy received a five-year unrestricted research award from the MacArthur Foundation in recognition of his past contributions and potential future contributions to economics. *Id.*

Dr. Scheffman is an Adjunct Professor of Business Strategy and Marketing, Owen Graduate School of Management, Vanderbilt University, and a Director with LECG, LLC. Scheffman Report ¶ 1 and App. A at 1. He has twice served as Director of the Bureau of Economics at the Federal Trade Commission, most recently from 2001 to 2003. *Id.* at 1 & 3. He is an expert in the fields of economics, microeconomics, industrial organization economics, antitrust economics (including mergers), econometrics, statistics, marketing, financial analysis, and retailing. Scheffman Report ¶¶ 3–6, 13, 16.

Dr. Scheffman has experience analyzing the competitive and efficiency benefits of mergers. Scheffman Report ¶ 16. This experience, and experience from private economics consulting, includes extensive work involving the supermarket industry. JX 18 at 21–24 (Scheffman Dep.). The FTC invited Dr. Scheffman to speak at its May, 2007, conference on "Grocery Store Antitrust: Historical Retrospective & Current Developments." PX 322; Scheffman Report, Appendix A at 7; JX 18 at 38–39 (Scheffman Dep.).

Dr. Stanton is Professor of Food Marketing at Saint Joseph's University in Philadelphia, Pennsylvania. He received his Ph.D. in marketing from Syracuse University. He has been in the food industry for over 30 years. His research and consulting has been in both the retail side and the supplier side of food marketing. Stanton Report ¶ 4. Dr. Stanton previously held the first endowed chair in food marketing in the United States, entitled the C.J. McNutt chair in food marketing research, from 1985 to 1995. Stanton Report ¶ 6.

Dr. Stanton teaches a variety of food marketing courses in both the B.S. and M.S. programs including Food Marketing Strategy, Target Marketing in the Food Industry, Segmentation and Positioning, and Food Marketing Advertising. His M.S. courses include elements of both retail food marketing and food service marketing. Stanton Report ¶ 5. Dr. Stanton has authored or co-authored 57 articles in refereed journals and has published several industry books. Stanton Report Appendix A. Dr. Stanton has also been the editor of the Journal of Food Products Marketing since 1994. Stanton Report Appendix A.

Dr. Stanton testified regarding his knowledge of the store formats and operations of the following chains: Sunflower, Kroger, Supervalu, Albertson's, Shaw's, Jewel, Safeway, Wal–Mart, Target, Giant Food, Food Lion, Hannaford, Bloom, Whole Foods, Wegmans, Wild Oats, Meijer, HEB, Central Market, Publix, Shop Rite, Harris Teeter, Price Chopper, Giant Eagle, A & P, Food Emporium, Waldbaum's, Pathmark, Trader Joe's, Tesco, Byerly's/Lund's, and Andronico's. *See* JX 19 at 123–167 (Stanton Dep.).

Ms. Conway and her firm, the polling company, inc., were commissioned by defendants to conduct a survey that would support Dr. Scheffman's report and would corroborate his analysis. Scheffman Report ***13** 159; PX02066 at 023; JX 20 at 7:16–20; 8:20–9:2 (Conway Dep.).

Dr. Van Liere was retained by the Federal Trade Commission to review and evaluate the survey conducted by Ms. Conway. Van Liere Report (PX02890–002) ¶ 2. Dr. Van Liere has an M.A. and a Ph.D. in Sociology from Washington State University where he specialized in social psychology and research methods and statistics, including survey research. Van Liere Report ¶ 4. From 1978 to 1985, he served as an Assistant, then Associate Professor with tenure, at the University of Tennessee, where he taught classes in attitudes and opinions, survey research, research methods and statistics. *Id.* He also regularly publishes academic research in leading journals based on data collected using surveys. *Id.* Dr. Van Liere has published papers in peer-reviewed journals and monographs on a range of topics involving surveys. Van Liere Report ¶ 8.

After reviewing Ms. Conway's report and the survey backup materials, Dr. Van Liere concluded that her survey methodology and procedures were fundamentally flawed, which rendered her data and results unreliable. Van Liere Report ¶ 3. The Court agrees with Dr. Van Liere. It therefore will not give Ms. Conway's report any weight or consideration in evaluating the evidence before it.[7]

The FTC also maintains that the reports of Dr. Stanton, also submitted on behalf of defendants, are entitled to no weight. The Court disagrees. Plaintiff criticizes Dr. Stanton's report for not analyzing the facts of this case, but rather discussing the food retailing industry more generally. The Court notes, however, that the state of the industry itself is an important factor in a case like this. *See supra* at 7–8; *infra* at 15; *see also FTC v. Arch Coal, Inc.,* 329 F.Supp.2d at 116–17, and Dr. Stanton is a recognized expert in this field. For that reason, the Court found Dr. Stanton's report to be helpful and will rely on it as appropriate. The Court also notes that plaintiff could have offered its own industry expert or rebuttal to Dr. Stanton's report, and chose not to do so.

The defendants and Dr. Scheffman criticize the methodology utilized by Dr. Murphy and the bases for his opinions and conclusions. The FTC and Dr. Murphy criticize the methodology, opinions and conclusions of Dr. Scheffman.

The defendants criticize Dr. Murphy because he has not conducted any direct test of whether Wild Oats imposes unique constraints on Whole Foods that will disappear as a result of the proposed transaction. They also criticize him for analyzing and relying upon Whole Foods' banner entries in certain markets and its impact on Wild Oats, without examining the effects of either banner entry or (the more relevant) banner exit by Wild Oats on Whole Foods, because Whole Foods will be the surviving company if this deal is consummated.

Because a central concern of the Merger Guidelines is with the impact of competition on prices, the defendants also criticize Dr. Murphy for relying on margins rather than on prices. They maintain that Dr. Murphy's reliance on analyses of margins is not based on sound methodology in economics, accounting, and financial analysis. *See* Scheffman Rebuttal Report ¶ 15. They argue that any effects inferred from margins, however defined and estimated, are relevant only if a valid inference can be made about prices from margins. Defendants ***14** and their experts maintain that in this case reliable inferences about prices cannot be made from margins alone. *See* Scheffman Rebuttal Report ¶ 16.

The defendants also argue that Dr. Murphy's analyses of the effect of Whole Foods' entry on Wild Oats net sales, margin and prices do not control for the pricing or promotional strategies of all other supermarkets in response to Whole Foods' entry. Instead, Dr. Murphy includes the responses of competitors to Whole Foods' entry, and the effects caused by those competitors, as effects caused by Whole Foods. *See* JX 26 at 233 (Murphy Dep.); *see also* Scheffman Rebuttal Report ¶ 10 ("Dr. Murphy's analysis of why competitive effects implicitly but importantly *assume* that non-PNOS competitors are not significant factors impacting the competition between [Whole Foods] and [Wild Oats]....").

Defendants criticize Dr. Murphy for inferring the price effect of a Wild Oats exit by equating that event with a Whole Foods entry in reverse—that is, Dr. Murphy's "exit" analysis assumes that the effect of a Wild Oats exit would be exactly the same as a Whole Foods entry, albeit in the opposite direction. Where multiple firms enter simultaneously, Dr. Murphy's regression analysis does not permit one to tell which of the firms is causing how much of the effect on Wild Oats' margins, net sales, and prices. *See* JX 26 at 228 (Murphy Dep.).

Fundamentally, the defendants maintain, Dr. Murphy's analyses study the wrong events. He analyzes the effects of Whole Foods' banner entry on Wild Oats when he should be looking at the price effects of Wild Oats exits. July 31 a.m. Hearing Tr. at 23–24, 26 (Scheffman); Scheffman Rebuttal Report ¶ 41. According to the defendants, the effect of Whole Foods' banner entry on Wild Oats' prices, margins or sales does not directly test whether Wild Oats imposes any constraint on Whole Foods. July 31 a.m. Hearing Tr. at 28–30 (Scheffman); *see* Murphy Report ¶ 63.

Finally, the defendants maintain that Dr. Murphy's study of five Whole Foods' entry events into Wild Oats "markets" was in fact based on only two areas (West Hartford, Connecticut and Fort Collins, Colorado), Murphy Report ¶ 58; Scheffman Rebuttal Report ¶ 56, only one of which offers sufficient post-entry "price" and volume data to discern a time-pattern of effects. Murphy Report ¶ 57; July 31 a.m. Hearing Tr. at 71–72 (Murphy). In the end, defendants maintain, Dr. Murphy's analysis of the effect of Whole Foods banner entry on Wild Oats' prices really comes down to his analysis of Hartford, Connecticut, and even there, he failed to account for all relevant variables, such as partial shrink, the idiosyncratic price observations for the salad bar, and the simultaneous entry of Trader Joe's.

The FTC has equally vigorous criticisms of Dr. Scheffman and his analysis. One of the FTC's criticisms of Dr. Scheffman is that he used a 5% standard for what constitutes a "small but significant non-transitory increase in price" ("SSNIP") under the Merger Guidelines, even though he accepts and recently publicly opined that smaller SSNIP's are more appropriate for mergers in low net margin industries like supermarkets. *See* Murphy Rebuttal Report ¶ 4; PX00322 at 132.

The FTC also criticizes Dr. Scheffman's "critical loss" analysis. It maintains that while Dr. Scheffman concludes that the actual loss for a hypothetical premium natural and organic food supermarket ("PNOS") monopolist would "greatly exceed" or "swamp" the critical loss thresholds, Dr. Scheffman actually only "assumes" what the actual loss would be and ***15** provides no quantitative evidence for the magnitude of the actual loss that could be compared to these thresholds, and no methodology for calculating the actual loss. Murphy Rebuttal Report ¶¶ 10–11.

Finally, the FTC criticizes Dr. Scheffman for basing his pricing analysis on item-specific register prices at Whole Foods stores on a *single day* in June of 2007. The FTC maintains that an analysis of a single day's pricing, even if otherwise well done, cannot provide the basis for any reliable conclusions. It criticizes Dr. Scheffman for extrapolating from this single day to reach a variety of conclusions about pricing generally. The FTC also says Dr. Scheffman's conclusions about pricing are also inconsistent with econometric evidence on Whole Foods' margins, which vary across stores according to the presence or absence of local competition from Wild Oats. Murphy Rebuttal Report ¶ 47.[8]

V. RELEVANT PRODUCT MARKET

As noted above, and as was the case in *Staples,* "the definition of the relevant product market in this case is crucial. In fact, to a great extent, this case hinges on the proper definition of the relevant product market." *FTC v. Staples, Inc.,* 970 F.Supp. at 1073. The FTC believes the relevant product market is premium natural and organic supermarkets ("PNOS"), of which it alleges there are four in the entire country—Whole Foods (the largest), Wild Oats (the second largest), Earth Fare (with 13 stores in only four states), and New Seasons (with eight stores, all in Oregon). Defendants Whole Foods and Wild Oats believe that the relevant product market is one that includes all supermarkets. "[O]nly examination of the particular market—its structure, history, and probable future"—how it operates in the real world—can provide the appropriate setting for determining the relevant product (and geographic) market and for judging the probable anticompetitive effects of a merger or acquisition. *FTC v. Arch Coal, Inc.,* 329 F.Supp.2d at 116–17. Antitrust theory "cannot trump facts, and even Section 13(b) cases must be resolved on the basis of the record evidence relating to the market and its probable future." *Id.*

The Court looks first at the Horizontal Merger Guidelines and the testimony and reports of the economic experts and then examines what the evidence shows is really happening in the marketplace.

A. The Horizontal Merger Guidelines and the Economic Evidence

The Horizontal Merger Guidelines issued by the Department of Justice and the Federal Trade Commission in 1992, and revised in 1997 ("Merger Guidelines"), articulate the analytical framework the Justice Department and the FTC apply in determining whether a merger is "likely substantially to lessen competition." Merger Guidelines § 0.1. Under the Guidelines, as under the case law, the relevant product market is determined according to the "reasonable interchangeability of use" or cross-elasticity of demand between the product sold and "substitutes for it." Merger Guidelines §§ 1.0, 1.11; *Brown Shoe Co. v. United States,* 370 U.S. at 325, 82 S.Ct. 1502. The analytical framework set forth in the Merger Guidelines approaches the inquiry regarding the reasonable interchangeability of use or cross-elasticity of demand by asking whether a "hypothetical monopolist ... ***16** would profitably impose at least a 'small but significant and nontransitory [price] increase' " ("SSNIP"). Merger Guidelines § 1.11.[9] Reasonable interchangeability of use in effect means "substitutability"—the practical ability of a consumer to switch from one product to another. *See Rothery Storage & Van Co. v. Atlas Van Lines, Inc.,* 792 F.2d at 218–19; *FTC v. Arch Coal, Inc.,* 329 F.Supp.2d at 119–20; *FTC v. Swedish Match,* 131 F.Supp.2d at 158. The forward-looking test of the Horizontal Merger Guidelines therefore asks where customers would turn if a hypothetical monopolist of the candidate product imposed a SSNIP. Merger Guidelines § 1.11.

As the FTC explained it, the issue is whether there is a group of customers for whom there are not sufficiently close substitutes that a price increase—a "small but significant nontransitory increase in price"—can be inflicted on them. Aug. 1 a.m. Hearing Tr. at 42 (Bloom). If there are alternatives to which customers could readily take their business such that the price increases would not be profitable for the hypothetical monopolist, the proposed product market is too narrow and additional alternatives must be included in the relevant product market, even if customers did not view them as substitutes at the lower price.

In order to determine which products should be included in the relevant product market, the Guidelines methodology begins with each of the products sold by the two firms in question and then performs the hypothetical monopolist test. If a hypothetical firm that was the sole seller of a given set of products would find it profitable to impose a small but significant non-transitory increase in the price of any of those products, then the given set of products satisfies the relevant product market test. If not, then the product which is the next best substitute (defined in the Guidelines as the product that gains the largest share of the revenue diverted by a price increase) is added. Merger Guidelines § 1.11. The test is then repeated. Products are added sequentially in this way until a sole seller would find it profitable to increase price by the amount deemed to be "small but significant." Murphy Report ¶ 96.[10]

Because the FTC contends that the relevant market is "premium and natural organic supermarkets" ("PNOS"), Dr. Scheffman applied the hypothetical monopolist test by focusing on how consumers likely would behave if the price of grocery products in PNOS rose relative to the price of grocery products in other supermarkets. JX 18 at 33–34, 49 (Scheffman Dep.); Scheffman Report ¶ 49. He stated that the economic implication of this framework is that product market definition must focus its attention on "consumers at the margin" rather than consumers who are "inframarginal." Scheffman Report ¶¶ 50, 99; *see* JX 18 at 95 (Scheffman Dep.).[11]

***17** A marginal consumer is someone who would switch where he or she shops in response to a SSNIP—that is, if his supermarket of choice imposed a small but significant and nontransitory price increase. According to Dr. Scheffman, in the context of supermarkets—including premium natural and organic supermarkets—such marginal consumers can switch or divert their purchases in any of three ways. First, they can reduce the size of their shopping basket at one supermarket and substitute by buying the same or similar items at another retailer—if that other retailer offers similar products for sale. Second, from the set of supermarkets that the consumer currently frequents, the consumer can switch a particular shopping trip from one supermarket to another. Third, the consumer can change retailers by deciding to no longer frequent a particular supermarket that the consumer no longer believes offers good quality for value. Scheffman Report ¶ 51.

Dr. Scheffman concludes that firms compete to retain existing business and win new business by competing for marginal consumers. It is these consumers who are susceptible to being won or retained by offering better prices, improved service, higher quality or more diverse product offerings. Scheffman Report ¶ 52. Supermarket retailers make their pricing, quality and service decisions in ways designed to retain and attract marginal consumers. While businesses value "core" customers, they simply "cannot survive—let alone grow and remain profitable—solely by catering to this small segment of customers." Scheffman Report ¶ 55. The appropriate focus for defining the relevant product (and geographic) market therefore is those marginal consumers. Dr. Scheffman concludes that the "marginal" consumer, not the so-called "core" or "committed" consumer, must be the focus of any antitrust analysis. Aug. 1 p.m. Hearing Tr. at 74–76 (Denis). He believes that this is consistent with the analytical framework set out in the Merger Guidelines. Scheffman Report ¶ 53. The Court agrees.

Dr. Scheffman used critical loss analysis to analyze the FTC's proposed product market. As the FTC acknowledges, this is a widely accepted analytical tool in antitrust cases both to analyze market definition and competitive effects. Scheffman Report ¶ 100; JX 18 at 33–34 (Scheffman Dep.); *see also* Aug. 1 a.m. Hearing Tr. at 64 (Bloom) (FTC agrees). That is because critical loss is implicit in the hypothetical monopolist test. Scheffman Report ¶ 100. The latter tests whether a SSNIP would be profitable over a candidate product; critical loss analysis assesses how much substitution in response to a SSNIP could occur before a SSNIP becomes unprofitable. Scheffman Report ¶ 110. To put it another way, SSNIP tests at what price increase a consumer will switch where he or she shops; critical loss tests at what point a purveyor's price increases lead to a sufficient amount of lost sales (and lost customers) that the economic loss exceeds the gain from having raised prices (the "critical" loss).

Critical loss analysis stems from the recognition that for almost any product, a price increase results in some lost sales as consumers make do with less, switch to other suppliers, or substitute other products. There is a profit detriment to the price increase equal to the product of the per unit gross margin and the number of units lost. But there is also an economic gain from the increased gross margin ***18** earned from the higher price on each remaining unit sold. The "critical loss" is the amount of lost sales at which the economic detriment equals the economic gain. It is a "critical" loss because any greater loss will result in the economic detriment exceeding the economic gain, thereby rendering the price increase unprofitable. Scheffman Report ¶ 96.

The application of the critical loss technique to market definition is a three step process. The first step is to estimate the incremental margin (gross margin) and determine the volume the hypothetical monopolist (or merged entity) would have to lose to render the price increase unprofitable (*i.e.,* the critical loss). The second step is to separately estimate what the actual loss in volume is likely to be as a result of the hypothesized price increase (*i.e.,* the estimated "actual loss"). The last step is to compare the estimate of the actual loss with the critical loss. If the actual loss is greater than the critical loss, the product market definition must be expanded. Scheffman Report ¶ 112.

In calculating critical loss, Dr. Scheffman originally used a SSNIP of 5% across all products sold by "premium natural and organic supermarkets." This is the SSNIP used in most contexts under the Merger Guidelines and (according to Dr. Scheffman) traditionally used by the FTC in supermarket mergers. JX 18 at 34–37 (Scheffman Dep.). As the FTC has pointed out, however, a lower SSNIP is sometimes used. *See also* Merger Guidelines § 1.11. According to the FTC, Dr. Scheffman himself has acknowledged that a 1% SSNIP may be appropriate to analyze markets characterized by high volume sales but low profit margins. *See* PX0322 at 132 (May 2007 remarks of Dr. Scheffman at an FTC conference); Scheffman Report ¶ 114.

Whole Foods has an average gross margin at the store level of approximately [Redacted] A 5% price increase implies a critical loss for Whole Foods of about [Redacted] in volume. Wild Oats stores typically have a gross margin at the store level of about [Redacted] or less. A 5% price increase implies a critical loss for Wild Oats of about [Redacted] in volume. Scheffman Report ¶ 115. In response to Dr. Murphy's report and the FTC's criticism of his use of a 5% SSNIP, Dr. Scheffman also did exactly the same analysis again but this time calculated critical loss for a 1% SSNIP. Critical loss for Whole Foods at that price increase would be a little over [Redacted] in volume—that is, if the hypothetical monopolist lost a little over [Redacted] of its sales, then a 1% SSNIP would not be profitable. JX 18 at 41–42 (Scheffman Dep.).

Critical loss analysis next considers what the actual loss is likely to be if prices increase. Actual loss depends on how many marginal customers are likely to exist and how likely they are to shift purchases in response to a SSNIP. Scheffman Report ¶ 98. There is no evidence in the record from which to determine cross-elasticity of demand between premium natural and organic supermarkets and other supermarkets and grocery retailers. July 31 p.m. Hearing Tr. at 13–14 (Scheffman); JX 18 at 70–71 (Scheffman Dep.). Nor is there statistical evidence of actual loss, as the SSNIP is hypothetical rather than actual. July 31 p.m. Hearing Tr. at 10 (Scheffman). Therefore, Dr. Scheffman based his estimate of actual loss on weighing the evidence in the case, including the 47 market studies he reviewed. JX 18 at 91 (Scheffman Dep.).

Dr. Scheffman summarized (and then discussed in detail) what the market studies show: (1) grocery shopping is a relatively highly price sensitive category of ***19** retail; (2) Whole Foods and Wild Oats customers are shifting purchases between PNOS and other supermarkets, and can further shift purchases costlessly, *i.e.,* without having to change their shopping patterns; (3) most Whole Foods and Wild Oats shoppers shop frequently at other supermarkets and grocery retailers; (4) other supermarkets compete vigorously for the patronage of customers who also shop at Whole Foods and Wild Oats; and (5) Whole Foods (and to a lesser degree Wild Oats) regularly and extensively price check other supermarkets and food retailers in order to gauge their pricing, their assortments, and other strategies that these competitors are using to attract Whole Foods shoppers and other customers into their stores. Scheffman Report ¶¶ 122, 123, 125, 127, 204, 212, 213, 216, 127, 224–29.

Dr. Scheffman concluded that a substantial portion of Whole Foods and Wild Oats business is at the margin such that in the event of a PNOS price increase, the actual loss would substantially exceed the critical loss. Scheffman Report ¶ 128. "Where marginal customers comprise such a significant portion of the business, there is no doubt that the actual loss from a PNOS price increase would greatly exceed the [Redacted] critical loss." Scheffman Report ¶ 121 (discussing 5% SSNIP test results). Dr. Scheffman's conclusion obtains regardless if the SSNIP is 5% or 1%. JX 18 at 40, 89 (Scheffman Dep.); *see id.,* at 89–93 (the actual loss on a 1% price increase would be more than [Redacted] and is likely to be about [Redacted].

Even accepting the possibility that certain products are sold only at Whole Foods or Wild Oats, or that certain consumers perceive that the quality they want is only available at those stores, Dr. Scheffman concluded that critical loss analysis shows that, particularly with a small SSNIP, a relatively small sales loss would make a price increase unprofitable. The record evidence, including market research studies and evidence of how both consumers and retailers are actually acting in the marketplace, suggests that because so many people are cross-shopping for natural and organic foods and are marginal rather than core customers, the actual loss from a SSNIP would exceed the critical loss. July 31 p.m. Hearing Tr. at 25–27 (Scheffman). The Court agrees with Dr. Scheffman.

Dr. Scheffman's critical loss analysis demonstrates that the relevant product market must be broader than the market proposed by the FTC: "If all PNOS raised prices, there would be a substantial loss in business," and the loss necessarily would be to other supermarkets. Scheffman Report ¶ 120. "Based on this qualitative and quantitative evidence, I have concluded that the relevant product market must encompass at least all supermarkets." Scheffman Report ¶ 120. Evidence of the significant amount of sales that are "at the margin" shows that it is not plausible that a 5% increase in prices attempted by the proposed merged entity would be profitable, since the actual loss in sales arising from such a price increase is likely to far exceed the critical loss. Scheffman Report ¶¶ 117, 121. Actual loss would also defeat a 1% price increase. Scheffman Rebuttal Report ¶¶ 104–105.

Applying the product market definition framework of the case law and the Merger Guidelines, it follows that the relevant product market within which to evaluate the proposed transaction must be at least as broad as the retail sale of food and grocery items in supermarkets. Scheffman Report ¶¶ 128, 235. As a result, the FTC's proposed relevant product market of PNOS fails. *See* JX 18 at 55–56 (Scheffman Dep.) ("[T]he FTC's relevant ***20** market is not supportable as a matter of economic analysis and [ ] it would have to include non-PNOS supermarkets and other grocery retailers").

Dr. Scheffman also reviewed data regarding the sales at newly opened Whole Foods stores in certain markets where Whole Foods had no other stores, so-called "banner" entries. Scheffman Report ¶¶ 60–94.[12] According to Dr. Scheffman, a study of these store opening events is relevant to product market definition because it provides a natural experiment regarding how consumers react to a change in their options. Scheffman Report ¶ 61; July 31 p.m. Hearing Tr. at 21–23 (Scheffman). His analysis demonstrates that when Whole Foods enters a new local area, Whole Foods generates substantial sales that are overwhelmingly captured from the local traditional or conventional supermarkets and grocery retailers regardless of whether there are other PNOS in the area. Scheffman Report ¶ 60. Dr. Scheffman concludes from this analysis that premium natural and organic supermarkets compete directly with other supermarkets.

In an area in which there are no other PNOS, all the sales for the new Whole Foods store necessarily come from other grocery retailers. Scheffman Report ¶ 62. Dr. Scheffman nevertheless found that these new Whole Foods stores succeeded even though they had to draw all of their customers from other grocery retailers and supermarkets. Scheffman Report ¶¶ 65–66; *see* July 31 p.m. Hearing Tr. at 11 (Scheffman). It is obvious that when Whole Foods opens a new store in an area with no other PNOS it does not create new demand for groceries; rather, consumers divert some of their grocery purchases from other grocery retailers to Whole Foods. Scheffman Report ¶ 65.

On the other hand, when a Whole Foods store opens in an area already served by a Wild Oats store (or other PNOS), clearly Wild Oats stores can be expected to lose sales. Scheffman Report ¶ 62. But combined Whole Foods and Wild Oats revenues after entry of the Whole Foods store average more than [Redacted] times the revenues of the Wild Oats store prior to entry. Scheffman Report ¶¶ 75–76. Reviewing Whole Foods entry events in areas where Wild Oats also operated, Dr. Scheffman found that the reduction in Wild Oats sales was only about [Redacted] in most areas

—in some less than [Redacted] In other words, when a Whole Foods enters an area that has a Wild Oats store, its sales do not overwhelmingly come from Wild Oats, but primarily from other supermarkets; the main competitive interaction is between Whole Foods and "other" grocery retailers. Scheffman Report ¶¶ 83, 90.

Dr. Scheffman found that: (1) on average, the opening of a new Whole Foods store generated substantially more sales of natural and organic products than existed in the area prior to the opening, and (2) in every instance, the new Whole Foods store generated substantially more in sales than the Wild Oats store previously had. Scheffman Report ¶ 76. He observed, "[c]ontrary to the prediction implied by the FTC's product market, in all cases ... [Whole Foods'] sales are much larger than the reduction in sales of ... [Wild Oats]." Scheffman Report ¶¶ 77–79. Thus, when Whole Foods opens a new store in an area that has a Wild Oats, the data shows that Whole Foods gains a lot of sales, "and most of those sales by far did not come ***21** from Wild Oats." JX 18 at 81–82 (Scheffman Dep.). From the data, it is clear that most of the sales are coming from non-PNOS supermarkets. *Id.* at 82. Whole Foods is "overwhelmingly ... picking up its sales from non-PNOS markets and of course necessarily has to be ... competitive with those supermarkets to attract those sales and keep them." *Id.,* at 83.

Dr. Scheffman made calculations that showed that the combined revenue at a new Whole Foods store and an existing area Wild Oats store was, on average, [Redacted] times the revenue that the Wild Oats store had attracted before the Whole Foods store opened. *Id.* ¶ 79. These facts show that most of Whole Foods' sales came from non "premium natural and organic" supermarkets and other grocery retailers. It follows that most of the customers who frequent the new Whole Foods store come not from Wild Oats but from other competitors. These facts lead to the inevitable conclusion that Whole Foods' and Wild Oats' main competitors are other supermarkets, not just each other. Scheffman Report ¶¶ 74–90.

Dr. Murphy conducted a number of economic analyses. He concluded, among other things, that the estimated impact of banner entry by Whole Foods on Wild Oats' existing-store dollar sales indicates that the entry by Whole Foods into a geographic area reduces sales at nearby Wild Oats stores by [Redacted] He further concluded that the introduction of competition from Whole Foods has a larger effect on Wild Oats than does the introduction of competition from other sources. Murphy Report ¶ 49.

Dr. Murphy studied five entry events in which a Whole Foods banner store entry occurred within five miles of an existing Wild Oats store. Murphy Report ¶¶ 56, 57. Of the five entry events studied, he focused on two—West Hartford, Connecticut, and Fort Collins, Colorado—because he believed they were the only ones that offered sufficient post-entry price and volume data to discern a long run time-pattern of effects. Murphy Report ¶ 58.

Compared to Wild Oats stores that did not face entry, Dr. Murphy found that prices in Wild Oats' West Hartford store were [Redacted] six months immediately following entry by Whole Foods, [Redacted] 7 to 12 months following entry, and [Redacted] one year or more. The corresponding percentage reductions in sales in West Hartford were [Redacted] and [Redacted] for these time intervals. Murphy Report ¶ 58. The initial (0–6 months) price effect in Fort Collins is [Redacted] and remains about [Redacted] its pre-entry level even after a year. In the second year post-entry, sales in Wild Oats' Fort Collins store had [Redacted] compared to control stores. Murphy Report ¶ 59. The Fort Collins Wild Oats store was closed in December 2006. Dr. Murphy did not analyze what happened to Whole Foods prices in Fort Collins in the months after the Wild Oats store closed in December 2006.

From his study of these Whole Foods entry events and his estimate for the effects on Wild Oats and Whole Foods store-wide margins from the banner entries of Whole Foods, Dr. Murphy reached certain conclusions by analogy to the likely exit events that will occur after the merger when Whole Foods closes Wild Oats stores in many markets where they overlap. The Court concludes that these "assumptions" cannot form the basis of a legitimate analysis of effects on competition from the proposed transaction. The Court is unwilling to accept the assumption that the effects on Wild Oats from Whole Foods' entries provide a mirror from which predictions can reliably be made about the effects on Whole Foods from Wild Oats' future exits if this transaction occurs.

***22** Despite the fact that their own expert, Dr. Scheffman, also studied certain banner entry events by Whole Foods and reached conclusions about the success of the new Whole Foods stores and from whom they drew their customers, the defendants vigorously criticize Dr. Murphy's study of banner entry events because they say Dr. Murphy studied the "wrong events"—banner entries by Whole Foods instead of banner exits by Wild Oats.[13] The FTC acknowledges that Dr. Murphy's study is a study of only those individual markets and "not itself a study beyond those markets." Aug. 1 a.m. Hearing Tr. at 62 (Bloom). It nevertheless is an important study, according to the FTC, because this information when merged with other studies "casts additional light on what's going on in the marketplace." *Id.* While the Court is troubled that Dr. Murphy's pricing analysis is based on only two entry events and no exit events, the Court considers it, as the FTC suggests it should, to the extent it "casts additional light on what's going on in the marketplace."

The problem is that "what's going on in the marketplace," according to the credible evidence before the Court, is that (1) Wild Oats prices are higher than Whole Foods prices where the two companies compete, (2) Whole Foods prices are essentially the same at all of its stores in a region, regardless of whether there is a Wild Oats store nearby, and (3) when Whole Foods does enter a new market where Wild Oats operates Whole Foods takes most of its business from other retailers, not from Wild Oats. *See* Scheffman Report ¶¶ 56–66, 77–79. Furthermore, the market studies and other evidence show that Whole Foods competes vigorously with other supermarkets to retain the business of its many marginal customers.

B. Product Differentiation or Separate Product Market; Consumer Demand for Natural and Organic Products

The complaint alleges that Whole Foods and Wild Oats are both supermarkets. Complaint ¶¶ 2, 4. According to the defendants' food marketing expert, Dr. John Stanton, a "supermarket" is a well-defined and widely accepted term within the food retailing industry—it is a retail food store that carries a full-line and wide variety of food and non-food grocery items, and it typically maintains the selection and depth of products to provide one-stop shopping for a customer's food and grocery needs. Stanton Report ¶ 15. Whole Foods and Wild Oats are supermarkets, but ones that have focused on high-quality perishables, specialty and natural organic produce, prepared foods, meat, fish, and bakery goods, rather than on dry goods. PX06613 at 005; PX01333 at 003–004; JX 37 at 77–79 (Odak I.H.); JX 32 at 40 (LaMacchia I.H.).

The evidence also shows that a typical Whole Foods store carries all the traditional categories of products: fresh produce (both conventional and organic), frozen foods (including ice cream), shelf-stable food and beverage products (including certain popular brands), bread and bakery items, dairy, refrigerated foods, fresh and prepared meats and poultry, fresh seafood, deli, prepared foods, as well as health and beauty aids, cleaning supplies, paper products and other general merchandise, including pet products, kitchen tools, and magazines. Stanton Report ¶ 18. While Whole Foods and Wild Oats had and still have as a primary focus the sale of natural and organic fruits, vegetables, meats and ***23** other perishables of high quality, Whole Foods and Wild Oats each target a large base of supermarket shoppers who shop for larger categories of food products in competition with other supermarkets. Stanton Report ¶¶ 3, 15, 18, 25, 80; Sud Decl. ¶ 14; JX 28 at 31 (Mackey I.H.).

Whole Foods and Wild Oats also emphasize high levels of customer service; they are "mission driven," with an emphasis on "social and environmental responsibility;" they provide the customer with the confidence of a "lifestyle brand" and a "unique environment," in stores that satisfy "core values" of a lifestyle of health and ecological sustainability and provide a "superior store experience." PX00718 at 001; JX 37 at 95:1–25; 96:1–6 (Odak I.H.); JX 31 at 59:4–7 (Paradise I.H.); JX 11 at 69:17–70:7 (Paradise Dep.); JX 33 at 18:22–19:6 (Coblentz I.H.). Whole Foods and Wild Oats traditionally have offered a higher level of service than do the majority of conventional supermarket retailers. PX01301; PX01302 at 004, 012 ("unparalleled customer service" at Whole Foods); JX 28 at 109:13–16, 113:18–21 (Mackey I.H.); JX 32 at 102:11–24 (LaMacchia I.H.) (Whole Foods employees will help the customer by describing the large variety of 450 to 600 types of cheese that Whole Foods offers and offering free samples of any cheese the customer would like to try); PX00670 at 006 ("superior service with sincerely friendly and knowledgeable people—World Class Service" at Wild Oats); PX00670 at 034 (Wild Oats "seek[s] to offer a higher level of service than conventional supermarkets."); PX00518 at 008 (discussing higher level of service, knowledgeable personnel, and more money spent on store labor than conventionals).

The FTC distinguishes between consumers who shop "casually" for natural and organic foods and "customers that have decided that natural and organic is important, lifestyle of health and ecological sustainability is important." The question, according to the FTC, is where will this latter group shop after the merger and the closure of Wild Oats stores. Aug. 1 a.m. Hearing Tr. at 43–44 (Bloom). As explained *supra* at 17–18 and *infra* at 35, however, the Court concludes that the effect of the proposed merger on marginal consumers is more important than the effect on such core consumers, as it is the marginal consumers for whom the stores must and do compete most vigorously.

According to Dr. Stanton, differentiation "is now the primary method a supermarket operator uses to attract customers away from its supermarket competitors, just as location and low prices [were] the primary method of competition several decades ago." Stanton Report ¶ 26. Representatives of other supermarkets, including Delhaize and Trader Joe's, agree with this view. *See* JX 21 at 25 (Vail Dep.) (supermarkets pick and choose what to focus on and offer to consumers), 32 (even though all supermarkets in the United States are differentiated, they all compete against each other); DX 644 at DZA 000089 (Delhaize, "DG Board of Directors"); Boardman Decl. ¶ 10; JX 24 at 112–14 (Bane Dep.) (Trader Joe's looks at what competing supermarkets are doing to differentiate themselves).

Dr. Stanton observed that in today's world of differentiation, most successful supermarkets have developed certain benefits that distinguish them from the "average" supermarket and give customers a reason for shopping their stores. Stanton Report ¶ 23. Differentiating factors can include such things as low prices, ethnic appeal, quality prepared foods, expanded variety within a specific category or department, customer service, or perishable departments such as meats or produce. ***24** *Id.* The question is whether this differentiation creates "sub-markets" or separate product markets for purposes of analyzing competitive impact. Dr. Stanton believes that as the consumer's desires for various benefits change, supermarket operators will continue to change with them, and that supermarkets modify, re-define and reformat themselves all the time to meet the trends in consumer demand and the trends in competition. Stanton Report ¶ 28.

No one can doubt that consumer demand for natural and organic products has sky rocketed in recent years. Stanton Report ¶¶ 31, 66–71; Scheffman Report, Appendix E ¶ 4; DX S73. Demand for the following specific types of organic products has increased dramatically just over the past five years: organic milk (20–30% annually); soymilk (10% annually); organic bread and grain products (13–21% annually); organic fruits and vegetables (10–20% annually); organic meat, poultry and fish (32–120% annually); organic sauces and condiments (16–24% annually); organic packaged and prepared foods (11–20% annually); and organic snack foods (15–30% annually). DX 591 (Organic Trade Association's 2006 Manufacturers' Survey).

Nor is there any doubt that the dramatic growth in demand for natural and organic products is expected to continue. DX 591; Stanton Report ¶ 31; JX 21 at 72 (consumer demand for natural and organic products is not a fad and "is here to stay"); Sliva (WhiteWave) Decl. ¶ 6 ("I expect that consumer demand for natural and organic products will continue to increase into the foreseeable future."); Simon (Hain Celestial) Decl. ¶ 3 ("double-digit growth rates [for natural and organic food products] are expected to continue going forward as more and more consumers demand these products."); JX 21 at 37:20–38:5 (Vail Dep.) ("we have really looked at organic and natural foods as an emerging group within the industry ...").

Traditional or conventional supermarkets have responded to this increased demand for natural and organic products. Supermarket chains throughout the country have been expanding and growing their natural and organic offerings, and most are steadily increasing their offerings of these products. Sliva (White Wave) Decl. ¶ 10; Simon Decl. ¶ 3; Mays Decl. ¶ 13; Stanton Report ¶¶ 31–34; Scheffman Report, Appendix E ¶ 8; JX 24 at 43–44 (Bane Dep.) (organic products available in virtually any supermarket); DX 663 (Kroger recognition of competitor activity, including Whole Foods, in organic products).

While this may not have been the case some years ago, the growth in consumer demand for these natural and organic products now has made them part of the mainstream. Manufacturers and distributors of these products no longer rely on "natural food" stores for distribution of their products. JX 23 at 34–35 (Sliva Dep.); DX 680 (Letter from President of Rainbow Blossom markets in Louisville, KY) ("Many items that used to be of a special nature have now become commodity items obtained almost anywhere food is sold, and have highly competitive pricing structures."); Mays Decl. ¶¶ 16–17, 19; Megahan Decl. ¶¶ 18–20.

The evidence also shows that Whole Foods' supermarket competitors have paid attention to Whole Foods' success and to the changing consumer demands for fresh, natural and organic foods. Stanton Report ¶ 29. Many conventional supermarkets have been refocusing their strategies and repositioning their formats to respond to the changes in consumer demands. *Id.;* Robb Decl. ¶ 19; Gallo Decl. ¶ 20.

Whole Foods' internal documents, prepared in the ordinary course of business, indicate that Whole Foods believes it faces ***25** "eroding product differentiation" as other supermarkets continue to stock many of the same products that Whole

Foods offers. DX 12 (2007 Board Report). Whole Foods believes it is in "a time of unprecedented competition" where it increasingly does not have "the advantage of offering a unique selection of products." DX 1 (June 2006 e-mail from Gallo to Mackey entitled "Thoughts on Competition"); *see also* Robb Decl. ¶ 24 ("Losing customers to our supermarket competitors hurts, especially now since they are doing things that used to set Whole Foods apart."); Sud Decl. ¶ 28; DX 253 (competitors mimicking Whole Foods in offering high quality natural and organic foods); DX 259 (competitors copying the offerings and atmosphere of Whole Foods); DX 723 at 3 (Whole Foods' margins will be pressured "once the soccer moms stop shopping at Whole Foods so often now that the same or equivalent products are available at Safeway"); *see also* Stanton Report ¶¶ 3, 28–30, 79–83.

Most of the major supermarket chains (regional and national) are improving perishable departments and offering an increased selection of natural and organic foods. DX 1 (June 2006 e-mail from Gallo to Mackey entitled "Thoughts on Competition"). As a result, Whole Foods believes it is in a "new era of the natural foods revolution" in which "we will all have to work harder and smarter to compete and differentiate." DX 198; Robb Decl. ¶ 18; JX 28 at 33 (Mackey I.H.) (Whole Foods' success has "caused all these supermarkets to try to want to steal Whole Foods' mojo."); *see also* Stanton Report ¶¶ 32–65 (the trend in supermarket retailing is toward expanded selections of fresh, quality perishables, expanded selections of natural and organic products, and improving the overall shopping experience); Scheffman Report, Appendix E, ¶ 8 ("many large supermarkets are focusing on improving quality and freshness and expanding natural and organic products in response to changing consumer demands."); DX 720; DX 721.

Many supermarket companies have invested significant resources into developing and opening new stores some of which mimic Whole Foods' store designs and product offerings. Sud Decl. ¶ 28. Many supermarkets have modeled the look and feel of their stores, as well as many of their current competitive strategies, on Whole Foods. Thus, remodeled competitors' stores often include expanded produce and organic selection, pro-active customer service, in-store demonstrations and promotions, and attractive, high quality fixtures and product cases. *See, e.g.,* JX 21 at 90–93 (Vail Dep.) (detailed account of Hannaford's remodel in Portland, Maine in response to anticipated Whole Foods entry); Paradise Decl. ¶¶ 21, 46–47, DX 49, DX 357, DX 368, DX 480 (discussing Safeway Lifestyle stores); DX 747 (discussing Publix Greenwise stores); Lannon Decl. ¶ 21; DX 504 (Shaw's president, stating that its newly remodeled store "sounds like a Whole Foods, looks like a Whole Foods, but it's a Shaw's").

Nearly every national supermarket chain now carries a wide array of natural and organic products, and many have significantly expanded their offerings of prepared and specialty foods. Sud Decl. ¶¶ 20, 22; Gallo Decl. ¶ 24; Stanton Report ¶¶ 32–65; DX 21; DX 49 (Safeway Lifestyle); DX 54 (Shop Rite); DX 56 (Publix); DX 77 (Wegmans); DX 216 (Ahold); DX 237 (Whole Foods private label strategy); DX 269 (Publix).

In addition, many competing supermarket chains have launched their own private label store brands of natural and organic products. *See infra* at 29–30, 44–48. These private labels are intended in part ***26** to allow other supermarkets to begin competing with Whole Foods in terms of product offerings and price. Sud Decl. ¶¶ 22, 26; DX 263 (Ahold); DX 269; DX 270 (Stop & Shop's private label advertised with tagline "Organic can be affordable.").

The defendants argue that the FTC improperly uses differentiation or uniqueness as the basis to define the market, while the defendants view differentiation as but one competitive dimension in which Whole Foods and Wild Oats engage in competition with other firms. According to the defendants, all supermarkets differentiate themselves in some way from their competitors in order to compete for the same supermarket shoppers and/or dollars. Stanton Report ¶¶ 3, 22–23; *see also* Martin Decl. ¶¶ 4, 5; DX 617 at 25–28, 32 (Vail Dep.). Whole Foods and Wild Oats tout their quality, including excellent perishables, healthful groceries, high-quality prepared foods, and natural and organic products. Some other supermarkets advertise their everyday prices, their special markdowns, or their broad selection of products, advantages that Whole Foods also tries to offer but that are not a central part of its brand image.

Differentiation, however, does not equate to a unique relevant product market for antitrust purposes. Stanton Report ¶ 3. The fact that supermarkets seek to differentiate themselves from one another does not address the relevant question for product market definition—are the differences between conventional supermarkets and PNOS so substantial that Whole Foods could retain most of its customers even if, post-merger, it were to raise price or reduce quality? The determinative question is not "are there any differences?" but "would customers switch?"

C. Whole Foods and Wild Oats Customers Cross–Shop at Conventional Supermarkets and Retailers

The evidence shows that many Whole Foods' customers also shop at other supermarkets and retailers, splitting their purchases and looking for the best price on a variety of different grocery items that they might purchase either at Whole Foods or elsewhere. Robb Decl. ¶ 21; Gallo Decl. ¶ 19; DX 8; Stanton Report ¶ 27; JX 21 at 25–27 (Vail Dep.).

A significant number of Whole Foods customers "cross-shop" between Whole Foods and other supermarkets, such as Delhaize, Kroger, Safeway, Albertsons, Ahold, Publix, and H–E–B. DX 2 at 16; *see also* DX 15 (frequent Whole Foods customers split purchases between Whole Foods and other stores such as Safeway, Costco, Wal–Mart, and Trader Joe's); DX 727; DX 735 at 5; JX 21 at 48:6–18 (Vail Dep.) ("if we can satisfy their needs on a particular shopping trip, then they will shop with us. If there's something they need that Whole Foods offers that we may not offer, then they will shop at Whole Foods, and that would apply to, potentially, other banners as well.").

Wild Oats customers also cross-shop at conventional supermarkets. DX 568 (national trade area study found that consumers considered food retailers such as [Redacted] to be the best alternative for products that Wild Oats sells); DX 568; DX 567 [Redacted]; DX 572; DX 575.

While cross-shopping has always existed—a customer may have bought organic fruits and vegetables at Whole Foods and milk, coffee and cereal at Safeway—cross-shopping has become particularly prevalent as the different types of distribution channels for natural and organic goods have blurred. Whole Foods' points of differentiation from other stores has eroded because consumers now can purchase natural ***27** and organic foods from the same stores where they traditionally bought their milk, coffee and cereal. Robb Decl. ¶ 21; Gallo Decl. ¶ 19; DX 3; DX 8 at 4; DX 13 (Wal–Mart); DX 15 at 18 ("Organic Users and Specialty/Gourmet Users [are] shopping more in mainstream [supermarkets], less in [Whole Foods]...."); DX 16 at 8; DX 24(HEB); DX 25 (Wal–Mart); DX 31 (Safeway); DX 37 (Wal–Mart); DX 38 (Costco); DX 40 (all competitors); DX 370 (Costco, Trader Joe's, Safeway, Wal–Mart, and Food Lion all components of "New Era of Competition"); DX 384 (Wal–Mart); *see also* JX 21 at 44–46 (Vail Dep.) (Delhaize has conducted research that shows that its customers cross-shop at Whole Foods).

The evidence shows that some Whole Foods' customers shop in other stores as often as once a week. JX 10 at 66–67 (Meyer Dep.) ("the reality we're in is our ... core customer base, shops at Safeway or Giant or Wegman's and then they shop at Whole Foods Market, and as those competitors add product to their stores that are like our products, with a halfway decent experience, they're going to not make that second trip. It's the inevitable reality."); *see also* JX 21 at 25–26 (Vail Dep.); Stanton Report ¶ 27; Allshouse Decl. ¶ 7.

Research by other supermarket chains also shows that their customers are cross-shopping at Whole Foods. [Redacted].

Market research reviewed by Dr. Scheffman demonstrates that shoppers at Whole Foods and Wild Oats shop frequently at other supermarkets and grocery retailers, and often do so more frequently than they shop at Whole Foods or Wild Oats. Indeed, some market research shows that many shoppers at Whole Foods and Wild Oats spend more than [Redacted] of their total grocery shopping purchases at retailers other than Whole Foods and Wild Oats. *See* Scheffman Report ¶¶ 131, 140, 148–49, 152, 161, 165–66; DX 568 (The Wild Oats' "core customer[s] only spend [ ] about [Redacted] of their dollars at Wild Oats."); DX 691 (Natural Marketing Institute Organic Trends & Perspective Study); DX 694; DX 702 at 13–18 (most segments of Whole Foods shoppers spend less than [Redacted] of total grocery budget at Whole Foods).

Market research and studies done even four and five years ago indicate that [Redacted] of Wild Oats customers did the majority of their food shopping at other stores. DX 567 at 3; DX 568 at 6, 48–49 ("Even [Wild Oats'] core customer only spends about [Redacted] of their dollars at Wild Oats," whereas [Redacted] of their grocery dollars are spent in "traditional food stores" such as [Redacted]; DX 575, DX 576 (customer interviews); *see* JX 37 at 86–88 (Odak I.H.); JX 16 at 62–65 (Odak Dep.) (Wild Oats customers shop at other supermarkets and compare prices).

As other retailers move more and more aggressively into the sale of organic and natural foods, market research indicates that a substantial percentage of shoppers at Whole Foods and Wild Oats purchase "healthy," organic and natural products (as well as other products) at other supermarkets. *See* Scheffman Report ¶¶ 131, 141, 150–51, 167–68; DX 568;

DX 691; DX 694; DX 703. In fact, today, the majority of natural and organic goods sold in the United States are sold by so-called "conventional" supermarkets. Mays Decl. ¶ 19; PX 2072 at 96. Market research also demonstrates Whole Foods shoppers cross-shop for private label products with other supermarkets and grocery retailers. Scheffman Report ¶¶ 171–72; DX 16 at 8 ("Multiple channel options and a myriad of reasons for purchasing have blurred the marketplace."); DX 240 ("There are significant levels of cross shopping between WFM and [Trader Joe's] ").

***28** The FTC argues that whatever cross-shopping may occur, the customers at Whole Foods and Wild Oats—or at least their "core" customers—do not shop at other, more conventional supermarkets routinely and certainly not for premium natural and organic food products. That is because (at least) these "core" customers and perhaps others are looking not just for the premium products but also for the service and unique atmosphere that Whole Foods and Wild Oats provide. The FTC lists the attributes unique to premium and organic supermarkets that define them—at least for their core customers—as a unique product market different from conventional supermarkets and other retailers:

- "generally focus on high-quality perishables, specialty and natural organic produce, prepared foods, meat, fish and bakery goods;"
- "generally have high levels of customer services;"
- "generally target affluent and well educated customers;"
- "generally select store sites based on the targeted customer;"
- "generally are mission driven with an emphasis on social and environmental responsibility;"
- "generally are a 'third place;' "
- "generally provide the customers with the confidence of a 'lifestyle' brand;"
- "generally provide the customer with added confidence and trust in the provision of the natural and organic products that are good for the consumer,"
- "generally provide a 'unique' environment;" and
- "generally are stores that meet 'core values' and a 'superior store experience.' "

Plaintiff's Third Supplemental Responses and Objections to Interrogatory No. 6 in the First Set of Interrogatories of Defendant Wild Oats Markets, Inc., July 15, 2007, DX 590 ("July 15 Supp. Responses").

Dr. Scheffman found, however, that the various marketing studies of Whole Foods and Wild Oats customers divided the shoppers in a variety of ways, not just by any or all of these attributes. He concluded that people shop at these stores for a variety of reasons, and that there is no clearly definable "core" Whole Foods or Wild Oats shopper. Scheffman Report ¶ 132. His conclusion is supported by market research that shows that there is no definable "core customer" for Whole Foods and that Wild Oats and that Whole Foods and Wild Oats customers cannot be characterized by a unique set of descriptors. Scheffman Report ¶ 170. Whole Foods shoppers "cannot be slotted into coherent categories because they shop at WFM or WO for such a wide variety of reasons." Scheffman Report ¶ 132.

One study showed that [Redacted] of Whole Foods shoppers are infrequent shoppers, shopping Whole Foods less than once every [Redacted] DX 16 (Natural Marketing Institute 2006 Market Corporate Tracker Study); *see* DX 240 at 9 (Natural Marketing Institute ESP Research Summary). Another study identified "6 unique customer segments whose differing attitudes and opinions impact their diverse shopping and buying behaviors". DX 703 (2007 Natural Marketing Institute "Shopper Segmentation Study: Identifying Unique Shopper Segments").

Yet another study run for Whole Foods in early 2007 shows that categories of "core" Whole Foods customers are declining and switching to conventional grocery stores. The data shows that Whole Foods share of specialty/gourmet customers have fallen from [Redacted] in 2005 to [Redacted] ***29** in 2006, whereas for traditional grocery stores that percentage has risen from 80% in 2005 to 94% in 2006. DX 15 at 14 (2006 Health and Wellness Trends Database). Wild Oats estimates that so-called "core" customers comprise only approximately [Redacted] of its total customers. Mays Decl. ¶ 18.

As the interest in natural and organic foods increases, the number of customers and potential customers for such foods increases. It logically follows that, with the prevalence of cross-shopping, some such consumers may be drawn to Whole Foods, while others will satisfy their new-found interest in natural and organic foods at their traditional, conventional supermarket. Either way, it increases the number of consumers who potentially will cross-shop between Whole Foods and conventional supermarkets.

D. Whole Foods and Wild Oats Compete with Other Supermarkets and Other Supermarkets Compete with Them

The FTC acknowledges that there is competition between Whole Foods and conventional supermarkets to some extent. But "[t]he question is what are the dimensions of that competition, and what are consumers looking for when they shop at Whole Foods and Wild Oats." Aug. 1 a.m. Hearing Tr. at 31 (Bloom).

Whole Foods checks its prices against the prices of other supermarkets, and "comp shops" their stores. Robb Decl. ¶ 27; Gallo Decl. ¶ 28.[14] Whole Foods has offered evidence that it price checks or comp shops against other supermarkets in every area in which it operates. [Redacted] Wild Oats [Redacted] it has price checked certain other grocery stores.

The evidence also shows that other supermarkets routinely price check Whole Foods' stores and adjust prices based on their assessment of Whole Foods' prices. *See, e.g.,* DX 359 (Whole Foods team member observing King Soopers employee walking Whole Foods' store and thereafter adjusting prices); Meyer Decl. ¶ 22; JX 10 at 48 (Meyer Dep.); DX 74 (Wegmans directly comparing prices to Whole Foods); DX 72 (scan of two bib tags from Wegmans' shelf directly comparing prices on two organic/natural products); Meyer Decl. ¶ 23 (Giant signage comparing prices to Whole Foods); DX 73 (Gallo email March 2007, forwarding picture of a sign from D.C. metro Giant supermarket comparing its prices to Whole Foods in a similar fashion as Trader Joe's as well as nearby store team member's report of Giant's inaccuracies in its representations of Whole Foods' prices).

Delhaize (consisting of Hannaford, Food Lion, Bloom, and Sweetbay supermarkets) considers Whole Foods to be a competitor. *See* JX 21 at 90 (Vail Dep.) ("They sell things that are core to our strategy, they're certainly a competitor."). It conducts full price checks on Whole Foods. JX 21 at 50–54 (Vail Dep.). According to Peter Vail, the leader of natural and organic foods for Hannaford/Delhaize, the Whole Foods price check is performed to the same degree as all other primary competitors—"They would get a full price check just like we would do against Stop and Shop or anybody else." JX 21 at 54 (Vail Dep.). These price checks cover the whole store and include both branded and private label products. *Id.* at 158. The price checks are then used for purposes of pricing at the Delhaize stores—"We would price check against all categories of Whole ***30** Foods and move [our prices] where we see appropriate." *Id.* at 139–40. Other supermarkets, such as Kroger and Supervalu, have also asked for permission to price check Wild Oats stores. JX 38 at 145 (Smith I.H.).

[Redacted] considers Whole Foods to be a [Redacted] DX 674.

[Redacted] has identified Whole Foods as its [Redacted] One of its business plans states: [Redacted] DX 810.

Whole Foods has three national private label programs: 365 Everyday Value ("365"), 365 Organic, and Whole Brands. Whole Foods' private label program is intended to be competitive with the natural and organic private label products of many supermarkets. A 2006 study by the Natural Marketing Institute shows that there is a significant overlap of private label offerings between Whole Foods, Safeway, Kroger, Costco, and Ahold, although each retailer has put "effort into diversifying their product line." DX 21 (Natural Marketing Institute Private Label Product Analysis). For many of these overlapped SKUs, "[Whole Foods'] prices are very competitive, and in many cases better than those of other stores (with the exception of Costco, most likely due to volume discounts, lower margins, and distribution structure)." *Id.* at 2.

According to Linda Boardman, Senior Coordinator for Private Label for Whole Foods, "[b]ecause more than [Redacted] of Whole Foods shoppers cross-shop at Trader Joe's, other supermarkets, and mass market stores, we want customers to purchase from Whole Foods more of the products they purchase from competing stores." Boardman Decl. ¶ 5. Indeed, Whole Foods specifically designed its private label program to compete against other supermarkets. The private label acts as "the entry point for crossover shoppers" and, according to Whole Foods internal documents, it faces competition from Trader Joe's and supermarket brands. Although the private label program was originally focused on competition with Trader Joe's, over time its goals have expanded and today Whole Foods uses its private label products to enhance competition with other supermarkets as well. Boardman Decl. ¶ 5; *see also* DX 27, DX 29; DX 733 (Whole Foods Private Label Review); DX 752 (Referring to Safeway, Whole Foods Director Mo Siegel opined that "[a]s competition increases the relevance of our private label increases.") For instance, Whole Foods actively checks against a list of over [Redacted] Safeway "O" Organic items that overlap with Whole Foods private label SKUs. DX 26, 35. Evidence has been offered that Whole Foods' private label pricing strategy requires 365 and 365 Organic private label prices to match Trader Joe's prices on all like items. Boardman Decl. ¶ 17; 17 n. 1, DX 27.

The evidence shows that, when Whole Foods reviews a potential location for a store, it systematically considers every significant supermarket chain in the area a potential competitor for the new store. Sales projections presume that the Whole Foods store will draw the vast majority of its sales from other large supermarket chains. Sud Decl. ¶ 57. Before Whole Foods decides whether to open a new supermarket in a proposed area, it does a demographic study. Bradley Decl. ¶ 6; JX 6 at 34–35 (Bradley Dep.). The study lists all competitors in the expected draw area and presents key data for each competing store to understand the potential competitive implications of competitor proximity. There is evidence in the record that shows that in reviewing competitors, the study computes the sales of all supermarkets in the area, not just those of so-called premium natural and organic supermarkets. *See, e.g.,* DX 80 (Louisville, KY ***31** site study); DX 635 (Boulder, CO site study); Megahan Decl. ¶ 11–15.

A site location report also analyzes what the sales volume potential would be if a store opened in a given area on a given piece of property. JX 7 at 9 (Kadish Dep.). This analysis includes all supermarkets, not just premium natural and organic stores and attempts to [Redacted] JX 7 at 116, 125 (Kadish Dep.). The analysis in the site selection reports include [Redacted] and [Redacted] *See, e.g.,* DX 636 [Redacted] projecting that [Redacted] of Whole Foods sales would be drawn from retailers other than Wild Oats); *see* DX 171 [Redacted] projecting about [Redacted] of its average weekly sales would be captured from non-Wild Oats retailers like [Redacted].

According to Wild Oats internal documents, the site selection process for new Wild Oats stores also considers locations of all other supermarkets. DX 587 (Wild Oats maps all of its competitors on site plan maps); JX 37 at 105–06, 124 (Odak I.H.) [Redacted]; JX 12 at 213–15 (Brier Dep.). Wild Oats analyzes the competitive impact of conventional grocery store openings [Redacted] JX 34 at 140–141 (Martin I.H.).

There is evidence in the record that Whole Foods has been quite concerned about competition from conventional supermarkets and other retailers and that it has seen decreases in sales in some regions that are directly attributable to such stores. For example, in October 2006, Whole Foods Co–President A.C. Gallo noted:

> Safeway, Giant Eagle, Giant, Stop & Shop, Harris Teeter, Food Lion, and Publix are all opening lots of new stores and are remodeling existing stores on the East Coast. Every time they open a new store or remodel an existing one with better perishables and natural foods we see a hit. There is an amazing level of activity here that we had not seen the past 5 years and it is affecting our older, smaller, parking challenged stores. Also there is the factor that people who are mostly supermarket shoppers and come to us for certain special items do not have to come to us as frequently now.

DX 3.

According to Whole Foods' Kenneth Meyer, the [Redacted] Whole Foods store's sales dropped [Redacted] when a [Redacted] store opened up just down the street. Meyer Decl. ¶¶ 4, 8; JX 10 at 18–19, 80, 82 (Meyer Dep.). According to Mr. Meyer, sales also at Whole Foods stores in [Redacted] and [Redacted] after [Redacted] stores opened in those areas, and sales dropped at Whole Foods stores in [Redacted] and [Redacted] after [Redacted] stores opened in those areas. Meyer Decl. ¶ 4; JX 10 at 18–19 (Meyer Dep.).

Whole Foods believes it faces competition from Trader Joe's because Trader Joe's now sells many natural and organic products. Whole Foods matches prices on a significant number of items, both branded and private label. Gallo Decl. ¶ 26; Robb Decl. ¶ 26; DX 251; DX 252; DX 257; DX 262 (Price matching necessary to "stop or minimize the loss of business that [Whole Foods has] been experiencing whenever [Trader Joe's] opens near" a Whole Foods store); DX 264; DX 267; DX 279 (E-mail regarding posters in Trader Joe's locations in Southern California and New England that post comparative register receipts from Whole Foods); Meyer Decl. ¶¶ 24, 32; JX 10 at 61–63 (Meyer Dep.); DX 75 at 3–6 (Meyer email October 2006, detailing planned response in Mid–Atlantic region to Trader Joe's price comparison tactics).

***32** Dr. Stanton's conclusions concerning the competition by Whole Foods and Wild Oats with other, more conventional supermarkets can best be summarized by Paragraph 3 of his Expert Report:

> Whole Foods and Wild Oats each compete in the supermarket industry with a plethora of other supermarket businesses. All supermarket retailers, including Whole Foods, attempt to differentiate themselves so as to give customers a reason to shop its stores over its competitors. *This does not, however, indicate that differentiated supermarkets do not compete with each other; to the contrary, it is how they compete with each other.* As consumer demand for fresh, healthy, organic and natural products has increased, more and more supermarket competitors have expanded their product offerings and store formats to more effectively compete for customers; the same customer base that Whole Foods is targeting. This trend has been dramatic, and will continue as consumer demand for these products, and competitor responses, continue to evolve. Whole Foods and Wild Oats face robust competition today in all the cities in which they compete, and Whole Foods will continue to face robust competition in the future after acquiring Wild Oats.

Stanton Report ¶ 3 (emphasis added).

As for the future, Dr. Stanton testified that "I believe that Wild Oats or Whole Foods and/or Wild Oats will face robust competition just about any major area that they go into." JX 19 at 120 (Stanton Dep.). When asked to explain what he meant by "robust competition," Dr. Stanton testified, "I mean that other supermarket chains will fight tooth and nail for those customers." JX 19 at 121 (Stanton Dep.). When asked if this competition includes price competition, Dr. Stanton testified "It certainly does." JX 19 at 121 (Stanton Dep.).

In sum, the evidence before the Court demonstrates that other supermarkets, including Safeway, Wegmans and Delhaize, compete today for the food purchases of customers who shop at Whole Foods and Wild Oats and that Whole Foods' customers already turn for some of their food purchases to the full range of supermarkets. *See, e.g.,* DX 609 at 18, 57–60 (Meyer Dep.); 57:5–60:21; Gallo Decl. ¶¶ 23–24; Robb Decl. ¶¶ 23–24; Sud Decl. ¶ 26; Paradise Decl. ¶ 17; Allshouse Decl. ¶ 7, DX 617 at 44–48 (Vail Dep.); Conway Report 5–36; Stanton Report ¶ 27. All of these stores carry many of the same products and, increasingly, many offer some of the same ambiance as well. Customers who shop at one of these stores usually shop at others as well. *See, e.g.,* DX 617 at 48 (Vail Dep.).

Today more supermarkets offer more natural and organic products, more high-quality perishables, and some even have more and improved service departments. *See, e.g.,* Paradise Decl. ¶ 19 ("King Soopers has been aggressively expanding its offerings of organic, natural and fresh products"), ¶ 20 ("Safeway's O Organic private label line carries many of the same organic products as Whole Foods and is priced similar to us"); DX 365 (King Soopers ad boasts that "Nobody sells more organic produce in Colorado—Nobody"); Stanton Report ¶¶ 28–30, 32–34.

Post-merger, all of these existing competitive alternatives will remain. If the combined firm raised prices or permitted quality to slide, many customers could and would readily shift more of their purchases to any of these alternative sources of natural and organic foods, often stores where they already shop. The evidence of substitutability ***33** or "interchangeability of use" is striking.

E. Whole Foods and Wild Oats Do Not Uniquely Compete with Each Other

The evidence shows that Whole Foods' does not have any specific competitive policies, practices, or strategies directed specifically at Wild Oats—its approach towards competing in a geographic area is the same whether Wild Oats is present or not. Gallo Decl. ¶ 29; Robb Decl. ¶ 29.

The evidence shows that Wild Oats' prices are generally higher than Whole Foods' prices. Gallo Decl. ¶ 9; Robb Decl. ¶ 15; Paradise Decl. ¶ 30; Lannon Decl. ¶¶ 14, 24; Besancon Decl. ¶ 64; JX 28 at 186–87 (Mackey I.H.); DX 488; DX 491; DX 584; DX 580; DX 581; DX 582; JX 37 at 41–46 (Odak I.H.). Furthermore, Whole Foods price checks or comp shops Wild Oats' stores less than it price checks or comp shops other supermarket competitors. Mays Decl. ¶ 27.

Whole Foods does not regard Wild Oats as a significant competitor in areas where they both operate. Kenneth Meyer, the Whole Foods Mid–Atlantic Regional President, described Whole Foods' view of Wild Oats as follows:

> Our experience with Wild Oats in Louisville, and most other areas in my region where we both operate, is that their prices are usually higher than ours, and that our true competition on price and other factors is the multitude of other grocery retailers in those areas—and not Wild Oats.

Meyer Decl. ¶ 13.

Sales data confirm the lack of competitive rivalry between Whole Foods and Wild Oats in Louisville, Kentucky. Whole

Foods' stores averaged $423,900 in weekly sales in 2006. Scheffman Rep., App. F at 57. By comparison, Wild Oats' weekly sales in 2006 averaged [Redacted] Scheffman Rep., App. F. at 57. Mr. Meyer explained that sales at Whole Foods' Louisville store are sufficiently high that the majority of its sales must be coming from grocery retailers other than Wild Oats, because otherwise "Wild Oats would have closed its doors by now." Meyer Decl. ¶ 7; JX 10 at 101–02 (Meyer Dep.).

Whole Foods and Wild Oats each have one store in the Portland, Maine area. Scheffman Report, Appendix F ¶ 307. Whole Foods and Wild Oats face substantial competition in Portland, Maine from Hannaford, Shaw's and others. Scheffman Report, Appendix F ¶ 309; Martin Decl. ¶¶ 17, 27; Gallo Decl. ¶ 33; DX 171 (2004 Portland, Maine site study); DX 497. Hannaford and Shaw's feature locally grown produce and sell a significant amount of natural and organic foods. Scheffman Report, Appendix F ¶¶ 310, 312; Gallo Decl. ¶ 33. The site report for Portland, Maine shows that Whole Foods expected conventional supermarkets, and not Wild Oats, to be its principal rivals. According to the Whole Foods Portland, Maine site study, Whole Foods expected [Redacted] of its average weekly sales would be captured from Wild Oats supermarkets other than Wild Oats, such as Hannaford and Shaw's. DX 171 at 6, 39; Lannon Decl. ¶ 23 (noting that Whole Foods expected sales to come from Hannaford and Shaw's "right off the bat," and not just Wild Oats).

Wild Oats' prices are significantly higher, on average, than those of Whole Foods in the [Redacted] area. Whole Foods Regional President David Lannon reported to the Whole Foods Leadership Team that, for [Redacted] Wild Oats' prices are "about [Redacted] higher" on average. DX 277 (February 2007 e-mail reporting on [Redacted] Whole Foods store opening); *see also* Lannon Decl. ¶ 24 (Whole Foods does not "find it necessary to price ***34** against Wild Oats, because Wild Oats' prices in [Redacted] as in areas throughout my region, are higher than all other supermarkets in the area.").

The lack of meaningful competition between Whole Foods and Wild Oats—at least in the Mid–Atlantic region headed by Kenneth Meyer and in the North Atlantic region headed by David Lannon—is confirmed by the absence of specific pricing comparisons against Wild Oats. Stores in the North Atlantic region were directed to compare the prices of a "market basket" of items against the same basket purchased from its lowest priced competitor. But the Whole Foods store in [Redacted] like other Whole Foods in that region, has "never targeted a Wild Oats [store]" and has never even requested to do so. Lannon Decl. ¶ 25.

Whole Foods created documents in the ordinary course of business documenting the proportion of Wild Oats current sales that might transfer to Whole Foods after the merger. PX 00553; DX 401 (Project Goldmine Board Discussion Materials) at 15. These "Project Goldmine" documents created by Whole Foods indicate that Whole Foods intends to close roughly [Redacted] Wild Oats stores [Redacted] more or less immediately), most of which currently overlap with Whole Foods stores. DX 402; *see also* Murphy Report ¶ 70. Of the Wild Oats stores that might be closed, the preliminary analysis projected that Whole Foods would capture less than [Redacted] of Wild Oats' sales for [Redacted] Wild Oats stores. PX 00553. The estimates of volume shifts average less than [Redacted] despite the non-existence of any other premium natural and organic supermarkets in most of the relevant geographic markets. DX 401; PX 553. In each of these markets, [Redacted] of the volume, on average, would be transferred to other supermarkets and other food retailers, not to Whole Foods.

The Project Goldmine estimates show the lowest transfers of sales from Wild Oats to Whole Foods in [Redacted] all stores where, after the merger, Whole Foods would be the only remaining PNOS. *See* DX 401. As defendant Whole Foods' counsel put it, "this is a strange monopoly if it results in a transfer of say less than a third of the store's volume.... [I]f two-thirds of the volume is going elsewhere in a market that is contended to be a monopoly, what kind of a monopoly is this?" Aug. 1 p.m. Hearing Tr. at 23 (Denis).

F. Conclusions Concerning Relevant Product Market

The economic evidence, market research studies, and evidence concerning the realities on the ground—the "practical indicia" discussed by the Supreme Court in *Brown Shoe* and the facts concerning the structure, history and probable future of the particular market alluded to by Judge Bates in *Arch Coal*—all lead to the conclusion that the relevant product market in this case is not premium natural and organic supermarkets ("PNOS") as argued by the FTC but, as Dr. Scheffman has said, at least all supermarkets.

Applying the SSNIP test of the Horizontal Merger Guidelines, the evidence shows that there are many alternatives to which customers could readily take their business if Whole Foods and Wild Oats merged and Whole Foods imposed small but significant and nontransitory price increases—so that such price increases would not be profitable. It follows under this test, as explicated by the critical loss analysis done by Dr. Scheffman, that the product market proposed by the FTC is thus too narrow even under its own Merger Guidelines.

Furthermore, Dr. Scheffman's analysis of banner entries shows that when a new ***35** Whole Foods store opens—both in areas where there are no other PNOSs like Wild Oats and in areas where there are one or more Wild Oats stores—Whole Foods sales do not come primarily from Wild Oats (or other PNOSs) but overwhelmingly from other supermarkets operating in the area. The competitive interaction is between Whole Foods and all supermarkets, not just, or even primarily, with Wild Oats. Indeed, the evidence shows that Whole Foods and Wild Oats do not uniquely compete with each other, but with all other supermarkets in areas where both Whole Foods and Wild Oats operate.

Preliminary studies show that after the merger Whole Foods would capture less than [Redacted] (perhaps only [Redacted] of Wild Oats' sales, meaning that [Redacted] would go to other supermarkets and other food retailers, not to Whole Foods. It follows that customers view natural and organic food products at many stores other than Whole Foods as adequate substitutes for those they can obtain at Wild Oats. Most consumers therefore would take their business elsewhere if prices at Whole Foods increased significantly after the merger.

The Court also concludes, along with Dr. Scheffman, Dr. Stanton and others, that the FTC is wrong to focus only on so-called "core" consumers or "committed" customers of Whole Foods. The economic analysis and other evidence show that the proper focus is on "marginal" customers. A fundamental problem with the FTC's reasoning is that it addresses whether Whole Foods has *any* customers who are so dedicated to that store's product array and other qualities that they would not switch *any* of their purchases to another supermarket if Whole Foods began to compete less vigorously by raising prices or decreasing quality. The question is whether *enough* customers would switch *enough* of their purchases that a post-merger price increase or quality decline would be unprofitable for Whole Foods. The evidence presented persuades the Court that certainly beyond the point of critical loss, enough customers would answer this question in the affirmative and switch some or all of their purchases to other food retailers, thus rendering unprofitable any post-merger effort by Whole Foods to increase prices beyond a certain point.

The FTC is also wrong in looking to differentiation or uniqueness as the basis on which to define a product market. The fact that supermarkets seek to differentiate themselves from one another by emphasizing certain products or services does not address the relevant question for product market definition. The real question is whether the differences and points of uniqueness are so substantial that Whole Foods could retain most of its customers even if it were to raise prices or reduce quality after the merger. Because supermarket chains throughout the country now have recognized the interest of a broad range of consumers in natural and organic foods, conventional supermarkets and other retailers have increased and expanded their offerings of such food products and will continue to do so. Consumers therefore now have the practical ability to switch from Whole Foods to other supermarkets to obtain these products.

The fact is that a large number of Whole Foods and Wild Oats customers today shop frequently at other supermarkets for the same products they sometimes also buy at Whole Foods and Wild Oats—so-called cross-shopping. At the same time, other supermarkets now sell many, and an increasing variety of, natural and organic products. Together, these facts further support the conclusion that the relevant product market for evaluating this merger ***36** includes, at a minimum, all supermarkets. While "cross-shopping" has always existed, as other retailers have moved more aggressively into the sale of natural and organic foods, market research shows that a substantial percentage of these cross-shoppers will purchase their natural and organic foods at stores other than Whole Foods more and more frequently, particularly if prices at Whole Foods increase. If, after the merger, Whole Foods raised its prices or permitted its quality to decline, customers could and would easily shift their purchases of natural and organic products from Whole Foods to other supermarkets.

There is yet another factor that leads to the conclusion that the relevant product market in this case must be broader than premium and organic supermarkets and, indeed, that it must be at least as broad as supermarkets: how the players in the marketplace view each other and how their conduct reflects those views. Whole Foods and Wild Oats view other, more conventional supermarkets as their primary competitors, and they plan their strategies accordingly—through "comp" shopping, price checking, and real estate site selection, among other things. The same is true in reverse. Conventional supermarkets like Delhaize, Publix, Safeway and Wegmans consider Whole Foods to be a significant competitor in the marketplace. In attempting to compete with Whole Foods for consumers interested in natural and organic products, stores like Safeway, Kroger and even Trader Joe's have developed so-called private labels—Safeway's "O" organic label being prime among them. Whole Foods has responded in kind and designed its own private label programs, primarily to compete against other supermarkets, particularly for the kind of cross-over shoppers previously discussed.

In sum, while all supermarket retailers, including Whole Foods, attempt to differentiate themselves in some way in order to attract customers, they nevertheless compete, and compete vigorously, with each other. The evidence before the Court demonstrates that conventional or more traditional supermarkets today compete for the customers who shop at Whole Foods and Wild Oats, particularly the large number of cross-shopping customers—or customers at the margin—with a growing interest in natural and organic foods. Post-merger, all of these competing alternatives will remain. Based upon the evidence presented, the Court concludes that many customers could and would readily shift more of their purchases to any of the increasingly available substitute sources of natural and organic foods. The Court therefore concludes that the FTC has not met its burden to prove that "premium natural and organic supermarkets" is the relevant product market in this case for antitrust purposes.

VI. RELEVANT GEOGRAPHIC MARKET

The Merger Guidelines delineate the relevant geographic market to be a region such that a hypothetical monopolist that was the only present or future producer of the relevant product at locations in that region would profitably impose a "small but significant and nontransitory increase in price." Merger Guidelines § 1.21. The question is what would happen if a hypothetical monopolist of the relevant product at that point imposed a SSNP in that region. *Id.* If the FTC shows that the merger may lessen competition in any one of the alleged geographic markets, it is entitled to injunctive relief. *See* 15 U.S.C. § 18.

The FTC has identified 17 areas where there is a Whole Foods store and a Wild ***37** Oats store within a six mile radius of the other ("overlapping draw areas") or within a 16–minute drive of each other. In an eighteenth area, Portland, Oregon, the FTC applies the same test, but there is also a New Seasons store in the area—another PNOS alleged by the FTC.

The defendants criticize the FTC for defining geographic markets by reference only to distance and driving time because it has failed to consider a myriad of other factors, such as traffic, demographics, locations of other supermarkets, projected population growth, and geography—all factors that likely would limit or expand the store's draw in various directions. Whole Foods notes that it considers these factors and more in siting its stores. *See, e.g.,* DX 171, 183, 514. In addition, according to the defendants, because of local variations in traffic and geography, the 16–minute driving distances in each direction from a store are highly unlikely to be equal, and, if plotted on a map, are highly unlikely to produce an even circle at any distance around the store.

The FTC responds that defendants' business records and testimony establish that they generally focus on customers within a distance of three to six miles of their stores—and roughly 16 minutes driving time—when selecting site locations and making other competitive assessments. PX02212 ("3 miles is a general area that we commonly use to compare our stores trade areas"); PX01011 (charting all stores within six miles of Whole Foods in a competitive analysis document); PX00186 at 007 (focusing on customers within a 16 minute driving distance of store); JX 6 at 44:24–45:12 (Bradley Dep.); JX 9 at 28:19–21(Megahan Dep.); JX 10 at 90:16–18 (Meyer Dep.); Lannon Decl. ¶ 23; Besancon Decl. ¶¶ 42, 44, 46, 57, 61, 63, 65, 68–70; Megahan Decl. ¶¶ 7, 8, 25, 28; Martin Decl. ¶ 25; Allshouse Decl. ¶¶ 14; Robb Decl. ¶¶ 36, 38; Paradise Decl. ¶¶ 26–30, 33–37, 39–43, 45–46, 51, 54; PX04733, at 005; PX01374.[15]

The Court agrees with the FTC that, in the context of this case and the evidence presented, this is a reasonable way to define the relevant geographic market. *See United States v. General Dynamics Corp.,* 415 U.S. 486, 521, 94 S.Ct. 1186, 39 L.Ed.2d 530 (1974) (markets need not be delineated by "metes and bounds"); *United States v. Pabst Brewing Co.,* 384 U.S. 546, 549, 86 S.Ct. 1665, 16 L.Ed.2d 765 (1966) (the geographic market need not be identified with scientific precision or "by metes and bounds as a surveyor would lay off a plot of ground").

Applying its six-mile overlapping draw area and 16–minute tests, the FTC maintains that the proposed merger will eliminate Whole Foods' only premium natural and organic supermarket competitor (Wild Oats) in defined areas within the following 17 localities: Albuquerque, New Mexico; Boston, Massachusetts; Boulder, Colorado; Hinsdale, Illinois (suburban Chicago); Evanston, Illinois (suburban Chicago); Cleveland, Ohio; Denver, Colorado; West ***38** Hartford, Connecticut; Henderson, Nevada; Kansas City–Overland Park, Kansas; Las Vegas, Nevada; Los Angeles, California; Louisville, Kentucky; Omaha, Nebraska; Pasadena, California; Portland, Maine; and St. Louis, Missouri. Murphy Supp. Rebut. Report ¶ 8, Exhibit 2 at 012–023, 025–026. In an eighteenth market, Portland, Oregon, the FTC maintains that because of the continuing presence of New Seasons, the proposed merger will Teduce the number of competitors from three to two in a defined area within Portland, Oregon. Murphy Supp. Rebut. Report ¶ 8, Exhibit 2 at 024. While it identifies these 18 overlap markets, the FTC has provided data concerning what percentage of Wild Oats' revenues would transfer from Wild Oats to Whole Foods upon closure of the Wild Oats stores for only nine of the 18 markets in which it says the acquisition and subsequent closure of the Wild Oats stores by Whole Foods would have anti-competitive effect. *See* Pl's FOF ¶¶ 457–499.

In addition, the FTC maintains that the proposed transaction will also eliminate future competition in seven local areas in which Whole Foods has plans in the works to open stores and where Whole Foods and Wild Oats had planned to compete with one another. These areas are located within: Fairfield County, Connecticut; Miami, Florida; Naples, Florida; Nashville, Tennessee; Palo Alto, California; Reno, Nevada; and Salt Lake City, Utah. PX04357. But the FTC has offered no evidence to support this assertion. *See* Pl's FOF ¶¶ 500–511.

Because the Court already has concluded that the relevant product market is not premium natural and organic supermarkets but, rather, all supermarkets, none of this matters. That is, since the FTC has not met its burden with respect to the relevant product market, the Court need not closely examine the alleged relevant geographic market.

VII. HARM TO COMPETITION

A. General Principles/Market Share and Concentration

Mergers that significantly increase market concentration are presumptively unlawful because the fewer the competitors and the larger the respective market shares, the greater the likelihood that a single firm or group of firms could raise prices above competitive levels. *United States v. Philadelphia Nat'l Bank,* 374 U.S. at 363, 83 S.Ct. 1715; *Hospital Corp. of Am. v. FTC,* 807 F.2d 1381, 1389 (7th Cir.1986); *FTC v. Cardinal Health, Inc.,* 12 F.Supp.2d at 52; Merger Guidelines § 2.0.

Concentration typically is measured by market share and by the Herfindahl–Hirschman Index ("HHI"). The HHI is calculated by summing the squares of the market shares of each market participant, so that greater weight is given to market shares of larger firms, consistent with their relative importance in competitive interactions. Merger Guidelines § 1.5. *See FTC v. Cardinal Health, Inc.,* 12 F.Supp.2d at 53–54; *FTC v. Staples, Inc.,* 970 F.Supp. at 1081–82. Where the pre-acquisition HHI exceeds 1800 points, it "is presumed that mergers producing an increase in the HHI of more than 100 points are likely to create or enhance market power or facilitate its exercise." Merger Guidelines § 1.51; *FTC v. Cardinal Health, Inc.,* 12 F.Supp.2d at 53.

The FTC argues in this case that the combined shares of Whole Foods and Wild Oats in the premium natural and organic supermarkets would be 100% in 17 of the 18 alleged relevant geographic markets, as they are the only premium natural and organic supermarkets in those geographic ***39** markets. This reaches the theoretical maximum HHI of 10,000 points. *See* PX01302 at 020; PX00613 at 018–019; PX01011.

The premise of the FTC's argument, however, is that premium natural and organic supermarkets constitute the relevant product market, that Whole Foods and Wild Oats are unique price competitors, that Wild Oats' presence in a market has a constraining effect on Wild Oats, and that the consumer will lose the availability of significant choices in one or more of the 17 relevant geographic markets. As discussed earlier, however, the evidence does not support these arguments. Thus, any presumption of likely anticompetitive effects has been overcome both by the testimony of the defendants' economic expert and by the realities of the marketplace as reflected in credible evidence presented in this proceeding. Accordingly, there is no need to analyze specific HHI calculations.

B. Presence or Absence of Another PNOS

The evidence shows that Whole Foods and Wild Oats pricing practices do not differ based on the presence or absence of the other in the area. Scheffman Report ¶ 291. Rather, both companies generally price based on relatively broad geographic areas and Wild Oats' prices typically are higher. Scheffman Report ¶ 286, JX 9 at 98 (Megahan Dep.); JX 38 at 71–73 (Smith I.H.); JX 37 at 35–36 (Odak I.H.)

Pricing for most products at Whole Foods is determined at the regional level rather than at the store level. Scheffman Report ¶ 289; JX 18 at 191 (Scheffman Dep.); JX 1 at 209–10 (Gallo Dep.). Whole Foods does not have price zones or other pricing policies that depend on whether a Whole Foods store is competing with a Wild Oats store. Scheffman Report ¶ 289; Gallo Decl. ¶ 29 ("Whole Foods follows the same general pricing policies or strategies in areas where WO operates as it does in areas where they do not.")

Dr. Scheffman analyzed prices by comparing actual "in the register" prices for June 9, 2007, for all items carried in multiple Whole Foods and Wild Oats stores within a region. Scheffman Report ¶ 298. "In the register" prices are those that are already programmed into the scanner system. *Id.* He testified that he used this approach because Whole Foods does not preserve historic register data due to storage capacity constraints. JX 18 at 189 (Scheffman Dep.); July 31 p.m. Hearing Tr. at 43 (Scheffman). A "snapshot" of prices, rather than a time series, is an appropriate analysis, according to Dr. Scheffman, since the objective was to determine whether prices are higher in monopoly regions. Scheffman Report ¶¶ 297–298. While the FTC criticizes this limited data basis for a variety of reasons, Dr. Scheffman looked at the best evidence available that was directly related to price—the one-day's worth of register prices. While it would have been preferable to have more data, the companies do not keep historical register data, and Dr. Scheffman's results are consistent with the other evidence in the record.

The results of Dr. Scheffman's analyses of actual prices show that there is no systematic pattern in pricing among Whole Foods and Wild Oats stores based on the presence or absence of PNOS competition. Scheffman Report ¶ 288. Whole Foods stores with and without PNOS competition have a low fraction of prices that differ from the regional mean, and the distribution does not differ significantly between overlap and non-overlap stores. Scheffman Report ¶ 312. Actual prices are consistent with the described practices for the two companies—prices are generally common across broad areas, and any differences are not systematically related to the ***40** presence or absence of competition with each other or with another PNOS. Scheffman Report ¶¶ 312, 323. Prices are not lower in areas in which Whole Foods and Wild Oats compete with one another or with another PNOS than in areas where Whole Foods or Wild Oats are PNOS monopolists. Scheffman Report ¶¶ 314, 325.

There is evidence, albeit based on a single example, that after Wild Oats closed its Fort Collins store in December 2006, the Whole Foods store experienced no increase in gross margins. JX 31 at 240 (Paradise I.H.). Whole Foods only gained [Redacted] to [Redacted] in sales per week after the Wild Oats Fort Collins store closed. JX 31 at 239–240 (Paradise I.H.). Under the FTC's theory, Whole Foods should have been able to raise prices after the Wild Oats Fort Collins store closed. Whole Foods did not raise prices after the Wild Oats' store closed because of competition with King Soopers, Vitamin Cottage, and multiple Safeway stores in Fort Collins. JX 31 at 240 (Paradise I.H.).

C. Wild Oats Is Not a Unique Constraint on Whole Foods

The evidence shows that Wild Oats prices are consistently higher than Whole Foods prices. JX 13 at 56–57, 60–61, 111–12 (Davidson Dep.) [Redacted].

Market research commissioned by Wild Oats revealed that the "price gap between Wild Oats and major food stores" [Redacted] DX 572; *see also* DX 570 [Redacted]. Wild Oats' documents confirm that its prices have been higher than Whole Foods. For example, Wild Oats found that Whole Foods' prices were below [Redacted] and Whole Foods private label products are priced as much as [Redacted] comparable Wild Oats products. DX 487 (noting that Wild Oats simply does "not have enough competitive advantages against Whole Foods to compete directly against them.").

Wild Oats' prices are higher than other competitors. DX 580, DX 582 (Wild Oats [Redacted] price check reports that Wild Oats has higher prices than Whole Foods in every category, and has higher prices than [Redacted] in some categories); JX 37 at 41–46 (Odak I.H.)(Wild Oats price checked [Redacted] and discovered Wild Oats was [Redacted] percent higher than the competition in the marketplace). Wild Oats price checking led it to conclude that Wild Oats is typically priced higher than Whole Foods. A September 2006 price check of [Redacted] SKUs revealed that Wild Oats' pricing was above Whole Foods in every geographic area in which the price check was conducted. DX 490. A Wild Oats January 2007 price analysis of [Redacted] items in the [Redacted] showed that Whole

Foods' prices were "significantly below" Wild Oats' prices. Wild Oats estimated that it would need to reduce costs by about [Redacted] to achieve pricing parity with Whole Foods. DX 580. Whole Foods' market research confirms this point. In October 2004, the Natural Marketing Institute reported that, based on both shopping frequency and private label brand usage, "Wild Oats seems to have little effect on [Whole Foods]." DX 240 at 8.

Whole Foods' price-checking also confirms that Wild Oats is higher priced than Whole Foods. A.C. Gallo, Co–President and Chief Operating Officer of Whole Foods, explained to Whole Foods regional presidents that:

> "[W]e could use the merger with WO to tell some of our stories one of which could be we have great prices. The concern in any merger is that prices may go up in acquired stores. In fact, we know that WOs prices are higher than ours and we will be bringing down ***41** quite a few prices. We could use this opportunity to shout out either on a local, regional or national basis our great prices."

DX 58.

David Lannon, Regional President for the North Atlantic Region for Whole Foods, explained that Whole Foods does not "find it necessary to price against Wild Oats, because Wild Oats' prices in [Redacted] as in areas throughout my region, are higher than all other supermarkets in the area." Lannon Decl. ¶ 24; *see also* Lannon Decl. ¶ 25. The North Atlantic stores have "never targeted a Wild Oats [store]" and no store has "ever requested to do so." Lannon Decl. ¶ 14.

Wild Oats is also typically higher priced in the Mid–Atlantic region. Meyer Decl. ¶ 13. Kenneth Meyer, the Mid–Atlantic Regional President for Whole Foods, explained that "our true competition on price and other factors is the multitude of other grocery retailers in those areas—and not Wild Oats." Meyer Decl. ¶ 13. Whole Foods' [Redacted] store has "had little occasion to need to compete—or pay much attention at all, for that matter—to the Wild Oats store in [Redacted] That store has not adapted to the marketplace and displays insufficient innovation or energy to cause us concern." Meyer Decl. ¶ 12; JX 10 at 108–09 (Meyer Dep.).

Whole Foods' Midwest region no longer systematically price checks Wild Oats on a monthly basis as it does for Trader Joe's and other supermarkets. Whole Foods determined that it was unnecessary to regularly check Wild Oats' prices in the Midwest region because Wild Oats pricing has been consistently higher than both Whole Foods and its other competitors. Bradley Decl. ¶ 13; JX 6 at 74 (Bradley Dep.).

In the Southern Pacific region, Wild Oats has little effect on Whole Foods' prices because Wild Oats' prices are also higher than those of Whole Foods and other competing supermarkets. Besancon Decl. ¶ 24. Because historical price checking confirms that Wild Oats is priced above all supermarkets, including Whole Foods, Whole Foods benchmarks other supermarkets and Trader Joe's to determine its own prices. Besancon Decl. ¶ 38.

In the Rocky Mountain region, Wild Oats has minimal impact on Whole Foods since its prices are "generally higher" than those of Whole Foods and other supermarkets. Paradise Decl. ¶ 22. Wild Oats rarely make capital improvements and are therefore not as strong a competitor to Whole Foods as other supermarkets and Trader Joe's. *Id.*

In sum, the existence of Wild Oats does not force Whole Foods' prices down because Wild Oats' prices are consistently higher. Thus, the elimination of Wild Oats will not harm competition with respect to price constraints on Whole Foods.

D. Other Supermarkets and Other Retailers Constrain Competition

As discussed above, competition from other supermarkets is more intense than ever, as supermarkets have improved operations and have increased offerings of natural and organic products. *See, e.g.,* DX 1 (June 2006 e-mail from Whole Foods Co–President and Chief Operating Officer containing thoughts on competition, stating that "[t]his is a time of unprecedented competition for us.... We are currently getting hit from many different directions in each market."); DX 3 (October 2006 e-mail from A.C. Gallo) ("After a total slump by the supermarket industry in the last five years we are seeing a comeback by the survivors. Safeway, Giant Eagle, Giant, Stop & Shop, Harris Teeter, Food Lion, Publix are all opening lots of new stores and remodeling stores on the East ***42** Coast. Every time they open a store or remodel an existing one with better perishables and natural foods, we see a hit.").[16]

E. Repositioning and Entry by Other Retailers

The Merger Guidelines recognize that a merger is not likely to enhance market power or facilitate its exercise if it is easy for other market participants to enter the market or reposition themselves better to compete. Merger Guidelines § 3.0. The question is whether the entry by others (or their repositioning) would be timely—is it easy to enter or reposition—likely and sufficient in its magnitude to "achieve significant market impact within a timely period." *Id.; see also FTC v. Cardinal Health,* 12 F.Supp.2d at 55–58 (adopting "timely, likely, and sufficient" test). To rebut the presumption of anticompetitive effects, the evidence must show that a firm would enter, and that "entry into the market would likely avert the anticompetitive effects from the acquisition." *FTC v. Staples, Inc.,* 970 F.Supp. at 1086 (quoting *United States v. Baker Hughes Inc.,* 908 F.2d at 989); *accord FTC v. Swedish Match,* 131 F.Supp.2d at 170; *FTC v. Cardinal Health,* 12 F.Supp.2d at 55. For entry to be sufficient to restore competition, it must replace the competition that existed prior to the acquisition. *FTC v. Cardinal Health,* 12 F.Supp.2d at 58.

The FTC concedes that there is always the possibility of de novo entry. In principle, the FTC also agrees that existing retailers could reposition to provide increased competition for existing premium natural and organic supermarkets and that such repositioning could increase competition enough to compensate for the loss of pricing restraint within the market. *See* Murphy Report ¶ 130.

The key question is whether such entry or repositioning would occur in a timely fashion and would be of sufficient magnitude to make a small but significant price increase unprofitable —that is, it would prevent any harm to competition that might otherwise result from the merger. Murphy Report ¶ 137. While it is possible that a new retailer, a conventional supermarket, or even a PNOS, could enter one of the relevant geographic markets with a new store or reposition themselves, the FTC argues that it is unlikely that retailers would do so in each relevant geographic market at issue in this case to the extent necessary to make price increases unprofitable. *Id.* ¶¶ 119, 121, 126, 129, 138.

The FTC argues that de novo entry would be neither easy nor timely. It argues that entry and growth in the PNOS market takes significantly longer than two years, the relevant time frame under the Guidelines. *See* Merger Guidelines § 3.2. Whole Foods agrees that it takes time and is costly and sometimes difficult to enter the market de novo. *See* Murphy Report ¶ 138. Finding and developing suitable real estate on which to locate a supermarket is often a multi-year task in many metropolitan areas, and it can easily take three or more years from conception to site selection. *See, e.g.,* JX 10 at 20:15–21, 107:3–25 (Meyer Dep.) ("[I]t's about a three-year process at a minimum of taking a store from the point of idea to opening, at a minimum.").

As for repositioning, the FTC argues that other retailers are unlikely to reposition because, in order to compete effectively with Whole Foods, they would have to dramatically change the nature of their operations. They would have to expand the amount of space dedicated to natural and organic products, increase their focus ***43** on perishables, devote substantially more selling space to perishables, improve quality, and provide extra services. The FTC does not suggest that other retailers do not or cannot sell fresh and organic produce. Rather, it argues that they would not reposition in a way that replaces the close, constraining competition that the FTC alleges that Wild Oats provides to Whole Foods. The question, according to the FTC, is how far can a traditional retailer or conventional supermarket go to court the Whole Foods/Wild Oatstype customer without losing focus on its own core constituency.

The problem with the FTC's analysis is that the evidence shows that retailers have already been repositioning their formats, services and product selection in order to respond to the growing consumer demand for natural and organic foods and to better compete against Whole Foods. Stanton Report ¶¶ 21, 29–34; Scheffman Report, Appendix E ¶¶ 3–8. And other supermarkets are expanding their product offering and repositioning themselves at Whole Foods' and Wild Oats' pre-merger prices and pre-merger quality. *See* Simon (Hain) Decl. ¶ 3; Sliva (White Wave) Decl. ¶¶ 7–8; DX 617 and 618–19 (Vail Dep.); Scheffman Report ¶ 256. Indeed, today, over 60% of all natural and organic products are sold by conventional stores. Mays Decl. ¶ 19; *see also* JX 28 at 33 (Whole Foods CEO Mackey explaining that "Our success has created more competition, it has bred more imitation, has caused all these supermarkets to try to want to steal Whole Foods' mojo."); 103 ("... Whole Foods no longer has this product differentiation to itself ...") (Mackey I.H.).

This repositioning trend likely will continue as large, better capitalized supermarkets leverage their scale to obtain high-quality natural and organic foods at lower costs than Whole Foods. JX 28 at 103 (Mackey I.H.). Should prices rise or quality fall post-merger, repositioning is likely to accelerate.

The evidence before the Court shows that the firms that have already proven themselves adept at repositioning and proving competitive in the premium natural and organic food field —through the addition and expansion of organic produce, perishable meats and other products, including private labels natural and organic products, and new "lifestyle" formats— are Delhaize America and in particular its high-end banners, Hannaford and Bloom; Safeway; Publix; Kroger; Supervalu; and Wegmans. The Court is less persuaded, despite some evidence to the contrary, that Trader Joe's is likely to reposition itself to better compete with Whole Foods, and it is not persuaded that Wal–Mart, Target, Costco or other mass-market retailers have repositioned or will reposition sufficiently quickly to provide serious competition with respect to a significant number of Whole Foods' marginal customers.[17] The same is ***44** true as to Tesco but for different reasons.[18]

1. Delhaize America

Delhaize operates over 1,500 supermarkets under the Hannaford Bros., Bloom, Food Lion, Kash n' Karry, Harvey's, Bottom Dollar and Sweetbay banners. Stanton Report ¶ 35. Delhaize has been actively growing the number of natural and organic products sold at its banners—especially Hannaford, Bloom and Sweetbay—in response to consumer demand. JX 21 at 37–40 (Vail Dep.); Stanton Report ¶¶ 35–36.

Peter Vail, the Leader of Organic and Natural Foods for Hannaford Bros., a part of Delhaize, testified that Delhaize has taken the approach that natural, organic and fresh foods are "critical" to the growth plan for all of its banner stores. Over the last four years or so, the company has viewed natural and organic products as an "emerging" part of the industry. JX 21 at 37 (Vail Dep.). These products have been identified as one of the "Engines of Growth" for the company. JX 21 at 56–57 (Vail Dep.); *see* Scheffman Report, Appendix E ¶ 18.

Delhaize has recently launched its own line of private label natural and organic products called "Nature's Place," and these products are being rolled-out at all its banners. The company introduced approximately 150–200 SKUs in this line in April 2007. The evidence shows that the company is planning to grow these offerings by introducing another 100 SKUs in the fall of 2007 and another 100 SKUs within a year. JX 21 at 38–39, 60–68, 104–105 (Vail Dep.). The company anticipates rolling out new products in 2008 and 2009 as well. JX 21 at 83–84 (Vail Dep.). Delhaize's sales of its private label natural and organic line have been so strong that the company doubled its original sales projections shortly after the product line was launched, and the sales have gone up another 25 percent since then. JX 21 at 114–115 (Vail Dep.). The private label organic line has become a "key strategic initiative for us and how we compete in our marketplace." JX 21 at 73–74 (Vail Dep.).

Delhaize's pricing strategy for its Nature's Place organic SKUs is targeted after other supermarkets, including Whole Foods and Wild Oats, and other food retailers. *See* DX 645 at DZA 000098 (Delhaize, "EOG Strategic Overview") (document specifically lists Whole Foods and Wild Oats). Peter Vail testified that Delhaize specifically prices its Nature's Place SKUs against Whole Foods and Wild Oats under its Engines of Growth (EOG) strategy because "... we look at Whole Foods and Wild Oats as two competitors ..." and "[w]e wanted to ensure that we were priced competitively against those two banners specifically...." JX 21 at 71 (Vail Dep.).

About 90 percent of Hannaford stores—one of Delhaize's banners—now have a dedicated "Nature's Place" section, which is a "store-within-a-store" concept specializing in natural and organic products, and which carries about 4,000 different natural and organic products. JX 21 at 16–17 ***45** (Vail Dep.). Hannaford stores currently carry approximately 5,000 different natural and organic products, or about 10 percent of its total SKUs. JX 21 at 18,108–109 (Vail Dep.).

A Hannaford customer survey also refers to Whole Foods and Wild Oats as both "Key" and "Primary" competitors. DX 652 at DZA 000111 (Delhaize, "2006 Customer Source Survey") ("primary" competitors for the Hannaford store in Norwell, Massachusetts for Sept. 16, 2006 are limited to Stop & Shop, Whole Foods, and Foodmaster); DX 653 at DZA 000115 (Delhaize, "2006 Customer Source Survey") ("primary" competitors for the Hannaford store on Forest Ave. in Portland, Maine as of Sept. 23, 2006–prior to the opening of Whole Foods in Feb. 2007–are limited to Shaw's, Wild Oats and Save–A–Lot).

Delhaize has developed two new banners—Bloom and Sweetbay—and is repositioning, re-formatting and re-branding a number of former Food Lion and Kash n' Karry stores so as to provide a new shopping experience, with a particularly strong emphasis on freshness, natural and organic products, and convenience. Stanton Report ¶ 37; JX 21 at 20–21 (Vail Dep.).

2. Safeway

Safeway is one of the largest supermarket chains in the United States. DX 592 at 4; Stanton Report ¶ 39; Scheffman Report, Appendix E ¶ 60. Safeway operates over 1,500 supermarkets in 21 states and the District of Columbia. DX 592 at 5–6; Scheffman Report, Appendix E ¶ 60. Safeway operates under the Safeway (Western and Mid–Atlantic states), Vons (Southern California), Pavilion, (Southern California), Dominick's (Chicago area), Genuardi's (Philadelphia area), Randall's (Texas), Tom Thumb (Texas), and Carr (Alaska) store banners. DX 592 at 5; Stanton Report ¶ 41; Scheffman Report, Appendix E ¶ 60.

As of December 31, 2006, Safeway had remodeled 751 of its stores into a newly developed "Lifestyle" format. DX 592 at 20. Safeway plans to spend $1.7 billion in 2007 to remodel 275 additional Safeway stores into the Lifestyle format and to open 25 newly constructed Lifestyle format stores. DX 592 at 20. In total, Safeway has spent several billion dollars repositioning its stores into the Lifestyle format. Stanton Report ¶ 40. [Redacted].

[Redacted].

Ms. Hasker testified that the Lifestyle format was developed in response to customers that "clearly articulated the desire for quality products, for knowledgeable and friendly service and a higher expectation of a shopping experience." JX 25 at 106–07 (Hasker Dep.). *See also* Scheffman Report, Appendix E ¶ 63 (citing a Bear Stearns December 2006 report noting that Safeway is "not only responding to shifting consumer demand, but helping to drive demand"); Stanton Report ¶ 39 (Lifestyle format also offers consumers an "experiential factor").

[Redacted] *See also* Scheffman Report, Appendix E ¶ 60.

[Redacted].

[Redacted] In addition to launching the "O" organic brand products, Safeway recently introduced its "Eating Right" brand of products for health conscious consumers. DX 592 at 11. "Eating Right products combine great taste with nutritional efficacy and feature a unique nutritional icon system to help consumers identify product attributes that they seek." DX 592 at 11. Safeway's increased emphasis on natural and organic products is in response to consumer demand. Rojan Hasker testified that "our customer base has an ***46** interest and a growing interest in organic and natural products. All trend [in]formation obviously supports that." JX 25 at 16 (Hasker Dep.).

[Redacted] Whole Foods considers Safeway a competitor and has observed the success Safeway has reported at its remodeled stores. DX 22 (E-mail December 2006 K. Meyer to Whole Foods executives) Paradise Decl. ¶ 21 (Safeway Lifestyle stores designed to compete with Whole Foods and imitates strategies Whole Food has used to compete against other supermarkets).

Dr. Stanton observed that Safeway's Lifestyle "strategy is aimed at helping the company [Safeway] compete with the likes of Whole Foods, and is winning over customers with organic foods, high-quality meats and produce, and extensive bakery and deli offerings." Stanton Report ¶ 40.

Whole Foods perceives that Safeway has increased the competitive pressure on Whole Foods. Robb Decl. ¶ 23 ("Safeway's aggressive launch of its "O" line of organic products is an important and challenging development for Whole Foods."); *see also* DX 609 at 18, 54 (Meyer Dep.) ("Safeway has put together a format, their Lifestyle format, that I think is very concerning to me that when they open their stores, ... [o]ur sales growth diminishes"). Safeway is also actively recruiting suppliers of natural and organic products, making it more difficult for Whole Foods to be "first to market with new organic foods." DX 7 at 1 (February 2006 e-mail, R. Megahan).

3. Publix

Publix operates a supermarket chain in the southeastern United States. The company's primary focus has been on providing an upscale "experience," high quality and excellent customer service. Stanton Report ¶ 56.

Publix [Redacted] Publix has added a large selection of organic and natural foods, including an entire line of private label organic foods called GreenWise. Scheffman Report, Appendix E ¶¶ 56–57. The first GreenWise store is set to open in September 2007 and will provide an array of natural and organic foods, earth-friendly products, freshly prepared cuisine, and high-quality produce, dairy, frozen food, vitamins, grocery items and nutrition products. Stanton Report ¶ 57. The GreenWise products include shelf-stable food products, dairy, poultry, snacks, juices and an environmentally-friendly line of paper products. Stanton Report ¶ 56.

[Redacted] DX 677.

4. Kroger

Kroger operates over 2,400 supermarkets and multi-department stores across the United States, and its banners include Kroger, Smith's, Fred Meyer, Dillon's, Ralphs, and King Soopers. Stanton Report ¶ 53; Scheffman Report, Appendix E ¶ 44.

Kroger sells a wide variety of natural and organic products, including shelf-stable groceries, produce, poultry, dairy, and beverages. It introduced its own line of private label natural and organic products under the “Naturally Preferred” label, which includes over 275 items in a variety of categories. Stanton Report ¶¶ 53–54. Kroger also offers a premium private label food line known as “Private Selection,” which is designed to meet or beat national or regional gourmet and upscale brands. *Id.* Many of the Kroger stores (approximately 1,600) feature dedicated natural and organic departments, such as the “Nature's Marketplace” section within Kroger-bannered stores. Stanton Report ¶ 54.

Kroger is aware of the growth in demand for natural and organic products, and the repositioning going on all around ***47** them in the industry. DX 66 (e-mail from Scott Allshouse). Kroger has stated in its recent internal planning documents: “Kroger is the # 1 grocery retailer; we should also be the # 1 natural and organic food retailer. The question is: ‘How big do we want to get and how soon do we want to get there?’ If we are to gain dominance in this industry, we must do more and we must do it now.” DX 663 (memorandum from Nancy Moon–Eilers). Chain-wide, Kroger's organic produce sales increased by over 82 percent by January of 2006, and the company felt “we still have a huge upside sales potential.” DX 669 (Kroger, Email re: “2006 Organic Produce Sales Goals”).

Kroger has a store-within-a-store concept in order to “improve on our ability to meet the Natural Foods needs of our Customers” and to “allow us to enhance our selection with new items and categories and to create an ease-to-shop destination for our Customers.” DX 664 (Kroger, “Natural Foods Growth Strategy”). One of Kroger's “Strategy Objectives” is to “Improve distribution for Natural Foods” which “will lower costs of goods and improve instocks.” DX 664.

Kroger is remodeling and upgrading its stores, including 158 store remodels in 2006. Kroger's other banners are also upgrading their formats. Stanton Report ¶ 54. For instance, the Ralph's “Fresh Fare” concept emphasizes fresh products, selection and service. Scheffman Report, Appendix E ¶ 54. King Soopers is planning to build a 99,000 square foot store (the largest in the chain) near Boulder, Colorado next year which will emphasize an improved shopping experience, expanded produce, and organic foods. Stanton Report ¶ 54.

5. Supervalu

Supervalu is one of the largest grocery distributors and supermarket operators in the nation. It operates supermarkets under the Albertson's, Shaw's, Star, Jewel–Osco, Cub, Acme and other banners, and distributes grocery products to over 2,000 independent supermarkets across the country. Stanton Report ¶¶ 47–48; Scheffman Report, Appendix E ¶ 76. Supervalu has recognized the importance of meeting the growing consumer demand for freshness, nutrition and organic products. Stanton Report ¶ 47.

Supervalu has recently established an aggressive remodeling campaign in order to expand its presence in natural, organic and premium foods. The company is spending approximately $1 billion to remodel and construct new stores in order to customize and enhance the customer shopping experience. Stanton Report ¶ 49; Scheffman report, Appendix E ¶ 78. The remodeling and new store campaign, called “Premium Fresh & Healthy,” places a strong emphasis on: the “Wild Harvest” concept, which is a store-within-a-store focused on natural and organic products; expanded perishables, including produce, meat, seafood, bakery and deli; “Shop the World,” which is an international food destination department; and expanded health and beauty care products to support a healthy lifestyle. Stanton Report ¶ 49.

Supervalu has established two different lines of private label organic products—“Nature's Best” and “Wild Harvest.” The Nature's Best brand is available to all of Supervalu's corporately-owned supermarkets and to the approximately 2,200 independent supermarkets to which Supervalu is the primary grocery distributor. There are currently over 500 different products under the Nature's Best label. Stanton Report ¶ 48.

In addition to the "Premium Fresh & Healthy" remodeling and new store campaign, Supervalu has created a new format ***48** called "Sunflower Market," which is a value-priced natural and organic retail outlet offering between 8,000 and 12,000 SKUs of natural and organic products. Supervalu has announced plans to open 50 Sunflower markets over the next five years. Stanton Report ¶ 51; Scheffman Report, Appendix E ¶ 96.

6. Wegmans

Wegmans operates supermarkets in New York, New Jersey, Pennsylvania, Maryland and Virginia. Scheffman Report, Appendix E ¶ 119. It has become recognized within the industry as one of the best supermarkets in the country in terms of produce, fresh product offerings and prepared foods. Stanton Report ¶¶ 43–45.

Wegmans has introduced its own line of private label organic products and offers a store-within-a-store format called "Nature's Marketplace," selling a large assortment of natural and organic foods, supplements, herbal remedies, non-food items, and foods for special dietary needs. Stanton Report ¶ 45; Scheffman Report, Appendix E ¶ 112.

Whole Foods sees [Redacted] every time Wegmans opens a store in the vicinity of a Whole foods store. DX 59 at 3 (FY 2007 First Quarter Board Report by A.C. Gallo); DX 209 at 3 (Co–President A C. Gallo explained to the Board of Directors that "Wegmans has temporarily taken from us the image of being the best Foodie store in [Redacted] For example, when Wegmans opened two new stores within 15 minutes of Whole Foods' [Redacted] store, Whole Foods ascribed a [Redacted] decrease in comps to Wegmans. DX 86 at 5. Wegmans also directly engages in price competition with Whole Foods by comparing its prices to Whole Foods' prices on shelf tags and advertisements. DX 72; DX 74. Whole Foods says it has been forced to reduce prices to retain sales. *See* DX 209 (stating Whole Foods will drop prices to go "toe to toe" with Wegmans).

In sum, the snapshot of the marketplace today is very different than it may have been a few years ago. Delhaize, Safeway, Publix, Kroger, Supervalu, and Wegmans have already repositioned themselves to compete vigorously with Whole Foods and Wild Oats for the consumers' premium natural and organic food business. To put it colloquially, this train has already left the station.

VIII. POTENTIAL DEFENSES

The defendants suggest two possible affirmative defenses to the potential conclusion that this merger's effect would be anticompetitive: (1) that the merged company would result in the more efficient use of existing resources, thus improving the performance of the merging firms and benefitting consumers, and (2) that Wild Oats is a "flailing" or weakened company.

The Request for Additional Information ("Request") issued to Whole Foods in the investigation of the proposed acquisition asked Whole Foods to provide a "detailed description of all efficiencies that [Whole Foods] claims will or may arise from the proposed acquisition." The Request also asked Whole Foods to describe the means by which each efficiency was to be accomplished, the investments required, the expected savings, and the time required for Whole Foods to achieve each efficiency. Whole Foods in its response to the Request did not include a single efficiency and did not specify the time in which it expected to achieve any efficiency. *See* PX01349 at 001–004.

Defendants' expert, Dr. Scheffman, testified in his deposition that he was "not putting forward a [Merger G]uidelines analysis of merger efficiencies" and that his analysis of the purported benefits of the acquisition were based on "guesstimates." ***49** JX 18 at 227:12, 233:24–25 (redacted) (Scheffman Dep.). Whole Foods' Senior Vice–President of Growth and Business Development, James Sud, testified that the savings he expected the company to achieve was based on unverified assumptions of general and administrative expenses as a percentage of sales. And Whole Foods' Co–President and COO, Walter Robb, testified that it would be speculative to identify the redundant jobs that would be eliminated to allow for cost savings until Whole Foods can "get in there" and see how Wild Oats is organized. JX 2 at 183:18–185:7 (Robb Dep.).

Based upon the testimony of Dr. Scheffman, Mr. Sud and Mr. Robb, as well as on defendants' response to the FTC's Request for Additional Information, the Court concludes that defendants have failed to meet their burden on the issue of efficiencies under Section 4 of the Horizontal Merger Guidelines. *See* Merger Guidelines § 4; *see also FTC v. H.J.*

Heinz Co., 246 F.3d at 720; *FTC v. Cardinal Health,* 12 F.Supp.2d at 62.

The defendants do not claim that Wild Oats is a failing firm or that it could meet the high standard for showing a failing firm defense. In Camera Session August 1, 2007 PM Tr. Mot. Hr'g at 47:23–24 (Under Seal) (Aronson). They do argue, however, that Wild Oats is a "weakened" or "flailing" firm and that its elimination by Whole Foods will lead to a more efficient competitor. As the FTC points out, however, the "flailing firm" doctrine is "probably the weakest ground of all for justifying a merger." *FTC v. Univ. Health, Inc.,* 938 F.2d 1206, 1221 (11th Cir.1991).

While the Court has some concern whether Wild Oats can remain as a stand-alone viable competitor if the merger does not go forward, there is simply insufficient record evidence in the record before the Court to reach any conclusion on this matter. And clearly the defendants have failed to carry their burden of establishing this defense.

CONCLUSION

As noted at the very outset of this Opinion, under Section 13(b) of the Federal Trade Commission Act, the FTC must demonstrate a likelihood of success on the merits-that is, that the effect of the Whole Foods/Wild Oats merger under Section 7 of the Clayton Act "may be substantially to lessen competition or tend to create a monopoly" in properly defined relevant product and geographic markets. 15 U.S.C. §§ 18, 53(b); *see United States v. Philadelphia National Bank,* 374 U.S. at 355–56, 83 S.Ct. 1715; *FTC v. H.J. Heinz Co.,* 246 F.3d at 714; *United States v. Baker Hughes Inc.,* 908 F.2d at 982–83; *FTC v. Libbey, Inc.,* 211 F.Supp.2d at 44; *FTC v. Staples, Inc.,* 970 F.Supp. at 1071. The FTC also has the burden of showing that the balance of the equities warrants entry of an injunction in the public interest. 15 U.S.C. § 53(b). *See FTC v. H.J. Heinz Co.,* 246 F.3d at 726; *FTC v. Exxon Corp.,* 636 F.2d 1336, 1343 (D.C.Cir.1980); *FTC v. Staples, Inc.,* 970 F.Supp. at 1091–92.

For all of these reasons discussed herein, the Court concludes that the FTC has not proven that it is likely to prevail on the merits at an administrative proceeding and subsequent appeal to the court of appeals. Considering the voluminous factual record taken as a whole, the FTC has not "raise[d] questions going to the merits so serious, substantial, difficult, and doubtful as to make them fair ground for thorough investigation, study, deliberation, and determination by the FTC in the first instance and ultimately by the Court of Appeals." *FTC v. H.J. Heinz Co.,* 246 F.3d at 714–15. There is no substantial likelihood ***50** that the FTC can prove its asserted product market and thus no likelihood that it can prove that the proposed merger may substantially lessen competition or tend to create a monopoly.

Because the FTC has not demonstrated a likelihood of success on the merits, the Court need not consider the equities and the public interest—whether, as defendants argue, there is a real risk that the transaction will not occur at all if an injunction issues or whether, as the FTC suggests, this is hyperbole based on a single unsubstantiated footnote in defendants' opening brief. The answer may lie in the language and terms of Article VII of the Agreement and Plan of Merger itself (DX 811), but, in view of the Court's findings and conclusions, the Court need not reach this issue.

For all the forgoing reasons, the Court will deny plaintiff Federal Trade Commission's motion for a preliminary injunction. An appropriate Order will be issued this same day.

ORDER

This matter is before the Court on plaintiff's motion for a preliminary injunction. Plaintiff, the Federal Trade Commission, filed this lawsuit on June 6, 2007 pursuant to Sections 7 and 11 of the Clayton Act, 15 U.S.C. §§ 18, 21, and Sections 5(b) and 13(b) of the Federal Trade Commission Act, 15 U.S.C. §§ 45(b), 53(b), seeking to enjoin defendant Whole Foods Market, Inc. from acquiring defendant Wild Oats Markets, Inc. during the pendency of an administrative proceeding to be commenced by the FTC. *See* Complaint at 2, 6.[1]

For the reasons set forth in the Court's 93–page Opinion issued this same day under seal, it is hereby

ORDERED that plaintiff Federal Trade Commission's motion for a preliminary injunction [4] is DENIED. This is a final appealable order. *See* 28 U.S.C. § 1292(a)(1); Fed. R.App. P. 4(a). Any other pending motions are denied as moot.[2]

SO ORDERED.

All Citations

502 F.Supp.2d 1, 2007-2 Trade Cases P 75,831

Footnotes

1 The papers submitted to the Court in connection with this proceeding include: plaintiff's Motion for Temporary Restraining Order and Preliminary Injunction ("Mot."); plaintiff's Memorandum in Support of Motion for Temporary Restraining Order and Preliminary Injunction ("TRO Mem."); Plaintiff's Corrected Brief on its Motion for Preliminary Injunction ("PI Mem."); Joint Memorandum of Points and Authorities of Whole Foods Market, Inc. and Wild Oats Markets, Inc. in Opposition to Motion for Preliminary Injunction ("Opp."); Plaintiff's Response Brief ("Pl's Reply"); Joint Reply Memorandum of Points and Authorities [of defendants] in Opposition to Motion for Preliminary Injunction ("Defs' Reply"); Defendants' Joint Proposed Findings of Fact and Conclusions of Law ("Defs' FOF"); and Plaintiff's Proposed Findings of Fact and Proposed Conclusions of Law ("Pl's FOF" and "Pl's COL").

2 The parties reached an agreement with respect to the issuance of a temporary restraining order during the pendency of this preliminary injunction proceeding, and the Court signed and entered the stipulated temporary restraining order on June 7, 2007.

3 Some of the lay witnesses were examined both at investigational hearings and at depositions.

4 All but two of the declarations submitted by defendants were of officers or employees of Whole Foods or Wild Oats. The Court agrees with plaintiff that these declarations, prepared for the purpose of litigation by defendants, should be viewed with caution and should be given less probative force than depositions taken of the same persons who were then subject to cross-examination. Such declarations are entitled to little weight to the extent they are "in conflict with contemporaneous documents." *United States v. U.S. Gypsum Co.,* 333 U.S. 364, 396, 68 S.Ct. 525, 92 L.Ed. 746 (1948).

5 As Judge Bork, himself a renowned antitrust expert, has pointed out, these practical indicia "seem to be evidentiary proxies for direct proof of substitutability." *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.,* 792 F.2d 210, 218 (D.C.Cir.1986).

6 The FTC asserts that with the assumed debt, the value of the transaction is approximately $700 million.

7 The Court notes that Dr. Scheffman, for whom Ms. Conway's report was intended, has not relied on it.

8 The Court discusses this pricing analysis and the plaintiff's criticism of it *infra* at 39–40.

9 The Merger Guidelines speak of a 5% SSNIP test, but recognize that in some cases it is appropriate to use a smaller percentage. Merger Guidelines § 1.11. Dr. Murphy and Dr. Scheffman agree that in some cases a hypothetical price increase as low as 1% may be appropriate.

10 Given the thousands of products sold by supermarkets, a product-by-product analysis was not feasible in this case. Such an analysis would also be misleading because consumers do not typically choose retailers of the goods in question on a product-by-product basis; rather, they typically purchase an array of products from a single source. Murphy Report ¶ 97.

11 It appears that the terms "core customer," "committed customer" and "inframarginal customer" are being used by the parties interchangeably. Aug. 1 p.m. Hearing Tr. at 76 (Denis). It is these customers who are being compared to and contrasted with "consumers at the margin" or "marginal consumers." The Court will generally use the terms "core customer" and "marginal consumer."

12 A "banner entry" event is the entry of the first store of a given brand into a given geographic market. Murphy Report ¶ 48.

13 It may be that at least one reason Dr. Scheffman and Dr. Murphy reached different conclusions from their respective studies is that they studied the entry of Whole Foods into different markets. Dr. Scheffman looked at markets that Dr. Murphy excluded.

14 A "comp shop" is a competitive assessment of another supermarket, including its prices, product offerings, configuration, and other attributes. Allshouse Decl. ¶ 10; Besancon Decl. ¶ 33; Gallo Decl. ¶ 27; Robb Decl. ¶ 28.

15 The FTC concedes that defendants' documents and testimony suggest that a larger area might be appropriate in a few instances. *See, e.g.,* JX 1 at 138:25–139:4 (Gallo Dep.) (competitive area tends to be smaller in urban areas; larger in suburban areas); JX 7 at 119:10–19 (Kadish Dep.) (Whole Foods will consider [Redacted] JX 10 at 90:13–15 (Meyer Dep.) [Redacted] Lannon Decl. ¶ 10 (most customers for Whole Foods' [Redacted] store come from a [Redacted] mile driving radius); JX 8 at 197:3–5 (Lannon Dep.) (customers of Whole Foods' [Redacted] store come from a [Redacted] mile radius); JX 2 at 91:14–16 (Robb Dep.) (data suggests that people do travel up to [Redacted] miles to shop at Whole Foods, but it does vary); PX00920 (Wild Oats considered stores within a [Redacted] mile radius).

16 The Court discusses the vigorous competition between the defendants and other supermarkets in much greater detail, *supra,* in Part V of this Opinion.

17 Whole Foods acknowledges that Trader Joe's offers only a limited range of natural products, not nearly the range that a Whole Foods customer expects to find. JX 32 at 84–85 (LaMacchia I.H.). Trader Joe's does not offer customers in-store service departments like bakeries, prepared food, or service meat counters. JX 39 at 62:1–18 (Bane I.H.); JX 10 at 79:2–10 (Meyer Dep.); *accord* JX 24 at 109:5–110:4 (Bane Dep.). Trader Joe's has no plans to add these services. *See* JX 39 at 105:2–10 (Bane I.H.). The evidence shows that Whole Foods openings cause only minimal impact on sales at nearby Trader Joe's. The current format for Trader Joe's uses a smaller format and a narrower range of SKUs than either Whole Foods or Wild Oats. A typical new Trader Joe's store is roughly 11,000 square feet, while recently built Whole Foods stores are typically larger than 40,000 square feet. Murphy Report ¶ 133; JX 39 at 44:20–25 (Bane I.H.); JX 24 at 8:16–17, 120:1–3 (Bane Dep.) (Trader Joe's has no plans to enlarge the footprint of future stores.)

18 Tesco will not begin opening stores in the United States until the end of 2007, and then with stores “intentionally smaller than the usual supermarket” at only 10,000 square feet. Tesco's plans to offer only a “limited item selection” of natural and organic items. Tesco's U.S. stores, operating under the “Fresh & Easy Neighborhood Market” small store banner, “will not have service departments such as cafeterias or full service food counters.” Neville–Rolfe Decl. ¶ 4. Defendants' industry consultant, Dr. Stanton, expressed his belief that Tesco will not compete against supermarkets. JX 19 at 154:5–6 (Stanton Dep.). The Court does not believe that it can effectively compete against Whole Foods.

1 On June 7, 2007, the Court signed and entered a stipulated temporary restraining order “pending the Court's ruling on the motion of the Commission for a preliminary injunction[.]”

2 Counsel for plaintiff and counsel for defendants should meet and confer and contact Chambers with their agreed-upon proposed redactions within two business days, after which time the Court will issue a redacted version of the Opinion on the public docket. As in the past, counsel should propose only those redactions necessary to protect confidential information.

End of Document

548 F.3d 1028
United States Court of Appeals,
District of Columbia Circuit.

FEDERAL TRADE COMMISSION, Appellant
v.
WHOLE FOODS MARKET, INC., et al., Appellees.

No. 07–5276.
|
Argued April 23, 2008.
|
Decided July 29, 2008.
|
Amended and Reissued Nov. 21, 2008.
|
Rehearing En Banc Denied Nov. 21, 2008.*

Synopsis
Background: Federal Trade Commission (FTC) brought action to enjoin, pursuant to Federal Trade Commission Act (FTCA), proposed merger of two large operators of premium natural and organic supermarkets (PNOS) while FTC conducted administrative proceeding to decide whether to block merger permanently under Clayton Act. The United States District Court for the District of Columbia, Paul L. Friedman, J., 502 F.Supp.2d 1, denied FTC's motion for preliminary injunction. FTC appealed.

Holdings: The Court of Appeals, Brown, Circuit Judge, held that:

appeal was not rendered moot by consummation of merger;

district court did not abuse its discretion in focusing on whether acquiring operator and competitor operated within a PNOS market;

FTC demonstrated likelihood of success of proving PNOS submarket was sufficient, using sliding scale, to balance against any equities weighing against injunction; and

remand to permit district court to consider the equities was warranted.

Reversed and remanded.

Tatel, Circuit Judge, filed an opinion concurring in the judgment.

Kavanaugh, Circuit Judge, filed a dissenting opinion.

Opinion, 533 F.3d 869, amended and superseded.

***1031** Appeal from the United States District Court for the District of Columbia (No. 07cv01021).

Attorneys and Law Firms

***1032** Marilyn E. Kerst, Attorney, Federal Trade Commission, argued the cause for appellant. With her on the briefs were John F. Daly, Deputy General Counsel, and Richard B. Dagen and Thomas H. Brock, Attorneys.

Paul T. Denis argued the cause for appellees. With him on the brief were Paul H. Friedman, Nory Miller, and Rebecca Dick. Cliford H. Aronson and Alden L. Atkins entered appearances.

David A. Balto was on the brief for amici curiae American Antitrust Institute, et al. in support of appellant.

Albert A. Foer was on the brief for amicus curiae American Antitrust Institute in support of appellant.

Before: TATEL, BROWN, and KAVANAUGH, Circuit Judges.

Opinion

Judgment of the Court filed by Circuit Judge BROWN.

Opinion filed by Circuit Judge BROWN.

Opinion concurring in the judgment filed by Circuit Judge TATEL.

Dissenting opinion filed by Circuit Judge KAVANAUGH.

BROWN, Circuit Judge.

****345** The FTC sought a preliminary injunction, under 15 U.S.C. § 53(b), to block the merger of Whole Foods and Wild Oats. It appeals the district court's denial of the injunction.

I conclude the district court should be reversed, though I do so reluctantly, admiring the thoughtful opinion the district court produced under trying circumstances in which the defendants were rushing to a financing deadline and the FTC presented, at best, poorly explained evidence. Nevertheless, the district court committed legal error in assuming market definition must depend on marginal consumers; consequently, it underestimated the FTC's likelihood of success on the merits.

I

Whole Foods Market, Inc. ("Whole Foods") and Wild Oats Markets, Inc. ("Wild Oats") operate 194 and 110 grocery stores, respectively, primarily in the United States. In February 2007, they announced that Whole Foods would acquire Wild Oats in a transaction closing before August 31, 2007. They notified the FTC, as the Hart–Scott–Rodino Act required for the $565 million merger, and the FTC investigated the merger through a series of hearings and document requests. On June 6, 2007, the FTC sought a temporary restraining order and preliminary injunction to block the merger temporarily while the FTC conducted an administrative proceeding to decide whether to block it permanently under § 7 of the Clayton Act. The parties conducted expedited discovery, and the district court held a hearing on July 31 and August 1, 2007.

The FTC contended Whole Foods and Wild Oats are the two largest operators of what it called premium, natural, and organic supermarkets ("PNOS"). Such stores "focus on high-quality perishables, specialty and natural organic produce, prepared foods, meat, fish[,] and bakery goods; generally have high levels of customer services; generally target affluent and well educated customers [and] ... are mission driven with an emphasis on social and environmental responsibility." *FTC v. Whole Foods Market, Inc.,* 502 F.Supp.2d 1, 28 (D.D.C.2007). In eighteen cities, asserted the FTC, the merger would create monopolies because Whole Foods and Wild Oats are the only PNOS. To support this claim, the FTC relied on emails Whole Foods's CEO John Mackey sent to other Whole Foods executives and directors, suggesting the purpose of the merger was to eliminate a competitor. In addition the FTC produced pseudonymous blog postings in which Mr. Mackey touted Whole ****346 *1033** Foods and denigrated other supermarkets as unable to compete. The FTC's expert economist, Dr. Kevin Murphy, analyzed sales data from the companies to show how entry by various supermarkets into a local market affected sales at a Whole Foods or Wild Oats store.

On the other hand, the defendants' expert, Dr. David Scheffman, focused on whether a hypothetical monopolist owning both Whole Foods and Wild Oats would actually have power over a distinct market. He used various third-party market studies to predict that such an owner could not raise prices without driving customers to other supermarkets. In addition, deposition testimony from other supermarkets indicated they regarded Whole Foods and Wild Oats as critical competition. Internal documents from the two defendants reflected their extensive monitoring of other supermarkets' prices as well as each other's.

The district court concluded that PNOS was not a distinct market and that Whole Foods and Wild Oats compete within the broader market of grocery stores and supermarkets. Believing such a basic failure doomed any chance of the FTC's success, the court denied the preliminary injunction without considering the balance of the equities.

On August 17, the FTC filed an emergency motion for an injunction pending appeal, which this court denied on August 23. *FTC v. Whole Foods Market, Inc.,* No. 07–5276 (D.C.Cir. Aug. 23, 2007). Freed to proceed, Whole Foods and Wild Oats consummated their merger on August 28. The dissent argues that a reversal today contradicts this earlier decision, but our standard of review then was very different, requiring the FTC to show "such a substantial indication of probable success" that there would be "justification for the court's intrusion into the ordinary processes of ... judicial review." *Wash. Metro. Area Transit Comm'n v. Holiday Tours, Inc.,* 559 F.2d 841, 843 (D.C.Cir.1977). It is hardly remarkable that the FTC could fail to meet such a stringent standard and yet persuasively show the district court erred in applying the much less demanding § 53(b) preliminary injunction standard.

II

At the threshold, Whole Foods questions our jurisdiction to hear this appeal. The merger is a *fait accompli,* and Whole Foods has already closed some Wild Oats stores and sold others. In addition, Whole Foods has sold two complete lines of stores, Sun Harvest and Harvey's, as well as some unspecified distribution facilities. Therefore, argues Whole

Foods, the transaction is irreversible and the FTC's request for an injunction blocking it is moot.

Only in a rare case would we agree a transaction is truly irreversible, for the courts are "clothed with large discretion" to create remedies "effective to redress [antitrust] violations and to restore competition." *Ford Motor Co. v. United States,* 405 U.S. 562, 573, 92 S.Ct. 1142, 31 L.Ed.2d 492 (1972). Indeed, "divestiture is a common form of relief" from unlawful mergers. *United States v. Microsoft Corp.,* 253 F.3d 34, 105 (D.C.Cir.2001) (en banc). Further, an antitrust violator "may ... be required to do more than return the market to the *status quo ante.*" *Ford Motor,* 405 U.S. at 573 n. 8 92 S.Ct. 1142. Courts may not only order divestiture but may also order relief "designed to give the divested [firm] an opportunity to establish its competitive position." *Id.* at 575, 92 S.Ct. 1142. Even remedies which "entail harsh consequences" would be appropriate to ameliorate the harm to competition from an antitrust violation. ****347 *1034** *United States v. E.I. du Pont de Nemours & Co.,* 366 U.S. 316, 327, 81 S.Ct. 1243, 6 L.Ed.2d 318 (1961).

Of course, neither court nor agency has found Whole Foods's acquisition of Wild Oats to be unlawful. Therefore, the FTC may not yet claim the right to have any remedy necessary to undo the effects of the merger, as it could after such a determination, *du Pont,* 366 U.S. at 334, 81 S.Ct. 1243. But the whole point of a preliminary injunction is to avoid the need for intrusive relief later, since even with the considerable flexibility of equitable relief, the difficulty of "unscrambl[ing] merged assets" often precludes "an effective order of divestiture," *FTC v. Dean Foods Co.,* 384 U.S. 597, 607 n. 5, 86 S.Ct. 1738, 16 L.Ed.2d 802 (1966). Section 53(b), codifying the ability of the FTC to obtain preliminary relief, *FTC v. Weyerhaeuser Co.,* 665 F.2d 1072, 1082 (D.C.Cir.1981), preserves the "flexibility" of traditional "equity practice," *id.* at 1084. At a minimum, the courts retain the power to preserve the *status quo nunc,* for example by means of a hold separate order, *id.,* and perhaps also to restore the *status quo ante.*

Thus, the courts have the power to grant relief on the FTC's complaint, despite the merger's having taken place, and this case is therefore not moot. *See Byrd v. EPA,* 174 F.3d 239, 244 (D.C.Cir.1999) ("The availability of a partial remedy is sufficient to prevent [a] case from being moot."). The fact that Whole Foods has sold some of Wild Oats's assets does not change our conclusion. To be sure, we have no "authority to command return to the status quo," *Weyerhaeuser,* 665 F.2d at 1077, in a literal way by forcing absent parties to sell those assets back to Whole Foods, but there is no reason to think that inability prevents us from mitigating the merger's alleged harm to competition. The stores Whole Foods has sold are only those under the Harvey's and Sun Harvest labels, which were never relevant to the anticompetitive harm the FTC fears. Our inability to command their return does not limit the relief available to the FTC. As to the distribution facilities, neither party has described what they are, suggested Wild Oats would not be a viable competitor without them, or explained why the district court could not order some provisional substitute. Moreover, the FTC is concerned about eighteen different local markets. If, as appears to be the situation, it remains possible to reopen or preserve a Wild Oats store in just one of those markets, such a result would at least give the FTC a chance to prevent a § 7 violation in that market.

III

"We review a district court order denying preliminary injunctive relief for abuse of discretion." *FTC v. H.J. Heinz Co.,* 246 F.3d 708, 713 (D.C.Cir.2001). However, if the district court's decision "rests on an erroneous premise as to the pertinent law," we will review the denial *de novo* "in light of the legal principles we believe proper and sound." *Id.*

Despite some ambiguity, the district court applied the correct legal standard to the FTC's request for a preliminary injunction. The FTC sought relief under 15 U.S.C. § 53(b), which allows a district court to grant preliminary relief "[u]pon a proper showing that, weighing the equities and considering the Commission's likelihood of ultimate success, such action would be in the public interest." The relief is temporary and must dissolve if more than twenty days pass without an FTC complaint. *Id.* Congress recognized the traditional four-part equity standard for obtaining an injunction was "not appropriate for the implementation of a Federal statute by an independent regulatory agency." *Heinz,* 246 F.3d at 714. Therefore, to obtain a § 53(b) preliminary injunction, the FTC need not show any irreparable ****348 *1035** harm, and the "private equities" alone cannot override the FTC's showing of likelihood of success. *Weyerhaeuser,* 665 F.2d at 1082–83.

In deciding the FTC's request for a preliminary injunction blocking a merger under § 53(b), a district court must balance the likelihood of the FTC's success against the equities, under a sliding scale. *See Heinz,* 246 F.3d at 727; *FTC* *v. Elders Grain, Inc.,* 868 F.2d 901, 903 (7th Cir.1989). The equities will often weigh in favor of the FTC, since “the public interest in effective enforcement of the antitrust laws” was Congress's specific “public equity consideration” in enacting the provision. *Heinz,* 246 F.3d at 726. Therefore, the FTC will usually be able to obtain a preliminary injunction blocking a merger by “rais[ing] questions going to the merits so serious, substantial, difficult[,] and doubtful as to make them fair ground for thorough investigation.” *Heinz,* 246 F.3d at 714–15. By meeting this standard, the FTC “creates a presumption in favor of preliminary injunctive relief,” *id.* at 726; but the merging parties may rebut that presumption, requiring the FTC to demonstrate a greater likelihood of success, by showing equities weighing in favor of the merger, *Weyerhaeuser,* 665 F.2d at 1087. Conversely, a greater likelihood of the FTC's success will militate for a preliminary injunction unless particularly strong equities favor the merging parties. *See Heinz,* 246 F.3d at 727; *Elders Grain,* 868 F.2d at 903.

In any case, a district court must not require the FTC to prove the merits, because, in a § 53(b) preliminary injunction proceeding, a court “is not authorized to determine whether the antitrust laws ... are about to be violated.” *FTC v. Food Town Stores, Inc.,* 539 F.2d 1339, 1342 (4th Cir.1976). That responsibility lies with the FTC. *Id.* Not that the court may simply rubber-stamp an injunction whenever the FTC provides some threshold evidence; it must “exercise independent judgment” about the questions § 53(b) commits to it. *Weyerhaeuser,* 665 F.2d at 1082. Thus, the district court must evaluate the FTC's chance of success on the basis of all the evidence before it, from the defendants as well as from the FTC. *See FTC v. Beatrice Foods Co.,* 587 F.2d 1225, 1229–30 (D.C.Cir.1978) (App'x to Stmt. of MacKinnon & Robb, JJ.) (“[W]e are also required to consider the inroads that the appellees' extensive showing has made ... [S]everal basic contentions of the FTC are called into serious question.”). The district court should bear in mind the FTC will be entitled to a presumption against the merger on the merits, *see Elders Grain,* 868 F.2d at 906, and therefore does not need detailed evidence of anticompetitive effect at this preliminary phase. Nevertheless, the merging parties are entitled to oppose a § 53(b) preliminary injunction with their own evidence, and that evidence may force the FTC to respond with a more substantial showing.

The district court did not apply the sliding scale, instead declining to consider the equities. To be consistent with the § 53(b) standard, this decision must have rested on a conviction the FTC entirely failed to show a likelihood of success. Indeed, the court concluded “the relevant product market in this case is not premium natural and organic supermarkets ... as argued by the FTC but ... at least all supermarkets.” *Whole Foods,* 502 F.Supp.2d at 34. It also observed that several supermarkets “have already repositioned themselves to compete vigorously with Whole Foods and Wild Oats for the consumers' premium natural and organic food business.” *Id.* at 48. Thus, considering the defendants' evidence as well as the FTC's, as it was obligated to do, the court was in no doubt that this merger would not substantially lessen competition, because it found the evidence proved Whole Foods ****349 *1036** and Wild Oats compete among supermarkets generally. If, and only if, the district court's certainty was justified, it was appropriate for the court not to balance the likelihood of the FTC's success against the equities.

IV

However, the court's conclusion was in error. The FTC contends the district court abused its discretion in two ways: first, by treating market definition as a threshold issue; and second, by ignoring the FTC's main evidence. The district court acted reasonably in focusing on the market definition, but it analyzed the product market incorrectly.

A

First, the FTC complains the district court improperly focused on whether Whole Foods and Wild Oats operate within a PNOS market. However, this was not an abuse of discretion given that the district court was simply following the FTC's outline of the case.

Inexplicably, the FTC now asserts a market definition is not necessary in a § 7 case, Appellant's Br. 37–38, in contravention of the statute itself, *see* 15 U.S.C. § 18 (barring an acquisition “where in any line of commerce ... the effect of such acquisition may be substantially to lessen competition”); *see also Brown Shoe Co. v. United States,* 370 U.S. 294, 324, 82 S.Ct. 1502, 8 L.Ed.2d 510 (1962) (interpreting “any line of commerce” to require a “determination of the relevant market” to find “a violation of the Clayton Act”); *Elders Grain,* 868 F.2d at 906 (“[A]ll this assumes a properly defined market.”). The FTC suggests “market definition ... is a means to an end—to enable some measurement of market power—

not an end in itself." Appellant's Br. 38 n. 26. But measuring market power is not the only purpose of a market definition; only "examination of the particular market—its structure, history[,] and probable future—can provide the appropriate setting for judging the probable anticompetitive effect of the merger." *Brown Shoe,* 370 U.S. at 322 n. 38, 82 S.Ct. 1502.

That is not to say market definition will always be crucial to the FTC's likelihood of success on the merits. Nor does the FTC necessarily need to settle on a market definition at this preliminary stage. Although the framework we have developed for a *prima facie* § 7 case rests on defining a market and showing undue concentration in that market, *United States v. Baker Hughes Inc.,* 908 F.2d 981, 982–83 (D.C.Cir.1990), this analytical structure does not exhaust the possible ways to prove a § 7 violation on the merits, *see, e.g., United States v. El Paso Natural Gas Co.,* 376 U.S. 651, 660, 84 S.Ct. 1044, 12 L.Ed.2d 12 (1964), much less the ways to demonstrate a likelihood of success on the merits in a preliminary proceeding. Section 53(b) preliminary injunctions are meant to be readily available to preserve the status quo while the FTC develops its ultimate case, and it is quite conceivable that the FTC might need to seek such relief before it has settled on the scope of the product or geographic markets implicated by a merger. For example, the FTC may have alternate theories of the merger's anticompetitive harm, depending on inconsistent market definitions. While on the merits, the FTC would have to proceed with only one of those theories, at this preliminary phase it just has to raise substantial doubts about a transaction. One may have such doubts without knowing exactly what arguments will eventually prevail.[1] Therefore, a district court's assessment of the FTC's chances will not ****350 *1037** depend, in every case, on a threshold matter of market definition.

In this case, however, the FTC itself made market definition key. It claimed "[t]he operation of premium natural and organic supermarkets is a distinct 'line of commerce' within the meaning of Section 7," and its theory of anticompetitive effect was that the merger would "substantially increase concentration in the operation of [PNOS]." Compl. ¶¶ 34, 43. Throughout its briefs, the FTC presented a straightforward § 7 case in which "whether the transaction creates an appreciable danger of anticompetitive effects ... depends upon ... [the] relevant product ... [and] geographic market ... and the transaction's probable effect on competition in the product and geographic markets." FTC's Br. Mot. Prelim. Inj. 11–12. It purported to show "undue concentration in the relevant market," as the mainstay of its case. *Id.* at 12. Because of the concentration in the supposed PNOS market, the FTC urged the district court to hold the merger "presumptively unlawful," and this was its sole reason for blocking the merger. FTC's Proposed Conclusions of Law ¶¶ 57–63, 99–108. At oral argument, the FTC's counsel suggested it had other ideas about the anticompetitive effect of the merger even if its PNOS market definition is wrong; but the FTC never offered those ideas to the district court. It is incumbent on the parties to shape a case, and it was hardly an abuse of discretion for the district court to focus on the questions as the FTC presented them.

B

Thus, the FTC assumed the burden of raising some question of whether PNOS is a well-defined market. As the FTC presented its case, success turned on whether there exist core customers, committed to PNOS, for whom one should consider PNOS a relevant market. The district court assumed "the 'marginal' consumer, not the so-called 'core' or 'committed' consumer, must be the focus of any antitrust analysis." *Whole Foods,* 502 F.Supp.2d at 17 (citing Horizontal Merger Guidelines, 57 Fed.Reg. 41,552 (1992)). To the contrary, core consumers can, in appropriate circumstances, be worthy of antitrust protection. *See* Horizontal Merger Guidelines § 1.12, 57 Fed.Reg. at 41,555 (explaining the possibility of price discrimination for "targeted buyers"). The district court's error of law led it to ignore FTC evidence that strongly suggested Whole Foods and Wild Oats compete for core consumers within a PNOS market, even if they also compete on individual products for marginal consumers in the broader market. *See, e.g.,* Appellant's Br. 50, 53.

A market "must include all products reasonably interchangeable by consumers for the same purposes." *Microsoft,* 253 F.3d at 52. Whether one product is reasonably interchangeable for another depends not only on the ease and speed with which customers can substitute it and the desirability of doing so, *see id.* at 53–54, but also on the cost of substitution, which depends most sensitively on the price of the products. A broad market may also contain relevant submarkets which themselves "constitute product markets for antitrust purposes." *Brown Shoe,* 370 U.S. at 325, 82 S.Ct. 1502. "The boundaries of such a submarket may be determined by examining such practical ****351 *1038** indicia as industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors." *Id.*

To facilitate this analysis, the Department of Justice and the FTC developed a technique called the SSNIP ("small but significant non-transitory increase in price") test, which both Dr. Murphy and Dr. Scheffman used. In the SSNIP method, one asks whether a hypothetical monopolist controlling all suppliers in the proposed market could profit from a small price increase. Horizontal Merger Guidelines § 1. 11, 57 Fed.Reg. at 41,560–61. If a small price increase would drive consumers to an alternative product, then that product must be reasonably substitutable for those in the proposed market and must therefore be part of the market, properly defined. *Id.*

Experts for the two sides disagreed about how to do the SSNIP of the proposed PNOS market. Dr. Scheffman used a method called critical loss analysis, in which he predicted the loss that would result when marginal customers shifted purchases to conventional supermarkets in response to a SSNIP.[2] *Whole Foods,* 502 F.Supp.2d at 18. He concluded a hypothetical monopolist could not profit from a SSNIP, so that conventional supermarkets must be within the same market as PNOS. In contrast, Dr. Murphy disapproved of critical loss analysis generally, preferring a method called critical diversion that asked how many customers would be diverted to Whole Foods and how many to conventional supermarkets if a nearby Wild Oats closed. Whole Foods's internal planning documents indicated at least a majority of these customers would switch to Whole Foods, thus making the closure profitable for a hypothetical PNOS monopolist. One crucial difference between these approaches was that Dr. Scheffman's analysis depended only on the *marginal* loss of sales, while Dr. Murphy's used the *average* loss of customers. Dr. Murphy explained that focusing on the average behavior of customers was appropriate because a core of committed customers would continue to shop at PNOS stores despite a SSNIP.

In appropriate circumstances, core customers can be a proper subject of antitrust concern. In particular, when one or a few firms differentiate themselves by offering a particular package of goods or services, it is quite possible for there to be a central group of customers for whom "only [that package] will do." *United States v. Grinnell Corp.,* 384 U.S. 563, 574, 86 S.Ct. 1698, 16 L.Ed.2d 778 (1966); *see also United States v. Phillipsburg Nat'l Bank & Trust Co.,* 399 U.S. 350, 360, 90 S.Ct. 2035, 26 L.Ed.2d 658 (1970) ("[I]t is the *cluster* of products and services ... that as a matter of trade reality makes commercial banking a distinct" market.). What motivates antitrust concern for such customers is the possibility that "fringe competition" for individual products within a package may not protect customers who need the whole package from market power exercised by a sole supplier of the package. *Grinnell,* 384 U.S. at 574, 86 S.Ct. 1698.

Such customers may be captive to the sole supplier, which can then, by means of price discrimination, extract monopoly profits from them while competing for the business of marginal customers. *Cf. Md. People's Counsel v. FERC,* 761 F.2d 780, 786–87 (D.C.Cir.1985) (allowing natural gas pipelines to charge higher prices to ****352 *1039** captive customers would be anticompetitive). Not that prices that segregate core from marginal consumers are in themselves anticompetitive; such pricing simply indicates the existence of a submarket of core customers, operating in parallel with the broader market but featuring a different demand curve. *See United States v. Rockford Mem'l Corp.,* 898 F.2d 1278, 1284 (7th Cir.1990). Sometimes, for some customers a package provides "access to certain products or services that would otherwise be unavailable to them." *Phillipsburg Nat'l Bank & Trust,* 399 U.S. at 360, 90 S.Ct. 2035. Because the core customers require the whole package, they respond differently to price increases from marginal customers who may obtain portions of the package elsewhere. Of course, core customers may constitute a submarket even without such an extreme difference in demand elasticity. After all, market definition focuses on what products are *reasonably* substitutable; what is reasonable must ultimately be determined by "settled consumer preference." *United States v. Phila. Nat'l Bank,* 374 U.S. 321, 357, 83 S.Ct. 1715, 10 L.Ed.2d 915 (1963).

In short, a core group of particularly dedicated, "distinct customers," paying "distinct prices," may constitute a recognizable submarket, *Brown Shoe,* 370 U.S. at 325, 82 S.Ct. 1502, whether they are dedicated because they need a complete "cluster of products," *Phila. Nat'l Bank,* 374 U.S. at 356, 83 S.Ct. 1715, because their particular circumstances dictate that a product "is the only realistic choice," *SuperTurf, Inc. v. Monsanto Co.,* 660 F.2d 1275, 1278 (8th Cir.1981), or because they find a particular product "uniquely attractive," *Nat'l Collegiate Athletic Ass'n v. Bd. of Regents of the Univ. of Okla.,* 468 U.S. 85, 112, 104 S.Ct. 2948, 82 L.Ed.2d 70 (1984). For example, the existence of core customers dedicated to office supply superstores, with their "unique combination of size, selection, depth[,] and breadth of inventory," was an important factor distinguishing that submarket. *FTC v. Staples, Inc.,* 970 F.Supp. 1066, 1078–79 (D.D.C.1997). As always in defining a market, we must "take into account the realities of competition." *Weiss v. York Hosp.,* 745 F.2d 786, 826 (3d Cir.1984). We look to the *Brown Shoe* indicia, among which the economic criteria are primary, *see Rothery Storage & Van Co. v. Atlas Van Lines, Inc.,* 792 F.2d 210, 219 n. 4 (D.C.Cir.1986).

The FTC's evidence delineated a PNOS submarket catering to a core group of customers who "have decided that natural and organic is important, lifestyle of health and ecological sustainability is important." *Whole Foods,* 502 F.Supp.2d at 23 (citing Hr'g Tr. 43–44, Aug. 1, 2007). It was undisputed that Whole Foods and Wild Oats provide higher levels of customer service than conventional supermarkets, a "unique environment," and a particular focus on the "core values" these customers espoused. *Id.* The FTC connected these intangible properties with concrete aspects of the PNOS model, such as a much larger selection of natural and organic products, FTC's Proposed Findings of Fact 13–14 & ¶ 66 (noting Earth Fare, a PNOS, carries "more than 45,000 natural and organic SKUs") and a much greater concentration of perishables than conventional supermarkets, *id.* 14–15 & ¶ 69–70 ("Over 60% of Wild Oats' revenues" and "[n]early 70% of Whole Foods sales are natural or organic perishables."). *See also Whole Foods,* 502 F.Supp.2d at 22–23 (citing defendants' depositions as evidence of Whole Foods's and Wild Oats's focus on "high-quality perishables" and a large variety of products).

Further, the FTC documented exactly the kind of price discrimination that enables a firm to profit from core customers for whom it is the sole supplier. Dr. Murphy compared the margins of Whole Foods ****353 *1040** stores in cities where they competed with Wild Oats. He found the presence of a Wild Oats depressed Whole Foods's margins significantly. Notably, while there was no effect on Whole Foods's margins in the product category of "groceries," where Whole Foods and Wild Oats compete on the margins with conventional supermarkets, the effect on margins for perishables was substantial. Confirming this price discrimination, Whole Foods's documents indicated that when it price-checked conventional supermarkets, the focus was overwhelmingly on "dry grocery," rather than on the perishables that were 70% of Whole Foods's business. Thus, in the high-quality perishables on which both Whole Foods and Wild Oats made most of their money, they competed directly with each other, and they competed with supermarkets only on the dry grocery items that were the fringes of their business.

Additionally, the FTC provided direct evidence that PNOS competition had a greater effect than conventional supermarkets on PNOS prices. Dr. Murphy showed the opening of a new Whole Foods in the vicinity of a Wild Oats caused Wild Oats's prices to drop, while entry by non-PNOS stores had no such effect. Similarly, the opening of Earth Fare stores (another PNOS) near Whole Foods stores caused Whole Foods's prices to drop immediately. The price effect continued, while decreasing, until the Earth Fare stores were forced to close.

Finally, evidence of consumer behavior supported the conclusion that PNOS serve a core consumer base. Whole Foods's internal projections, based on market experience, suggested that if a Wild Oats near a Whole Foods were to close, the majority (in some cases nearly all) of its customers would switch to the Whole Foods rather than to conventional supermarkets. Since Whole Foods's prices for perishables are higher than those of conventional supermarkets, such customers must not find shopping at the latter interchangeable with PNOS shopping. They are the core customers. Moreover, market research, including Dr. Scheffman's own studies, indicated 68% of Whole Foods customers are core customers who share the Whole Foods "core values." FTC Proposed Findings of Fact ¶ 135.

Against this conclusion the defendants posed evidence that customers "cross-shop" between PNOS and other stores and that Whole Foods and Wild Oats check the prices of conventional supermarkets. *Whole Foods,* 502 F.Supp.2d at 30–32. But the fact that PNOS and ordinary supermarkets "are direct competitors in some submarkets ... is not the end of the inquiry," *United States v. Conn. Nat'l Bank,* 418 U.S. 656, 664 n. 3, 94 S.Ct. 2788, 41 L.Ed.2d 1016 (1974). Of course customers cross-shop; PNOS carry comprehensive inventories. The fact that a customer might buy a stick of gum at a supermarket or at a convenience store does not mean there is no definable groceries market. Here, cross-shopping is entirely consistent with the existence of a core group of PNOS customers. Indeed, Dr. Murphy explained that Whole Foods competes actively with conventional supermarkets for dry groceries sales, even though it ignores their prices for high-quality perishables.

In addition, the defendants relied on Dr. Scheffman's conclusion that there is no "clearly definable" core customer.

Whole Foods, 502 F.Supp.2d at 28. However, this conclusion was inconsistent with Dr. Scheffman's own report and testimony. Market research had found that customers who shop at Whole Foods because they share the core values it champions constituted at least a majority of its customers. Scheffman Expert Report 56–57. Moreover, Dr. Scheffman acknowledged "there ****354 *1041** are core shoppers [who] will only buy organic and natural" and for that reason go to Whole Foods or Wild Oats. Hr'g Tr. 31, July 31, 2007. He contended they could be ignored because the numbers are not "substantial." *Id.* Again, Dr. Scheffman's own market data undermined this assertion.

In sum, the district court believed the antitrust laws are addressed only to marginal consumers. This was an error of law, because in some situations core consumers, demanding exclusively a particular product or package of products, distinguish a submarket. The FTC described the core PNOS customers, explained how PNOS cater to these customers, and showed these customers provided the bulk of PNOS's business. The FTC put forward economic evidence—which the district court ignored—showing directly how PNOS discriminate on price between their core and marginal customers, thus treating the former as a distinct market. Therefore, I cannot agree with the district court that the FTC would never be able to prove a PNOS submarket. This is not to say the FTC has in fact proved such a market, which is not necessary at this point. To obtain a preliminary injunction under § 53(b), the FTC need only show a likelihood of success sufficient, using the sliding scale, to balance any equities that might weigh against the injunction.

V

It remains to address the equities, which the district court did not reach, and see whether for some reason there is a balance against the FTC that would require a greater likelihood of success. The FTC urges us to carry out the rest of this determination, but "[w]e believe the proper course of action at this point is to remand to the district court, *Chaplaincy of Full Gospel Churches v. England,* 454 F.3d 290, 304 (D.C.Cir.2006)." Since the district court "expressly withheld consideration," *id.* at 305, of the equities, we have not had the benefit of its findings. Although the equities in a § 53(b) preliminary injunction proceeding will usually favor the FTC, *Heinz,* 246 F.3d at 726, the district court must independently exercise its discretion considering the circumstances of this case, including the fact that the merger has taken place. The district court should remember that a "risk that the transaction will not occur at all," by itself, is a private consideration that cannot alone defeat the preliminary injunction. *See id.; Weyerhaeuser,* 665 F.2d at 1082–83.

I appreciate that the district court expedited the proceeding as a courtesy to the defendants, who wanted to consummate their merger just thirty days after the hearing, *Whole Foods,* 502 F.Supp.2d at 4, but the court should have taken whatever time it needed to consider the FTC's evidence fully. For the reasons stated above, the district court's conclusion that the FTC showed no likelihood of success in an eventual § 7 case must be reversed and remanded for proceedings consistent with this opinion.

So ordered.

TATEL, Circuit Judge, concurring in the judgment.

I agree with my colleagues that the district court produced a thoughtful opinion under incredibly difficult circumstances, that this case presents a live controversy, and that the district court generally applied the correct standard in reviewing the Federal Trade Commission's request for a preliminary injunction. I also agree with Judge Brown that the district court nonetheless erred in concluding that the FTC failed to "raise[ ] questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination ****355 *1042** by the FTC in the first instance and ultimately by the Court of Appeals." *FTC v. H.J. Heinz Co.,* 246 F.3d 708, 714–15 (D.C.Cir.2001). Specifically, I believe the district court overlooked or mistakenly rejected evidence supporting the FTC's view that Whole Foods and Wild Oats occupy a separate market of "premium natural and organic supermarkets."

I

"Section 7 of the Clayton Act prohibits acquisitions, including mergers, 'where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.' " *Id.* at 713 (quoting 15 U.S.C. § 18). "Congress used the words '*may be* substantially to lessen competition,' to indicate that its concern was with probabilities, not certainties." *Brown Shoe Co. v. United*

States, 370 U.S. 294, 323, 82 S.Ct. 1502, 8 L.Ed.2d 510 (1962).

When the FTC believes an acquisition violates section 7 and that enjoining the acquisition pending an investigation "would be in the interest of the public," section 13(b) of the Federal Trade Commission Act authorizes the Commission to ask a federal district court to block the acquisition. 15 U.S.C. § 53(b); *Heinz,* 246 F.3d at 714. Because Congress concluded that the FTC—an expert agency acting on the public's behalf—should be able to obtain injunctive relief more readily than private parties, it "incorporat[ed] a unique 'public interest' standard in 15 U.S.C. § 53(b), rather than the more stringent, traditional 'equity' standard for injunctive relief." *FTC v. Exxon Corp.,* 636 F.2d 1336, 1343 (D.C.Cir.1980) (citing H.R. Rep. No. 93–624, at 31 (1973), U.S.Code Cong. & Admin.News 1973, pp. 2417, 2533). Under this more lenient rule, a district court may grant the FTC's requested injunction "[u]pon a proper showing that, weighing the equities and considering the Commission's likelihood of ultimate success, such action would be in the public interest." 15 U.S.C. § 53(b). In this circuit, "the standard for likelihood of success on the merits is met if the FTC 'has raised questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC in the first instance and ultimately by the Court of Appeals.' " *Heinz,* 246 F.3d at 714–15 (quoting *FTC v. Beatrice Foods Co.,* 587 F.2d 1225, 1229 (D.C.Cir.1978) (Appendix to Joint Statement of Judges MacKinnon & Robb)); *accord FTC v. Freeman Hosp.,* 69 F.3d 260, 267 (8th Cir.1995); *FTC v. Warner Commc'ns Inc.,* 742 F.2d 1156, 1162 (9th Cir.1984).

Critically, the district court's task is not "to determine whether the antitrust laws have been or are about to be violated. That adjudicatory function is vested in the FTC in the first instance." *Heinz,* 246 F.3d at 714 (quoting *FTC v. Food Town Stores, Inc.,* 539 F.2d 1339, 1342 (4th Cir.1976)). As Judge Posner has explained:

> One of the main reasons for creating the Federal Trade Commission and giving it concurrent jurisdiction to enforce the Clayton Act was that Congress distrusted judicial determination of antitrust questions. It thought the assistance of an administrative body would be helpful in resolving such questions and indeed expected the FTC to take the leading role in enforcing the Clayton Act....

Hosp. Corp. of Am. v. FTC, 807 F.2d 1381, 1386 (7th Cir.1986).

The dissent accuses Judge Brown and me of "dilut[ing] the standard for preliminary injunction relief in antitrust merger cases, such that the FTC ... need not establish a likelihood of success on the merits." Dissenting Op. at 1059 (internal quotation marks omitted). This is baffling ****356** ***1043** given that our opinions scrupulously follow *Heinz*'s articulation of the likelihood-of-success standard, which even Whole Foods insists we apply, *see* Appellee's Br. 32 (urging that "the district court performed the role Congress delegated" to it by "applying the standard of review this Court prescribed in *Heinz* "). The Supreme Court's recent decision in *Munaf v. Geren,* 553 U.S. 674, 128 S.Ct. 2207, 171 L.Ed.2d 1 (2008), does nothing to undermine this precedent: it concerns the common law standard for preliminary injunctions, not section 13(b)'s " unique 'public interest' standard," *Exxon Corp.,* 636 F.2d at 1343. *Cf.* Dissenting Op. at 1060. In his zeal to reach the merits and preempt the FTC, it is in fact our dissenting colleague who ignores both circuit precedent and section 13(b).

II

In this case the district court concluded that the FTC had failed to raise the "serious, substantial" questions necessary to show a likelihood of success on the merits. *FTC v. Whole Foods Market, Inc.,* 502 F.Supp.2d 1, 49 (D.D.C.2007). Following the FTC's lead, the court focused on defining the product market in which Whole Foods and Wild Oats operate, saying:

> [I]f the relevant product market is, as the FTC alleges, a product market of "premium natural and organic supermarkets" ..., there can be little doubt that the acquisition of the second largest firm in the market by the largest firm in the market will tend to harm competition in that market. If, on the other hand, the defendants are merely differentiated firms operating within the larger relevant product market of "supermarkets," the proposed merger will not tend to harm competition.

Whole Foods, 502 F.Supp.2d at 8. Thus, the " 'case hinge[d]'—almost entirely—'on the proper definition of the relevant product market.' " *Id.* (quoting *FTC v. Staples, Inc.,* 970 F.Supp. 1066, 1073 (D.D.C.1997)). And after reviewing the evidence, the district court concluded that "[t]here is no substantial likelihood that the FTC can prove its asserted product market and thus no likelihood that it can prove that the proposed merger may substantially lessen competition or tend to create a monopoly." *Id.* at 49–50.

I agree with the district court that this " 'case hinges'—almost entirely—'on the proper definition of the relevant product market,' " for if a separate natural and organic market exists, "there can be little doubt that the acquisition of the second largest firm in the market by the largest firm in the market will tend to harm competition in that market." *Id.* at 8 (quoting *Staples,* 970 F.Supp. at 1073). But I respectfully part ways with the district court when it comes to assessing the FTC's evidence in support of its contention that Whole Foods and Wild Oats occupy a distinct market. As the Supreme Court explained in *Brown Shoe Co. v. United States:* "The outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it." 370 U.S. at 325, 82 S.Ct. 1502. In this case the FTC presented a great deal of credible evidence—either unmentioned or rejected by the district court—suggesting that Whole Foods and Wild Oats are not "reasonabl[y] interchangeab[le]" with conventional supermarkets and do not compete directly with them.

To begin with, the FTC's expert prepared a study showing that when a Whole Foods opened near an existing Wild Oats, it reduced sales at the Wild Oats store dramatically. *See* Expert Report of Kevin M. Murphy ¶¶ 48–49 & exhibit 3 (July 9, 2007) ("Murphy Report"). By contrast, when a conventional supermarket opened ****357 *1044** near a Wild Oats store, Wild Oats's sales were virtually unaffected. *See id.* This strongly suggests that although Wild Oats customers consider Whole Foods an adequate substitute, they do not feel the same way about conventional supermarkets. Rejecting this study, the district court explained that it was "unwilling to accept the assumption that the effects on Wild Oats from Whole Foods' entries provide a mirror from which predictions can reliably be made about the effects on Whole Foods from Wild Oats' future exits if this transaction occurs." *Whole Foods,* 502 F.Supp.2d at 21. But even if exit and entry events differ, this evidence suggests that consumers do not consider Whole Foods and Wild Oats "reasonabl[y] interchangeab [le]" with conventional supermarkets. *Brown Shoe,* 370 U.S. at 325, 82 S.Ct. 1502.

The FTC also highlighted Whole Foods's own study—called "Project Goldmine"—showing what Wild Oats customers would likely do after the proposed merger in cities where Whole Foods planned to close Wild Oats stores. According to the study, the average Whole Foods store would capture most of the revenue from the closed Wild Oats store, even though virtually every city contained multiple conventional retailers closer to the shuttered Wild Oats store. *See* Murphy Report ¶ 70 & app. C; Rebuttal Expert Report of Kevin M. Murphy ¶¶ 31–32 (July 13, 2007) ("Murphy Rebuttal"). This high diversion ratio further suggests that many consumers consider conventional supermarkets inadequate substitutes for Wild Oats and Whole Foods. The district court cited the Project Goldmine study for the opposite conclusion, pointing only to cities in which Whole Foods expected to receive a low percentage of Wild Oats's business. *Whole Foods,* 502 F.Supp.2d at 34. These examples, however, do not undermine the study's broader conclusion that Whole Foods would capture most of the revenue from the closed Wild Oats, and the district court never mentioned the FTC expert's testimony that the diversion ratio estimated here "is at least *four times* the diversion ratio[ ] needed to make a price increase of 5% profitable for a joint owner of the two stores." Murphy Rebuttal ¶ 32. The dissent also ignores this testimony, saying incorrectly that the Project Goldmine study "says nothing about whether Whole Foods could impose a five percent or more price increase." Dissenting Op. at 1056.

Several industry studies predating the merger also suggest that Whole Foods and Wild Oats never truly competed with conventional supermarkets. For example, a study prepared for Whole Foods by an outside consultant concludes that "[Whole Foods] will not encounter significant, if any, competition from leading mainstream retailers['] (Safeway, Wal–Mart, Costco, etc.) entry into organics." Tinderbox Consulting, Exploring Private Label Organic Brands 4. Another study concludes that "[w]hile th[e] same consumer shops" at both "mainstream grocers such as Safeway" and "large-format natural foods store[s] such as Wild Oats or Whole Foods Market," "they tend to shop at each for different things (e.g., Wild Oats for fresh and specialty items, Safeway for canned and packaged goods)." The Hartman Group, Organic 2006, at ch. 8, p. 1 (May 1, 2006). In addition, Wild Oats's former CEO, Perry Odak, explained in a deposition why conventional stores have difficulty competing with Whole Foods and Wild Oats: if conventional stores offer a lot of organic products, they don't sell enough to their existing customer base, leaving the stores with spoiled products and reduced profits. But if conventional stores offer only a narrow range of organic products, customers with a high demand for organic items refuse to shop there. Thus, "the conventionals have a very difficult time getting into this business." Investigational ****358 *1045** Hearing of Perry Odak 77–78 (quoted in Murphy Report ¶ 77) ("Odak Hearing"). The district court mentioned none of this.

In addition to all this direct evidence that Whole Foods and Wild Oats occupy a separate market from conventional supermarkets, the FTC presented an enormous amount of evidence of "industry or public recognition" of the natural and organic market "as a separate economic entity"—one of the "practical indicia" the Supreme Court has said can be used to determine the boundaries of a distinct market. *Brown Shoe,* 370 U.S. at 325, 82 S.Ct. 1502. For example, dozens of record studies about the grocery store industry—including many prepared for Whole Foods or Wild Oats—distinguish between "traditional" or "conventional" grocery stores on the one hand and "natural food" or "organic" stores on the other. *See, e.g.,* Food Mktg. Inst., U.S. Grocery Shopper Trends 2007, at 20–22 (2007). Moreover, record evidence indicates that the Whole Foods and Wild Oats CEOs both believed that their companies occupied a market separate from the conventional grocery store industry. In an email to his company's board, Whole Foods CEO John Mackey explained that "[Wild Oats] is the only existing company that has the brand and number of stores to be a meaningful springboard for another player to get into this space. Eliminating them means eliminating this threat forever, or almost forever." Email from John Mackey to John Elstrott et al. (Feb. 15, 2007). Echoing this point, former Wild Oats CEO Perry Odak said that "there's really only two players of any substance in the organic and all natural [market], and that's Whole Foods and Wild Oats.... [T]here's really nobody else in that particular space." Odak Hearing 58. Executives from several conventional retailers agreed, explaining that Whole Foods and Wild Oats are not "conventional supermarkets" because "they focus on a premium organic-type customer" and "don't sell a lot of the things that ... a lot of people buy." Dep. of Rojon Diane Hasker 128–29 (July 10, 2007) ("Hasker Dep."). As Judge Bork explained, this evidence of " 'industry or public recognition of the submarket as a separate economic' unit matters because we assume that economic actors usually have accurate perceptions of economic realities." *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.,* 792 F.2d 210, 218 n. 4 (D.C.Cir.1986).

The FTC also presented strong evidence that Whole Foods and Wild Oats have "peculiar characteristics" distinguishing them from traditional supermarkets, another of the "practical indicia" the Supreme Court has said can be used to determine the boundaries of a distinct market. *Brown Shoe,* 370 U.S. at 325, 82 S.Ct. 1502. Most important, unlike traditional grocery stores, both Whole Foods and Wild Oats carry only natural or organic products. *See* http://www.wholefoodsmarket.com/products/index.html ("We carry natural and organic products ... unadulterated by artificial additives, sweeteners, colorings, and preservatives...."). Glossing over this distinction, the dissent says "the dividing line between 'organic' and conventional supermarkets has been blurred" because "[m]ost products that Whole Foods sells are not organic" while "conventional supermarkets" have begun selling more organic products. Dissenting Op. at 1054. But the FTC never defined its proposed market as "organic supermarkets," it defined it as "premium natural and organic supermarkets." And everything Whole Foods sells is natural and/or organic, while many of the things sold by traditional grocery stores are not. *See, e.g.,* Hasker Dep. 130–34; http://www.wholefoodsmarket. com/products/unacceptablefoodingredients.html (explaining that Whole Foods refuses to carry any food item containing one of dozens of "unacceptable ****359 *1046** food ingredients," ingredients that can be found in countless products at traditional grocery stores).

Insisting that all this evidence of a separate market is irrelevant, Whole Foods and the dissent argue that the FTC's case must fail because the record contains no evidence that Whole Foods or Wild Oats charged higher prices in cities where the other was absent—i.e., where one had a local monopoly on the asserted natural and organic market—than they did in cities where the other was present. This argument is both legally and factually incorrect.

As a legal matter, although evidence that a company charges more when other companies in the alleged market are absent certainly indicates that the companies operate in a distinct market, *see, e.g., Staples,* 970 F.Supp. at 1075–77, that is not the *only* way to prove a separate market. Indeed, *Brown Shoe* lists "distinct prices" as only one of a non-exhaustive list of seven "practical indicia" that may be examined to determine whether a separate market exists. 370 U.S. at 325, 82 S.Ct. 1502. Furthermore, even if the FTC could *prove* a section 7 violation only by showing evidence of higher prices in areas where a company had a local monopoly in an alleged market, the FTC need not *prove* a section 7 violation to obtain a preliminary injunction; rather, it need only raise "serious, substantial" questions as to the merger's legality. *Heinz,* 246 F.3d at 714. Thus, the dissent misses the mark when it cites the FTC's Horizontal Merger Guidelines to suggest that the Commission may obtain a preliminary injunction only by "mak[ing] a sufficient showing that the merged company could ... profitably impose a significant and nontransitory increase in price" of 5% or more. Dissenting Op. at 1052 (internal quotation marks omitted). Such evidence in a case like this, which turns entirely on market definition, would be enough *to prove* a section 7 violation in the FTC's administrative proceeding. *See Hosp. Corp.,* 807 F.2d at 1389 (stating that "[a]ll that is necessary" to prove a section 7 case "is that the merger create an appreciable danger of [higher prices] in the future"). Yet our precedent clearly holds that to obtain a preliminary injunction "[t]he FTC is not required to *establish* that the proposed merger would in fact violate section 7 of the Clayton Act." *Heinz,* 246 F.3d at 714. Moreover, the Merger Guidelines—which "are by no means to be considered binding on the court," *FTC v. PPG Indus., Inc.,* 798 F.2d 1500, 1503 n. 4 (D.C.Cir.1986)—specify how the FTC decides which cases to bring, "*not* ... how the Agency will conduct the litigation of cases that it decides to bring," Horizontal Merger Guidelines § 0.1 (emphasis added); *see also id.* ("[T]he Guidelines do not attempt to assign the burden of proof, or the burden of coming forward with evidence, on any particular issue.").

In any event, the FTC did present evidence indicating that Whole Foods and Wild Oats charged more when they were the only natural and organic supermarket present. The FTC's expert looked at prices Whole Foods charged in several of its North Carolina stores before and after entry of a regional natural food chain called Earth Fare. Before any Earth Fare stores opened, Whole Foods charged essentially the same prices at its five North Carolina stores, but when an Earth Fare opened near the Whole Foods in Chapel Hill, that store's prices dropped 5% below those at the other North Carolina Whole Foods. *See* Tr. of Mots. Hr'g, Morning Session 125–30 (July 31, 2007); Supplemental Rebuttal Expert Report of Kevin M. Murphy ¶¶ 2–6 (July 16, 2007) ("Murphy Supp."). Prices at that store remained lower than at the other Whole Foods in North Carolina for nearly a year, ****360 *1047** until just before the Earth Fare closed. *See* Murphy Supp. ¶¶ 4–5. Whole Foods followed essentially the same pattern when an Earth Fare opened near its stores in Raleigh and Durham —the company dropped prices at those stores but nowhere else in North Carolina. *See id.;* Tr. of Mots. Hr'g, Morning Session 127 (July 31, 2007). The FTC's expert presented similar evidence regarding Whole Foods's impact on Wild Oats's prices, showing that a new Whole Foods store opening near a Wild Oats caused immediate and lasting reductions in prices at that Wild Oats store compared to prices at other Wild Oats stores. *See* Tr. of Mots. Hr'g, Morning Session 132 (July 31, 2007); Murphy Report ¶¶ 57–59 & exhibit 5. In addition to this quantitative evidence, the FTC pointed to Whole Foods CEO John Mackey's statement explaining to the company's board why the merger made sense: "By buying [Wild Oats] we will ... avoid nasty price wars in [several cities where both companies have stores]." Email from John Mackey to John Elstrott et al. (Feb. 15, 2007).

The dissent raises two primary arguments against this pricing evidence. First, it relies on a study by Whole Foods's expert to conclude that Whole Foods's prices remain steady regardless of the presence or absence of a nearby Wild Oats, Dissenting Op. at 1053, calling this "all-but-dispositive price evidence," *id.* at 1053. In fact, this study is all-but-meaningless price evidence because it examined Whole Foods's pricing on a single day several months *after* the company announced its intent to acquire Wild Oats; this gave the company every incentive to eliminate any price differences that may have previously existed between its stores based on the presence of a nearby Wild Oats, not only to avoid antitrust liability, but also because the company was no longer competing with Wild Oats. *See Hosp. Corp.,* 807 F.2d at 1384 ("[E]vidence that is subject to manipulation by the party seeking to use it is entitled to little or no weight."). Second, the dissent asserts that all Mackey's statements are irrelevant because—it claims—anticompetitive "intent is not an element of a § 7 claim." Dissenting Op. at 1057. But the Supreme Court has clearly said that "evidence indicating the purpose of the merging parties, where available, *is an aid* in predicting the probable future conduct of the parties and thus the probable effects of the merger." *Brown Shoe,* 370 U.S. at 329 n. 48, 82 S.Ct. 1502 (emphasis added); *see also* 4A Phillip E. Areeda et al., Antitrust Law ¶ 964a (2d ed. 2006) ("[E]vidence of anticompetitive intent cannot be disregarded.").

To be sure, the pricing evidence here is unquestionably less compelling than the pricing evidence in some other cases, and perhaps this will make a difference in the Commission's ultimate evaluation of this merger. *Cf. Staples,* 970 F.Supp. at 1075–77 (showing price differences of up to 13% where competitors were absent). But at this preliminary, pre-hearing stage, the pricing evidence here, together with the other evidence described above, is certainly enough to raise "serious, substantial" questions that are "fair ground for thorough investigation, study, deliberation, and determination by the FTC." *Heinz,* 246 F.3d at 714–15.

Attempting to make these serious questions disappear, Whole Foods points to evidence the district court cited in concluding that the FTC could never prove a separate natural and organic market. That evidence, however, fails to overcome the "serious, substantial" questions the FTC's evidence raises.

To begin with, the district court relied on a study by a Whole Foods expert concluding that the post-merger company would be unable to impose a statistically significant non-transitory increase in price ****361 *1048** because the "actual loss" from such an increase would exceed the "critical loss"—the point at which the revenue gained from raising prices equals the revenue lost from reduced sales. The FTC's expert, however, reached the exact opposite conclusion, finding that the combined company could impose a statistically significant non-transitory increase in price. Murphy Report ¶ 147. He also raised a number of criticisms of the Whole Foods expert's study. Most important, he pointed out that the Whole Foods expert "provide[d] literally no quantitative evidence for the magnitude of the Actual Loss ... and no methodology for calculating the Actual Loss." Murphy Rebuttal ¶ 11. He further argued that the Whole Foods expert's study embodied a widely recognized flaw in critical loss analysis, namely that such analysis often overestimates actual loss when a company has high margins—which Whole Foods does. *See id.* ¶¶ 6–16 (explaining that when a company has high margins the critical loss is small, so one might predict an "Actual Loss greater than the Critical Loss," but "this story is very incomplete because a high margin tends to imply a small Actual Loss" given that high margins suggest customers are price insensitive (quoting Michael L. Katz & Carl Shapiro, *Further Thoughts on Critical Loss,* Antitrust Source, March 2004, at 1, 2)); *see also* Daniel P. O'Brien & Abraham L. Wickelgren, *A critical analysis of critical loss analysis,* 71 Antitrust L.J. 161, 162 (2003). In light of these cogent criticisms—which neither Whole Foods's expert nor the district court ever addressed—this study cannot eliminate the " serious, substantial" questions the FTC's evidence raises. Although courts certainly must evaluate the evidence in section 13(b) proceedings and may safely reject expert testimony they find unsupported, they trench on the FTC's role when they choose between plausible, well-supported expert studies.

The district court next emphasized that when a new Whole Foods store opens, it takes business from conventional grocery stores, and even when an existing Wild Oats is nearby, most of the new Whole Foods store's revenue comes from customers who previously shopped at conventional stores. According to the district court, this led "to the inevitable conclusion that Whole Foods' and Wild Oats' main competitors are other supermarkets, not just each other." *Whole Foods,* 502 F.Supp.2d at 21. As the FTC points out, however, "an innovative [product] can create a new product market for antitrust purposes" by "satisfy[ing] a previously-unsatisfied consumer demand." Appellant's Opening Br. 50. To use the Commission's example, when the automobile was first invented, competing auto manufacturers obviously took customers primarily from companies selling horses and buggies, not from other auto manufacturers, but that hardly shows that cars and horse-drawn carriages should be treated as the same product market. That Whole Foods and Wild Oats have attracted many customers away from conventional grocery stores by offering extensive selections of natural and organic products thus tells us nothing about whether Whole Foods and Wild Oats should be treated as operating in the same market as conventional grocery stores. Indeed, courts have often found that sufficiently innovative retailers can constitute a distinct product market even when they take customers from existing retailers. *See, e.g., Photovest Corp. v. Fotomat Corp.,* 606 F.2d 704, 712–14 (7th Cir.1979) (finding a distinct market of drive-up photo-processing companies even though such companies took photo-processing customers from drugstores, camera stores, and supermarkets); *Staples,* 970 F.Supp. at 1077 (finding a distinct market of office supply superstores even though such stores took sales primarily from mail-order ****362 *1049** catalogues and stores carrying a broader range of merchandise).

The district court also cited evidence that Whole Foods compares its prices to those at conventional stores, not just natural foods stores. But nearly all of the items on which Whole Foods checks prices are dry grocery items, even though nearly 70% of Whole Foods's revenue comes from perishables. Murphy Report ¶ 77. As Judge Brown's opinion explains, this suggests that any competition between Whole Foods and conventional retailers may be limited to a narrow range of products that play a minor role in Whole Foods's profitability. Op. at 1039.

Finally, the district court observed that more and more conventional stores are carrying natural and organic products, and that consumers who shop at Whole Foods and Wild Oats also shop at conventional stores. But as noted above, other record evidence suggests that although some conventional retailers are beginning to offer a limited range of popular organic products, they have difficulty competing with Whole Foods and Wild Oats. *See* Murphy Report ¶ 77. As Whole Foods CEO John Mackey put it: "[Wild Oats] is the *only existing company* that has the brand and number of stores to be a meaningful springboard for another player to get into this space. Eliminating them means *eliminating this threat* *forever, or almost forever.*" Email from John Mackey to John Elstrott et al. (Feb. 15, 2007) (emphasis added). Other studies show that "[w]hile th[e] same consumer shops" at both "mainstream grocers such as Safeway" and "large-format natural foods store[s] such as Wild Oats or Whole Foods," "they tend to shop at each for different things." The Hartman Group, Organic 2006, at ch. 8, p. 1 (May 1, 2006); *see also Photovest,* 606 F.2d at 714 ("The law does not require an exclusive class of customers for each relevant submarket.").

In sum, much of the evidence Whole Foods points to is either entirely unpersuasive or rebutted by credible evidence offered by the FTC. Of course, this is not to say that the FTC will necessarily be able to prove its asserted product market in an administrative proceeding: as the district court recognized, Whole Foods has a great deal of evidence on its side, evidence that may ultimately convince the Commission that no separate market exists. But at this preliminary stage, the FTC's evidence plainly establishes a reasonable probability that it will be able to prove its asserted market, and given that this " 'case hinges'—almost entirely—'on the proper definition of the relevant product market,' " *Whole Foods,* 502 F.Supp.2d at 8 (quoting *Staples,* 970 F.Supp. at 1073), this is enough to raise "serious, substantial" questions meriting further investigation by the FTC, *Heinz,* 246 F.3d at 714.

III

Because we have decided that the FTC showed the requisite likelihood of success by raising serious and substantial questions about the merger's legality, all that remains is to "weigh the equities in order to decide whether enjoining the merger would be in the public interest." *Id.* at 726. Although in some cases we have conducted this weighing ourselves, *see, e.g., id.* at 726–27, three factors lead me to agree with Judge Brown that the better course here is to remand to the district court for it to undertake this task. First, in cases in which we have weighed the equities, the district court had already done so, giving us the benefit of its factfinding and reasoning. *See, e.g., id.* Here, by contrast, the district court never reached the equities and the parties have not briefed the issue, leaving us without the evidence needed to decide this question. *See Whole Foods,* 502 F.Supp.2d at 50. Second, this case stands in a unique ****363 *1050** posture, for in cases where we reversed a district court's denial of a section 13(b) injunction, either the district court or this court had enjoined the merger pending appeal. *See Heinz,* 246 F.3d at 713; *PPG Indus.,* 798 F.2d at 1501 n. 1. Here, by contrast, the companies have already merged, and although this doesn't moot the case, it may well affect the balance of the equities, likely requiring the district court to take additional evidence. Finally, given this case's unique posture, the usual remedy in section 13(b) cases—blocking the merger—is no longer an option. Therefore, if the district court concludes that the equities tilt in the FTC's favor, it will need to craft an alternative, fact-bound remedy sufficient to achieve section 13(b)'s purpose, namely allowing the FTC to review the transaction in an administrative proceeding and reestablish the premerger status quo if it finds a section 7 violation. To accomplish this, the district court could choose anything from issuing a hold separate order, *see FTC v. Weyerhaeuser Co.,* 665 F.2d 1072, 1083–84 (D.C.Cir.1981), to enjoining further integration of the companies, to ordering the transaction partially or entirely rescinded, *see FTC v. Elders Grain,* 868 F.2d 901, 907–08 (7th Cir.1989) (Posner, J.). Without more facts, however, we are in no position to suggest which remedy is most appropriate.

Given the novel and significant task the district court faces on remand, I think it important to emphasize the principles that should guide its weighing of the equities. To begin with, as this court has held, "a likelihood of success finding weighs heavily in favor of a preliminary injunction blocking the acquisition," *Weyerhaeuser,* 665 F.2d at 1085, "creat[ing] a presumption in favor of preliminary injunctive relief," *Heinz,* 246 F.3d at 726. That said, the district court must still weigh the public and private equities "to decide whether enjoining the merger would be in the public interest." *Id.* "The principal public equity weighing in favor of issuance of preliminary injunctive relief is the public interest in effective enforcement of the antitrust laws." *Id.* That is, because "[a]dministrative experience shows that the Commission's inability to unscramble merged assets frequently prevents entry of an effective order of divestiture" after administrative proceedings, *FTC v. Dean Foods Co.,* 384 U.S. 597, 607 n. 5, 86 S.Ct. 1738, 16 L.Ed.2d 802 (1966), the court must place great weight on the public interest in blocking a possibly anticompetitive merger before it is complete. Here, of course, the merger has already been consummated, although as the FTC points out, the process of combining the two companies is far from complete. Thus, the district court must consider the extent to which any of the remedial options mentioned above would make it easier for the FTC to separate Wild Oats and Whole Foods after the Commission's administrative proceeding (should it find a section 7 violation) than it would be if the court did nothing. The court must then weigh this and any other equities opposing the merger against any public and private equities that support allowing the merger to proceed immediately.

In conducting this weighing, if Whole Foods can show no public equities in favor of allowing the merger to proceed immediately—such as increased employment or reduced prices—the district court should go no further, for "[w]hen the Commission demonstrates a likelihood of ultimate success, a countershowing of private equities alone [does] not suffice to justify denial of a preliminary injunction barring the merger." *Weyerhaeuser,* 665 F.2d at 1083. But if Whole Foods can show some public equity favoring the merger, then the court should also consider private equities on Whole Foods's side of the ledger, such as whether it would allow an otherwise failing firm to survive. That said, "[w]hile it is ****364 *1051** proper to consider private equities in deciding whether to enjoin a particular transaction, we must afford such concerns little weight, lest we undermine section 13(b)'s purpose of protecting the public-at-large, rather than the individual private competitors." *Heinz,* 246 F.3d at 727 n. 25 (quoting *FTC v. Univ. Health, Inc.,* 938 F.2d 1206, 1225 (11th Cir.1991)) (internal quotation marks omitted). Moreover, "[w]e do not rank as a private equity meriting weight a mere expectation of private gain from a transaction the FTC has shown is likely to violate the antitrust laws." *Weyerhaeuser,* 665 F.2d at 1083 n. 26. In other words, even if allowing the merger to proceed would increase Whole Foods's profits, that is irrelevant to the private equities under section 13(b).

KAVANAUGH, Circuit Judge, dissenting.[1]

The Federal Trade Commission has sought a preliminary injunction to block the Whole Foods–Wild Oats merger as anticompetitive under § 7 of the Clayton Act. As in many antitrust cases, the analysis comes down to one issue: market definition. Is the relevant product market here *all* supermarkets? Or is the relevant product market here only so-called "organic supermarkets"? If the former, as Whole Foods argues, the Whole Foods–Wild Oats merger would be lawful because it would not lessen competition in the broad market of all supermarkets: Whole Foods and Wild Oats together operate about 300 of the approximately 34,000 supermarkets in the United States. If the latter, as the FTC contends, the merger may be unlawful: Whole Foods and Wild Oats are the only significant competitors in the alleged organic-store market and their merger would substantially lessen competition in such a narrowly defined market.

More than a year ago, after a lengthy evidentiary hearing and in an exhaustive and careful opinion, the District Court found that the record evidence overwhelmingly supports the following conclusions: Whole Foods competes against all supermarkets and not just so-called organic stores; the relevant market for evaluating this merger for antitrust purposes is all supermarkets; and the merger of Whole Foods and Wild Oats would not substantially lessen competition in a market that includes all supermarkets. The court therefore denied the FTC's motion for a preliminary injunction.

Also more than a year ago, a three-judge panel of this Court unanimously denied the FTC's request for an injunction pending appeal, thereby allowing the Whole Foods–Wild Oats deal to close. Since then, the merged entity has shut down, sold, or converted numerous Wild Oats stores and otherwise effectuated the merger through many changes in supplier contracts, leases, distribution, and the like.

The Court's splintered decision in this case seeks to unring the bell. In my judgment, this Court got it right a year ago in refusing to enjoin the merger, and there is no basis for a changed result now. Both a year ago and now, the same central question has been before the Court in determining whether to approve an injunction: whether the FTC demonstrated the necessary "likelihood of success" on its § 7 case. A year ago, the Court said no. Now, the Court says yes. The now-merged entity, the industry, and consumers ****365 *1052** no doubt will be confused by this apparent judicial about-face.

The law does not allow the FTC to just snap its fingers and temporarily block a merger. Even at the preliminary injunction stage, the relevant statutory text and precedents expressly require that the FTC show a "likelihood of success on the merits." *FTC v. H.J. Heinz Co.,* 246 F.3d 708, 714 (D.C.Cir.2001); *see also* 15 U.S.C. § 53(b) ("likelihood of ultimate success"); *cf. Munaf v. Geren,* 553 U.S. 674, 128 S.Ct. 2207, 2218–19, 171 L.Ed.2d 1 (2008). Because "[m]erger enforcement, like other areas of antitrust, is directed at market power," *Heinz,* 246 F.3d at 713, the FTC therefore needs to make a sufficient showing that the merged company could exercise market power and profitably impose a "small but significant and nontransitory increase in price," typically meaning a five percent or greater price increase. Horizontal Merger Guidelines § 1.11 (internal quotation marks omitted); *see* 15 U.S.C. § 18. As the District Court concluded, the FTC did not come close to presenting that kind of evidence in this case; the FTC completely failed to make the economic showing that is Antitrust 101.

By seeking to block a merger without a sufficient showing that so-called organic stores constitute a separate product market and that the merged entity could impose a significant and nontransitory price increase, the FTC's position—which Judge Brown and Judge Tatel largely accept—calls to mind the bad old days when mergers were viewed with suspicion regardless of their economic benefits. *See generally* Robert H. Bork, The Antitrust Paradox (1978). I would not turn back the clock. I agree with and would affirm the District Court's excellent decision denying the FTC's motion to enjoin the merger of Whole Foods and Wild Oats. *See FTC v. Whole Foods Mkt., Inc.,* 502 F.Supp.2d 1 (D.D.C.2007).

I

A

Section 7 of the Clayton Act prohibits mergers "where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly." 15 U.S.C. § 18. The Horizontal Merger Guidelines jointly promulgated by two Executive Branch agencies (the Department of Justice and the FTC) implement that statutory directive and recognize that the key initial step in the analysis is proper product-market definition. *See* Horizontal Merger Guidelines § 1.11; *see also* 2B Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law ¶ 536, at 284–85 (3d ed.2007). Proper product-market analysis focuses on products' interchangeability of use or cross-elasticity of demand. A product "market can be seen as the array of producers of substitute products that could control price if united in a hypothetical cartel or as a hypothetical monopoly." *Id.* ¶ 530a, at 226. In the merger context, the inquiry therefore comes down to whether the merged entity could profitably impose a "small but significant and nontransitory increase in price" typically defined as five percent or more. *See* Horizontal Merger Guidelines § 1.11 (internal quotation marks omitted). If the merged entity could profitably impose at least a five percent price increase (because the price increase would not cause a sufficient number of consumers to switch to substitutes outside of the alleged product market), then there is a distinct product market and the proposed merger likely would substantially lessen competition in that market, in violation of § 7 of the Clayton Act.

In considering whether the merged entity could increase prices, courts of course recognize that "future behavior must be ****366 *1053** inferred from historical observations." 2B Areeda & Hovenkamp, Antitrust Law ¶ 530a, at 226. Therefore, the courts scrutinize existing markets to assess the probable effects of a merger.

This approach was applied sensibly by Judge Hogan in his thorough and leading opinion in *FTC v. Staples,* 970 F.Supp. 1066 (D.D.C.1997). There, Judge Hogan found that office products sold by an office superstore were functionally interchangeable with office products sold at other types of stores, but he nonetheless found that office-supply superstores constituted a distinct product market. One key fact led Judge Hogan to that conclusion: In areas where Staples was the only office superstore, it was able to set prices significantly higher than in areas where it competed with other office superstores (Office Depot and OfficeMax). *See id.* at 1075–76. For example, the FTC presented "compelling evidence" that Staples's prices were 13 percent higher in areas where no office-superstore competitors were present. *Id.* Judge Hogan ultimately concluded that "[t]his evidence all suggests that office superstore *prices* are affected primarily by other office superstores and not by non-superstore competitors." *Id.* at 1077 (emphasis added). For that reason, the Court enjoined the merger of Staples and Office Depot.

B

Consistent with the statute, the Executive Branch's Merger Guidelines, and Judge Hogan's convincing opinion in *Staples,* the District Court here carefully analyzed the economics of supermarkets, including so-called organic supermarkets. The court considered whether Whole Foods charged higher prices in areas without Wild Oats than in areas with Wild Oats. After an evidentiary hearing and based on a painstaking review of the evidence in the record, the court concluded that "Whole Foods prices are essentially the same at all of its stores in a region, regardless of whether there is a Wild Oats store nearby." *FTC v. Whole Foods Mkt., Inc.,* 502 F.Supp.2d 1, 22 (D.D.C.2007). That factual conclusion was supported by substantial evidence offered by Dr. Scheffman, Whole Foods's expert, and by the lack of any credible evidence to the contrary.

Dr. Scheffman analyzed Whole Foods's actual prices across stores and concluded that "there is no evidence that [Whole Foods] and [Wild Oats] price higher" where they face no competition from so-called organic supermarkets compared with where they do face such competition. Scheffman Expert Report ¶ 292, at 113. At a regional level, his studies revealed that only a "very small percentage" of products vary in price within a region, indicating that "prices are set across broad geographic areas." *Id.* ¶ 300, at 116. He also analyzed prices at the individual store level, examining how many products sold at a specific store have prices that differ from the most common price in the region. He found that "differences in prices across stores are generally very small (less than one half of one percent) and there is no systematic pattern as to the presence or absence of [organic-supermarket] competition." *Id.* ¶ 305, at 116.

Moreover, the record evidence in this case does not show that Whole Foods changed its prices in any significant way in response to exit from an area by Wild Oats. In the four cases where Wild Oats exited and a Whole Foods store remained, there is no evidence in the record that Whole Foods then raised prices. Nor was there any evidence of price increases after Whole Foods took over two Wild Oats stores.

The facts here contrast starkly with *Staples,* where Staples charged significantly different prices based on the presence or ****367 *1054** absence of office-superstore competitors in a particular area. The evidence there showed that Staples charged prices 13 percent higher in markets without office-superstore competitors than in markets with such competitors. There is nothing remotely like that in this case.

In the absence of any evidence in the record that Whole Foods was able to (or did) set higher prices when Wild Oats exited or was absent, the District Court correctly concluded that Whole Foods competes in a market composed of all supermarkets, meaning that "all supermarkets" is the relevant product market and that the Whole Foods–Wild Oats merger will not substantially lessen competition in that product market.

In addition to the all-but-dispositive price evidence,[2] the District Court identified other factors further demonstrating that the relevant market consists of all supermarkets.

The record shows that Whole Foods makes site selection decisions based on all supermarkets and checks prices against all supermarkets, not only so-called organic supermarkets. As Dr. Scheffman concluded, Whole Foods "price checks a broad set of competitors ... nationally, regionally and locally." *Id.* ¶ 224, at 86. This "demonstrates that [Whole Foods] views itself as competing with a broad range of supermarkets and that these supermarkets, in fact, constrain the prices charged by [Whole Foods]." *Id.* Those other supermarkets include conventional supermarkets such as Safeway, Albertson's, Wegman's, HEB, and Harris Teeter, as well as so-called organic supermarkets like Wild Oats. *Id.* ¶¶ 225–26, at 86–87. As Professors Areeda and Hovenkamp have explained, a "broad-market finding gains some support from long-standing documents indicating that *A* or *B* producers regard the other product as a close competitor." 2B Areeda & Hovenkamp, Antitrust Law ¶ 562a, at 372. The point here is simple: Whole Foods would not examine the locations of and price check conventional grocery stores if it were not a competitor of those stores. Whole Foods does not price check Sports Authority; Whole Foods does price check Safeway.

The record also demonstrates that conventional supermarkets and so-called organic supermarkets are aggressively competing to attract customers from one another. After reviewing a wide variety of industry information and trade journals, Dr. Scheffman concluded that " '[o]ther' supermarkets are competing vigorously for the purchases made by shoppers at [Whole Foods] and [Wild Oats]." Scheffman Expert Report ¶ 212, at 77. Whole Foods "recognizes the fact that it has to appeal to a significantly broader group of consumers than organic and natural focused consumers." *Id.* ¶ 279, at 108. The record shows that Whole Foods has made progress: Most products that Whole Foods sells are not organic. Conversely, conventional supermarkets have shifted towards "emphasizing fresh, 'natural' and organic" products. *Id.* ¶ 215, at 80. "[M]ost of the major chains and others are expanding into private label organic and natural products." *Id.* ¶ 220, at 85; *see also id.* ¶ 219, at 83–85 (listing changes in other supermarkets).

So the dividing line between "organic" and conventional supermarkets has blurred. As the District Court aptly put it, the "train has already left the station." ***1055 **368** *Whole Foods,* 502 F.Supp.2d at 48. The convergence undermines the threshold premise of the FTC's case. This is an industry in transition, and Whole Foods has pioneered a product differentiation that in turn has caused other supermarket chains to update their offerings. These are not separate product markets; this is a market where all supermarkets including so-called organic supermarkets are clawing tooth and nail to differentiate themselves, beat the competition, and make money.

The District Court's summary of the evidence warrants extensive quotation:

> In sum, while all supermarket retailers, including Whole Foods, attempt to differentiate themselves in some way in order to attract customers, they nevertheless compete, and compete vigorously, with each other. The evidence before the Court demonstrates that conventional or more traditional supermarkets today compete for the customers who shop at Whole Foods and Wild Oats, particularly the large number of cross-shopping customers—or customers at the margin—with a growing interest in natural and organic foods. Post-merger, all of these competing alternatives will remain. Based upon the evidence presented, the Court concludes that many customers could and would readily shift more of their purchases to any of the increasingly available substitute sources of natural and organic foods. The Court therefore concludes that the FTC has not met its burden to prove that "premium natural and organic supermarkets" is the relevant product market in this case for antitrust purposes.

Id. at 36.[3]

II

In an attempt to save its merger case despite its inability to meet the test reflected in the Merger Guidelines and applied in *Staples,* the FTC cites marginally relevant evidence and advances a scattershot of flawed arguments.

First, the FTC says that so-called organic supermarkets like Whole Foods and Wild Oats constitute their own product market because they are characterized by factors that differentiate them from conventional supermarkets. Those factors include intangible qualities such as customer service and tangible factors such as a focus on perishables.

This argument reflects the key error that permeates the FTC's approach to this case. Those factors demonstrate only product differentiation, and product differentiation does not mean different product markets. "For antitrust purposes, we apply the differentiated label to products that are distinguishable in the minds of buyers but not so different as to belong in separate markets." 2B Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law ¶ 563a, at 385 (3d ed.2007). As the District Court noted, supermarkets including so-called organic supermarkets differentiate themselves by emphasizing specific benefits or characteristics to attract customers to their stores. *See FTC v. Whole Foods Mkt., Inc.,* 502 F.Supp.2d 1, 24–26 (D.D.C.2007). They may differentiate ****369 *1056** themselves along dimensions such as "low price, ethnic appeal, prepared foods, health and nutrition, variety within a product category, customer service, or perishables such as meats or produce." Stanton Expert Report ¶ 23, at 6.

The key to distinguishing product differentiation from separate product markets lies in price information. As Professors Areeda and Hovenkamp have stated, differentiated sellers "generally compete with one another sufficiently" that the prices of one are "greatly constrained" by the prices of others. 2B Areeda & Hovenkamp, Antitrust Law ¶ 563a, at 384. To distinguish differentiation from separate product markets, courts thus must "ask whether one seller could maximize profit" by charging "more than the competitive price" without "losing too much patronage to other sellers." *Id.* ¶ 563a, at 385. Here, in other words, could so-called organic supermarkets maximize profit by charging more than a competitive price without losing too much patronage to conventional supermarkets? Based on the evidence regarding Whole Foods's pricing practices, the District Court correctly found that the answer to that question is no. So-called organic supermarkets are engaged in product differentiation; they do not constitute a product market separate from all supermarkets.

Second, the FTC points to internal Whole Foods studies and other evidence showing that if a Wild Oats near a Whole Foods were to close, most of the Wild Oats customers would shift to Whole Foods. But that says nothing about whether Whole Foods could impose a five percent or more price increase and still retain those customers (and its other customers), which is the relevant antitrust question. In other words, the fact that many Wild Oats customers would shift to Whole Foods does not mean that those customers would stay with Whole Foods, as opposed to shifting to conventional supermarkets, if Whole Foods significantly raised its prices. And even if one could infer that all of those former Wild Oats customers would so prefer Whole Foods that they would shop there even in the face of significant price increases, that would not show whether Whole Foods could raise prices without driving out a sufficient number of other customers as to make the price increases unprofitable. In sum, this argument is a diversion from the economic analysis that must be conducted in antitrust cases like this. The District Court properly found that the expert evidence in the record leads to the conclusion that Whole Foods could not profitably impose such a significant price increase.[4]

Third, the FTC cites comments by Whole Foods CEO John Mackey as evidence ****370 *1057** that Whole Foods perceived Wild Oats to be a unique competitor. Even if Mackey's comments were directed only to Wild Oats, that would not be evidence that Whole Foods and Wild Oats are in their own product market separate from all other supermarkets. It just as readily suggests that Whole Foods and Wild Oats are two supermarkets that have similarly *differentiated* themselves from the rest of the market, such that Mackey would be especially pleased to see that competitor vanish. Beating the competition from similarly differentiated competitors in a product market is ordinarily an entirely permissible competitive goal. Saying as much, as Mackey did here, does not mean that the similarly differentiated competitor is the only relevant competition in the marketplace. Moreover, Mackey nowhere says that the merger would allow Whole Foods to significantly raise prices, which of course is the issue here. In any event, intent is not an element of a § 7 claim, and a CEO's bravado with regard to one rival cannot alter the laws of economics: Mere boasts cannot vanquish real-world competition—here, from Safeway, Albertson's, and the like. As Judge Easterbrook has explained, “Firms need not like their competitors; they need not cheer them on to success; a desire to extinguish one's rivals is entirely consistent with, often is the motive behind, competition.” *A.A. Poultry Farms, Inc. v. Rose Acre Farms, Inc.,* 881 F.2d 1396, 1402 (7th Cir.1989). And “[i]f courts use the vigorous, nasty pursuit of sales as evidence of a forbidden ‘intent’, they run the risk of penalizing the motive forces of competition.” *Id.* “Intent does not help to separate competition from attempted monopolization....” *Id.*

Fourth, the FTC says that a study by its expert, Dr. Murphy, demonstrates that Whole Foods's profit margins decreased in geographic areas where it competed against Wild Oats. But the relevant inquiry under the Merger Guidelines is *prices.* And Dr. Murphy did not determine whether Whole Foods prices ever differed as a result of competition from Wild Oats.

Moreover, there was only a slight difference between Whole Foods margins when Wild Oats was in the same area and when it was not. The overall difference was 0.7 percent, which Dr. Murphy himself recognized was not statistically significant. The FTC's evidence on margins is wafer-thin and does not suffice to show that organic stores constitute their own product market.

Fifth, the FTC points to evidence that Whole Foods's entry into a particular area, unlike the entry of conventional supermarkets, caused Wild Oats to lower its prices. Dr. Murphy's reliance on Wild Oats's reaction to Whole Foods's entry is questionable. Dr. Murphy based his entire analysis on a meager two events, hardly a large sample size. In addition, Dr. Murphy's analysis did not control for the reaction of conventional supermarkets to Whole Foods's entry. In other words, he *assumed* that the relevant product market was so-called organic supermarkets (the point he was trying to prove) and therefore assumed that all changes in Wild Oats's prices were directly caused by Whole Foods's entry. But if conventional supermarkets also lowered prices to compete with Whole Foods when Whole Foods entered, Wild Oats's price decreases may well have been due to the overall reduction in prices by all supermarkets in the area. If that were true, the relevant product market would obviously be all supermarkets, not just so-called organic supermarkets. Dr. Murphy's analysis never confronted that possibility or the complexity of how competition works in this market; his analysis appears to have assumed the conclusion and reasoned backwards from there.

***1058 **371** Moreover, the fact that Whole Foods and Wild Oats went toe-to-toe on occasion does not mean that they did not also go toe-to-toe with conventional supermarkets, which is the key question. And it is revealing that despite having access to the necessary data for six such events, Dr. Murphy did not analyze the effect of a Wild Oats exit on Whole Foods's prices. As Dr. Scheffman wrote: “A number of [Wild Oats] stores have closed.... [Dr. Murphy] has done no analysis to assess the effects of those store exits in the local shopping areas.... This is a curious omission, since such evidence, if reliable and reliably analyzed, would be relevant to the issue of what happens in local market areas in which a [Wild Oats] store closes.” Scheffman Rebuttal ¶ 63, at 21.

The bottom line is that, as the District Court found, there is no evidence in the record suggesting that Whole Foods priced differently based on the presence or absence of a Wild Oats store in the area. That is a conspicuous—and all but dispositive—omission in Dr. Murphy's analysis and in the FTC's case.

Sixth, the FTC cites the openings of three Earth Fare stores near Whole Foods stores in North Carolina, which caused decreases in Whole Foods's prices in those areas. But soon after those entries, Whole Foods's prices returned to normal levels. So the record hardly shows the sort of "nontransitory" price changes that are the touchstone of product-market definition. *See* Merger Guidelines § 1.11. A price increase ordinarily must last "for the foreseeable future," *id.,* considered by some to be more than a year, to qualify as "nontransitory" *See* 2B Areeda & Hovenkamp, Antitrust Law ¶ 537a, at 290. Moreover, the entry of a Safeway store in Boulder, Colorado, had a similar short-term impact on Whole Foods, indicating that whatever inference should be drawn from the Earth Fare entries cannot be limited to so-called organic supermarkets but rather applies to conventional supermarkets.

The FTC's reference to Earth Fare mistakenly focuses on a few isolated trees instead of the very large forest indicating a competitive market consisting of all supermarkets. In short, I fail to see how Whole Foods's *temporary* price changes to compete against three Earth Fare stores in North Carolina could possibly be a hook to block this nationwide merger of Whole Foods and Wild Oats.

III

A

The opinions of Judge Brown and Judge Tatel rest on two legal points with which I respectfully but strongly disagree.

First, the Court's decision resuscitates the loose antitrust standards of *Brown Shoe Co. v. United States,* 370 U.S. 294, 82 S.Ct. 1502, 8 L.Ed.2d 510 (1962), the 1960s-era relic. *See, e.g.,* Brown Op. at 1039 ("We look to the *Brown Shoe* indicia...."); Tatel Op. at 1046 ("*Brown Shoe* lists 'distinct prices' as only one of a non-exhaustive list of seven 'practical indicia' that may be examined to determine whether a separate market exists.") (citation omitted). This is a problem because *Brown Shoe's* brand of free-wheeling antitrust analysis has not stood the test of time. *See, e.g.,* Einer Elhauge & Damien Geradin, Global Antitrust Law and Economics 874 (2007) ("Modern practice takes a much more rigorous approach to market definition [than *Brown Shoe*]"); 4 Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law ¶ 913a, at 62 (2d ed. 2006) ("One alternative that we do not recommend is a return to *Brown Shoe*'s language of 'submarkets' ").

As demonstrated in this Court's most recent merger case, the practical indicia test of *Brown Shoe* no longer guides courts' merger analyses because it does ****372 *1059** not sufficiently account for the basic economic principles that, according to the Supreme Court, must be considered under modern antitrust doctrine. *See FTC v. H.J. Heinz Co.,* 246 F.3d 708, 715–16 (D.C.Cir.2001) (not applying *Brown Shoe* practical indicia test; instead using the economically grounded Herfindahl–Hirschman Index test for market definition employed in *FTC v. Staples, Inc.,* 970 F.Supp. 1066 (D.D.C.1997)); *cf. Leegin Creative Leather Prods. v. PSKS, Inc.,* 551U.S. 877, 127 S.Ct. 2705, 2718, 168 L.Ed.2d 623 (2007) ("the antitrust laws are designed primarily to protect interbrand competition"); *State Oil Co. v. Khan,* 522 U.S. 3, 14, 118 S.Ct. 275, 139 L.Ed.2d 199 (1997) ("Our analysis is also guided by our general view that the primary purpose of the antitrust laws is to protect interbrand competition."); *Hosp. Corp. of Am. v. FTC,* 807 F.2d 1381, 1386 (7th Cir.1986) (Posner, J.) (noting the "most important developments that cast doubt on the continued vitality of such cases as *Brown Shoe* "). Judge Bork forcefully catalogued the flaws in the *Brown Shoe* approach 30 years ago in his landmark antitrust book; indeed, his cogent critique helped usher *Brown Shoe* and several other cases to the jurisprudential sidelines. *See* Robert H. Bork, The Antitrust Paradox 210, 216 (1978) ("It would be overhasty to say that the *Brown Shoe* opinion is the worst antitrust essay ever written.... Still, all things considered, *Brown Shoe* has considerable claim to the title.... *Brown Shoe* was a disaster for rational, consumer-oriented merger policy."); George L. Priest, *The Abiding Influence of* The Antitrust Paradox, 31 Harv. J.L. & Pub. Pol'yY 455, 459 (2008) (praising Judge Bork's criticism of the "now notorious, though then mainstream" *Brown Shoe* opinion).

The Court's revival of the loose *Brown Shoe* standard threatens to reverse this trend and to upend modern merger practice.[5]

Second, the opinions of Judge Brown and Judge Tatel both dilute the standard for preliminary injunction relief in antitrust merger cases, such that the FTC apparently need not establish a "likelihood of success on the merits." *Heinz,* 246 F.3d at 714. In particular, Judge Brown and Judge Tatel rely heavily on their belief that: "In this circuit, the standard for likelihood of success on the merits is met if the FTC has raised questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC in the first instance and ultimately by the Court of Appeals." Tatel Op. at 1042 (internal quotations and citations omitted); *see also id.* at 1042; Brown Op. at 1035 (indicating that "the FTC will usually be able to obtain a preliminary injunction blocking a merger" by satisfying the same test).

In applying this watered-down test for issuing a preliminary injunction in FTC merger cases, Judge Brown and Judge Tatel rely on language contained in our opinion in *Heinz.* However, *Heinz* only *assumed* this particular gloss on the "likelihood of success on the merits" requirement for preliminary injunctions based on ****373 *1060** a concession in the case. *See Heinz,* 246 F.3d at 715 (D.C.Cir.2001) ("This specific standard was articulated by the court below, and it is a standard to which the appellees have not objected.") (citation omitted). *Heinz* did not hold that this gloss was the proper meaning of 15 U.S.C. § 53(b) in FTC preliminary injunction merger cases.[6]

This "serious questions" standard is inconsistent with the relevant statutory text. The statute unambiguously requires that courts consider "the Commission's likelihood of ultimate success" when the FTC seeks to preliminarily enjoin a merger. 15 U.S.C. § 53(b).[7]

There is a significant difference, moreover, between the relaxed "serious questions" standard applied by Judge Brown and Judge Tatel and the traditional likelihood of success standard—as the Supreme Court explained just a few months ago in *Munaf v. Geren,* 553 U.S. 674, 128 S.Ct. 2207, 171 L.Ed.2d 1 (2008), *rev'g sub nom. Omar v. Harvey,* 479 F.3d 1 (D.C.Cir.2007). To be sure, that case did not involve a merger; but the Supreme Court there did address the general likelihood-of-success preliminary injunction standard—the same standard that is expressly articulated in 15 U.S.C. § 53(b). The District Court in the *Omar* litigation—like Judge ****374 *1061** Brown and Judge Tatel here—had concluded that a preliminary injunction was justified because the case presented questions "so serious, substantial, difficult and doubtful, as to make them fair ground for litigation and thus for more deliberative investigation." *Omar v. Harvey,* 416 F.Supp.2d 19, 23–24 (D.D.C.2006) (citation omitted). This Court then affirmed the District Court's preliminary injunction. *See Omar v. Harvey,* 479 F.3d 1, 11 (D.C.Cir.2007) (concluding that the Court " need not address" the merits of petitioner's claims).

But the Supreme Court unanimously rejected that lesser "serious questions" standard as too weak and not equivalent to the "likelihood of success" necessary for a preliminary injunction to issue. *See Munaf,* 128 S.Ct. at 2219 ("We begin with the basics.... [A] party seeking a preliminary injunction must demonstrate, among other things, 'a likelihood of success on the merits.' ") (citations omitted); *see also Winter v. NRDC,* 555U.S. 7, 129 S.Ct. 365, 374, 172 L.Ed.2d 249 (2008) ("A plaintiff seeking a preliminary injunction must establish that he is likely to succeed on the merits") (citing *Munaf,* 128 S.Ct. at 2218–19). And the Supreme Court directly criticized the approach of the District Court and this Court in the *Omar* litigation: "one searches the opinions below in vain for any mention of a likelihood of success as to the merits." *Munaf,* 128 S.Ct. at 2219.

The Court in this case repeats the same mistake made in *Omar* of watering down the preliminary injunction standard. Both Judge Brown and Judge Tatel approve the FTC's request for preliminary injunction without making the essential "likelihood of success" finding that is required by the statutory text and Supreme Court precedent. *See* Brown Op. at 1035, 1041; Tatel Op. at 1041–42, 1042–43. To the extent the "serious questions" standard they apply was ever appropriate for preliminary injunction merger cases, the combination of the clear statutory text in 15 U.S.C. § 53(b) and the Supreme Court decision in *Munaf* convincingly demonstrates that it is not the proper standard now.

In short, the approach of Judge Brown and Judge Tatel revives the moribund *Brown Shoe* practical indicia test and applies an overly lax preliminary injunction standard for merger cases. I respectfully disagree on both counts. In my judgment, the FTC may obtain a preliminary injunction only by establishing a likelihood of success—namely, a likelihood that, among other things, the merged entity would possess market power and could profitably impose a significant and nontransitory price increase.[8]

****375 *1062** B

In reaching her conclusion, Judge Brown also relies on a distinction between marginal consumers and core consumers. *See, e.g.,* Brown Op. at 1041 ("In sum, the district court believed the antitrust laws are addressed only to marginal consumers. This was an error of law, because in some situations core consumers, demanding exclusively a particular product or package of products, distinguish a submarket."). But the FTC never once referred to, much less relied on, the distinction between marginal and core consumers in 86 pages of briefing or at oral argument. The terms "marginal consumer" and "core consumer" are nowhere to be found in its briefs.

In any event, I respectfully disagree with Judge Brown's emphasis on core customers. For a business to exert market power as a result of a merger, it must be able to increase prices (usually by five percent or more) while retaining enough customers to make that price increase profitable. *See* 2B Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law ¶ 501, at 109 (3d ed. 2007) ("A defendant firm has market power if it can raise price without a total loss of sales."). If too many "marginal" customers are turned off by a price hike, then the hike will be unprofitable even if a large group of die-hard "core" customers remain active clients. Therefore, a focus on core customers alone cannot resolve a merger case. The question here is whether Whole Foods could increase prices by five percent or more without losing so many marginal customers as to make the price increase unprofitable. *See id.* ¶ 536, at 284. As discussed above, the FTC has not come close to making that showing. Moreover, there is no support in the law for that singular focus on the core customer. Indeed, if that approach took root, it would have serious repercussions because virtually *every* merger involves some core customers who would stick with the company regardless of a significant price increase. So under this "core customer" approach, many heretofore permissible mergers presumably could be blocked as anticompetitive. That cannot be the law, and it is not the law.

In a related vein, Judge Brown repeatedly suggests that Whole Foods and Wild Oats engage in "price discrimination"—more specifically, Judge Brown asserts that organic supermarkets "discriminate on price between their core and marginal customers, thus treating the former as a distinct market." Brown Op. at 1041. But this assertion has no factual support in the record. For antitrust purposes, price discrimination normally involves one seller charging different prices to different customers for the same pro ****376** duct ***1063** *See* 2b Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law ¶ 517a (noting as an indication of market power "systematic price discrimination, as when a seller can identify two (or more) groups of customers with different demands and charge each group different prices even though its cost of serving each group is the same"). If there is price discrimination in an industry, then under certain circumstances a relevant market may be defined to include only those customers who pay the higher price. *See* Horizontal Merger Guidelines § 1.12. In this case, however, neither Judge Brown nor the FTC has pointed to any evidence suggesting either that price discrimination occurred before this merger or that the merged entity will be able to price-discriminate. In other words, there is no reason to think that "core" as opposed to non-core customers ever pay higher prices for the same products in organic supermarkets.

IV

In the end, the FTC's case is weak and seems a relic of a bygone era when antitrust law was divorced from basic economic principles. The record does not show that Whole Foods priced differently based on the presence or absence of Wild Oats in the same area. The reason for that and the conclusion that follows from that are the same: Whole Foods competes in an extraordinarily competitive market that includes all supermarkets, not just so-called organic supermarkets. The merged entity thus could not exercise market power such that it could profitably impose a significant and nontransitory price increase. Therefore, there is no sound legal basis to block this merger.

The issues presented in this case are important to antitrust regulators and practitioners, to potentially merging companies, and ultimately to the overall economy. The splintered panel opinions will create enormous uncertainty, debate, and litigation over the meaning and effect of this decision. And to the extent common principles and holdings are derived from the opinions of Judge Brown and Judge Tatel, those principles will authorize the FTC to obtain preliminary injunctions and block mergers based on a watered-down preliminary injunction standard and without sufficient regard for the economic principles that have undergirded modern antitrust law. That will give the FTC far greater power to block mergers than the statutory text or Supreme Court precedents permit.

* * *

I respectfully dissent.

GINSBURG, Circuit Judge, with whom Chief Judge SENTELLE joins, concurring in the denial of rehearing en banc:

I concur in the denial of rehearing en banc because, there being no opinion for the Court, that judgment sets no precedent beyond the precise facts of this case. *See King v. Palmer*, 950 F.2d 771, 783 (D.C.Cir.1991) (en banc) ("without implicit agreement" among a majority of the judges "we are left without a controlling opinion").

All Citations

548 F.3d 1028, 383 U.S.App.D.C. 341

Footnotes

* Circuit Judge Kavanaugh would grant the petition. A statement by Circuit Judge Ginsburg, with whom Chief Judge Sentelle joins, concurring in the denial of rehearing en banc is attached.

1 For example, a merger between two close competitors can sometimes raise antitrust concerns due to unilateral effects in highly differentiated markets. *See generally* Horizontal Merger Guidelines, 57 Fed.Reg. 41,552, 41,560–61, § 2.2 (1992). In such a situation, it might not be necessary to understand the market definition to conclude a preliminary injunction should issue. The FTC alludes to this theory on appeal, but to the district court it argued simply that the merger would result in a highly concentrated PNOS market.

2 Dr. Scheffman did not actually calculate the amount of this loss. He simply predicted that because many Whole Foods and Wild Oats customers also shop at conventional supermarkets, the loss would at any rate be too large.

1 In light of changes made by Judge Brown and Judge Tatel to their opinions in response to the petition for rehearing—most notably, the fact that Judge Tatel no longer joins Judge Brown's opinion, meaning there is no majority opinion for the Court—this dissent contains changes throughout, including a new Part III, from the dissenting opinion released on July 29, 2008.

2 Judge Tatel's opinion disparages the evidence about Whole Foods's prices, calling it “all-but-meaningless” and implicitly suggesting that Whole Foods manipulated its prices just for the expert study. Tatel Op. at 1047. But Judge Tatel offers no evidence for that suggestion.

3 A showing that the merged entity would possess market concentration in a defined product market is *necessary* but not *sufficient* to establish an antitrust violation. *See* *United States v. Baker Hughes Inc.,* 908 F.2d 981, 985 (D.C.Cir.1990) (listing factors that might militate against finding an antitrust violation, even assuming market concentration exists). I need not address the other necessary components of the FTC's case, however, because the FTC has not satisfied the threshold requirement of showing that the merged entity would have such market concentration.

4 According to Judge Tatel's opinion, the FTC's expert purported to say that Whole Foods could impose a five percent or greater price increase because of the number of Wild Oats customers who would switch to Whole Foods rather than conventional supermarkets. Tatel Op. at 1044 (citing Rebuttal Expert Report of Kevin M. Murphy ¶ 32 (July 13, 2007)). But that ambiguous statement constituted a single, unexplained sentence in the middle of a lengthy report. Moreover, the expert apparently based his conclusion entirely on the so-called “Project Goldmine” analysis of diversion ratios associated with store closures—that is, of the number of Wild Oats customers who would switch to Whole Foods in the event that a Wild Oats store closes and Whole Foods prices remain constant. As the expert himself appeared to acknowledge, *see* Murphy Report ¶ 32 (noting that “marginal and average diversion ratios could be different”), the data do not necessarily shed any light on how many customers would continue to shop at a merged Wild Oats–and–Whole Foods entity in the event that the entity uniformly increased prices. All of this no doubt explains why the FTC never even mentioned this aspect of its expert's report in the argument section of its opening brief.

5 As two antitrust commentators perceptively stated: “The basic problem with the FTC's position in *Whole Foods* was that it lacked the pricing evidence it had in *Staples,* which showed that customers did not go elsewhere if the office superstores increased their prices. *Whole Foods* is an attempt by the FTC to persuade a court that if you take a CEO's statements about a merger and stir it in with evidence showing the existence of several ‘practical indicia’ from *Brown Shoe,* the resulting mixture should trump objective evidence about how customers would react in the event of a price increase.” Carlton Varner & Heather Cooper, *Product Markets in Merger Cases: The* Whole Foods *Decision* (Oct.2007), www. antitrustsource.com.

6 The gloss on § 53(b) appears to have arisen originally in other circuits around the middle of the 20th century in connection with a more general view that a lighter “likelihood of success” standard is appropriate whenever the balance of equities weighs strongly in favor of issuing an injunction. *Compare* *FTC v. Beatrice Foods Co.,* 587 F.2d 1225, 1229 (D.C.Cir.1978) (Appendix to Statement of MacKinnon & Robb, JJ.) (citing *Hamilton Watch Co. v. Benrus Watch Co.,* 206 F.2d 738, 740 (2d Cir.1953) (which noted in the FTC merger context that “if the other elements are present (i.e., the balance of hardships tips decidedly toward plaintiff), it will ordinarily be enough that the plaintiff has raised questions going to the merits so serious ....”)), *with* *Omar v. Harvey,* 416 F.Supp.2d 19, 28 (D.D.C.2006) (citing *Washington Metro. Area Transit Comm'n v. Holiday Tours,* 559 F.2d 841, 842–44 & n. 1 (D.C.Cir.1977) (which noted outside the FTC merger context

that courts may generally apply the relatively lax "serious questions" approach *only* "when confronted with a case in which the other three [preliminary injunction] factors strongly favor interim relief")). But as explained below in footnote 7, Congress in 1973 codified a preliminary injunction standard for FTC merger cases that specifically directs courts to consider the Commission's "likelihood of ultimate success." 15 U.S.C. § 53(b). And as explained in the text, the Supreme Court recently repudiated the "serious questions" approach to preliminary injunctions in general by requiring a likelihood of success showing in all cases, regardless of whether the balance of equities weighs in favor of the injunction. *See Munaf v. Geren,* 553 U.S. 674, 128 S.Ct. 2207, 2219, 171 L.Ed.2d 1 (2008).

7 In justifying his adoption of the "serious questions" test for likelihood of success, Judge Tatel highlights the "unique 'public interest' standard in 15 U.S.C. § 53(b)." Tatel Op. at 1043 (citing *FTC v. Exxon Corp.,* 636 F.2d 1336, 1343 (D.C.Cir.1980)); *see also id.* at 1043. But the statute explicitly *preserves* the traditional likelihood of success requirement. *See* § 53(b) ("Commission's likelihood of ultimate success"). What makes § 53's standard for preliminary injunctions "unique," as we have explained, is that the FTC need not show irreparable harm and, secondarily, that private equities are subordinated to public equities. *See FTC v. Weyerhaeuser Co.,* 665 F.2d 1072, 1081–83 (D.C.Cir.1981) ("The case law Congress codified removes irreparable damage as an essential element of the preliminary injunction proponent's case and permits the judge to presume from a likelihood of success showing that the public interest will be served by interim relief."); *see also Heinz,* 246 F.3d at 727 n. 25; *Exxon Corp.,* 636 F.2d at 1343. Far from reading the "likelihood of ultimate success" language out of the statute, we have recognized that the statutory phrase "weighing the equities and considering the likelihood of ultimate success" was specifically added by the Conference Committee and that this "deliberate addition" should not "be brushed aside as essentially repetitive or meaningless." *Weyerhaeuser,* 665 F.2d at 1081.

8 The precedential effect of today's splintered decision is muddied somewhat by the fact that Judge Brown and Judge Tatel have issued individual opinions concurring in the judgment. That said, it is of course well-settled that the mere fact that there is no majority opinion does not mean that the decision constitutes no precedent for future cases. This happens quite frequently with splintered Supreme Court decisions where there is no majority opinion. As the Supreme Court has repeatedly explained, in the vast majority of cases without a majority opinion there is still a binding holding of the Court —even if it can occasionally be difficult to determine. This is known as the *Marks* principle. *See Marks v. United States,* 430 U.S. 188, 193, 97 S.Ct. 990, 51 L.Ed.2d 260 (1977); *King v. Palmer,* 950 F.2d 771, 783 (D.C.Cir.1991) (en banc) ("implicit agreement" between judges can produce a "controlling" principle of law); *see generally Planned Parenthood of Southeastern Pennsylvania v. Casey,* 947 F.2d 682, 691–97 (3d Cir.1991). Like the Supreme Court, this Court has routinely recognized that a decision without a majority opinion usually still constitutes a binding precedent. *See, e.g., In re Navy Chaplaincy,* 534 F.3d 756, 759 n. 2 (D.C.Cir.2008) (construing *Hein v. Freedom From Religion Foundation,* 551 U.S. 587, 127 S.Ct. 2553, 168 L.Ed.2d 424 (2007)); *Shurberg Broadcasting of Hartford, Inc. v. FCC,* 876 F.2d 902, 910 (D.C.Cir.1989) ("a lower federal court must do its level best to extract the holding that commanded a majority in each case to arrive at the governing principles and limitations"), *rev'd on other grounds sub nom. Metro Broad., Inc. v. FCC,* 497 U.S. 547, 110 S.Ct. 2997, 111 L.Ed.2d 445 (1990); *Martin v. Malhoyt,* 830 F.2d 237, 247 n. 28 (D.C.Cir.1987) (citing *Marks* and noting that Justice Black's concurrence in *Barr v. Matteo,* 360 U.S. 564, 79 S.Ct. 1335, 3 L.Ed.2d 1434 (1959), "provides the 'narrowest grounds' for the Court's disposition of the case and thus constitutes the Court's holding"). Only in very rare cases do the opinions making up a majority of a court contain no common principles or common ground on which to derive any precedential holding of the court. *See Nichols v. United States,* 511 U.S. 738, 743–46, 114 S.Ct. 1921, 128 L.Ed.2d 745 (1994) (construing *Baldasar v. Illinois,* 446 U.S. 222, 100 S.Ct. 1585, 64 L.Ed.2d 169 (1980)); *King,* 950 F.2d at 782–85.

It is unclear whether district courts and future courts of appeals will construe this case as one of those rare situations that falls entirely outside the *Marks* rule. At a minimum, this confused decision will invite years of uncertainty and litigation over what the holding of this case is—a separate but important problem with the Court's approach.

End of Document

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA **Plaintiff,** **v.** **CARGILL, INCORPORATED and CONTINENTAL GRAIN COMPANY,** **Defendants.**	)	**CASE NUMBER 1:99CV01875 (GK)** **JUDGE: Gladys Kessler** **DECK TYPE: Antitrust** **DATE STAMP:**

<u>COMPETITIVE IMPACT STATEMENT</u>

The United States, pursuant to Section 2(b) of the Antitrust Procedures and Penalties Act ("APPA"), 15 U.S.C. § 16(b)-(h), files this Competitive Impact Statement relating to the proposed Final Judgment submitted for entry in this civil antitrust proceeding.

I.

NATURE AND PURPOSE OF THE PROCEEDING

On July 8, 1999, the United States filed a civil antitrust Complaint alleging that the proposed acquisition by Cargill, Incorporated ("Cargill") of the Commodity Marketing Group of Continental Grain Company ("Continental") would violate Section 7 of the Clayton Act, 15 U.S.C. § 18. The Complaint alleges that Cargill is the second largest grain trader in North America, and that, until recently, Continental was the third largest grain trader in North America. The Complaint alleges that if the acquisition is permitted to proceed, it will substantially lessen competition for grain purchasing services to farmers and other suppliers in a number of areas in the United States in violation of Section 7 of the Clayton Act, 15 U.S.C. § 18. The Complaint further alleges that unless the acquisition is enjoined, many American farmers and other suppliers likely will receive lower prices for their grain and oilseed crops, including corn, soybeans, and wheat (collectively referred to as "grain"). The request for relief in the Complaint seeks: (1) preliminary and permanent injunctive relief preventing the consummation of the transaction; and (2) such other relief as is proper.

When the Complaint was filed, the United States also filed a proposed consent decree ("Final Judgment") that would permit Cargill to complete its acquisition of Continental's commodity marketing business, but requires divestitures and other relief that would preserve competition for grain purchasing services to farmers and other suppliers in a number of areas in the United States.[1/] The proposed Final Judgment orders defendant Cargill to divest all of its property rights in the river elevators located in East Dubuque, Illinois and Morris, Illinois within five (5) months after the filing of the proposed Final Judgment or within five (5) calendar days after notice of entry of the Final Judgment, whichever is later. The proposed Final Judgment also orders defendant Cargill to divest all of its property rights in the Seattle port elevator within six (6) months after the filing of the proposed Final Judgment or within five (5) calendar days after notice of entry of the Final Judgment, whichever is later. The proposed Final Judgment orders defendant Continental to divest all of its property rights in the river elevators located at Lockport, Illinois and Caruthersville, Missouri, the rail elevators located at Salina, Kansas and Troy, Ohio, and the port elevators located at Beaumont, Texas, Stockton, California, and Chicago, Illinois within five (5) months after the filing of the proposed Final Judgment or within five (5) calendar days after notice of entry of the Final Judgment, whichever is later. The

---

[1] Cargill and Continental entered into a Stipulation (filed contemporaneously with the Final Judgment) in which they agreed to be bound by the proposed Final Judgment pending final determination by the Court.

proposed Final Judgment also requires defendant Cargill to enter into a “throughput agreement” -- an agreement providing for one grain trader to lease elevator capacity from another -- to make one-third of the loading capacity at its Havana, Illinois river elevator available to an independent grain company, within five (5) months after the filing of the proposed Final Judgment or within five (5) calendar days after notice of entry of the Final Judgment, whichever is later.

In addition, the proposed Final Judgment prohibits defendant Cargill from acquiring any interest in the facilities to be divested by Continental, or the river elevator located at Birds Point, Missouri, in which Continental until recently had held a minority interest. The proposed Final Judgment also makes defendant Cargill subject to various restrictions in the event it seeks to enter into a throughput agreement with the acquirer of the Seattle port facility.

If the defendants should fail to accomplish the divestitures or to enter into a Havana throughput agreement within the prescribed time periods, a trustee appointed by the Court would be empowered to divest these assets or otherwise satisfy the Havana throughput requirement.

The plaintiff and defendants have stipulated that the proposed Final Judgment may be entered after compliance with the APPA. Entry of the proposed Final Judgment would terminate this action, except that the Court would retain jurisdiction to construe, modify, or enforce the provisions of the proposed Final Judgment and to punish violations thereof.

II.

EVENTS GIVING RISE TO THE ALLEGED VIOLATIONS

A. The Defendants and the Proposed Transaction

Cargill is a Delaware corporation with its principal place of business in Minnetonka, Minnesota. It is the second largest grain trader in North America. Continental is a Delaware corporation with its principal place of business in New York City, New York. It was, as recently as 1997, North America's third largest grain trader. The defendants are also the first and third largest U.S. grain exporters, collectively exporting approximately 40 percent of all U.S. agricultural commodities. Both Cargill and Continental purchase grain and other crops from farmers, brokers, and elevator operators throughout the United States.

On October 9, 1998, Cargill and Continental entered into an agreement entitled "Purchase Agreement" under which Cargill agreed to purchase Continental's Commodity Marketing Group.

B. The Grain Purchasing Market

Grain traders such as Cargill and Continental operate extensive grain distribution networks, which facilitate the movement of grain from farms to domestic consumers of these commodities and to foreign markets. Country elevators are often the first stage of the grain distribution system, with producers hauling wheat, corn, and soybeans by truck from their farms for sale to the country elevators. Here, the grain is off-loaded, sampled, graded, and put into storage. Sometimes other services are offered by the country elevators, such as grain drying and conditioning services. The grain is then transported by truck, rail, or barge to larger distribution facilities, such as river, rail, or port elevators, which may or may not be affiliated with the country elevators, or to feedlots or processors.

River elevators or rail terminals may receive grain directly from the farm or from country elevators. From the river elevator, grain typically moves outbound by barge to port elevators. From the rail terminal, grain typically moves outbound by rail to port elevators or to domestic feedlots or processors.

The final stage in the grain distribution system for grain intended for export is a port elevator, where it is transferred to ocean vessels for shipment to foreign buyers. Grain normally comes to port elevators from river elevators (via barge) and rail terminals, although some port elevators receive grain directly from farmers and country elevators located within a relatively short distance from the port elevator.

Because the transportation of grain is relatively costly and time-consuming, farmers generally sell their grain within a limited geographic area surrounding their farms, usually to a country elevator -- although farmers located near river, rail, or port elevators sometimes bypass the country elevator and ship their grain directly to those facilities. Grain traders purchase grain at these country, rail, river, and port elevators from farmers and from other suppliers, such as brokers and independent elevator operators who have purchased grain from the farmers.

The Complaint alleges that the purchasing of wheat, corn, and soybeans each constitutes a relevant product market and a line of commerce within the meaning of the Clayton Act.

The draw area for a country, river, rail, or port elevator is the geographic area from which the facility receives grain. The draw area of one grain company's country, river, rail or port elevator will overlap the draw area of a competitor's elevator if their facilities are relatively close to each other -- and the cost of shipping grain from the producer to both elevators is comparable. Cargill and Continental operate a number of facilities with overlapping draw areas, and therefore compete with one another in a number of markets for the purchase of wheat, corn, and soybeans from the same producers or other suppliers.

Many farmers and other suppliers located within overlapping Cargill/Continental draw areas depend solely on competition among Cargill, Continental, and perhaps a small number of other nearby grain companies to obtain a competitive price for their products. The areas in which these suppliers are located are referred to as “captive draw areas” in the Complaint. The Complaint alleges that these captive draw areas are relevant geographic markets and separate sections of the country within the meaning of the Clayton Act.

The following are the overlapping and captive draw areas for competing Cargill and Continental facilities:

- The Pacific Northwest. Cargill’s port elevator in Seattle competes with Continental’s port elevator in Tacoma for the purchase of corn and soybeans. The overlapping draw area for these facilities includes portions of North Dakota, South Dakota, Minnesota, Nebraska, and Iowa. Captive suppliers are located primarily in eastern North Dakota, eastern South Dakota, and western Minnesota.
- Central California. Cargill’s port elevator in Sacramento competes with Continental’s port elevator in Stockton for the purchase of wheat and corn. The overlapping draw area for these facilities is located in the Sacramento/Stockton area, where all suppliers are captive.
- Texas Gulf. Cargill’s port elevator in Houston competes with Continental’s port elevator in Beaumont for the purchase of soybeans and wheat. The overlapping draw area for these facilities includes portions of Texas, Louisiana, Oklahoma, Kansas, New Mexico, Colorado, Nebraska, Missouri, Iowa, and Illinois. Captive suppliers are located primarily in eastern Texas and western Louisiana.
- Rail and River Elevators. Cargill and Continental compete for the purchase of grain from captive suppliers located near their rail elevators in Salina, Kansas and Troy, Ohio, and

their river elevators in the vicinity of Morris, Illinois, Lockport, Illinois, Dubuque, Iowa/East Dubuque, Illinois, and New Madrid/Caruthersville, Missouri.

According to the Complaint, if Cargill were allowed to acquire the Continental facilities that purchase grain in these captive draw areas, it would be in a position unilaterally, or in coordinated interaction with the few remaining competitors, to depress prices paid to farmers and other suppliers, because transportation costs would preclude them from selling to other grain traders or purchasers in sufficient quantities to prevent an anticompetitive price decrease.

The Complaint also alleges that producers of corn, soybeans, and wheat would not switch to an alternative crop in sufficient numbers to prevent a small but significant decrease in price because of the length of growing seasons and of the suitability of those crops to certain climates and regions. Nor are processors or feedlots that purchase grain to manufacture food products or fatten livestock likely to constrain pricing decisions by grain trading companies because their purchasing decisions are based on factors other than small but significant changes in crop prices. Therefore, significant changes in concentration among grain trading companies can have an anticompetitive impact upon prices received by farmers and other suppliers.

C. The Chicago Board of Trade Futures Markets

In addition, Cargill and Continental compete to purchase corn and soybeans from grain sellers seeking to deliver these crops to river elevators on the Illinois River that, beginning in year 2000, will be authorized as delivery points for the settlement of Chicago Board of Trade (CBOT) corn and soybean futures contracts. The provision of authorized delivery points for corn and soybean futures contracts is a relevant product market within the meaning of the Clayton Act. These delivery points are regulated by the Commodities Futures Trading

Commission. The authorized delivery points, running the entire length of the Illinois River for soybeans, and from Chicago to Peoria, Illinois for corn, each constitutes a relevant geographic market within the meaning of the Clayton Act; and undue concentration in these markets would increase the possibilities of anticompetitive manipulations of the futures markets.

D. Harm to Competition as a Consequence of the Acquisition

The Complaint alleges that Cargill's acquisition of Continental's Commodity Marketing Group will substantially lessen competition for the purchase of corn, soybeans, and wheat in each of the relevant geographic markets by enabling Cargill unilaterally to depress the prices paid to farmers and other suppliers. The Complaint further alleges that the proposed transaction will also make it more likely that the few remaining grain trading companies that purchase corn, soybeans, and wheat in these markets will engage in anticompetitive coordination to depress grain prices. Moreover, it is not likely that Cargill's exercise of market power in any of these relevant geographic markets would be thwarted by significantly increased purchases of corn, soybeans, or wheat by processors, feedlots, or other buyers, by new entry, by farmers and other suppliers transporting their products to more distant markets, or by any other countervailing force.

In addition, the Complaint alleges that by consolidating the Cargill and Continental river elevators on the Illinois River, this transaction would give two firms approximately 80% of the authorized delivery capacity for settlement of CBOT corn and soybeans futures contracts. This concentration would increase the likelihood of price manipulation of futures contracts by those firms, resulting in higher risks for buyers and sellers of futures contracts.

Finally, the Complaint alleges that the defendants' Purchase Agreement includes a Covenant Not to Compete that is longer than is reasonably necessary for Cargill to have a fair opportunity to gain the loyalty of Continental's suppliers and customers, and has the effect of unlawfully dividing markets between the two companies in violation of Section 1 of the Sherman Act, 15 U.S.C. § 1.

III.

EXPLANATION OF THE PROPOSED FINAL JUDGMENT

The provisions of the proposed Final Judgment are designed to preserve existing competition for grain purchasing services to farmers and other suppliers in numerous areas in the United States, and to prevent anticompetitive manipulation of CBOT corn and soybean futures markets. To preserve existing competition for grain purchasing services, it requires divestitures of Cargill or Continental river elevators at Morris, Illinois, Lockport, Illinois, East Dubuque, Illinois, and Caruthersville, Missouri; rail terminals at Troy, Ohio and Salina, Kansas; and port elevators at Beaumont, Texas, Stockton, California, and Seattle, Washington. This relief is intended to maintain the level of competition that existed preacquisition, and ensures that farmers and other suppliers in the affected markets will continue to have effective alternatives to Cargill when selling their crops. To prevent manipulations of CBOT corn and soybean futures markets, the proposed Final Judgement requires divestitures of Cargill or Continental elevators along the Illinois River at Morris, Lockport and Chicago, Illinois, as well as providing one-third of Cargill's capacity at Havana, Illinois to a new entrant pursuant to a throughput agreement.[2/]

---

[2] The divestitures of the Morris and Lockport river elevators provide relief for both the grain purchasing markets and the CBOT futures markets.

A. East Dubuque and Morris River Elevators, and Seattle Port Elevator Provisions

Section IV.A of the proposed Final Judgment provides that, within five (5) months from the filing of the proposed Final Judgment with the Court, or five (5) calendar days after notice of the entry of the Final Judgment by the Court, whichever is later, defendant Cargill must divest all of its property rights in the East Dubuque, Illinois river elevator and the Morris, Illinois river elevator to an acquirer acceptable to the United States. Section IV.A of the proposed Final Judgment also provides that, within six (6) months from the filing of the proposed Final Judgment with the Court, or five (5) calendar days after notice of the entry of the Final Judgment by the Court, whichever is later, defendant Cargill must divest all of its property rights in the Seattle port elevator to an acquirer acceptable to the United States.

Section IV.B of the proposed Final Judgment imposes conditions on Cargill and the acquirer of the Seattle port elevator, should the acquirer decide to enter into a throughput agreement with Cargill or any joint venture involving the Tacoma elevator to which Cargill is a party ("Cargill Joint Venture"). Throughput agreements, which are common in the grain industry, allow one firm to move its grain through another firm's elevator for a fee. Under the terms of the Final Judgment: (a) Cargill may not obtain continuing rights to move more than 8.5 million bushels of grain per month through the Seattle port elevator (which ensures that the acquirer of that facility will have continuing rights to a substantial majority of the facility's throughput capacity); (b) the throughput agreement gives Cargill no more rights concerning the operations of the Seattle facility than are commonly granted to sublessees in standard throughput agreements (which insures that the acquirer will retain overall operational control of the facility);

and (c) that, in any event, the throughput agreement will not interfere with the ability or incentive of the acquirer to compete for the purchase of corn and soybeans.

Section IV.C of the proposed Final Judgment provides that Cargill need not divest the Seattle port elevator if it does not buy, lease, or otherwise acquire an interest in Continental's port elevator at or near Tacoma, Washington.

B. Lockport River Elevator, Caruthersville River Elevator, Salina Rail Elevator, Troy Rail Elevator, Beaumont Port Elevator, Stockton Port Elevator, and Chicago Port Elevator Provisions

Section IV.D of the proposed Final Judgment provides that, within five (5) months from the filing of the proposed Final Judgment with the Court, or five (5) calendar days after notice of the entry of the Final Judgment by the Court, whichever is later, defendant Continental must divest all of its property rights in the river elevators located at Lockport, Illinois and Caruthersville, Missouri; the rail terminals located at Salina, Kansas and Troy, Ohio; and the port elevators located at Beaumont, Texas, Chicago, Illinois, and Stockton, California, to an acquirer acceptable to the United States. These facilities were originally part of the defendants' Purchase Agreement. This divestiture requirement will ensure that these facilities are sold to purchasers who will operate these assets as grain elevators; and it is intended to preserve the market structure that existed in those geographic areas prior to the acquisition.

C. General Divestiture Provisions

Sections IV.E through IV.H of the proposed Final Judgment apply to all the divestitures ordered in Sections IV.A and IV.D (as qualified by Sections IV.B and IV.C). Section IV.E provides that unless the United States consents in writing, the divestitures shall include the entire assets defined in Sections IV.A and IV.D. The divestitures must be accomplished in such a way to satisfy the United States, in its sole discretion, that the assets can and will be operated by the acquirer as a viable, ongoing entity capable of competing in the grain business. In addition, any Standard Throughput Agreement that may be negotiated between Cargill or the Cargill Joint Venture and the purchaser of the Seattle port elevator must be acceptable to the United States, in its sole discretion.

Under Section IV.F of the proposed Final Judgment, defendants shall make known, by usual and customary means, the availability of the assets and provide any prospective purchasers with a copy of the Final Judgment. The pertinent defendant is required to offer to furnish any prospective purchaser, subject to customary confidentiality assurances, all information regarding the assets customarily provided in a due diligence process, except such information subject to attorney-client privilege or attorney work-product privilege. The pertinent defendant must also permit prospective purchasers to have reasonable access to personnel and to make inspection of physical facilities and financial, operational, or other documents and information customarily provided as part of a due diligence process.

Section IV.G prohibits defendants from interfering with any negotiations by the purchaser to hire any employee whose primary responsibility involves the use of the assets. Under Section IV.H, defendants must take all reasonable steps necessary to accomplish the prompt divestitures contemplated by the proposed Final Judgment, and may not impede the operation of the assets.

Section IV.I of the proposed Final Judgment prohibits Cargill from purchasing, leasing, or acquiring any interest in any of the assests required to be divested by defendant Continental pursuant to Section IV.D, or any interest in the river elevator at or near Bird’s Point, Missouri (in which Continental formerly owned a minority interest and had a right of first refusal to purchase grain). Section IV.I also prohibits Cargill from subsequently purchasing or leasing the Tacoma port elevator should another firm acquire that facility, or from acquiring any other interest in that facility (including a joint venture interest) without the written consent of the United States. Section IV.I does not explicitly prohibit Cargill from reacquiring the assets that it will divest, because that prohibition is inherent in the requirement that Cargill divest these assets for the ten-year term of the Final Judgment.

Pursuant to Section IV.J of the proposed Final Judgment, defendant Cargill must enter into a throughput agreement that makes one-third (1/3) of the daily loading capacity at its river elevator located at or near Havana, Illinois, or one barge-load per day, whichever is greater, to an independant grain company acceptable to the United States in its sole discretion (the "Havana Throughput Agreement").[3/] Unless the United States agrees to an extension, Cargill must enter into the Havana Throughput Agreement within five (5) months from the date the Final Judgment is filed with the Court, or five (5) calendar days after notice of the entry of the Final Judgment by the Court, whichever is later.

D. Trustee Provisions

If the defendants fail to complete any of the divestitures or to enter into the Havana Throughput Agreement within the required time periods, the Court will appoint a trustee,

---

[3] The divestitures of the facilities at Morris, Lockport, and Chicago were sufficient to resolve concerns about consolidation of authorized delivery points for CBOT corn futures markets, which extend from Chicago to Pekin. To resolve concerns about concentration of authorized delivery points for CBOT soybean futures markets, which extend the entire length of the Illinois River, it was necessary to provide delivery capacity for a new entrant on the southern portion of the Illinois River.

pursuant to Section V of the proposed Final Judgment, to accomplish the divestitures. Once appointed, only the trustee will have the right to sell the divestiture assets or enter into the Havana Throughput Agreement, and the pertinent defendant will pay all costs and expenses of the trustee and any professionals and agents retained by the trustee. The compensation paid to the trustee and any such professionals or agents shall be reasonable and based on a fee arrangement providing the trustee with an incentive based on the price and terms of the divestiture and the speed with which it is accomplished. The proposed Final Judgment also requires the pertinent defendant to use its best efforts to assist the trustee in accomplishing the required divestitures.

Pursuant to Section V.E, the trustee must file monthly reports with the parties and the Court, setting forth the the trustee's efforts to accomplish the divestitures ordered under the proposed Final Judgment. If the trustee does not accomplish the divestitures within six (6) months after its appointment, the trustee shall promptly file with the Court a report setting forth (1) the trustee's efforts to accomplish the required divestitures, (2) the reasons, in the trustee's judgment, why the required divestitures have not been accomplished, and (3) the trustee's recommendations. At the same time, the trustee will furnish such report to the United States and defendants, who will each have the right to be heard and to make additional recommendations. The Court shall thereafter enter such orders as appropriate in order to carry out the purpose of the Final Judgment, including extending the term of the trustee's appointment.

E. Notification Provisions

Section VI of the proposed Final Judgment assures the United States an opportunity to review any proposed sale, whether by the pertinent defendant or the trustee, before it occurs.

Under this provision, the United States is entitled to receive complete information regarding any proposed sale or any prospective purchaser prior to consummation. Upon objection by the United States to a sale of any of the divestiture assets by the pertinent defendant or the trustee, any proposed divestiture may not be completed. Should a defendant object to a divestiture by the trustee pursuant to Section V.B, that sale shall not be consummated unless approved by the Court.

Section VII of the proposed Final Judgment prohibits defendants from financing all or any part of any purchase of the assets made pursuant to Sections IV or V of the Final Judgment. However, the pertinent defendant will not violate this condition with respect to assets leased by a defendant if: (1) the lessor holds the pertinent defendant responsible for lease payments under an assignment or sublease of the defendant's leasehold interests; or (2) the pertinent defendant makes up any shortfall between its lease payment obligations and the lease payments negotiated by the person to whom it assigns or subleases its leasehold interests.

F. Hold Separate Provisions

Under Section VIII of the proposed Final Judgment, defendants must take certain steps to ensure that, until the required divestitures and the execution of the Havana Throughput Agreement have been accomplished, all the previously defined assets and Cargill's Havana river elevator will be maintained as separate, distinct and saleable assets, and maintained as usable grain elevators. Until such divestitures, the defendants shall continue to operate these facilities as grain elevators. The defendants must maintain all these facilities so that they continue to be saleable, including maintaining all records, loans, and personnel necessary for their operation. Defendant Continental must operate the Lockport river elevator, Caruthersville river elevator, Troy rail elevator, Beaumont port elevator, Stockton port elevator, and Chicago port elevator independently from and in competition with Cargill.

G. Non-Compete Provisions

The Cargill/Continental Purchase Agreement contains a five-year non-compete provision. Under the proposed Final Judgement, defendants are prohibited from implementing any non-compete agreements until all of the assets have been divested. Furthermore, the term of any such non-compete agreement may not be more than three (3) years.

H. Compliance Inspection, Retention of Jurisdiction and Termination Provisions

Section IX requires defendants to make available, upon request, the business records and the personnel of its businesses. This provision allows the United States to inspect defendants' facilities and ensure that they are complying with the requirements of the proposed Final Judgment. Section X provides for jurisdiction to be maintained by the Court. Section XI of the proposed Final Judgment provides that it will expire on the tenth anniversary of its entry by the Court.

IV.

REMEDIES AVAILABLE TO POTENTIAL PRIVATE LITIGANTS

Section 4 of the Clayton Act, 15 U.S.C. § 15, provides that any person who has been injured as a result of conduct prohibited by the antitrust laws may bring suit in federal court to recover three times the damages the person has suffered, as well as costs and reasonable attorneys' fees. Entry of the proposed Final Judgment will neither impair nor assist the bringing of any private antitrust damage action. Under the provisions of Section 5(a) of the Clayton Act, 15 U.S.C. § 16(a), the proposed Final Judgment has no prima facie effect in any subsequent private lawsuit that may be brought against defendants.

V.

PROCEDURES AVAILABLE FOR MODIFICATION OF THE PROPOSED FINAL JUDGMENT

The United States and defendants have stipulated that the proposed Final Judgment may be entered by the Court after compliance with the provisions of the APPA, provided that the United States has not withdrawn its consent. The APPA conditions entry upon the Court's determination that the proposed Final Judgment is in the public interest.

The APPA provides for a period of at least sixty days preceding the effective date of the proposed Final Judgment within which any person may submit to the United States written comments regarding the proposed Final Judgment. Any person who wishes to comment should do so within sixty days of the date of publication of this Competitive Impact Statement in the Federal Register. The United States will evaluate and respond to the comments. All comments will be given due consideration by the Department of Justice, which remains free to withdraw its consent to the proposed Final Judgment at any time prior to its entry. The comments and the response of the United States will be filed with the Court and published in the Federal Register. Written comments should be submitted to:

Roger W. Fones
Chief, Transportation, Energy & Agriculture Section
Antitrust Division
United States Department of Justice
325 Seventh Street, N.W., Suite 500
Washington, DC 20530

The proposed Final Judgment provides that the Court retains jurisdiction over this action, and the parties may apply to the Court for any order necessary or appropriate for the modification, interpretation, or enforcement of the Final Judgment.

VI.

ALTERNATIVES TO THE PROPOSED FINAL JUDGMENT

The United States considered, as an alternative to the proposed Final Judgment, a full trial on the merits against Cargill and Continental. The United States is satisfied, however, that the divestitures and other relief contained in the proposed Final Judgment should preserve competition in grain purchasing services as it was prior to the proposed acquisition, and that the proposed Final Judgment would achieve all of the relief that the government would have obtained through litigation, but merely avoids the time and expense of a trial.

VII.

STANDARD OF REVIEW UNDER THE APPA FOR PROPOSED FINAL JUDGMENT

The APPA requires that proposed consent judgments in antitrust cases brought by the United States be subject to a sixty-day comment period, after which the Court shall determine whether entry of the proposed Final Judgment "is in the public interest." In making that determination, the Court may consider:

> (1) the competitive impact of such judgment, including termination of alleged violations, provisions for enforcement and modification, duration or relief sought, anticipated effects of alternative remedies actually considered, and any other consideration bearing upon the adequacy of such judgment;
>
> (2) the impact of entry of such judgment upon the public generally and individuals alleging specific injury from the violations set forth in the complaint including consideration of the public benefit, if any, to be derived from a determination of the issues at trial.

15 U.S.C. § 16(e). As the Court of Appeals for the District of Columbia Circuit held, the APPA permits the Court to consider, among other things, the relationship between the remedy secured and the specific allegations set forth in the government's complaint, whether the decree is sufficiently clear, whether enforcement mechanisms are sufficient, and whether the decree may positively harm third parties. See United States v. Microsoft, 56 F.3d 1448 (D.C. Cir. 1995).

In conducting this inquiry, "the Court is nowhere compelled to go to trial or to engage in extended proceedings which might have the effect of vitiating the benefits of prompt and less costly settlement through the consent decree process."[4/] Rather,

> absent a showing of corrupt failure of the government to discharge its duty, the Court, in making its public interest finding, should . . . carefully consider the explanations of the government in the competitive impact statement and its responses to comments in order to determine whether those explanations are reasonable under the circumstances.

United States v. Mid-America Dairymen, Inc., 1977-1 Trade Cas. ¶ 61,508, at 71,980 (W.D. Mo. 1977).

Accordingly, with respect to the adequacy of the relief secured by the decree, a court may not "engage in an unrestricted evaluation of what relief would best serve the public." United States v. BNS, Inc., 858 F.2d 456, 462 (9th Cir. 1988), quoting United States v. Bechtel Corp., 648 F.2d 660, 666 (9th Cir.), cert. denied, 454 U.S. 1083 (1981). Precedent requires that

---

[4] 119 Cong. Rec. 24598 (1973); see also United States v. Gillette Co., 406 F. Supp. 713, 715 (D. Mass. 1975). A "public interest" determination can be made properly on the basis of the Competitive Impact Statement and Response to Comments filed pursuant to the APPA. Although the APPA authorizes the use of additional procedures, 15 U.S.C. § 16(f), those procedures are discretionary. A court need not invoke any of them unless it believes that the comments have raised significant issues and that further proceedings would aid the court in resolving those issues. See H.R. 93-1463, 93rd Cong. 2d Sess. 8-9, reprinted in (1974) U.S.C.C.A.N. 6535, 6538.

> [t]he balancing of competing social and political interests affected by a proposed antitrust consent decree must be left, in the first instance, to the discretion of the Attorney General. The court's role in protecting the public interest is one of insuring that the government has not breached its duty to the public in consenting to the decree. The court is required to determine not whether a particular decree is the one that will best serve society, but whether the settlement is '<u>within the reaches of the public interest.</u>' More elaborate requirements might undermine the effectiveness of antitrust enforcement by consent decree.[5/]

The proposed Final Judgment, therefore, should not be reviewed under a standard of whether it is certain to eliminate every anticompetitive effect of a particular practice or whether it mandates certainty of free competition in the future. Court approval of a final judgment requires a standard more flexible and less strict than the standard required for a finding of liability. "[A] proposed decree must be approved even if it falls short of the remedy the court would impose on its own, as long as it falls within the range of acceptability or is 'within the reaches of public interest.' ").[6/]

Moreover, the Court's role under the Tunney Act is limited to reviewing the remedy in relationship to the violations that the United States has alleged in its complaint, and the Act does not authorize the Court to "construct [its] own hypothetical case and then evaluate the decree against that case." <u>Microsoft</u>, 56 F.3d at 1459. Since "[t]he court's authority to review the decree depends entirely on the government's exercising its prosecutorial discretion by bring a

---

[5] <u>United States v. Bechtel</u>, 648 F.2d at 666 (internal citations omitted) (emphasis added); <u>see</u> <u>United States v. BNS, Inc.</u>, 858 F.2d at 463; <u>United States v. National Broadcasting Co.</u>, 449 F. Supp. 1127, 1143 (C.D. Cal. 1978); <u>Gillette</u>, 406 F. Supp. at 716. <u>See also</u> <u>United States v. American Cyanamid Co.</u>, 719 F.2d 558, 565 (2d Cir. 1983).

[6] <u>United States v. American Tel. & Tel. Co.</u>, 552 F. Supp. 131, 150 (D.D.C. 1982) (citations omitted), <u>aff'd sub nom.</u> <u>Maryland v. United States</u>, 460 U.S. 1001 (1983), <u>quoting</u> <u>Gillette</u>, 406 F. Supp. at 716; <u>United States v. Alcan Aluminium, Ltd.</u>, 605 F. Supp. 619, 622 (W.D. Ky. 1985).

case in the first place," it follows that the court "is only authorized to review the decree itself," and not to "effectively redraft the complaint" to inquire into other matters that the United States might have but did not pursue. Id.

VIII.

DETERMINATIVE DOCUMENTS

There are no determinative materials or documents within the meaning of the APPA that were considered by the United States in formulating the proposed Final Judgment.

FOR PLAINTIFF UNITED STATES OF AMERICA:

Dated: July 23, 1999

Respectfully submitted,

"/s/"

Robert L. McGeorge
D.C. Bar No. 91900

Trial Attorney
U.S. Department of Justice, Antitrust Division
325 Seventh Street, N.W.; Suite 500
Washington, DC 20530
Telephone: (202) 307-6361 or (202) 307-6351
Facsimile: (202) 307-2784

EN

Case No COMP/M.6756 - NORSK HYDRO/ ORKLA/ JV

Only the English text is available and authentic.

REGULATION (EC) No 139/2004
MERGER PROCEDURE

Article 6(1)(b) in conjunction with Art 6(2)
Date: 13/05/2013

In electronic form on the EUR-Lex website under document number 32013M6756

Office for Publications of the European Union
L-2985 Luxembourg

EUROPEAN COMMISSION

Brussels, 13.5.2013
C(2013) 2883 final

In the published version of this decision, some information has been omitted pursuant to Article 17(2) of Council Regulation (EC) No 139/2004 concerning non-disclosure of business secrets and other confidential information. The omissions are shown thus […]. Where possible the information omitted has been replaced by ranges of figures or a general description.

PUBLIC VERSION

MERGER PROCEDURE
ARTICLE 6(1)(b) DECISION

To the notifying parties

Dear Sir/Madam,

Subject: Case No COMP/M.6756 - NORSK HYDRO/ ORKLA/ JV
Commission decision pursuant to Article 6(1)(b) in conjunction with Article 6(2) of Council Regulation No 139/2004[1]

1. On 18 March 2013, the European Commission received a notification of a proposed concentration pursuant to Article 4 of the Merger Regulation, by which the undertakings

Norsk Hydro ASA ("Hydro", Norway) and Orkla ASA ("Orkla", Norway) acquire within the meaning of Article 3(4) of the Merger Regulation joint control of a newly created company constituting a joint venture (JV), by way of purchase of shares.[2] Hydro and Orkla are designated hereinafter as the "Parties".

I. THE PARTIES AND THE TRANSACTION

2. Hydro is a global supplier of aluminium with activities throughout the value chain, including the production and sale of primary aluminium, soft-alloy extrusions, building systems and flat-rolled products.

1 OJ L 24, 29.1.2004, p. 1 ("the Merger Regulation"). With effect from 1 December 2009, the Treaty on the Functioning of the European Union ("TFEU") has introduced certain changes, such as the replacement of "Community" by "Union" and "common market" by "internal market". The terminology of the TFEU will be used throughout this decision.

2 Publication in the Official Journal of the European Union No C88, 26.3.2013, p. 8.

3. Orkla is a Norwegian company with international operations. Its main focus is the branded consumer goods sector. In addition it operates in the aluminium, hydro power and financial investment sector.

4. On 14 October 2012, Hydro and Orkla signed a contribution agreement with a view to establishing the JV operating in the aluminium soft-alloy extrusion sector ("Contribution Agreement"). Included within the businesses to be transferred to the JV are also the Parties' building systems activities and their precision tubing businesses.

5. The businesses being contributed by Orkla all fall under the ownership of Orkla's wholly-owned subsidiary, Sapa Holding AB ("Sapa").

6. Each of Hydro and Orkla will retain outside the JV their respective interests in aluminium flat-rolled products.[3]

I.1. JOINT CONTROL

7. The JV will be jointly controlled by Orkla and Hydro within the meaning of the Merger Regulation. Orkla will hold 50% of the issued share capital in the JV and Hydro the remaining 50%. Pursuant to the shareholders' agreement which is attached to the Contribution Agreement, the Parties will have parity of voting at the shareholders' meeting and each will appoint the same number of directors to the board. No member of the board of directors will have a casting vote.

I.2. FULL-FUNCTIONALITY

8. The JV will have a management dedicated to its day-to-day operations and sufficient resources to operate independently on the market, including finance, staff and assets. It will also have direct access to customers and suppliers independent of its parents.

9. As for the lasting basis requirement, Article 19 of the shareholders' agreement attached to the Contribution Agreement provides that […]subject to a procedure set out in the Shareholders agreement.

10. The Commission considers that this provision is not sufficient to conclude that the proposed transaction is not constituted on a lasting basis. This is because the Contribution Agreement, while providing for an option to terminate the joint venture, also provides for the possible continuation of the joint venture for an indefinite period.

11. As a result, the Commission concludes that the proposed transaction consists of the creation of a full-functional joint venture which will perform all the functions of an autonomous economic entity on a lasting basis.

II. EU DIMENSION

12. The undertakings concerned have a combined aggregate world-wide turnover of more than EUR 5 000 million (Hydro: EUR 11 733 million; Orkla: EUR 7 351 million). The two of them have an EU-wide turnover in excess of EUR 250 million (Hydro: EUR […] million; Orkla: EUR […] million), but they do not achieve more than two-thirds of their

[3] In the context of its strategy to reposition the focus of its activities on consumer goods, Orkla has announced that it will explore the opportunity for a divestment of its flat-rolled products business and has appointed a financial adviser to support this process.

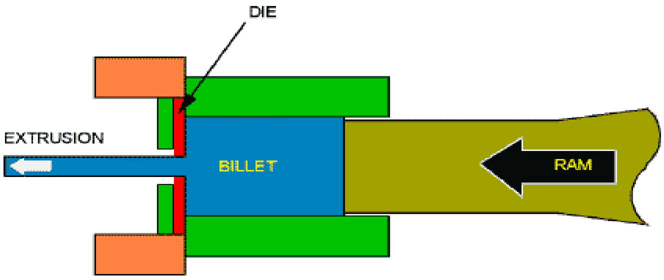
aggregate EU-wide turnover within one and the same Member State. The notified operation therefore has an EU dimension pursuant to Article 1(2) of the Merger Regulation.

III. COMPETITIVE ASSESSMENT

III.1. INTRODUCTION TO THE ALUMINIUM EXTRUSION INDUSTRY

13. Aluminium extrusions are produced from billets of aluminium alloys. Extrusion aluminium billets are heated in an oven and consequently pushed through a pre-shaped iron die by a large hydraulic press. The traditional analogy is that of squeezing toothpaste from a tube (see Figure 1 below).

Figure 1 – Soft alloy extrusions – production process



14. Following the extrusion process some extrusions are cooled and may be milled, drilled, tapped, bent, aged, anodized or painted. Extrusions are finally sawed in transportable lengths and packed.

15. There are two broad categories of alloys used for extrusion: hard-alloys and soft-alloys.

16. In the EEA, the principal aluminium-magnesium alloys used to manufacture soft alloy extrusions are alloy 6063 (and its alternative alloy 6060) and alloy 6082 (and its alternative alloy 6005a).

17. Plants vary as to the size of press in use. The most common press sizes are in the 7-9 inches diameter range,[4] although there are a number of larger presses in the EEA (i.e. 12 inches and above). Presses can produce extrusions that are smaller in diameter than their classification and larger presses are sometimes employed to produce smaller extrusions (although this is often not economically profitable). There are more than 500 soft-alloy presses in the EEA.

18. Dies can be changed quickly and easily, allowing a large number of different shapes to be manufactured using the same machinery (see Figure 2 below). The dies may be manufactured in integrated die-shops, or designed to the customer's specifications at relatively little cost and in little time by independent die-shops. Most manufacturers keep a large stock of dies. Once a die is available, the time taken in switching a press from one die to another is on average only two minutes.

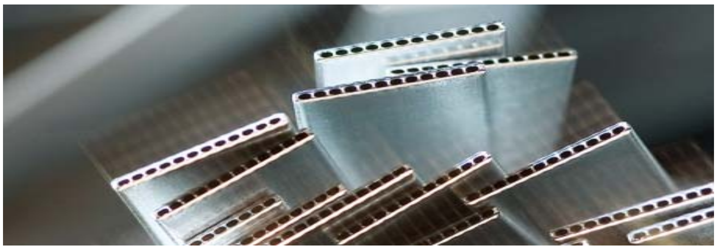
4 The press size refers to the diameter of the billet used in the press.

Figure 2 – Soft alloy extrusions – Shaping the billet through a die

19. The process of extrusion is capable of producing a variety of metal shapes. Consequently, extruded products are used in a range of applications, including construction (e.g. window frames, doorframes, and other architectural products), automotive, and industrial uses. Extrusions are produced in a huge variety of shapes, including rods, bars, tubing profiles, and forge stock, among others.

20. The same basic manufacturing process is used for all extrusion products, regardless of the end-use application. In some specific cases, however, a process involving additional steps is necessary for the production of some specialty extruded products. For instance, this is the case for multi-port extrusions ("MPEs"), which are small but important components widely used in the automotive industry for the manufacturing of condensers and evaporators.

Figure 3 – Multi-port extrusions (MPEs)



21. The proposed transaction gives rise to horizontal overlaps between the Parties' activities as regards (1) general soft-alloy extrusions; (2) MPEs; (3) a downstream market: building systems; and (4) a neighbouring product market: precision welded tubes. The Parties' activities do not overlap in precision drawn tubes.[5]

22. The proposed transaction also gives rise to vertical relationships with respect to the following: (1) Hydro's primary aluminium activities upstream and the Parties' soft-alloy extrusions activities downstream; and (2) the Parties' aluminium flat products activities upstream and the Parties' precision welded tubes activities downstream.

III.2. RELEVANT PRODUCT MARKET

III.2.1 Soft-alloy extrusions

23. There are two broad categories of alloys used for extrusion: hard-alloys and soft-alloys.

5 Sapa is not active in the production of precision drawn tubes.

24. In previous decisions, the Commission has identified separate markets for hard-alloy and soft-alloy extrusions.[6] Although some companies manufacture both hard and soft-alloy extrusions, not all extrusion facilities operate with both types of alloy since different treatment processes are used in the preparation of hard-alloys.

25. In the past, the Commission has also concluded that the market for soft-alloy extrusions should not be further divided into segments relating to alloys,[7] shapes or end-uses.[8] Although from a demand-side perspective different shapes and alloys are often not substitutes to each other, there is significant supply-side substitutability, which allows many extruders to produce a wide range of products.

26. The Parties submit that, in line with Commission's precedents, the relevant product market comprises all soft-alloy extrusions.

27. Respondents to the Commission's requests for information confirmed that hard alloy extrusions constitute a separate market from soft alloy extrusions.[9] The replies received also confirmed the Commission's precedents regarding different types of alloys and shapes

28. The Commission investigated whether it would be appropriate to define a separate market for profiles for the automotive industry, since only a limited number of suppliers, which have to go through a certification process, produce extrusions for the automotive industry. The results of the investigation confirmed that automotive manufacturers should be ISO/TS 16949 certified and that almost all extruders are able to obtain such certification. In any event, the Commission considers that the question whether the segment for soft alloy extrusions for the automotive industry would constitute a separate relevant product market can, however be left open, as the concentration would not give rise to serious doubts in that potential segment.

29. In previous decisions the Commission investigated and ultimately left open the question as to whether it would be appropriate to define separate markets for larger sized (more than 14" diameter) soft alloy extrusions, since only a limited number of supplier's operate large presses.[10] In relation to a possible segment for large extrusions, the market investigation confirmed that the size of the final product is closely related to the size of the press which is used. The issue of a separate market for large extrusions with a diameter larger than 14" does not arise in this case given that the Parties' activities do not overlap as regards presses with more than 12" diameter. The Commission however investigated whether a market for larger sized extrusion could be defined as including the 12" press diameter. The Commission considers that it can be left open whether the potential segment for soft alloy extrusions produced with large extruded presses (above and including 12") would constitute a separate relevant product market, as the concentration would not give rise to serious doubts in that potential segment.

---

6 See, e.g., Case COMP/M.4827 *Rio Tinto/Alcan*, paragraph 35; Case COMP/M.4605 *Hidalco/Novelis*, paragraph 14; Case COMP/M.4518 *Alcoa/Orkla/Soft alloy Extrusion JV*, paragraph 11.

7 See for instance Case COMP/M.4518 *Alcoa/Orkla/Soft alloy extrusion JV*, paragraph 19.

8 See, e.g., Case COMP/M.2404 *Elkem/Sapa*, paragraph 12.

9 See replies to question 5 of Questionnaire Q1, Soft Alloy Extrusions Competitors; question 6 of Questionnaire Q2, Soft Alloy Extrusions Customers, Soft Alloy Extrusions Customers UK, Soft Alloy Extrusions Customers UK-2, Soft Alloy Extrusions Customers Norway / Sweden.

10 See Case COMP/M. 3170 *Sapa/Remi Claeys*; Case COMP/M.4518 *Alcoa/Orkla/Soft alloy extrusion JV*.

III.2.2 Multi-port extrusions (MPEs)

30. MPEs are extruded tubes that are designed to combine small dimensions (e.g., width of 16 mm, height of 1.8 mm and a wall thickness of 0.2 mm) with a large internal surface area. These characteristics make MPEs especially suited for use in heat exchangers for automotive applications.

31. There are no Commission precedents dealing specifically with MPEs.

32. The Parties submit that from a demand-side MPEs are not substitutable with normal soft-alloy extrusions. As regards demand-side substitutability, the Parties also submit that aluminium folded tubes represent a viable alternative to MPEs for customers and that they would indeed switch to folded tubes as a reaction to a price increase.

33. As regards supply-side substitution, the Parties submit that there is a certain degree of supply-side substitutability between MPEs and normal soft-alloy extrusions given that at the core of the MPEs production there is a standard extrusion press. However, in this regard the Parties acknowledge that a standard extrusion press would have to be modified in order to accommodate for the production of MPEs.

34. For these reasons, the Parties acknowledge that it may be appropriate to define a separate market for MPEs.

35. From the demand side, respondents to the Commission's requests for information stated that MPEs cannot be substituted with normal soft-alloy extrusions and cannot be replaced easily with other products.[11]

36. As regards substitutability with aluminium folded tubes, a majority of customers replied that they would switch from MPEs to folded tubes further to a 5-10% permanent price increase. However, when questioned about the concrete possibility of such switch, the same customers expressed a number of reservations in terms of feasibility and timeliness of such switch. The market investigation showed that folded tubes cannot be used as substitutes for MPEs for all applications (in particular, not for evaporators and refrigerators). In addition, non-automotive applications, which are expected to be developed in the next years by a number of players, are mainly based on the use of MPEs. Furthermore, a number of market players still believe that MPEs constitute the leading technology and that MPEs are superior in performances to folded tubes (for further details see below, paragraphs 136-137).

37. From the supply side the market investigation indicated that although the technical production process for producing MPEs is similar to that of soft-alloy extrusions, significant investments are required to adjust the equipment to the requirements of MPEs production. For instance, the production of MPEs requires coiling lines, zinc spray and strict tolerance controls which are not necessary for the production of soft-alloy extrusions. Furthermore, market participants have indicated that MPEs are sophisticated products and specific production know-how is required.

38. In view of the above, the Commission considers that that a separate relevant product market for MPEs exists.

---

11 See replies to question 4-5-6 of Questionnaire Q6 MPEs Competitors; 5-6-7-8 of Questionnaire Q6 MPEs Customers.

III.2.3 Building systems

39. The Commission has not previously considered the market for building systems.

40. According to the Parties, building systems comprise profiles made of different materials (aluminium, steel, wood or PVC) which are specifically designed to be used in the building industry. The building system suppliers add value to the basic profiles as their final product is considered a "system", which includes, apart from the profiles, other elements such as the design and conceptualisation of the system, the purpose-specific fabrication of the profiles (surface treatment of the profiles, cutting, drilling, punching, bending or the installation of a thermal brake), a variety of articles needed to install the products (all accessories and fittings) and service and logistics. The building system suppliers carry out R&D work in order to ensure that the systems meet the desired performance requirements in terms of insulation, tightness or durability. They do not offer the assembled products, such as windows frames or door frames, only the components needed to produce those.

Division between end applications

41. According to the Parties, the three main end applications of building systems are (1) windows; (2) doors; and (3) curtain walls. While doors or windows can be made from aluminium, PVC or wood (as main materials), building systems for façades use only soft alloy profiles as the basis to fabricate and install a "curtain wall".[12] Aluminium curtain walls are generally used on the exterior of buildings and might also incorporate technologies such as active double-skin façades for ventilation and heating and sun-shading or photovoltaic devices. The Parties do not consider a further segmentation of the market according to different end applications to be necessary. Nevertheless, they have provided data on this narrower segmentation.

42. The Commission notes that the replies to the market investigation in this case largely contradicted the segmentation proposed by the Parties between windows and doors. The vast majority of respondents indicated that, although the installation process and legal requirements could be different, windows and doors and other products should be considered as belonging to the same segment as there is no difference between (i) the manufacturing process, (ii) the knowhow used in the production, (iii) the complexity of their design, and (iv) the distribution channels.

43. On the contrary, the replies to the market investigation confirmed Parties' views as regards curtain walls as being a different segment different from all other products (including doors, windows or any other building system product). Competitors consider that curtain walls are different from other products due to the technical complexity of the projects. As usually curtain walls represent large projects, the technical complexity is higher than for the other products. Also, special requirements as wind loads and water resistance tests, and earthquake secure testing are specific for this segment.

Substitution between different types of materials

44. Although the Parties are active only in the production of aluminium building systems, they argue that to a certain extent, building systems made of other materials (among

12 A “curtain wall” is attached to the façade of the building and does not help carry the weight of the building.

which the most important are PVC and wood) are substitutable and therefore the product market could be considered to be the supply of aluminium, PVC and wood building systems for the use in the construction market.

45. The Parties consider that PVC and wood are widely used as direct substitutes for aluminium, either for use as window or as door frames. Nevertheless, the Parties admit that, from the demand point of view, for some applications like large sliding doors, PVC and wood may be less suitable alternatives due to the weight that needs to be carried. As regards facades, even though from the technical point of view PVC or wood are not alternative materials, the Parties submit that, by opting for a different design concept, however, a PVC-based solution can be used as a substitute to an aluminium facade. The more complex the products are, the less PVC or wood can be regarded as a substitute for aluminium building systems.

46. From the supply-side perspective, aluminium on the one hand and other products, mainly PVC and wood, on the other hand cannot be regarded as close substitutes mainly due to the fact that the manufacturing process involved in the production of building systems from various materials are different and the machineries used differ from one material to another.

47. The Parties consider that the product market could be considered to be the supply of aluminium, PVC and wood products for use in constructions. However, they have adopted a filter focusing only on aluminium-based products and provided data on this narrower segmentation.

48. To verify the Parties' claims, the Commission analysed both supply-side and demand-side aspects of the substitution between aluminium and different other materials, mainly PVC and wood. Thus, the majority of competitors confirmed that from the supply side building systems made of aluminium are totally different from other building systems as the equipment used in their production is different (machineries and tools), operations may differ, and producing aluminium building systems seems to be more difficult than for the other materials. In addition, even though some suppliers offer besides the aluminium building systems also PVC products, the majority of them tend to specialize in the production of only one material.

49. From the demand side, the market investigation pointed also to a separate market for aluminium building systems and confirmed that customers do not consider PVC or wood as a real substitution for aluminium. Moreover, the vast majority of customers indicated that they buy only aluminium products and even if the price would increase with 5-15% they would not switch to other materials.[13] The price difference between a building system made of aluminium and other materials is also important, aluminium windows and doors being more expensive than PVC.[14]

Different distribution channels

50. For the most standardized products like windows and doors, building systems users will typically use a customer tailor made window or door. Nevertheless, these products can be also sourced from stockists, which purchase standardised profiles directly from the

13 See replies to question 27 of the Questionnaires to building system customers.

14 See replies to question 20 of the Questionnaire Q3 building systems competitors.

profile suppliers or from Building Systems suppliers. They sell the profiles together with fittings to the metal builders who in turn assemble the product and install it. Alternatively, the metal builders/installers can purchase equivalent components from the Building Systems suppliers. Finally, the metal builders/installers can purchase ready-made windows, doors or other products directly from original equipment manufacturers ("OEMs"), who assemble standardised products on an industrial scale. Nevertheless, as the products become more sophisticated or increasingly bespoke, the option of purchasing standardised profiles or pre-fabricated products from stockists and OEMs becomes less and less suitable.

51. Given the fact that a straightforward separation of the different types of competitors at different levels of production and distribution of the building systems suppliers from stockists or OEMs is difficult, the Parties have adopted a conservative approach, excluding these alternative channels of distribution.

52. The market investigation in this case indicated that although some competitors consider OEMs and stockists in direct competition with them, the majority of suppliers indicated that the products that they deliver to their customers are tailor-made and specific to each project and therefore stockists and OEMs could not be considered as alternative suppliers. From the demand side, OEMs and/or stockists are considered more often as alternative sources for their building systems' needs.

53. The Commission considers that the precise product market definition for building systems can be left open in this case, since the transaction does not raise serious doubts as to its compatibility with the internal market regardless of the exact product market definition.

III.2.4 Aluminium welded precision tubes

54. The Commission has not previously considered the market for aluminium precision welded tubes. Precision welded tubes are produced by taking a flat coil of aluminium strip, forming it into a tube and welding it together. Welded precision tubes are derived from flat rolled products (FRP) and do not involve any extrusion process. Thus, welded precision tubes can be shaped so that they are round, flat-oval or rectangular pipes.

55. Although the precision welded tubes and the extruded tubes have similar shapes and may look the same, the Parties submit that the two products are not substitutable as extruded tubes are not produced with the same welding mills as the welded precision tubes. From the demand side, the replies to the market investigation revealed that, although welded precision tubes could in principle be substituted with other products (e.g. MPEs or extruded drawn tubes), the level of substitution is low and depends on the compatibility of the products with the final application. In addition, the businesses tend to be structured so as to focus primarily on one type of tubes.

56. Also, the difference between the standard welded tubes and the high precision welded tubes is important. Switching production from welded precision tube to high precision welded tube production is not as fast as in the case of soft-alloy extrusions. On the supply side, the replies to the market investigation confirmed that, although some producers produce both the standard and the precision welded tubes, for the production of the latter products there is a need for specific knowledge and experience in the field to be able to deliver quality products.

57. In any event, for the purpose of the present case the Commission considers that the product market definition can be left open, as the transaction does not raise serious doubts irrespective of the precise product market definition.

III.3. RELEVANT GEOGRAPHIC MARKET

III.3.1 Soft-alloy extrusions

58. In past decisions, the Commission has generally found the scope of the geographic market for soft-alloy extrusions to be EEA-wide.[15] In more recent decisions, however, the Commission also considered whether a separate market for the UK existed, but ultimately left the question open.[16]

59. In particular, in *Alcoa/Orkla/Soft alloy extrusion JV*,[17] the Commission concluded that the scope of the geographic market for soft-alloy extrusions was likely to be EEA-wide, with the possible exception of the UK, because of (i) the significant amount of trade flows of aluminium extrusions throughout the EEA; (ii) the low transport costs, in the region of 2-4% of the final selling price; and (iii) no major price differences within the EEA.

60. The Parties submit that the relevant geographic market for soft-alloy extrusions is at least as broad as the EEA, given that there are no tariffs or regulatory barriers to trade soft-alloy extrusions within the EEA, transportation costs represent only a small proportion of the final selling price and there are significant trade flows within the EEA.

61. The Commission notes that replies to the market investigation have not been fully supportive of the Parties' views.

62. On the one hand, according to the replies to the market investigation, there are large trade flows between different Member States, which are normally an indication that markets may be wider than national. In addition, many customers have replied that they source soft-alloy extrusions from a radius of more than 500 km.[18] Lastly, many customers stated that transport costs normally represent a relatively small proportion of the final price (between 1% and 5%).

63. On the other hand, a large number of customers responding to the Commission's requests for information also stated that they find it economically profitable to source soft-alloy extrusions within a maximum radius of 500 km. Secondly, the Parties' business organisation is based on business units constituted by one or more nearby plants. Often, these business units are limited to one Member State (e.g. Italy) or to geographic regions smaller than the EEA (e.g. Benelux). […]Fourth, independent

---

15 See Cases COMP/M. 2111 *Alcoa/British Aluminium*, COMP/M. 1161 *Alcoa/Alumax*, COMP/M.1003 *Alcoa/Inespal* and COMP/M.675 *Alumix/Alcoa*.

16 Case COMP/M.4518. See also Cases COMP/M2404 *Elkem/Sapa* and COMP/M.3170 *Sapa/Remi Claeys aluminium*.

17 Case COMP/M.4518 *Alcoa/Orkla/Soft alloy extrusion JV*.

18 See replies to question 23 of Questionnaire Q1, Soft Alloy Extrusions Competitors; question 26 of Questionnaire Q2, Soft Alloy Extrusions Customers, Soft Alloy Extrusions Customers UK, Soft Alloy Extrusions Customers UK-2, Soft Alloy Extrusions Customers Norway / Sweden.

industry analysts normally report market data such as prices on a national level for the larger Member States, and not on an aggregated EEA level.

64. In view of the above, and in the light of a high number of customers expressing concerns in (1) Norway and Sweden (the "Nordic Region") and in (2) the UK, the Commission investigated more in depth whether these two regions were separate from the mainland European market.

III.3.1.A Nordic Region

65. The Commission considers that there are a number of elements pointing at a possible separate market for soft alloy extrusions in a region composed by Norway and Sweden.

66. First, there are significant and persistent price differences between the Nordic Region and the remaining Member States. The average price difference between these regions for the past 6 years amounts to [10-20]%. In addition, there is no trend showing that in recent years the price differences have been decreasing. This appears to be incompatible with functioning price arbitrage across regions.

67. Second, there are significant and persistent differences in the "extrusion premia" charged by soft alloy extrusion suppliers between the Nordic Region and the remaining Member States. The extrusion premium is the price paid by customers for the value added by extruders (i.e. full price – aluminium price – billets conversion cost). In the course of its market investigation, the Commission has found that in the aluminium soft-alloy industry, negotiations between customers and suppliers normally only concern the extrusion premium. On the contrary, the aluminium price and the billet conversion cost are generally not object of negotiations and are therefore fixed for all customers. In the presence of a similar price structure, it seems appropriate to take as relevant benchmark price the extrusion premia rather than the full price.[19] The premium difference between the Nordic Region and the remaining Member States for the past 6 years is [10-20]%, and therefore even higher than the price difference.

68. Third, a significant part of customers in the Nordic Region seems to be prevented by transport costs to source from continental Europe. In particular, some customers stated that transport costs may reach up to 20% of the final price. A significant number of customers also stated that they would not find it profitable to purchase soft-alloy extrusions beyond a radius of 500 km. It should be pointed out that other elements of the logistics system than transportation costs are equally important. Timely delivery of the products is essential for many customers due to their tight production schedules. A number of customers indicated that the transportation network was more congested for flows into the Nordic Region than out of it, making it more difficult to import into this part of the world in a sufficiently "just in time" manner than to export from it.

69. Fourth, the market structure in the Nordic Region is very different in comparison to other geographic areas. The supply-side of the market in many Member States such as Germany, Italy, Spain and the United Kingdom is fragmented and characterised by the presence of

[19] A similar approach has been used by the Commission in Case COMP/M.6541 *Glencore/Xstrata*. It is also used by other merger enforcement agencies worldwide. See for instance the US Horizontal Merger Guidelines, Section 4.1.2. "Where explicit or implicit prices for the firms' specific contribution to value can be identified with reasonable clarity, the Agencies may base the SSNIP on those prices."

many suppliers of different size. By contrast, in the Nordic Region only three companies (Hydro, Sapa and ProfilGruppen) operate soft alloy extrusion plants.

70. Fifth, imports of soft-alloy extrusions in the Nordic Region account for approximately 20% of sales in that region, which is significantly lower than the average imports in other Member States or regions.[20] In the course of its investigation, the Commission has found that the Parties account for part of these imports (imports from Parties' Business Units are not necessarily driven by price arbitrage but could be driven e.g. by distribution needs of the merging parties). Therefore imports in the Nordic Region (excluding the Parties) would be even lower than 20%. In addition, it is not likely that the sources on which imports data is based are not reliable, insofar as they may also include products which are different from soft alloy extrusions, such as billets and windows frames. As a result, imports in the Nordic Region are likely to account for even less than 20% of sales in that region.

71. In view of the above, the Commission concludes that it is likely that a separate market for the Nordic Region exists. In any event, it is not necessary for the Commission to conclude on the matter, given that the Parties have submitted remedies that eliminate serious doubts on a possible market for soft-alloy extrusions in the Nordic Region in their entirety.

III.3.1.B UK

72. In some of its precedents on the soft alloy extrusions market, the Commission considered whether a separate market for the United Kingdom existed.[21]

73. In the present case, the results of the market investigation do not suggest that the United Kingdom constitutes a separate market for soft alloy extrusions.[22]

74. First, price differences between the UK and remaining Member States (excluding Norway and Sweden) do not appear to be significant. In particular, prices in the United Kingdom tend to be only slightly higher or lower than prices in the remaining Member States (excluding Norway and Sweden). As for the premia, these seem to be systematically lower than in the other Member States.

75. Second, imports represent a significant proportion of consumption in the United Kingdom and account for approximately 50% of demand.

76. In any event, the Commission considers that the question as to whether a separate market for soft alloy extrusions in the United Kingdom exists can be left open, given that the proposed transaction would not give rise to serious doubts even under the narrowest product market definition.

---

20 See RBB paper submitted on 8 March 2013, titled "Trade flow analysis for soft alloy extrusions" (e.g. imports in West Europe represented 78% of soft alloy extrusions consumption in that region; in Central/Eastern Europe 73%).

21 Case COMP/M.4518. See also Cases COMP/M2404 *Elkem/Sapa* and COMP/M.3170 *Sapa/Remi Claeys aluminium*.

22 See replies to questions 21-22-26 of Questionnaire Q2, Soft Alloy Extrusions Customers UK, Soft Alloy Extrusions Customers UK-2.

III.3.1.C Geographic markets for potential automotive and large extrusions profiles markets

77. The Commission investigated whether a potential segment for automotive profiles could be narrower than EEA in scope. The replies to the market investigation have not confirmed that there are narrower markets in the Nordic Region and in the UK. These profiles are more added-value products compared to the general soft alloy extrusions and therefore go through longer distances (relative transport costs are lower). In view of the above, the Commission has assessed the impact of the proposed transaction of the potential segment for automotive profiles in the EEA as a whole.

78. The Commission investigated also whether a potential segment for soft alloy extrusions produced with large extruded presses (above and including 12") could be narrower than EEA in scope. This does not appear to be likely because these profiles are more added-value products compared to the general soft alloy extrusions and therefore go through longer distances (relative transport costs are lower). In the UK there is not any press above and including 12". In any event, the Commission considers that the geographic market for the potential segment for larger profiles can be left open, given that the proposed transaction would not give rise to competition concerns even under the narrowest approach.

III.3.1.D Conclusion on the geographic market for soft alloy extrusions

79. In view of the above, the Commission has assessed the impact of the proposed transaction for soft alloy extrusions in the following possible markets: (1) in the EEA as a whole; (2) in the Nordic Region; (3) and in the United Kingdom. The Commission has also assessed the potential sub-segments for automotive in the EEA as a whole, and for large extrusions in the EEA as a whole and in the Nordic Region.

III.3.2 MPEs

80. The Parties submit that the relevant geographic market for MPEs is at least EEA-wide and could possibly be worldwide because of low transport costs, the common features of the products worldwide and the worldwide scope of the main customers' activities.

81. The responses to the Commission's requests for information indicated that MPE customers based in Europe purchase across the whole EEA territory.[23] MPEs are comparatively high value products and therefore transport costs do not play a major role in determining the customers' purchase patterns.

82. On the other hand, imports of MPEs from outside the EEA represent only a small proportion of the EEA consumption (approximately 3%). The responses of market participants indicate that imports do not play an important role in the EEA,[24] mainly because of quality reasons as well as the obstacles constituted by the certification process that is necessary to supply automotive customers.

83. In view of the above, the Commission concludes that the market for MPEs is EEA wide.

---

23 See replies to question 12 of Questionnaire Q6 MPEs Customers.

24 See replies to question 17 of Questionnaire Q6 MPEs Customers.

III.3.3 Building systems

84. According to the Parties, the relevant geographic market for Building Systems should be considered as being EEA-wide for several reasons.

85. Firstly, although from a demand-side perspective there are traditional and regulatory preferences and requirements that differ between some countries, from the supply side the basic profile typically does not differ much and it is not technically complex for a building systems supplier to adapt its product in order to meet a specific demand in a given country. There is also easiness for building systems suppliers from a certain Member State to devote resources to enter on another market offering solutions meeting the local demand. Also in cases of contraction or expansion of neighbouring countries, building system suppliers are continuously optimizing their portfolio to respond to the opportunity to earn a profit in other countries. This situation is often met in the Baltics countries (comprising Lithuania, Estonia and Latvia).

86. Secondly, national patterns seem to be less obvious for big projects or more sophisticated building systems, as such buildings tend to be built according to European standards and in the same manner and style throughout Europe.

87. Thirdly, language barriers for the customers for these building systems are less important and they usually conduct supra-national tenders to achieve the best prices for the project. Therefore, these products have a European-wide scope and can be supplied throughout the entire EEA.

88. During the market investigation, the large majority of respondents have submitted that the market for the aluminium building system appears to be narrower than EEA, possibly national, due to several reasons: customers' preferences, national habits, regulatory requirements, language barriers and price difference[25]. Customers have also mentioned that a local presence of the suppliers represents an advantage for them as technical and logistic support is needed. The transport costs as indicated by the customers are also important and range from 1-4% within an area of less than 200 km up to 20% of the final price for a distance of 500-1000 km.

89. Nevertheless, the replies to the market investigation confirmed that customers in the Baltic countries tend to purchase their building systems also from suppliers located outside their country.

90. In any event, the Commission considers that the precise geographic market definition can be left open for the purpose of the present case, as the transaction is unlikely to raise serious doubts irrespective of the precise geographic market definition.

III.3.4 Aluminium welded precision tubes

91. The Parties submit that the relevant geographic market for aluminium welded precision tubes is at least EEA-wide and could possibly be worldwide for the following reasons.

92. Firstly, the vast majority of welded precision tubes are consumed by a small number of automotive heat transfer system (HTS) manufacturers. HTS manufacturers more generally operate on a worldwide basis and sell their products to car manufacturers

25 See replies to question 24 of Questionnaire Q3.

around the world. Moreover, the products supplied to the HTS manufacturers are the same around the world. Secondly, the transport costs are not significant, and account for approximately 5% of the final sale price for products sourced worldwide. Thirdly, there are no quotas, tariffs or other barriers that would impact the imports into the EEA. In 2011, the level of imports into the EEA accounted of around 10% of all sales of welded precision tubes.

93. The market investigation indicated that transport costs account for around 3-10% of the final price for the welded precision tubes. As regards transport costs for imports from outside EEA, however, the market respondents appreciated that the transport cost can become a constraint, especially taken into account the added customs duties.

94. In any event, the Commission considers that the precise geographic market definition can be left open for the purpose of the present case, as the transaction is unlikely to raise serious doubts irrespective of the precise geographic market definition.

III.4. COMPETITIVE ASSESSMENT

III.4.1 Horizontal overlaps

III.4.1.A Soft alloy extrusions

95. As already said above, the Commission has assessed the impact of the proposed transaction for soft alloy extrusions in the following possible markets: (a) in the EEA as a whole (excluding automotive and large extrusions profiles); (b) in the Nordic Region (excluding automotive and large extrusions profiles); (c) and in the United Kingdom (excluding automotive and large extrusions profiles). The Commission has also assessed the potential sub-segments (d) for automotive in the EEA as a whole, and (e) for large extrusions in the EEA as a whole and in the Nordic Region.

III.4.1.A.a EEA

96. Table 1 below shows the market shares of the Parties and their competitors.

Table 1 – 2011 Shares of soft alloy extrusion sales at EEA level

PRODUCER	KMT	%
Hydro	[…]	[10-20%]
Sapa	[…]	[10-20]%
Combined	**[…]**	**[20-30]%**
Constellium	[…]	[5-10]
Aleris International	[…]	[0-5]
Metra	[…]	[0-5]
Cortizo	[…]	[0-5]
Alumil	[…]	[0-5]
Others	[…]	[60-70]%
Total	[…]	100

Source: Form CO

97. Table 2 below shows the share of capacity of the Parties and their competitors.

Table 2 – 2011 Shares of soft alloy extrusion production capacity at EEA level

PRODUCER	KMT	%
Hydro	[…]	[10-20]%
Sapa	[…]	[10-20]%
Combined	[…]	**[20-30]%**
Others	[…]	[70-80]%
Total	[…]	100

Source: Form CO

98. The market shares in Table 1 and 2 show that the proposed transaction will create the largest producer of soft alloy extrusions in the EEA. The Parties' combined market share for the sales of soft alloy extrusions amount to [20-30]%, but the Parties will continue to face competition from many smaller players such as Constellium, Aleris, Metra and Cortizo.

99. In the EEA (excluding the Nordic Region and the UK, which has been assessed in the following sections) only a very small minority of the respondents to the Commission's requests for information raised concerns.

100. The Parties submit that the market for soft alloy extrusions is very fragmented. In 2011, the shares of the leading suppliers (Hydro, Sapa, Constellium, Aleris International, Metra, Cortizo and Alumil) together accounted for only around 40% of 2011 EEA sales. The remaining 60% of demand was met by more than 250 independent extruders that own over 500 presses.

101. According to the Parties, entry into the production of soft alloy extrusions is relatively straightforward, as there are no technical or regulatory barriers. The Parties estimate that to set up a single press with 8 to 10 KMT annual capacity would take around 12 months. The initial investment required is around EUR 10 million.[26] Despite the downturn in demand, according to the Parties, there were new entrants in the EEA market in the last five years.[27]

102. The Parties submit as well that the soft alloy extrusion market in 2011 in the EEA was characterized by significant levels of overcapacity. Average utilization in the EEA in 2011 was around [50-60]%. The Parties' utilization was slightly higher than the average. Therefore, according to the Parties, a significant proportion of spare capacity is found with the Parties' competitors and, as such, customers have alternative sources of supply to the Parties for soft alloy extrusions.

26 According to the Parties, 70% of the cost accounted for by the press and other necessary equipment and 30% of the cost accounted for by building infrastructure; no more than around 40 employees are required to conduct operations.

27 Emax (Belgium), and Extrusion Berlin and Schletter, both based in Germany, have all started supplying soft alloy extrusions within that period. Also, Smart has over the past 2 years increased its sales in the UK from zero to around 10 KMT.

103. The respondents to the Commission's requests for information confirmed the existence of alternative suppliers and a significant part of customers in the rest of the EEA confirmed that it is possible to switch easily between different suppliers within a short time period.[28] Almost all competitors confirmed that they have free capacity to expand production without any significant investment.

104. In view of the above, the Commission considers that the proposed transaction does not give rise to serious doubts as regards its compatibility with the internal market in relation to an EEA (as a whole) market for soft alloy extrusions.

105. If the relevant geographic market were to be considered as the EEA excluding the UK, the Commission consideres that there would be additional reasons to conclude that the transaction does not raise serious doubts because, by excluding the relatively high market shares of the Parties in the UK, the market shares in the rest of the EEA would be even lower.

106. Similarly, if the relevant geographic market were to be considered as the EEA excluding the Nordic Region (or the Nordic Region and the UK), the transaction does not raise serious doubts because, by excluding the high market shares of the Parties in the Nordic Region, the market shares in the rest of the EEA would be even lower.

III.4.1.A.b Nordic Region

107. Tables 3 and 4 below show the sales and capacity shares of the Parties and their competitors in the Nordic Region market for soft-alloy extrusions.

Table 3 – Shares of soft alloy extrusion sales in the Nordic Region in 2011

PRODUCER	**KMT**	**%**
Hydro	[…]	[20-30]%
Sapa	[…]	[50-60]%
Combined	[…]	**[70-80]%**
Others (including ProfilGruppen)[29]	[…]	[20-30]%
Total	[…]	100

Source: Market reconstruction based on internal documents

28 See replies to question 36 of Q2 Soft Alloy Extrusions Customers.

29 This share of sales exclude Benteler (see footnote below) and includes imports and volumes sold by stockists. Currently there are only three extruders in the Nordic Region: Hydro, Sapa and ProfilGruppen.

Table 4 – 2011 Shares of soft alloy extrusion production capacity in the Nordic Region in 2011 [30]

PRODUCER	KMT	%
Hydro	[…]	[30-40]%
Sapa	[…]	[40-50]%
Combined	[…]	**[70-80]**
ProfilGruppen	[…]	[20-30]
Total	[…]	100

Source: Market reconstruction based on internal documents

108. The Parties are respectively the only producer of soft-alloy extrusions in Norway (Hydro) and the largest producer of soft-alloy extrusions in Sweden (Sapa). The only remaining competitor operating presses in the Nordic Region would be ProfilGruppen, which is already today much smaller than each of Hydro and Sapa. The proposed transaction would therefore eliminate one of the only three producers of soft alloy extrusions in the Nordic Region. The combined capacity share of the Parties would amount to [70-80]% in the Nordic Region.

109. The majority of customers replying to the Commission's requests for information expressed concerns that the proposed transaction will result in a reduction of competition and increase of prices.[31] Some respondents stated that competition in the Nordic Region is only or mainly depending on the rivalry between Hydro and Sapa, which would be eliminated as a result of the proposed transaction.

110. The Commission considers that similar conclusions can be reached on the basis of an analysis of the Parties' internal documents. […]This shows that the merging parties are close competitors and, consequently, the transaction would remove a competitive constraint in relation to the soft-alloy extrusions. ProfilGruppen (excluding the merging parties) is the only other extruder currently producing in the Nordic Region. ProfilGruppen has some spare capacity but would not have the production capacity to strongly compete with the merging parties.

111. The Parties submit that the proposed transaction would not result in anticompetitive effects. The Parties claim that (1) their competitor ProfilGruppen will strongly compete for share after the merger; (2) imports from Finnish producers and a trader will defeat the price rise; (3) large scale imports from continental Europe will defeat a possible price rise; (4) they are making losses in the Nordic Region due to high labour costs.

30 These shares of capacity exclude Benteler's extrusion capacity in Norway. Benteler uses extrusions for captive purposes (see Parties' internal documents and call with Benteler) and therefore its inclusion in the shares would not be justified.

31 See replies to questions 41 and 42 of Q2, Soft Alloy Extrusions Customers Norway / Sweden.

112. […]In addition, a customer in the Nordic Region explicitly pointed out that in the past it conducted some trials with alternative suppliers in Finland, however, the results were not satisfactory, in particular in terms of quality standards required.[32]

113. Furthermore, the Nordic Region has the lowest share of imports in all the EEA (at most approximately 20%). The reasons for this appear to be mixed and are related mainly to higher transport costs[33] than in the rest of the EEA and product mix (in the Nordic Region customers require, in relative terms, a lower amount of simple extrusions - which have on average lower transport costs).

114. In theory, barriers to entry are not particularly high and economies of scale are not significantly important. However, from the market investigation there were no indications that entry would be likely, timely and sufficient.[34] Respondents to the market investigation stated that there was no entry in recent years and that they did not expect any entry in the Nordic Region. Internal documents of the Parties do not refer to any significant entry that could take place in the close future.

115. Therefore, contrary to the Parties' submissions, the Commission's investigation indicated that customers would face limited possibilities of switching supplier post-transaction.

116. Furthermore, as regards the Parties' submission that they are […] in the Nordic Region due to […], the Commission considers that the fact that the Parties are […] does not mean that they do not today, and could in the future, enjoy significant market power, but may be linked to other issues including […].

117. In view of the above and of the other available evidence, the Commission considers that the proposed transaction raises serious doubts as regards its compatibility with the internal market in relation to soft-alloy extrusions market in the Nordic Region.

III.4.1.A.c UK

118. Tables 5 and 6 below show the sales and capacity shares of the Parties and their competitors in a possible UK market for soft-alloy extrusions.

Table 5 – Shares of soft alloy extrusion sales in the UK in 2011

PRODUCER	**KMT**	**%**
Hydro	[…]	[10-20]%
Sapa	[…]	[20-30]%
Combined	[…]	**[40-50]%**
Boal	[…]	[5-10]
Smart	[…]	[5-10]
Kayes	[…]	[0-5]

32 See minutes of the call with Dovista on 27 March 2013.

33 See minutes of the call with Benteler on 16 April 2013.

34 In the meaning of the Commission Guidelines on the assessment of horizontal mergers (para. 68 and following).

Others	[…]	[40-50]%
Total	[…]	100

Source: Form CO

Table 6 – Shares of soft alloy extrusion production capacity in the UK in 2011

PRODUCER	**KMT**	**%**
Hydro	[…]	[20-30]%
Sapa	[…]	[20-30]%
Combined	[…]	**[50-60]%**
Boal[35]	[…]	[10-20]
Smarts	[…]	[10-20]
Kayes	[…]	[10-20]
Others	[…]	[10-20]%
Total	[…]	100

Source: Form CO

119. In a possible separate market encompassing the UK only, the Parties had a combined market share in 2011 of [40-50]%.[36] Boal would be the second largest supplier with a share of [5-10]%, followed by Smart ([5-10]%) and Kayes ([0-5]%).

120. The Parties are by far the two largest suppliers of soft-alloy extrusions in the UK. In addition, the merged entity would achieve a share of [50-60]% of the UK installed capacity.

121. Some customers answering the Commission's requests for information stated that the proposed transaction will result in a reduction of competition and increase of prices.[37]

122. According to the Parties, the proposed transaction will not result in anticompetitive effects. The Parties claim that (1) there is strong competition from stockists such as Amari which import large volumes of soft alloy extrusions into the UK; (2) the other three main extruders (i.e. Boal, Smart and Kayes) are also strong players with spare capacity which can provide the same products as the Parties; (3) imported products accounted for approximately 50% of 2011 UK sales, the largest source of imports into the UK being China, with a share of approximately 18%, followed by Germany (17%) and Belgium + Luxembourg (9%).

123. According to the replies to the market investigation, stockists have a strong position in the UK (e.g. Amari alone being around [10-20]% of sales to end users) and stockists tend to source large volumes from non-EU suppliers, in particular from Asia (therefore

35 In the course of the State of Play meeting, the Parties reported of a clerical error in the shares of capacity of Boal. The table above has been amended in accordance with the new data.

36 Soft alloy extrusions in the UK represented around 5% of total EEA sales by volume in 2011.

37 See replies to question 41 and 42 of Q2, Soft Alloy Extrusions Competitors UK, Soft Alloy Extrusions Competitors UK-2.

explaining the high levels of imports into the UK).[38] Independent stockists exercise a strong competitive constraint, supplying approximately 39% of soft-alloy extrusions in the UK.

124. In addition, the replies to the market investigation indicated that even post-transaction, there is considerable excess capacity (spare capacity estimated by the Parties to be around [30-40]%) and that the Parties will continue to face competitive pressure from the remaining extruders.

125. In view of the above and of the other available evidence, the Commission considers that the proposed transaction does not raise serious doubts as regards its compatibility with the internal market in relation to the possible soft-alloy extrusions market in the UK.

III.4.1.A.d Profiles for the automotive industry

126. Concerning the potential segment for automotive profiles, the Parties estimate the combined share of soft alloy extrusion sales to the automotive industry to amount to [10-20]% (Hydro:[5-10]%, Sapa:[5-10]%) in 2011 at EEA level. Automotive end-users often require that suppliers are certified to the ISO/TS 16949 standard. The Parties submit that many of their competitors are certified to that standard. Among them: Constellium: [10-20]%, Benteler: [10-20]%, Aleris: [5-10]%, Herbsloeh: [5-10]%, Honsel: [5-10]%, Brokelmann: [5-10]%, Hai: [5-10]%, etc.

127. Internal documents of the Parties confirm the submissions of the Parties. They show that strategic decisions on the automotive profiles are based on EEA level. Automotive profiles are more added-value than general soft alloy extrusions and travel longer distances. Competitors' replies to the market investigation confirmed the Parties' submission.

128. Therefore, the Commission concludes that the proposed transaction does not raise serious doubts in relation to the potential automotive segment.

III.4.1.A.e Large extrusions profiles

129. Concerning the potential segment for soft alloy extrusions produced with large extruded presses (above and including 12"), the Parties estimate the combined share of extrusion capacity on presses of 12" and higher to amount to approximately to [20-30]% at EEA level. Hydro does not contribute any press of diameter larger than 12" to the JV. For soft alloy extrusions with diameters of 12", the Commission considers that although Hydro would contribute one 12" press to the JV (in the Raufoss plant in Norway, described in details below), several competitors remain operating large size presses within the EEA. Furthermore, as the Parties have submitted remedies, which include the divestment of the Raufoss plant, the overlap is eliminated in relation to presses of 12" or larger.

130. Therefore, the Commission concludes that the proposed transaction does not raise serious doubts as regards its compatibility with the internal market in relation to the potential segment for soft alloy extrusions produced with large extruded presses (above and including 12").

---

38 See minutes of the call with Kayes on 9 April 2013. On the contrary, in the Nordic Region, the Commission did not observe any significant import from Asia (which is explained by the size of the market and, on average, by quality requirements of the customers).

III.4.1.B MPEs

131. Table 7 below shows the market shares of the Parties and their competitors.

Table 7 –Shares of MPEs sales at EEA level in 2011

PRODUCER	KMT	%
Hydro	[…]	[50-60]%
Sapa	[…]	[10-20]%
Combined	[…]	**[60-70]%**
Herbsloeh	[…]	[20-30]%
Sumitomo	[…]	[10-20]%
Imports	[…]	[0-5]%
Total	[…]	100

Source: Form CO

132. The proposed transaction would eliminate one of the only four European suppliers of MPEs in the EEA. The proposed transaction would also further strengthen the already strong position of Hydro, which pre-merger accounts for more than [50-60]% of the MPEs sales in the EEA. […]This shows that the merging parties are close competitors and, consequently, the transaction would remove a competitive constraint in relation to MPEs.

133. All the customers responding to the Commission's requests for information raised concerns as to the effect of the proposed transaction with regard to the EEA market for MPEs. These customers submitted that the proposed transaction would result in the merged entity achieving or reinforcing a dominant position. As a result, prices for MPEs in the EEA would be affected.

134. The Parties submitted that the proposed transaction would not result in anticompetitive effects for three reasons. First, the competitors of the merged entity have spare capacity and would be ready to expand output further to a price increase from the merged entity. Second, customers would switch to folded tubes as a reaction to a price increase. According to the Parties, folded tubes represent a viable alternative to MPEs and can be easily produced in-house by customers. Third, the large majority of the MPEs customers are large tier-1 automotive producers who are capable to exercise sufficient buyer power to prevent a possible price increase.

135. With regard to the likely reaction of competitors, the Commission found that both competitors of the merged entity are currently operating at high utilisation rate. This means that competitors would be unlikely to have the ability to increase output to counter a possible price increase from the merged entity.

136. In addition, the Commission has not found any evidence of future entry in the EEA market for MPEs. While some customers stated that in principle they would try to sponsor entry as a reaction to a price increase, all but one customers replying to the Commission's requests for information stated that they do not expect any entry in the future.

137. As regards possible substitution of MPEs with folded tubes, a narrow majority of customers responding to the Commission's requests for information stated that they would switch to folded tubes further to a permanent increase in the price of MPEs in the range of 5-10%. However, further investigation showed the following:

(a) Folded tubes cannot be used as substitutes for MPEs for all applications (in particular, not for evaporators and refrigerators). In addition, non-automotive applications, which are expected to be developed in the next years by a number of players, are mainly based on the use of MPEs;

(b) A switch to folded tubes cannot be immediate and would probably require time. In particular, customers wishing to switch would need to invest to build captive production and request approval to final OEMs customers. The use of folded tubes in the automotive segment may also involve the use of patented processes;[39]

(c) A number of market players still believe that MPEs constitute the leading technology and that MPEs are superior in performances to folded tubes;

(d) None of the two remaining competitors of the Parties expects any major impact of the switching to folded tubes on the MPEs business; and

(e) The Parties' internal documents show that apart for a few isolated statements, no in-depth analysis on the future impact of folded tubes on the MPEs business has been carried out. In addition, there has not been any significant decrease in the volume of MPEs due to the switch to folded tubes in recent years.

138. In view of the above, the Commission considers that some degree of future substitution between MPEs and folded tubes cannot be excluded. However, such substitution would not be certain and it would be, in any event, limited. In addition, in light of the above, the Commission has doubts that it would be timely and sufficient to exclude any anticompetitive effect stemming from the proposed transaction.

139. As regards buyer power, the Parties have not submitted compelling evidence that customers enjoy sufficient countervailing buyer power to prevent a price increase. On the contrary, a number of customers have submitted that Hydro enjoys a strong if not dominant bargaining position, and makes use of that position to influence the outcome of the negotiations in its favour, for instance by adopting a "take it or leave it" approach or threatening interruptions in deliveries.[40]

140. In view of the above and of the other available evidence, the Commission considers that the proposed transaction raises serious doubts as regards its compatibility with the internal market in relation to the EEA market for MPEs.

III.4.1.C Building systems

141. According to the Parties, the proposed transaction would not significantly impede effective competition in the market for aluminium building systems in general and in any potential sub-segments for the following reasons.

---

39 Behr, for instance, stated that it would consider switching to folded tubes for a product, but that it would find it difficult given that a number of competitors' patents protect the use of folded tubes in this product.

40 See minutes of calls with Behr on 4 April 2013 and with Delphi on 5 April 2013.

142. First, the building systems suppliers operate in a market where they compete with non-integrated stockists and specialist fabricators who source profiles that they turn into complete systems. These companies offer products and services that in the case of stockists often are less, and in the case of specialist fabricators often are more sophisticated than those offered by building systems suppliers. Therefore, the competition in the building system market is very dynamic and the competitive pressure from other alternative suppliers like stockists and OEMs is stronger on the low level sophisticated products (windows or doors) and it is less for the high sophisticated level products (facades with special technical characteristics like high energy efficiency buildings).

143. Second, the Parties consider the estimated market shares as the most conservative approach. In the absence of any public available data for the building system market, the Parties have adopted a filter, focusing only on aluminum-based products and only to the extent that the building system suppliers are directly involved in that products flow, thus excluding the potential competition from the specialist fabricators (OEMs) and stockists, as well as from profiles that are based on other materials, like PVC or wood.

144. The Parties' activities overlap in the production and supply of aluminium building systems. Neither of them is active in supplying building systems based on other materials, except aluminum.

145. Should the market of aluminum building systems be considered as an overall market, the Parties combined market shares at EEA level would reach [10-20]% (in volume) and [20-30]% (in value). Their main competitors are Schueco ([10-20]% market share in volume and [10-20]% in value) and Reynaers ([0-5]% market share both in volume and in value). Other players are Metra ([0-5]% market share in volume and [0-5]% in value), Alumil ([0-5]% market share both in volume and in value), Cortizo ([0-5]% market share both in volume and in value). According to Parties' best estimates, the EEA building system market amounted to […] MT in 2011, equivalent to aproximativelly EUR […[.

146. Should the market of building systems be further segmented, the *curtain walls* segment would not represent an affected market at EEA level, as the combined market shares would reach only [10-20]%. Nevertheless, on the *other products* segment Hydro has a market share of [10-20]% and Sapa [5-10]%. Therefore, the combined market share of the Parties would reach almost [20-30]% at EEA level. Post-transaction the merged entity will face the same competitors as in the overall market for building system. Among all, Schueco has a market share equal to the merged entity. In addition, other competitors like Reynaers, Metra, Alumil, Kawneer (Alcoa) and Cortizo are also active across the EEA and will continue to compete with the Parties.

147. Thus, the Commission considers that taking into account the moderate combined market share of the Parties in the overall market for building systems and in the *other products* segment and the existence of the alternative suppliers mentioned above who will continue to exercise competitive pressure on the merged entity, the proposed transaction does not raise serious doubts in this market.

148. At national level, according to the Parties, the combined market share is above 15% in Austria, Belgium, Czech Republic, France, Ireland, Italy, Norway, Portugal, Spain, Sweden, the UK and the Baltics. On the basis of value market shares, Slovakia is not an affected market, but it would be considered if volume figures are taken into account. On

the contrary, Denmark is an affected market based on volume figures. Except this, the Parties have confirmed that the competitive situation would not change if value figures are taken into account. Therefore, the competitive analysis based on country level is carried out on the basis of volume figures only, except for Denmark.

149. At national level by segment, there are 9 affected national markets in the curtain walls segment and another 15 affected national markets in the other products segment.

Austria

150. The Parties estimate the total supply for Building Systems in Austria to be approximately […] MT in 2011. The Parties' combined share of supply amounts to [20-30]% in volume. Schueco will continue to be the largest competitor of the merged entity with a share of around [20-30]%. Reynaers is also present (with a share of around [0-5]%), together with a number of other suppliers including Hueck [10-20]%, Heroal [5-10]%, Alumil [0-5]%, Kawneer (Alcoa) [0-5]%, Metra [0-5] %, AluK [0-5]% and Akotherm, Gutmann/Alco, Lumon, Feal and Raico with less than [0-5]%.

151. The Commission considers that should the market for building system be further segmented, the curtain walls segment in Austria would not be an affected market. In the other products segment, the situation would be similar to the one on the overall market for building system.

152. The replies to the market investigation in this case did not reveal any competitive concern on this market. Moreover, they indicated that the market for building systems in Austria is competitive, confirming the alternative suppliers mentioned above who will continue to exercise competitive pressure on the merged entity. Therefore, in view of the above and of the other available evidence, the Commission considers that the proposed transaction does not raise serious doubts in relation to the building systems market and to any of its narrower segments in Austria.

The Baltics

153. The Parties estimate the total supply for Building Systems in the Baltics to be approximately […] MT in 2011. Of this, Hydro supplied […] MT and Sapa […] MT. The Parties' combined share of supply amounts to [30-40]% (Hydro [20-30]%/Sapa [10-20]%). The Parties believe that Schueco is the largest supplier in the Baltics with a market share of around [30-40]%. There are numerous other competitors including Reynaers ([10-20]%), Hueck ([5-10]%), Aluprof and Javal (with market shares of less than [5-10]%). The Parties consider Cortizo as a potential new entrant on this market due to its Polish operations.

154. At segment level, the Parties would have a similar market presence in the curtain wall segment with a combined market share of [30-40]%. Their main competitor Schueco would also reach [30-40]%. Other players present in this market are Reynaers (supplying from Poland) and Hueck, each with a share of around 5-10 %. Cortizo, Heroal and Guttmann would also be active, as would Raico. The Parties also consider that Aluprof and Yawal may also be supplying curtain walls into the Baltics from Poland.

155. As regards the *other products* segment, the combined market shares will be smaller than in curtain walls of [20-30]%, facing competitive constraint from Schueco (with a market

share of [20-30]%), Reynaers, Heroal and Aluprof, each with market share in the range of 5-10%. Metra, Alumil, Cortizo and Aliplast are also present on this market with market shares of less than [5-10]%.

156. The Parties confirmed that the competitive situation in all three of the Baltic States (i.e., Estonia Latvia and Lithuania) is similar to the overall position on the Baltics. Moreover, in all these countries Hydro does not have a local presence and therefore it exports building system products from neighbouring countries. Reynaers has the same strategy , supplying all these countries from its Polish offices.

157. The Commission considers that the replies to the market investigation in this case confirmed that customers do purchase building systems from outside their country. In the Baltics, respondents confirmed the presence of other alternative suppliers mentioned above. Moreover, respondents confirmed that the market leader is Schueco and that Sapa is among other alternative suppliers. Hydro seems indeed to have limited presence and therefore is not seen as a close competitor of Sapa. Therefore, in view of the above and of the other available evidence, the Commission considers that the proposed transaction does not raise serious doubts in relation to the building systems and to any of its narrower segments in the Baltics.

Belgium

158. The Parties estimate the total supply for Building Systems in Belgium to be approximately […] MT in 2011. Of this, Hydro supplied […] MT and Sapa […] MT. In Belgium, the Parties’ combined share of supply amounts to [20-30]% in 2011, with a small increment of [0-5]% brought by Hydro. Reynaers, a Belgian company, is by far the largest supplier in Belgium, with around [40-50]% of sales on a national basis. Schueco and Aliplast are also present, with Schueco supplying around [10-20]% of sales and Aliplast supplying [10-20]%, as well as a number of smaller local suppliers, including Van Beveren [5-10]%, Heroal, Flandria and Blyweert, each of them with around [0-5]% market share.

159. At segment level, the Parties' activities overlap only in *other products* segment, where the situation is similar to the one in the overall segment of building systems. The Commission considers that the replies to the market investigation in this case confirmed that due to the minimum increment in market shares and the existence of other alternative suppliers, the proposed transaction does not raise serious doubts in relation to the building systems and to any of its narrower segments in Belgium.

Czech Republic

160. The Parties estimate the total supply for Building Systems in the Czech Republic to be approximately […] MT in 2011. Of this, Hydro supplied […] MT and Sapa […] MT. In the Czech Republic, where the Parties’ combined share of supply amounts to [10-20]%, Schueco is the most important supplier and will continue to be so post-transaction, with around [40-50]% of total sales. Reynaers is also another significant supplier with around [10-20]% of sales.

161. If considering product segments, the combined market share would be just above the level of constituting a horizontally affected market in relation to Building Systems for other products ([10-20]% combined market share) and curtain walls would not represent an affected market ([10-20]% combined market share). The Parties argue that the

structure of competition in the Czech Republic would not materially change after the proposed transaction.

162. Indeed, the replies to the market investigation in this case confirmed that due to the relatively small market shares of the Parties and the existence of other alternative suppliers who will continue to exercise competitive pressure on the merged entity. In the light of the above and of the other available evidence, the Commission considers that the proposed transaction does not raise serious doubts in relation to the building systems and to any of its narrower segments in the Czech Republic.

Denmark

163. The Parties estimate the total supply of Building Systems in Denmark to be approximately […] MT in 2011. Of this, Hydro supplied […] MT and Sapa […] MT. In Denmark, the Parties' combined share of supply amounts to [10-20]% (in value) and only [10-20]% (in volume). Schueco will continue to be by far the largest competitor, with a share of around [40-50]%, with Metra ([5-10]%), Alumil and H S Hansen also being present (each of the two with market shares less than [0-5]%).

164. For the product segment, only the segment for Building Systems for curtain walls would represent a horizontally affected market. The Parties would have a combined market share of [20-30]%. Schueco would be the most significant competitor in relation to the supply of curtain walls in Denmark, representing around [30-40]% of total sales and Hueck accounting for around 5-10%. The Parties are also in direct competition with facade specialists, such as Hansen, with a share of [20-30]%, and Permasteelisa and Oskomera, which would represent between [10-20]% of sales each.

165. The Commission considers that the replies to the market investigation in this case confirmed that due to the relative moderate combined market share, the existence of other alternative suppliers, and the fact that customers indicated that they do purchase building systems also from regional suppliers located outside their country,[41] the proposed transaction does not raise serious doubts in relation to this the building systems and to any of its narrower segments in Denmark.

France

166. The Parties estimate the total supply of Building Systems in France at […] MT in 2011. Of this, Hydro supplied […] MT and Sapa […] MT. The Parties' combined share would reach [30-40]%. Other large competitors include local suppliers Profile Systemes and Sepalumic with estimated shares of local sales of [5-10]% and [5-10]%, respectively. In addition, Schueco, Reynaers, Alcoa and Aliplast are all present, accounting for shares of [5-10]%. The remainder of the market ([30-40]% by volume) is fragmented.

167. In the curtain wall segment, Schueco has a market share of [20-30]%, with Reynaers and Alcoa each accounting for around 5-10%. The Parties also face significant direct competition from the large national facade specialists, Ouest Alu and Goyer each accounting for around [10-20]% of sales. There are also international facade specialists, like Permasteelisa accounting for between [10-20]% of the French market. Metal Yapi from Turkey is also seen as an active competitor, winning projects on this market. The Parties also sometimes encounter companies like Profiles Systemes, Sepalumic,

41 See replies to Question 25 of Questionnaire Q4, Building systems customers DA.

Installux and Raico competing for curtain wall projects, but also Yuanda, a Chinese facade specialist.

168. In the other products segment, the Parties have a combined market share of [20-30]% (Hydro [20-30]% and Sapa [5-10]%). The most important competitor is again Schueco with a market share of [10-20]%. There are numerous other smaller competitors in this segment like Reynaers, Kawneer (Alcoa), Profiles Systemes, Sepalumic or Installux, each with a market share of 5-10% and also Cortizo and Heroal with market shares below [5-10]%. The Parties argue that Cortizo, a recent entry in the market decided to establish a local manufacturing facility in France and increase its sales here.

169. The Parties also argue that Hydro and Sapa are not closed competitors in the French market. Whereas Hydro has a stronger position due to historical reasons, it is addressing the higher-end customers, where Sapa presence is insignificant. Moreover, the supply of building systems in France has been industrialized to a greater extent than in other European countries. Thus, approximately 20 000MT of additional supplies in France go through OEMs who source components and assemble the systems in large factories. These products would account for windows and other products, which represent an alternative supply for the building systems customers.

170. The Commission considers that the replies to the market investigation on the French market confirmed the fact that indeed some customers do consider OEMs and/or stockists as alternative sources for aluminum building systems.[42] Customers also confirmed the existence of others as alternative suppliers as indicated by the Parties. Moreover, Cortizo indeed confirmed its plans to expand its presence in France.[43]

171. Taking into account the moderate market shares of the Parties, the existence of other alternative suppliers, some of them having the intention to expand their presence here and also considering other distribution channels as a real alternative for the customers who will continue to exercise competitive pressure on the merged entity, the proposed transaction does not raise serious doubts in relation to the building systems and to any of its narrower segments in France.

Ireland

172. The Parties estimate the total supply of Building Systems in Ireland at […] MT in 2011. Of this, Hydro supplied […] MT and Sapa […] MT. In Ireland, the Parties' combined share of the overall building systems supply amounts to [20-30]% volume. Here, too, Schueco, Kawneer (Alcoa) and Reynaers are all active competitors with shares of [20-30]%, [10-20]% and [5-10]%, respectively. Other smaller competitors together account for [30-40]% of the Irish market.

173. The Parties have insignificant presence in the curtain walls segment. In the other products segment the combined market share reaches [20-30]% (Hydro [10-20]% and Sapa [5-10]%). Schueco and Kawneer (Alcoa) are the most important competitors with market shares of [20-30]% and [10-20]% respectivelly. Reynaers and Profiles Systemes are also active with market shares of 5-10% each. In addition, there are a number of active smaller players such as Beufort, Comar, Senior Universal and Metal Technology

42 See replies to Question 6 to Questionnaire 4, Building System customers FR.

43 See minutes of the call with Cortizo on 12 April 2013.

with market shares between 0-5%. Taking into account the moderate market shares of the Parties and strong presence of Schueco and Kawneer (Alcoa) and the existence of other smaller competitors who will continue to exercise competitive pressure on the merged entity, the proposed transaction does not raise serious doubts in relation to the building systems and to any of its narrower segments in Ireland.

Italy

175. The Parties estimate the total supply of Building Systems in Italy at […] MT in 2011. Of this, Hydro supplied […] MT and Sapa […] MT. In Italy, the Parties' combined market share of supply thus amounts to [10-20]% (Hydro: [10-20]%;Sapa: [5-10]%). Their main competitors have a volume based share of supply as follows: Metra ([10-20]%), Alumil ([5-10]%) Ponzio ([5-10]%), Schueco ([5-10]%) and Allco ([5-10]%). [30-40]% of the Italian supply is fragmented between smaller competitors.

176. In the other products segment, the situation is similar, where the combined market share of the Parties reaches [10-20]%. The main competitors in this segment are as follows: Metra ([10-20]%), Schueco, Alumil, Ponzio, Allco and Aluk(Valfidus) each with market shares of around 5-10%. Reynaers have a smaller presence on the Italian market, as well as Gold Indinvest with market shares below [5-10]%. Curtain walls would not represent an affected market.

177. Taking into account that replies to the market investigation in this case have confirmed the existence of other alternative suppliers, the moderate market shares of the Parties and the existence of s relative number of other alternative suppliers who will continue to exercise competitive pressure on the merged entity, the proposed transaction does not raise serious doubts in relation to the building systems and to any of its narrower segments in Italy.

Portugal

178. The Parties estimate the total supply of Building Systems in Portugal at […] MT in 2011. Of this, Hydro supplied […] MT and Sapa […] MT. In Portugal, the Parties' combined share of sales therefore amounts to [30-40]% (Hydro: [10-20]%; Sapa [10-20]%) by volume. Other notable competitors include Navarra, a local supplier with a market share of [10-20]%, Anicolor ([5-10]%), Reynaers ([5-10]%), Cortizo ([0-5]%) and Schueco ([0-5]%). Due to the lack of data public sources, the Parties argue that it is difficult to accurately estimate market shares for Portugal as there is a significant portion of demand that is sourced through Portugal but exported to African countries, including Angola. For Sapa, it is estimated that such exports account for around [20-30]% of Sapa's sales reported above. The Parties' combined market share therefore is likely to be overestimated and would actually be less than [30-40]%.

179. In relation to curtain walls segment, the combined market share would be just over [30-40]%. The Parties' main competitor in this segment is Cortizo, supplying both from Spain and now from within Portugal (see below), which represents between [10-20]% of total sales. Reynaers is also a significant player, accounting for around 5-10% of sales. Alcoa and Hueck are both active competitors, each with just under [5-10]% of total supply. The Parties also see Extrusal, Jobefar, Navarra and Sosoares competing in this segment as well. In addition, facade specialists also compete directly with the Parties, such as Permasteelisia and Oskomera, each accounting for around [10-20]% of this segment.

180. In the other products segment, the combined market share would also be just above [30-40]%. where Reynaers, Cortizo, Navarra and Sosoares have each a market share of 5-10%. Small other competitors such as Schueco, Kawneer (Alcoa), Anicolor, Extrusal and Jobefar are also present, having a market shares of less than [5-10]%.

181. According to the Parties, the Portuguese building system market is intensely competitive and experiences significant price pressure as a result of the significant decline in demand and overall economic climate. Under the prevailing economic conditions, the Parties consider that their customers tend to multi-source more than in other countries. As regards the closeness of competition, the Parties' activities overlap primarily in the higher end commercial and residential developments space which represents aproximatively only [30-40]% of Hydro's local sales and [30-40]% of Sapa's local sales. In this segment the Parties view Schueco and Reynaers as their main competitors. For the remainder of its sales Hydro does not consider Sapa its closest competitor as Sapa's local offering is more focused at the lower end of demand with lower prices.

182. The Commission considers that the market investigation in this country did not largely infirm or confirm the arguments of the Parties. Although some customers mentioned that they only use one single supplier, there are also customers who use two or even more than two suppliers in the same time in order to secure their purchases.[44] Also, as regards the closeness of competition between the two Parties, although some customers mentioned that Hydro and Sapa are both seen as close competitors, innovative companies with a good reputation, having competitive prices, some of them said that Hydro is perceived as offering better quality products.[45]

183. Some customers raised concerns about the combined entity's ability to increase prices post-transaction. However, all respondent customers confirmed that it is easy for them to switch suppliers,[46] indicating the existence of other alternative suppliers. They also mentioned that they multisource, some of them from more than two suppliers.[47] Therefore, it is unlikely that the combined entity could impose a significant price increase after the transaction.

184. In light of the above, the Commission considers that the proposed transaction does not raise serious doubts in relation to the building systems market and to any of its narrower segments in Portugal.

Spain

185. The Parties estimate the total supply of Building Systems in Spain to be approximately […] MT in 2011. Of this, Hydro supplied […] MT and Sapa […] MT. Thus, the combined market share after the transaction amounts to [10-20]%. The largest supplier post-transaction will be Cortizo, with a share of over [20-30]%. In addition, there are a number of other European suppliers active in Spain, including Schueco ([0-5]%), Reynaers ([0-5]%), Metales ([5-10]%) and Laminex ([5-10]%).

---

44 See replies to Question 43 to Questionnaire 4, Building system customers PL.

45 See replies to Question 34 to Questionnaire 4, Building system customers PL.

46 See replies to Question 38 to Questionnaire 4, Building system customers PL.

47 See replies to Question 43 to Questionnaire 4, Building system customers PL.

186. The curtain walls segment is not an affected market, as the combined market shares would be only [5-10]%. In the other products segment, the combined market share of the Parties and their competitors would be similar to the one in the overall building system.

187. The Commission considers that the market investigation in this case has confirmed the existence of other alternative suppliers, the moderate market shares of the Parties and the presence of other suppliers, especially the Spanish producer Cortizo, who will continue to exercise competitive pressure on the merged entity. Therefore, the proposed transaction does not raise serious doubts in relation to the building systems market and to any of its narrower segments in Spain.

Sweden

188. The Parties estimate the total supply of Building Systems in Sweden to be approximately […] MT in 2011. Of this, Hydro supplied […] MT and Sapa […] MT, reaching a combined share of [30-40]% in volume. The largest competitor is Schueco with an estimated share of [20-30]% followed by H S Hansen with [0-5]% and Reynaers with [0-5]% which has priced its products aggressively to gain market share. In addition, the Parties argue that close to 25% of the Swedish market is supplied through foreign metal builders who source Building Systems elsewhere (mainly from the Baltics, Poland, Hungary and, increasingly, Finland), assemble them locally and then install the Building Systems in Sweden.

189. The combined market share for the Parties in curtain walls segment is estimated to be [30-40]% with an increment of only [5-10]%. The Parties largest competitor with regard to curtain walls is Schueco, accounting for around [20-30]% of total sales in Sweden. Reynaers, Cortizo (supplying from its operations in Poland) and Hueck are also active, each with a share of just under [5-10]%. In addition, the Parties face direct competition from facade specialists, including Oskomera, which would represent around [10-20]% of total sales. Imports from Purso in Finland and from the Baltic states also represent a significant competitive constraint in relation to the supply of curtain walls.

190. In the other products segment, the combined market share would reach [30-40]%. As in curtain walls segment, Schueco remains the strongest competitor for the merged entity, with a market share of [20-30]%. The other suppliers like Reynaers, the new entrant Cortizo, Aluprof and Yawal are also present with market shares of less than [5-10]%. In addition, Purso is supplying the Swedish market, reaching a market share of 5-10%.

191. The Parties argue that in Sweden, the competitive pressure coming from OEMs is also stronger, estimating that there are approximately 60 metal builders (not including glaziers) active in Sweden accounting for almost all large projects. Specialist fabricators like Skandinaviska Glassystem, Upglaze, Fasadlas Bäcklin are all present there being regarded as three major players on the Swedish building system market.

192. The Commission considers that the market investigation in this case confirmed indeed that the Parties have important presence in this market. Nevertheless, all customers confirmed that they do not see the local presence of a supplier as necessary, even though it is considered as an advantage. Moreover, Swedish customers do think that switching

suppliers is easy, providing examples of past switches.[48] Some customers also indicated that when they take a purchasing decision they take into consideration the offer of suppliers outside Sweden, especially in Denmark or the Baltic countries.[49] As regards the competitive pressure coming from OEMs, 2 out of 4 customers considered OEMs as alternative suppliers for their needs of building systems.[50]

193. Taking into account the results of the market investigation, especially the competitive constraints coming from neighbouring countries like Denmark or the Baltic countries, the fact that most of the respondent customers mentioned that it is easy for them to switch to other suppliers confirming the existence of other alternative suppliers,[51] the proposed transaction does not raise serious doubts in relation to the building systems market and to any of its narrower segments in Sweden.

United Kingdom

194. The Parties estimate the total supply of Building Systems in the UK at […] MT million in 2011. Of this, Hydro supplied […] MT and Sapa […] MT, reaching a combined market share of [20-30]% in volume. The other strong competitors are Schueco ([10-20]%) and Kawneer (Alcoa) ([10-20]%). In addition, Reynaers (with a volume-based share of [5-10]%), Aliplast and Beaufort are also present. The remainder of supply (around [40-50]%) is divided between a large number of smaller players.

195. In curtain walls segment, the Parties have a relatively low combined market share of [10-20]%, with an increment of just [0-5]%. The market leader remains Schueco, with around [20-30]% of sales. Alcoa is also a significant competitor in this segment, representing around [10-20]% of total supply. In addition, Reynaers, Hueck and Aliplast are all active, each accounting for just under [5-10]% of sales. The Parties also face direct competition from facade specialists, such as Permasteelisa and Oskomera, representing around [20-30]% and [10-20]% of the segment, respectively, and also Yuanda.

196. In the other products segment, the Parties combined market share reaches [20-30]%. Here again Schueco remains the main and stronger competitive constraint with a market share of [10-20]%, but also Kawneer (Alcoa), Aliplast, each with [10-20]% market shares and Reynaers (5-10%). Beaufort, Comar, Senior Universal and Metal Technology are also present, each with a modest market share of 0-5%.

197. The Commission considers that the the market investigation in this case revealed that the Parties are not close competitors, some indicating that their offer is not comparable from the quality point of view, either they address different geographic areas.[52] The

48 See replies to question 38 to Questionnaire 4, Building systems customers Sw.

49 See replies of Scandifront to question 45 and reply of Preconal Fasad to question 44.1 to Questionnaire 4, Building systems customers Sw.

50 See replies to question 6.2 to Questionnaire 4, Building systems customers Sw.

51 See replies to question 36 to Questionnaire 4, Building systems customers Sw.

52 See reply of Dortech Architectural Systems and Coastal Windows to question 34 to Questionnaire 4, Building systems customers UK.

majority of customers indicated that it is easy for them to switch suppliers, confirming the existence of various alternative suppliers.[53]

198. Taking into account the moderate combined market share with the limited increment, especially for the curtain walls segment and the existence of other alternative suppliers that will continue to exercise competitive pressure on the merged entity, the proposed transaction does not raise serious doubts in relation to the building systems market and to any of its narrower segments in United Kingdom.

Norway

199. The Parties estimate the total supply of Building Systems in Norway to be approximately […] MT in 2011. Of this, Hydro supplied […] MT and Sapa […] MT, reaching a combined share of [20-30]% in volume. Schueco is the main competitor with a market share of [30-40]%. In addition, Hueck Building Systems (market share [0-5]%) imported from Germany are sold in Norway through the wholesale company Astrup AS, re-distributing to 10 to 15 customers (this represents around €[…] of sales). HS Hansen Building Systems (market share [0-5]%) are sold in Norway through its subsidiary Hubro AS. Some specialized facade fabricators ([30-40]%) have also developed their own Building Systems: SG Bøckmann AS, Nord Norsk Aluminium AS and Bårdsen Aluminium AS. The Parties estimate that total imports of Building System products into Norway represent close to [30-40]% of total supply. Most of these imports come from Sweden, the Baltics and Poland.

200. At segment level, the combined shares are lower in the other products segment, reaching only [10-20]%. Schueco has a very strong presence in this market, accounting for [30-40] of total sales in volume. Hueck has also an important presence with a market share of [10-20]%. Numerous smaller suppliers are also present with market shares of 0-5%, i.e. Reynaers, Cortizo, Aluprof, Yawal, Aliplast, Purso and Hansen.

201. For the curtain wall segment, the Parties' combined share is around [10-20]%. By far the largest competitor is Schueco, with a share of around [40-50]%. Hueck is also a significant competitor, with a share of between [10-20]%, and Reynaers, Cortizo and Aliplast are all active each with shares of just under [5-10]%. The Parties also face direct competition from specialist facade companies, including Oskomera which the Parties estimate delivered around [10-20]% of total supply of curtain wall.

202. The Parties consider that Hydro is not a close competitor of Sapa. Hydro specialises particularly on the higher end of demand through its Wicona brand. Sapa's products are positioned at a lower price. Moreover, Hydro’s products have undergone two further design upgrades. Accordingly, Hydro does not consider Sapa as its closest competitor but focuses its competitive efforts in terms of benchmarking more on Schueco. In addition, a substantial part of Hydro’s activities in Norway [20-30] relate to the supply of customized project solutions which Sapa does not offer at all. Instead, Hydro’s main competitors here are again Schueco and specialist fabricators such as Skandinavske Glassysteme or Gartner. A particular focus of Hydro in Norway is the supply of solutions for energy-efficient buildings and so-called ‘passive houses’. Sapa’s presence in this segment is very limited.

53 See replies to question 36 and 38 to Questionnaire 4, Building systems customers UK.

203. Taking into account the moderate market shares of the Parties and the existence of a relative number of other alternative suppliers who will continue to exercise competitive pressure on the merged entity, the proposed transaction does not raise serious doubts in relation to the building systems market and to any of its narrower segments in Norway.

III.4.1.D Aluminium welded precision tubes

204. The Parties estimate the merchant sales of welded precision tubes to […] MT in the EEA in 2011. According to the Parties, Hydro's share of supply amounts to [5-10]% of all sales in the EEA, while Sapa's amounts to [20-30]%. The Parties' combined share therefore amounts to [20-30]% in the EEA in 2011. Other competitors are Thermasys/Arup with [40-50]%, Soll [10-20]% and Lingemann with [10-20]%.

205. According to the Parties, the proposed transaction will not result in anticompetitive effects. First, large customers are able to captively produce all types of welded precision tubes. The captive manufacturing capacity in the market is estimated at [5-10] times the merchant market. Second, the buyer power of customer would in any event prevent the merging entity from any possible price increase. Customers typically spread their orders across a number of suppliers, allowing them to shift demand easily with significant investment. Third, the welded precision tubes market is characterised by high levels of overcapacity, both at the merchant level as well as at the captive level.

206. The market investigation confirmed the argument of the Parties that large customers operate in-house production facilities for welded precision tubes. In this respect, the capacity utilisation operated captively appears to be as large as several times the size of the merchant market. Any price increase would be therefore easily offset by an output increase from the customers' side. Given the magnitude of the captive capacity, an output increase by large customers will be also likely to protect the remaining small customers who do not operate captive capacity.

207. In addition, even post-transaction the Parties will continue to face competitive pressure from the remaining competitors, and notably from the market leader Thermasys/Arup (market share: 47%).

208. In view of the above, the proposed transaction does not raise serious doubts with regard to the market for aluminium welded precision tubes in the EEA.

III.4.2 Vertical relationships

III.4.2.A Primary aluminium / Soft – alloy extrusions and MPEs

209. The proposed transaction gives rise to a vertical relationship with respect to Hydro's primary aluminium activities upstream and the Parties' soft-alloy extrusions activities downstream.

210. Hydro's market share for primary aluminium in the EEA amounts to [10-20]%. Sapa has no activities in the manufacture or sale of primary aluminium.

211. As stated above, the combined market share of the Parties for soft-alloy extrusions at EEA level amounts to only [20-30]%.

212. The market for soft alloy extrusions is particularly fragmented. The Parties face strong competition from a number of credible competitors. In 2011, the shares of the leading suppliers (Hydro, Sapa, Constellium, Aleris International, Metra, Cortizo and Alumil) together accounted for only around [40-50]% of 2011 EEA sales. The remaining [60-70]% of demand was supplied by more than 250 independent extruders.

213. Furthermore, none of the respondents to the market investigation raised any substantiated concerns with respect to the Parties' vertical relationship.

214. Therefore, it can be concluded that the Parties would have neither the ability nor the incentive to engage in any foreclosure strategies with regard to the supply of primary aluminium for the downstream production of soft alloy extrusions in the EEA. As regards a possible input foreclosure scenario, the Parties lack the degree of market power on the upstream market that is required for input foreclosure to be a concern. There is also no risk of customer foreclosure given that the proposed transaction will not lead to the elimination of a key portion of demand.

215. In the light of the above, it can be concluded that the proposed transaction does not raise serious doubts as to its compatibility with the internal market as regards the supply of primary aluminium for the downstream production of soft alloy extrusions in the EEA.

216. As regards possible vertical concerns in relation to the downstream markets for soft alloy extrusions in the Nordic Region and MPEs, the Commission concludes that the proposed transaction does not raise serious doubts as to its compatibility with the internal market in the light of the commitments offered by the Parties to remedy horizontal competition concerns.

III.4.2.B Aluminium flat products / welded precision tubes

217. The proposed transaction gives rise to a vertical relationship between the Parties' activities on the upstream market for aluminium flat rolled products and the downstream market for precision welded tubes. Both Parties manufacture flat rolled products which they use as an input for their downstream production of precision welded tubes.

218. The Parties' combined market shares on the upstream market for flat rolled products in the EEA are relatively low ([10-20]%). Furthermore, the Parties face strong competition from a number of credible competitors (Novelis; Constellium; Alcoa; Aleris).

219. As stated above, the Parties' combined market shares on the downstream market for precision welded tubes are not particularly large ([20-30]%). Furthermore, the Parties face strong competition from a number of credible competitors (Thermasys/Arup; Soll; Lingemann) and a particularly large captive capacity is operated by end-customers.

220. Furthermore, none of the respondents to the market investigation raised any substantiated concerns with respect to the Parties' vertical relationship.

221. Therefore, it can be concluded that the Parties have neither the ability nor the incentive to engage in any foreclosure strategies with regard to the supply of aluminium flat rolled products for the production of precision welded tubes in the EEA. As regards a possible input foreclosure scenario, the Parties lack the degree of market power on the upstream market that is required for input foreclosure to be a concern. There is also no risk of customer foreclosure given that the proposed transaction will not lead to the elimination of a key portion of demand. In conclusion the transaction does not raise serious doubts in relation to the vertical relationship between Parties' activities on the aluminium flat rolled products and the downstream market for precision welded tubes.

IV. REMEDIES

222. In order to render the concentration compatible with the internal market, the Parties have modified the notified concentration by entering into commitments in relation to: (i) the market for Soft Alloy Extrusions in the Nordic Region (composed of Norway and Sweden); and (ii) the EEA market for MPEs. The commitments are annexed to this Decision and form an integral part thereof.

IV.1. PROPOSED REMEDIES

IV.1.1 Nordic Region market for soft alloy extrusions

223. In order to address the serious doubts identified by the Commission in relation to the Nordic Region market for soft alloy extrusions,[54] the Parties entered into the commitments in annexed to this Decision in Annex 1 and which are described and assessed in Section IV.1.1 and IV.2.1 of this Decision.

224. By virtue of these commitments, the Parties propose to divest the Hydro’s soft-alloy extrusions plant in Raufoss, Norway and, if required by the Purchaser, Hydro’s soft-alloy extrusion facility in Vetlanda, which consists of value-added activities, along with Hydro’s Swedish sales team (the "SAE Divestment Business").

225. Hydro’s Raufoss plant operates three presses and also carries out value-added anodizing and packing activities in-house, as well as thermal break, painting and fabrication activities which are outsourced. Hydro’s Vetlanda facility carries out soft-alloy extrusion value-added fabrication activities.[55]

226. This represents almost all of Hydro's soft alloy extrusion operations in Norway and Sweden with the exception of its Magnor extrusion facility.

227. The SAE Divestment Business, described in more detail in Annex 1, includes:

(A) the following main tangible assets:

i. the Raufoss plant used for the production of soft-alloy extrusion including all tangible assets and production equipment (all of which is owned by the SAE Divestment Business) located at Fabrikkveien, Bygning 232, N-2830 Raufoss,

54 See Section III.4.1.A.b above.

55 In Hydro's Vetlanda facility there are no extrusion press lines.

Norway, including the three extrusion press lines (6, 8 and 12 inches), an automatic packing line, an anodizing plant and a thermal-break line (which is leased to a subcontractor);

ii. the shares currently held by Hydro Aluminium Profiler AS in Profilanlegg ANS ([…]);

iii. at the request of the Purchaser, the Vetlanda plant including all tangible assets and production equipment (all of which is owned by the Divestment Business) located at Tomasbaken 6, SE-574 23, Vetlanda, Sweden, including CNC machines, robotized production lines and other fabrication machinery;

iv. the real estate property on which the Vetlanda plant is located.

(B) the following main intangible assets:

i. There are no intangible assets such as brand names or intellectual property rights used in conducting the SAE Divestment Business.

(C) the following main licences, permits and authorisations:

For the Raufoss plant:

i. ISO 14001/2004 certification
ii. Manufacturing permit

For the Vetlanda plant:

i. ISO 14001/2004 certification
ii. ISO 9001:2008 certification
iii. Environmental protection license Vetlanda County Council
iv. Functional control of Ventilation - Vetlanda County Council

(D) the following main contracts, agreements, leases, commitments and understandings:

i. the Seller will make its best efforts to transfer the real estate contract lease for the Raufoss plant which is held by Profilanlegg ANS to the Purchaser;

ii. the Seller will make its best efforts to transfer to the Purchaser the existing contracts entered into with die manufacturers for the purpose of die manufacturing for the Raufoss plant;

iii. the Seller will make its best efforts to transfer to the Purchaser the existing contract entered into with Benteler Raufoss for the supply of billets.

(E) the following customer, credit and other records:

For the Raufoss plant:

i. All of the customers currently served by the Raufoss plant. In relation to the sales of large profiles to Hydro companies which are then delivered to third parties, the Seller will facilitate the introduction of the Purchaser to those third party customers. In addition, the Seller will provide the Purchaser with the records pertaining to such sales of large profiles that are manufactured by the Raufoss plant for onward sale to third party customers.

For the Vetlanda plant:

i. The two main customers serviced by Hydro's Vetlanda plant to be divested together with the respective turnover.

(F) […] at the Divestment Business.

(G) […] at the Divestment Business.

(H) the arrangements for the supply with the following products or services by Seller for a transitional period after Closing:

Hydro and its Affiliated Undertakings commit, <u>at the option of the Purchaser of the SAE Divestment Business</u>, to:

i. enter into a temporary supply or toll-manufacturing agreement with the Purchaser for the non-exclusive supply or toll-manufacturing of billets on same or similar terms to the supply contract between Hydro Primary Metal and the new Joint Venture;

ii. enter into a temporary supply agreement for metal price hedging services on terms to be agreed with the Purchaser;

iii. enter into a temporary supply agreement for the supply of electricity for the Raufoss and Vetlanda plants (which is currently sourced through a scheme in conjunction with Hydro Energy) on terms to be agreed with the Purchaser;

iv. provide to the Purchaser certain support services for a temporary period, namely IT services (including IT software), logistics and customer services (back office) on terms to be agreed with the Purchaser.

228. In addition the Parties have entered into related commitments, *inter alia* regarding the separation of the divested businesses from their retained businesses, the preservation of the viability, marketability and competitiveness of the divested businesses, including the appointment of a monitoring trustee and, if necessary, a divestiture trustee.

229. The Parties submit that the commitments ensure that there will be effective competition in the Nordic Region by divesting the vast majority of the competitive overlap between the Parties relating to the supply of soft alloy extrusions in the Nordic Region including Hydro's larger press capabilities and almost all of its value-added sales activities. The Parties claimed that the commitments will entirely eliminate all of the concerns leading to the Commission's serious doubts. Furthermore, the Parties submit that, until the divestiture, the viability, marketability and competitiveness of the SAE Divestment Business will be ensured through the use of a hold-separate manager under the supervision of a monitoring trustee.

230. The proposed commitments were verified in the market by the Commission with market players that have an in-depth knowledge of how the market functions.

IV.1.2 EEA market for MPEs

231. In order to address the serious doubts identified by the Commission in relation to the EEA market for MPEs,[56] the Parties submitted the commitments annexed to this Decision in Annex 2 and which are described and assessed in Section IV.1.2 and IV.2.2 of this Decision.

232. By virtue of these commitments, the Parties propose to divest all of the MPE manufacturing capacity and sales and marketing activity in the EEA owned by Sapa, as well as its dedicated MPEs R&D facility located in Louisville, US (the "MPE Divestment Business").

233. The MPE Divestment Business, described in more detail in Annex 2 includes:

(A) the following main tangible assets:

i. the physical part of the plant used for the production of MPEs including all production equipment located at Harderwijk in the Netherlands, and the property on which the plant is located.[57] Internal divisions, a separate entrance and goods dock will be constructed at the current plant to allow the current MPE and Sapa general profiles businesses to be operated separately. Outside space for storage of billets, scrap and parking will also be allocated to the Divestment Business;

ii. tangible assets required for the manufacture of MPEs, in particular: (a) 1800T 7” press (3500-4000 MT capacity); (b) zinc arc spray equipment; (c) flux coating equipment (2000 MT); and (d) cut-to-length equipment (2 high speed, 2 medium speed, 5 conventional speed);

iii. at the request of the Purchaser, the land[58] and premises currently used to house the R&D facility together with all testing and other equipment and assets, including but not limited to: a) general metallurgical laboratory services; b) light optical microscopy; c) scanning electron microscopy; d) X-Ray microanalysis; e) controlled atmosphere brazing furnaces; f) corrosion testing SWAAT cabinets; g) prototype flux coating line; and

iv. all other tangible assets which are needed to operate the Divestment Business in the way it is currently operated;

(B) the following main intangible assets:

i. licensed patents in relation to: (a) aluminium alloys with optimum combinations of Formability, Corrosion Resistance and Hot Workability, and Methods of Use; (ii) aluminium Alloy with Intergranular Corrosion Resistance, Methods of Manufacturing and its Use; and

ii. the rights to use the NEXCOR name in relation to products produced by the MPE Divestment Business using the relevant technology;

---

56 See Section III.4.1.B above.

57 Currently located at Industrieweg 15, 3846 BB Harderwijk, the Netherlands.

58 Currently located at 4301 Produce Road, Louisville, Kentucky, 40218-3099, USA.

iii. at the request of the Purchaser, all expertise and know-how with regard to R&D projects and pipeline products and developments currently held by the NAAC facility in relation to MPEs supplied by the Divestment Business;

(C) the following main licences, permits and authorisations:

i. Quality management system - ISO TS 16949:2009;
ii. Environmental management system – ISO 14001:2004;
iii. WVO license/permit Harderwijk 2004;
iv. Integrated environmental permit;
v. Permit under the Environmental Management Act; and
vi. all other licenses, permits and authorisations which are needed to operate the MPE Divestment Business in the way it is currently operated;

(D) all supplier arrangements which are needed to operate the MPE Divestment Business in the way it is currently operated; and customers contracts and/or relationships with certain customers;

(E) the transfer of all customer, credit and other records which are needed to operate the MPE Divestment Business in the way it is currently operated;

(F) the employees working at the Divestment Business plant who fulfil a range of functions including production, manufacture, IT, research and development and human resources and all other personnel needed to operate the Divestment business in the way it is currently operated;

(G) 18 key personnel, including plant, production, sales/marketing, quality and engineering managers and application engineers;

(H) 5 R&D employees (a manager, a laboratory technician and an assistant, a material specialist and an application engineer); and

(I) arrangements for the supply with the following products or services by the seller of the MPE Divestment Business (or affiliated undertakings) for a transitional period after closing of the proposed transaction to secure the handover of such services: (i) IT services, financial back office services, local IT service support, human resources and purchasing support; (ii) the use of certain facilities and capabilities (caustic facilities, air compressors, nitrogen tanks, billet and scrap handling equipment) which are currently shared with Sapa Profiles, until such facilities and capabilities are installed on a standalone basis at the MPE Divestment Business;

234. In addition the Parties have entered into related commitments, *inter alia* regarding the separation of the divested businesses from their retained businesses and the preservation of the viability, marketability and competitiveness of the divested businesses, including the appointment of a monitoring trustee and, if necessary, a divestiture trustee. The only exception to the commitment to hold the MPE Divestment Business separate from the retained business, relates to R&D for a transitory period. That is, Sapa's Monterrey MPEs plant will continue to receive R&D support and services from NAAC, as it does currently, until either the transfer of the legal title of the Divestment Business to the Purchaser or the completion of the proposed transaction whichever comes earlier.

235. The Parties submit that the commitments which they have offered in relation to the EEA MPE market remove the grounds for the Commission's serious doubts in relation to this market. In this regard, the Parties submit that the commitments remove, in its entirety, the horizontal overlap between the Parties' activities on this market. Furthermore, the Parties submit that, until the divestiture, the viability, marketability and competitiveness of the Divestment Business will be ensured through the use of a hold-separate manager under the supervision of a monitoring trustee.

IV.2. ASSESSMENT OF THE PROPOSED REMEDIES

236. Where a concentration raises serious doubts as to its compatibility with the internal market, the Parties may undertake to modify the concentration so as to remove the grounds for the serious doubts identified by the Commission with a view to having the transaction approved in phase I of the merger review procedure.

237. As set out in the Commission Notice on Remedies,[59] the commitments have to eliminate the competition concerns entirely and have to be comprehensive and effective from all points of view and must be capable of being implemented effectively within a short period of time as the conditions of competition on the market will not be maintained until the commitments have been fulfilled.[60]

238. In assessing whether or not the remedy will restore effective competition, the Commission considers the type, scale and scope of the remedies by reference to the structure and the particular characteristics of the market in which the competition concerns arise.[61]

239. Divestiture commitments are the best way to eliminate competition concerns resulting from horizontal overlaps.[62] The divested activities must consist of a viable business that, if operated by a suitable purchaser, can compete effectively with the Merged Entity on a lasting basis and that is divested as a going concern.[63]

240. The business must include all the assets which contribute to its current operation or which are necessary to ensure its viability and competitiveness and all personnel which are currently employed or which are necessary to ensure the business' viability and competitiveness. Personnel and assets which are currently shared between the business to be divested and other businesses of the parties, but which contribute to the operation of the business or which are necessary to ensure its viability and competitiveness, must also be included. Otherwise, the viability and competitiveness of the business to be divested would be endangered. Therefore, the divested business must contain the personnel providing essential functions for the business such as, for instance, group R & D staff —at least in a sufficient proportion to meet the on-going needs of the divested business.[64]

---

59 Commission Notice on remedies acceptable under Council Regulation (EEC) No 139/2004 and under Commission Regulation (EC) No 802/2004, Official Journal C 267, 22.10.2008, p. 1-27.

60 Commission Notice on Remedies, paragraph 9.

61 Commission Notice on Remedies, paragraph 12.

62 Commission Notice on Remedies, paragraph 17.

63 Commission Notice on Remedies, paragraph 23.

64 Commission Notice on Remedies, paragraphs 25 and 26.

IV.2.1 Nordic Region market for soft alloy extrusions

241. The objective of the soft alloy extrusions commitments is to ensure that the proposed transaction will have almost no impact on the manufacturing capacity, sales and supply of soft alloy extrusions in the Nordic Region.

242. The Parties submitted an initial commitments proposal regarding the Nordic Region market for soft alloy extrusions on 18 April 2013. This initial set of commitments did not include the possibility of the introduction to the Purchaser of the customers purchasing large profiles form other Hydro Business Units but extruded in Raufoss.

243. The Commission launched a market test regarding the proposed commitments on 22 April 2013. The main purpose of the market test was to check whether the proposed commitments were sufficient to clearly rule out the serious doubts identified by the Commission. The feedback received from respondents to the market test as to the suitability of the remedy to remove the serious doubts identified by the Commission in relation to the Nordic Region market for soft alloy extrusions was positive overall. However, some issues regarding whether Raufoss could be dependent on exports to other Hydro's Business Units in Europe with large extrusions were raised by respondents to the market test.

244. In light of these issues, the Parties have made modifications to the commitments with a view to ensuring that the commitments are workable and effective. In relation to the sales of large profiles to Hydro companies which are then delivered to third parties, the Seller will facilitate the introduction of the Purchaser to those third party customers. In addition, the Seller will provide the Purchaser with the records pertaining to such sales of large profiles that are manufactured by the Raufoss plant for onward sale to third party customers. The final commitments regarding the Nordic Region market for soft alloy extrusions (described in Section IV.1.1 above) were submitted by the Parties on 2 May 2013.

245. The Commission considers that the remedy proposed in relation to soft alloy extrusions eliminates almost all the horizontal overlap in the Nordic Region between the Parties. The remedy will therefore almost restore the market structure which existed before the merger. The purchaser of the SAE Divestment Business will have an initial soft alloy extrusion production capacity share of [20-30]% in the Nordic Region.

246. The Commission notes that the majority of respondents to the Commission's market test indicated that they consider that the proposed commitments remove the competition concerns raised in relation to the Nordic Region market for soft alloy extrusions. Furthermore, respondents generally indicated that they consider that the SAE Divestment Business constitutes a viable business that would enable a suitable purchaser to compete effectively on the Nordic Region market for soft alloy extrusions.[65]

[65] See replies to questions 1 and 2 of the Market test questionnaires to suppliers and to customers both dated 29 April 2013.

247. Some respondents to the market test stressed the potential dependence of Raufoss on other Hydro's Business Units.[66]

248. The Commission considers that the improved commitments submitted by the parties on 2 May 2013 now fully address by including the commitment to introduce the Purchaser to customers purchasing large profiles form other Hydro Business Units but extruded in Raufoss. No further significant issues were raised by respondents to the market test regarding tangible or intangible assets which would affect the suitability of the commitments to remove the Commission's serious doubts in relation to the Nordic Region market for soft alloy extrusions.

249. In light of the above, the Commission considers that the commitments dated 02 May 2013 regarding the Nordic Region market for soft alloy extrusions adequately address the concerns identified by respondents to the Commission's market test.

250. For the reasons outlined above, the Commission concludes that the commitments entered into by the Parties regarding the Nordic Region market for soft alloy extrusions (attached hereto as Annex 1) are sufficient to remove the serious doubts as to the compatibility of the transaction with the internal market in relation to the Nordic Region market for soft alloy extrusions.

IV.2.2 EEA market for MPEs

251. The Parties submitted an initial commitments proposal regarding the EEA market for MPEs on 18 April 2013. This initial set of commitments did not include the possibility of the transfer, at the request of the purchaser, of the R&D facility providing support to the MPE plant in Harderwijk.

252. The Commission launched a market test regarding the proposed commitments on 22 April 2013. The main purpose of the market test was to check whether the proposed commitments were sufficient to clearly rule out the serious doubts identified by the Commission. The feedback received from respondents to the market test as to the suitability of the remedy to remove the serious doubts identified by the Commission in relation to the EEA MPE market was positive overall. However, respondents to the market test raised some issues regarding R&D which are set out below..

253. In light of these issues, the Parties amended the commitments, including the R&D facility with a view to ensuring that the commitments are workable and effective. The final commitments regarding the EEA market for MPEs (described in Section IV.1.2 above) were submitted by the parties on 2 May 2013.

254. The Commission considers that these commitments completely eliminate the horizontal overlap at EEA level between the parties' MPE activities. The remedy will therefore restore the market structure which existed before the merger. The purchaser of the MPE Divestment Business will have an initial EEA market share of [10-20]%.

255. The MPE Divestment Business is not a stand-alone business but includes several tangible and intangible assets, contracts and licences belonging to or having been

66 See in particular replies to question 1 the Market test questionnaires to suppliers and to customers both dated 29 April 2013.

concluded by Sapa. Some of these assets are currently shared with other product areas which are being retained by the Parties.

256. Although normally the divestiture of an existing viable standalone business is required, the Commission taking into account the principle of proportionality, may also consider the divestiture of businesses which have existing strong links or are partially integrated with businesses retained by the parties and therefore need to be 'carved out' in those respects.[67]

257. The Divestment Business will be carved out from the remaining general profiles business which will be retained by the parties. In such carve-out operations, it is of utmost importance for the viability of the transferred business that it has access to all inputs and other resources such as R&D necessary to carry out its operation in full independence. The Commission can only accept commitments which require such carve out of a business if it can be certain that, when the business is transferred to the purchaser the risks for the viability and competitiveness caused by the carve-out will be reduced to a minimum.

258. The Commission notes that the majority of respondents to the Commission's market test indicated that they consider that the proposed commitments remove the competition concerns raised in relation to the EEA market for MPEs. Furthermore, respondents generally indicated that they consider that the divestment business constitutes a viable business that would enable a suitable purchaser to compete effectively on the EEA market for MPEs.[68]

259. As regards the separation of the tangible assets forming part of the MPE Divestment Business from the remaining assets at Harderwijk which will be retained by the Parties, the majority of respondents to the market test did not consider this separation as posing a risk of negatively affecting the implementation of the commitments or the viability of the MPE business to be divested.[69]

260. As regards intangible assets and personnel, several respondents to the market test stressed the importance of R&D and know-how in the MPE sector. Indeed, several respondents indicated that the divestment business would require relevant know-how and R&D facilities in order for it to be able to successfully compete in the EEA market for MPEs.[70]

261. The Commission considers that the improved commitments submitted by the Parties on 2 May 2013 now fully address this issue. Indeed, the commitments now provide for the transfer of all R&D facilities and related personnel that will provide the divestment business with the required capabilities and necessary knowhow to continue its activity in the MPE area.

---

67 Commission Notice on Remedies, paragraphs 25 and 26.

68 See replies to questions 1 and 2 of the Market test questionnaires to suppliers and to customers both dated 29 April 2013.

69 See replies to question 6 of the Market test questionnaires to suppliers and to customers both dated 29 April 2013.

70 See in particular replies to questions 3, 4 and 5 of the Market test questionnaires to suppliers and to customers both dated 29 April 2013.

262. Several respondents to the market test also indicated it would be important for the purchaser of the MPE Divestment Business to have experience in the aluminium extrusion market or neighbouring market in order to be considered suitable.[71]

263. In the commitments dated 2 May 2013 the Parties expressly state that the purchaser must, inter alia, have proven expertise and incentive to maintain and develop the Divestment Business as a viable competitive force on the MPE market in order to be considered suitable. The Commission considers that proven expertise in the aluminium extrusion market or neighbouring markets is indeed an important condition for the approval of the Purchaser.

264. No further significant issues were raised by respondents to the market test regarding tangible or intangible assets (beyond those related to R&D/know-how and purchaser suitability criteria) which would affect the suitability of the commitments to remove the Commission's grounds serious doubts in relation to the EEA MPE market.

265. In light of the above and of the other available evidence, the Commission considers that the commitments dated 2 May 2013 regarding the EEA MPE market adequately address the concerns identified by respondents to the Commission's market test.

266. For the reasons outlined above, the Commission concludes that the commitments entered into by the Parties regarding the EEA MPE market (attached hereto as Annex 2) are sufficient to remove the serious doubts as to the compatibility of the transaction with the internal market in relation to the EEA MPE market.

V. CONDITION AND OBLIGATION

267. Under the first sentence of the second subparagraph of Article 6(2) of the EC Merger Regulation, the Commission may attach to its decision conditions and obligations intended to ensure that the undertakings concerned comply with the commitments they have entered into vis-à-vis the Commission with a view to rendering the concentration compatible with the common market.

268. The achievement of the measure that gives rise to the structural change of the market is a condition, whereas the implementing steps which are necessary to achieve this result are generally obligations on the Parties. Where a condition is not fulfilled, the Commission’s decision declaring the concentration compatible with the common market no longer stands. Where the undertakings concerned commit a breach of an obligation, the Commission may revoke the clearance decision in accordance with Article 8(5) of the EC Merger Regulation. The undertakings concerned may also be subject to fines and periodic penalty payments under Articles 14(2) and 15(1) of the EC Merger Regulation.

269. In accordance with the basic distinction described above, the decision in this case is conditional on the full compliance with: (i) Section B and the Schedule of the commitments dated 2 May 2013, relating to the Nordic Region market for soft alloy extrusions (attached hereto as Annex 1) and (ii) Section B and the Schedule of the commitments dated 2 May 2013, relating to the EEA MPE market (attached hereto as

71 See in particular replies to questions 3, 4 and 5 of the Market test questionnaires to suppliers and to customers both dated 29 April 2013.

Annex 2). The remaining requirements set out in the other Sections of the said commitments are considered to constitute obligations.

VI. CONCLUSION

270. For the above reasons, the Commission has decided not to oppose the notified operation as modified by the commitments and to declare it compatible with the internal market and with the functioning of the EEA Agreement, subject to full compliance with the conditions contained in Section B and the Schedule of the commitments dated 02 May 2013, relating to the Nordic Region market for soft alloy extrusions and in Section B and the Schedule of the commitments dated 02 May 2013, relating to the EEA MPE market, annexed to the present decision, and with the obligations contained in the other Sections of the said commitments. This decision is adopted in application of Article 6(1)(b) in conjunction with Article 6(2) of the Merger Regulation.

For the Commission
(signed)

Joaquín ALMUNIA
Vice-President

By hand and by fax: 00 32 2 296 4301
European Commission
DG Competition
Merger Registry
Place Madou / Madouplein 1
1210 Saint-Josse-ten-Noode / Sint-Joost-ten-Node
Belgique / België

Case M. 6756 – Norsk Hydro ASA / Orkla ASA / JV

Pursuant to Article 6(2) of Council Regulation (EC) No. 139/2004 as amended (the "***Merger Regulation***"), Orkla ASA ("***Orkla***") and Norsk Hydro ASA ("***Hydro***") (the "***Parties***") hereby provide the following Commitments (the "***SAE Commitments***") in order to enable the European Commission (the "***Commission***") to declare the creation of a full-function joint venture between Orkla and Norsk Hydro which will own and operate the soft alloy extrusion businesses of each of Orkla's wholly-owned subsidiary, Sapa Holding AB ("***Sapa***"), and Hydro, including their respective building systems and precision tubing activities compatible with the common market and the EEA Agreement by its decision pursuant to Article 6(1)(b) of the Merger Regulation of the Merger Regulation (the "***Decision***").

Orkla will provide separate commitments with respect to the divestment of certain of its activities in the field of multi-port extrustions (the "***MPE Commitments***").

The SAE Commitments shall take effect upon the date of adoption of the Decision. The scope of the Parties' respective obligations under the SAE Commitments depends on the time at which the divestment will take place; *i.e.*, prior to or post Completion.

This text shall be assessed in conjunction with the MPE Commitments of this date, and interpreted in the light of the Decision to the extent that the Commitments are attached as conditions and obligations, in the general framework of Community law, in particular in the light of the Merger Regulation, and by reference to the Commission Notice on remedies acceptable under Council Regulation (EC) No 139/2004 and under Commission Regulation (EC) No 802/2004.

Section A. Definitions

For the purpose of the SAE Commitments, the following terms shall have the following meaning:

Affiliated Undertakings: undertakings controlled by the Parties and/or by the ultimate parents of the Parties, including the JV, whereby the notion of control shall be interpreted pursuant to Article 3 Merger Regulation and in the light of the Commission Consolidated Jurisdictional Notice under Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings.

Closing: the transfer of the legal title of the Divestment Business to the Purchaser.

Completion: the completion of the transaction to create a joint venture between Hydro and Orkla.

Divestment Business: the business or businesses as defined in Section B and the Schedule that Hydro commits to divest.

Divestiture Trustee: one or more natural or legal person(s), independent from the Parties, who is approved by the Commission and appointed by the Parties and who has received from Hydro the exclusive Trustee Mandate to sell the Divestment Business to a Purchaser at no minimum price.

Effective Date: the date of adoption of the Decision.

First Divestiture Period: the period of [CONFIDENTIAL] months from the Effective Date.

Hold Separate Manager: the person appointed by Hydro for the Divestment Business to manage the day-to-day business under the supervision of the Monitoring Trustee.

Hydro: Norsk Hydro ASA incorporated under the laws of Norway, with its registered office at Drammensveien 260, PO Box 980 Skøyen, NO-0240, Oslo, Norway.

Joint Venture: the proposed joint venture between Hydro and Orkla which the Commission is currently reviewing under Case COMP/M.6756.

Key Personnel: all personnel necessary to maintain the viability and competitiveness of the Divestment Business, as listed in the Schedule.

Monitoring Trustee: one or more natural or legal person(s), independent from the Parties, who is approved by the Commission and appointed by the Parties, and who has the duty to monitor the Parties' compliance with the conditions and obligations attached to the Decision.

Orkla: Orkla ASA incorporated under the laws of Norway, with its registered office at Karenslyst allé 6, PO Box 423 Skøyen, NO-0213, Oslo, Norway.

Personnel: all personnel currently employed by the Divestment Business, including Key Personnel, staff seconded to the Divestment Business, shared personnel and the additional personnel listed in the Schedule.

Purchaser: the entity approved by the Commission as acquirer of the Divestment Business in accordance with the criteria set out in Section D.

Seller: Hydro if the sale of the Divestment business takes place prior to Completion, or the Joint Venture, if the sale of the Divestment business takes place post Completion.

SAE: Soft alloy extrusions are produced from billets of aluminium alloys, and are the products sold by the Divestment Business.

Trustee(s): the Monitoring Trustee and the Divestiture Trustee.

Trustee Divestiture Period: the period of [CONFIDENTIAL] months from the end of the First Divestiture Period.

Section B. The Divestment Business

<u>Commitment to divest</u>

1. In order to restore effective competition, Seller commits to divest, or procure the divestiture of the Divestment Business by the end of the Trustee Divestiture Period as a going concern to a purchaser and on terms of sale approved by the Commission in accordance with the procedure described in paragraph 17. To carry out the divestiture, Seller commits to find a purchaser and enter into a final binding sale and purchase agreement for the sale of the Divestment Business within the First Divestiture Period. If Seller has not entered into such an agreement at the end of the First Divestiture Period, Seller shall grant the Divestiture Trustee an exclusive mandate to sell the Divestment Business in accordance with the procedure described in paragraph 27 in the Trustee Divestiture Period.

2. The Parties shall be deemed to have complied with this commitment if, by the end of the Trustee Divestiture Period, Seller has entered into a final binding sale and purchase agreement, if the

Commission approves the Purchaser and the terms in accordance with the procedure described in paragraph 17 and if the closing of the sale of the Divestment Business takes place within a period not exceeding 3 months after the approval of the purchaser and the terms of sale by the Commission.

3. In order to maintain the structural effect of the Commitments, the Parties and the Joint Venture shall, for a period of 10 years after the Effective Date, not acquire direct or indirect influence over the whole or part of the Divestment Business, unless the Commission has previously found that the structure of the market has changed to such an extent that the absence of influence over the Divestment Business is no longer necessary to render the proposed concentration compatible with the common market.

Structure and definition of the Divestment Business

4. The Divestment Business consists of Hydro’s soft-alloy extrusions plant in Raufoss, Norway and, if required by the Purchaser, Hydro’s soft-alloy extrusion facility in Vetlanda which consists of value-added activities along with Hydro’s Swedish sales team.

5. Hydro’s Raufoss plant is located at Fabrikkveien, Bygning 232, 2830 Raufoss, Norway. The plant is part of Hydro Aluminium Profiler AS, a company registered under Norwegian law with its registered address at N-2830 Raufoss, Norway. Hydro’s Raufoss plant operates three presses (6 inches, 8 inches and 12 inches, providing a wide product range capability) and also carries out value-added anodizing and packing activities in-house, as well as thermal break, painting and fabrication activities which are outsourced.

6. Hydro’s Vetlanda facility is located at Tomasbaken 6, SE-574 23, Vetlanda, Sweden. The facility is Hydro’s Swedish headquarters and part of Hydro Aluminium Profiler AB, a company registered under Swedish law and with its registered address at Vetlanda, Sweden. Hydro’s Vetlanda facility carries out soft-alloy extrusion value-added fabrication activities specialized in advance milling of aluminium components based on CNC machines and robotized production lines. The Vetlanda facility also houses Hydro’s sales team in Sweden. Vetlanda acts as (i) a subcontract fabricator for both of Hydro Aluminium Profiler AS’ Raufoss and Magnor plants, and (ii) a sales agency for the Raufoss and Magnor plants.

7. The present legal and functional structure of the Divestment Business as operated to date is described in the Schedule. The Divestment Business, described in more detail in the Schedule, includes

   a. all tangible and intangible assets (including intellectual property rights), which contribute to the current operation or are necessary to ensure the viability and competitiveness of the Divestment Business;

   b. all licences, permits and authorisations issued by any governmental organisation for the benefit of the Divestment Business;

   c. all contracts, leases, commitments and customer orders of the Divestment Business; all customer, credit and other records of the Divestment Business (items referred to under (a)-(c) hereinafter collectively referred to as “***Assets***”);

   d. the Personnel; and

   e. the benefit, for a transitional period of up to [CONFIDENTIAL] months after Closing and on terms and conditions equivalent to those at present afforded to the Divestment Business, of all current arrangements under which Hydro or Affiliated Undertakings supply products or services to the Divestment Business, as detailed in the Schedule, unless otherwise agreed with the Purchaser.

Section C. Related commitments

Preservation of Viability, Marketability and Competitiveness

8. From the Effective Date until Closing, Seller shall preserve the economic viability, marketability and competitiveness of the Divestment Business, in accordance with good business practice, and shall minimise as far as possible any risk of loss of competitive potential of the Divestment Business. In particular Seller undertakes:

    (a) not to carry out any act upon its own authority that might have a significant adverse impact on the value, management or competitiveness of the Divestment Business or that might alter the nature and scope of activity, or the industrial or commercial strategy or the investment policy of the Divestment Business;

    (b) to make available sufficient resources for the development of the Divestment Business, on the basis and continuation of the existing business plans

    (c) to take all reasonable steps, including appropriate incentive schemes (based on industry practice), to encourage all Key Personnel to remain with the Divestment Business.

Hold-separate obligations of Seller

9. Seller commits, from the Effective Date until Closing, to keep the Divestment Business separate from the businesses retained by Hydro and to ensure that Key Personnel of the Divestment Business – including the Hold Separate Manager – have no involvement in any Hydro business retained and vice versa. Seller shall also ensure that the Personnel does not report to any individual outside the Divestment Business.

10. Until Closing, Seller shall assist the Monitoring Trustee in ensuring that the Divestment Business is managed as a distinct and saleable entity separate from the businesses retained by Hydro. Seller shall appoint a Hold Separate Manager who shall be responsible for the management of the Divestment Business, under the supervision of the Monitoring Trustee. The Hold Separate Manager shall manage the Divestment Business independently and in the best interest of the business with a view to ensuring its continued economic viability, marketability and competitiveness and its independence from the businesses retained by the Parties.

Ring-fencing

11. Seller shall implement all necessary measures to ensure that they do not after the Effective Date obtain any business secrets, know-how, commercial information, or any other information of a confidential or proprietary nature relating to the Divestment Business. In particular, the participation of the Divestment Business in a central information technology network shall be severed to the extent possible, without compromising the viability of the Divestment Business. Hydro may obtain information relating to the Divestment Business which is reasonably necessary for the divestiture of the Divestment Business or whose disclosure to Hydro is required by law.

Non-solicitation clause

12. The Parties and the Joint Venture undertake, subject to customary limitations, not to solicit, and to procure that Affiliated Undertakings do not solicit, the Key Personnel transferred with the Divestment Business for a period of [CONFIDENTIAL] after Closing.

Due Diligence

13. In order to enable potential purchasers to carry out a reasonable due diligence of the Divestment Business, Seller shall, subject to customary confidentiality assurances and dependent on the stage of the divestiture process:

    (a) provide to potential purchasers sufficient information as regards the Divestment Business;

    (b) provide to potential purchasers sufficient information relating to the Personnel and allow them reasonable access to the Personnel.

Reporting

14. Seller shall submit written reports in English on potential purchasers of the Divestment Business and developments in the negotiations with such potential purchasers to the Commission and the Monitoring Trustee no later than 10 days after the end of every month following the Effective Date (or otherwise at the Commission's request).

15. The Parties shall inform the Commission and the Monitoring Trustee on the preparation of the data room documentation and the due diligence procedure and shall submit a copy of an information memorandum to the Commission and the Monitoring Trustee before sending the memorandum out to potential purchasers.

Section D. The Purchaser

16. In order to ensure the immediate restoration of effective competition, the Purchaser, in order to be approved by the Commission, must:

    (a) be independent of and unconnected to the Parties and the Joint Venture;

    (b) have the financial resources, proven expertise and incentive to maintain and develop the Divestment Business as a viable and active competitive force in competition with the Parties, the Joint Venture and other competitors;

    (c) neither be likely to create, in the light of the information available to the Commission, *prima facie* competition concerns nor give rise to a risk that the implementation of the Commitments will be delayed, and must, in particular, reasonably be expected to obtain all necessary approvals from the relevant regulatory authorities for the acquisition of the Divestment Business (the before-mentioned criteria for the purchaser hereafter the "***Purchaser Requirements***").

17. The final binding sale and purchase agreement shall be conditional on the Commission's approval. When Seller has reached an agreement with a purchaser, it shall submit a fully documented and reasoned proposal, including a copy of the final agreement(s), to the Commission and the Monitoring Trustee. Seller must be able to demonstrate to the Commission that the purchaser meets the Purchaser Requirements and that the Divestment Business is being sold in a manner consistent with the Commitments. For the approval, the Commission shall verify that the purchaser fulfils the Purchaser Requirements and that the Divestment Business is being sold in a manner consistent with the Commitments. The Commission may approve the sale of the Divestment Business without one or more Assets or parts of the Personnel, if this does not affect the viability and competitiveness of the Divestment Business after the sale, taking account of the proposed purchaser.

Section E. Trustee

I. Appointment Procedure

18. The Parties shall appoint a Monitoring Trustee to carry out the functions specified in the Commitments for a Monitoring Trustee. If Seller has not entered into a binding sales and purchase

agreement one month before the end of the First Divestiture Period or if the Commission has rejected a purchaser proposed by the Seller at that time or thereafter, the Seller shall appoint a Divestiture Trustee to carry out the functions specified in the Commitments for a Divestiture Trustee. The appointment of the Divestiture Trustee shall take effect upon the commencement of the Extended Divestment Period.

19. The Trustee shall be independent of the Parties and of the Joint Venture, possess the necessary qualifications to carry out its mandate, for example as an investment bank or consultant or auditor, and shall neither have nor become exposed to a conflict of interest. The Trustee shall be remunerated by the Seller in a way that does not impede the independent and effective fulfilment of its mandate. In particular, where the remuneration package of a Divestiture Trustee includes a success premium linked to the final sale value of the Divestment Business, the fee shall also be linked to a divestiture within the Trustee Divestiture Period.

Proposal by the Seller

20. No later than one week after the Effective Date, the Parties shall submit a list of one or more persons whom they propose to appoint as the Monitoring Trustee to the Commission for approval. No later than one month before the end of the First Divestiture Period, Seller shall submit a list of one or more persons whom they propose to appoint as Divestiture Trustee to the Commission for approval. The proposal shall contain sufficient information for the Commission to verify that the proposed Trustee fulfils the requirements set out in paragraph 19 and shall include:

    (a) the full terms of the proposed mandate, which shall include all provisions necessary to enable the Trustee to fulfil its duties under these Commitments;

    (b) the outline of a work plan which describes how the Trustee intends to carry out its assigned tasks;

    (c) an indication whether the proposed Trustee is to act as both Monitoring Trustee and Divestiture Trustee or whether different trustees are proposed for the two functions.

Approval or rejection by the Commission

21. The Commission shall have the discretion to approve or reject the proposed Trustee(s) and to approve the proposed mandate subject to any modifications it deems necessary for the Trustee to fulfil its obligations. If only one name is approved, Seller shall appoint or cause to be appointed, the individual or institution concerned as Trustee, in accordance with the mandate approved by the Commission. If more than one name is approved, Seller shall be free to choose the Trustee to be appointed from among the names approved. The Trustee shall be appointed within one week of the Commission's approval, in accordance with the mandate approved by the Commission.

New proposal by the Seller

22. If all the proposed Trustees are rejected, Seller shall submit the names of at least two more individuals or institutions within one week of being informed of the rejection, in accordance with the requirements and the procedure set out in paragraphs 18 and 21.

Trustee nominated by the Commission

23. If all further proposed Trustees are rejected by the Commission, the Commission shall nominate a Trustee, whom the Seller shall appoint, or cause to be appointed, in accordance with a trustee mandate approved by the Commission.

II. <u>Functions of the Trustee</u>

24. The Trustee shall assume its specified duties in order to ensure compliance with the Commitments. The Commission may, on its own initiative or at the request of the Trustee or the Parties, give any orders or instructions to the Trustee in order to ensure compliance with the conditions and obligations attached to the Decision.

Duties and obligations of the Monitoring Trustee

25. The Monitoring Trustee shall:

(i) propose in its first report to the Commission a detailed work plan describing how it intends to monitor compliance with the obligations and conditions attached to the Decision.

(ii) oversee the on-going management of the Divestment Business with a view to ensuring its continued economic viability, marketability and competitiveness and monitor compliance by the Seller with the conditions and obligations attached to the Decision. To that end the Monitoring Trustee shall:

(a) monitor the preservation of the economic viability, marketability and competitiveness of the Divestment Business, and the keeping separate of the Divestment Business from the business retained by the Parties and the Joint Venture, in accordance with paragraphs 8 and 9 of the Commitments;

(b) supervise the management of the Divestment Business as a distinct and saleable entity, in accordance with paragraph 10 of the Commitments;

(c) (i) in consultation with the Parties, determine all necessary measures to ensure that the Seller does not after the effective date obtain any business secrets, knowhow, commercial information, or any other information of a confidential or proprietary nature relating to the Divestment Business, in particular strive for the severing of the Divestment Business' participation in a central information technology network to the extent possible, without compromising the viability of the Divestment Business, and (ii) decide whether such information may be disclosed to the Seller as the disclosure is reasonably necessary to allow the Seller to carry out the divestiture or as the disclosure is required by law;

(d) monitor the splitting of assets and the allocation of Personnel between the Divestment Business and the Seller or Affiliated Undertakings;

(iii) assume the other functions assigned to the Monitoring Trustee under the conditions and obligations attached to the Decision;

(iv) propose to the Seller such measures as the Monitoring Trustee considers necessary to ensure the Seller's compliance with the conditions and obligations attached to the Decision, in particular the maintenance of the full economic viability, marketability or competitiveness of the Divestment Business, the holding separate of the Divestment Business and the non-disclosure of competitively sensitive information;

(v) review and assess potential purchasers as well as the progress of the divestiture process and verify that, dependent on the stage of the divestiture process, (a) potential purchasers receive sufficient information relating to the Divestment Business and the Personnel in particular by reviewing, if available, the data room documentation, the information memorandum and the due diligence process, and (b) potential purchasers are granted reasonable access to the Personnel;

(vi) provide to the Commission, sending the Seller a non-confidential copy at the same time, a written report within 15 days after the end of every month. The report shall cover the operation and management of the Divestment Business so that the Commission can assess whether the business is held in a manner consistent with the Commitments and the progress of the divestiture process as well as potential purchasers. In addition to these reports, the Monitoring Trustee shall promptly report in writing to the Commission, sending the Seller a non-confidential copy at the same time, if it concludes on reasonable grounds that the Seller is failing to comply with these Commitments;

(vii) within one week after receipt of the documented proposal referred to in paragraph 17, submit to the Commission a reasoned opinion as to the suitability and independence of the proposed purchaser and the viability of the Divestment Business after the Sale and as to whether the Divestment Business is sold in a manner consistent with the conditions and obligations attached to the Decision, in particular, if relevant, whether the Sale of the Divestment Business without one or more Assets or not all of the Personnel affects the viability of the Divestment Business after the sale, taking account of the proposed purchaser.

Duties and obligations of the Divestiture Trustee

26. Within the Trustee Divestiture Period, the Divestiture Trustee shall sell at no minimum price the Divestment Business to a purchaser, provided that the Commission has approved both the purchaser and the final binding sale and purchase agreement in accordance with the procedure laid down in paragraph 17. The Divestiture Trustee shall include in the sale and purchase agreement such terms and conditions as it considers appropriate for an expedient sale in the Trustee Divestiture Period. In particular, the Divestiture Trustee may include in the sale and purchase agreement such customary representations and warranties and indemnities as are reasonably required to effect the sale. The Divestiture Trustee shall protect the legitimate financial interests of the Seller, subject to the Seller's unconditional obligation to divest at no minimum price in the Trustee Divestiture Period.

27. In the Trustee Divestiture Period (or otherwise at the Commission's request), the Divestiture Trustee shall provide the Commission with a comprehensive monthly report written in English on the progress of the divestiture process. Such reports shall be submitted within 15 days after the end of every month with a simultaneous copy to the Monitoring Trustee and a non-confidential copy to the Seller.

III. <u>Duties and obligations of the Seller</u>

28. The Seller shall provide and shall cause its advisors to provide the Trustee with all such cooperation, assistance and information as the Trustee may reasonably require to perform its tasks. The Trustee shall have full and complete access to any of the Seller's or the Divestment Business' books, records, documents, management or other personnel, facilities, sites and technical information necessary for fulfilling its duties under the Commitments and the Seller and the Divestment Business shall provide the Trustee upon request with copies of any document. The Seller and the Divestment Business shall make available to the Trustee one or more offices on their premises and shall be available for meetings in order to provide the Trustee with all information necessary for the performance of its tasks.

29. The Seller shall provide the Monitoring Trustee with all managerial and administrative support that it may reasonably request on behalf of the management of the Divestment Business. This shall include all administrative support functions relating to the Divestment Business which are currently carried out at headquarters level. The Seller shall provide and shall cause its advisors to provide the Monitoring Trustee, on request, with the information submitted to potential purchasers, in particular give the Monitoring Trustee access to the data room documentation and all other information granted to potential purchasers in the due diligence procedure. The Seller shall inform the Monitoring Trustee on possible purchasers, submit a list of potential purchasers, and keep the Monitoring Trustee informed of all developments in the divestiture process.

30. The Seller shall grant or procure Affiliated Undertakings to grant comprehensive powers of attorney, duly executed, to the Divestiture Trustee to effect the sale, the Closing and all actions and declarations which the Divestiture Trustee considers necessary or appropriate to achieve the sale

and the Closing, including the appointment of advisors to assist with the sale process. Upon request of the Divestiture Trustee, the Seller shall cause the documents required for effecting the sale and the Closing to be duly executed.

31. The Seller shall indemnify the Trustee and its employees and agents (each an "***Indemnified Party***") and hold each Indemnified Party harmless against, and hereby agrees that an Indemnified Party shall have no liability to the Seller for any liabilities arising out of the performance of the Trustee's duties under the Commitments, except to the extent that such liabilities result from the wilful default, recklessness, gross negligence or bad faith of the Trustee, its employees, agents or advisors.

32. At the expense of the Seller, the Trustee may appoint advisors (in particular for corporate finance or legal advice), subject to the Seller's approval (this approval not to be unreasonably withheld or delayed) if the Trustee considers the appointment of such advisors necessary or appropriate for the performance of its duties and obligations under the Mandate, provided that any fees and other expenses incurred by the Trustee are reasonable. Should the Seller refuse to approve the advisors proposed by the Trustee the Commission may approve the appointment of such advisors instead, after having heard the Seller. Only the Trustee shall be entitled to issue instructions to the advisors. Paragraph 31 shall apply mutatis mutandis. In the Trustee Divestiture Period, the Divestiture Trustee may use advisors who served the Seller during the Divestiture Period if the Divestiture Trustee considers this in the best interest of an expedient sale.

IV. <u>Replacement, discharge and reappointment of the Trustee</u>

33. If the Trustee ceases to perform its functions under the Commitments or for any other good cause, including the exposure of the Trustee to a conflict of interest:

    (a) the Commission may, after hearing the Trustee, require the Parties to replace the Trustee; or

    (b) the Seller, with the prior approval of the Commission, may replace the Trustee.

34. If the Trustee is removed according to paragraph 33, the Trustee may be required to continue in its function until a new Trustee is in place to whom the Trustee has effected a full hand over of all relevant information. The new Trustee shall be appointed in accordance with the procedure referred to in paragraphs 18-23.

35. Beside the removal according to paragraph 33, the Trustee shall cease to act as Trustee only after the Commission has discharged it from its duties after all the Commitments with which the Trustee has been entrusted have been implemented. However, the Commission may at any time require the reappointment of the Monitoring Trustee if it subsequently appears that the relevant remedies might not have been fully and properly implemented.

Section F. The Review Clause

36. The Commission may, where appropriate, in response to a request from the Seller showing good cause and accompanied by a report from the Monitoring Trustee:

    (i) Grant an extension of the time periods foreseen in the Commitments, or

    (ii) Waive, modify or substitute, in exceptional circumstances, one or more of the undertakings in these Commitments.

Where the Seller seeks an extension of a time period, it shall submit a request to the Commission no later than one month before the expiry of that period, showing good cause. Only in exceptional circumstances shall the Seller be entitled to request an extension within the last month of any period.

…………………………
duly authorised for and on behalf of
Norsk Hydro ASA

…………………………
duly authorised for and on behalf of
Orkla ASA

SCHEDULE

1. The Divestment Business as operated to date has the following legal and functional structure:

Hydro's Raufoss plant is located at Fabrikkveien, Bygning 232, N-2830 Raufoss, Norway. The plant is part of Hydro Aluminium Profiler AS. Raufoss leases its premises at Raufoss industrial park from Profilanlegg ANS. Hydro Aluminium Profiler AS owns [CONFIDENTIAL]% of the shares in Profilanlegg ANS. The remaining [CONFIDENTIAL]% shareholding of Profilanlegg ANS is owned by Benteler, which also operates a facility on the industrial park. The SAE Divestment Business shall consist of the Raufoss plant and the shareholding in Profilanlegg ANS.

An organisation chart of the Raufoss plant is provided below:

[CONFIDENTIAL]

In addition, at the request of the Purchaser, Hydro's Vetlanda facility located in Sweden will also be divested. Hydro's Vetlanda facility is the entire activity of Hydro Aluminium Profiler AB which is a subsidiary of Hydro Aluminium AS.

An organisation chart of the Vetlanda plant is provided below:

[CONFIDENTIAL]

Three of the internal sales personnel included in this organisation chart are located in Magnor, and one at Raufoss, all employed by Hydro Aluminium Profiler AS. The three located in Magnor will remain with Hydro/the JV and the person in Raufoss will transfer with the Raufoss business.

The working assumption for a transaction structure is that:
(i) the assets and business of the Raufoss plant will be divested from Hydro Aluminium Profiler AS, including its shares in Profilanlegg ANS, and that
(ii) at the request of the Purchaser, Hydro Aluminium AS' shares in Hydro Aluminium Profiler AB will also be divested.

2. Following paragraph 4 of these Commitments, the Divestment Business includes, but is not limited to:

(a) the following main tangible assets:

- the Raufoss plant used for the production of soft-alloy extrusion including all tangible assets and production equipment (all of which is all owned by the Divestment Business) located at Fabrikkveien, Bygning 232, N-2830 Raufoss, Norway, including the three extrusion press lines (6, 8 and 12 inches), an automatic packing line, an anodizing plant and a thermal-break line (which is leased to a subcontractor),

- the shares currently held by Hydro Aluminium Profiler AS in Profilanlegg ANS (representing 74% of Profilanlegg ANS),

- at the request of the Purchaser, the Vetlanda plant including all tangible assets and production equipment (all of which is all owned by the Divestment Business) located at Tomasbaken 6, SE-574 23, Vetlanda, Sweden, including CNC machines, robotized production lines and other fabrication machinery,

- the real estate property on which the Vetlanda plant is located.

(b) the following main intangible assets:

There are no intangible assets such as brand names or intellectual property rights used in conducting the SAE Divestment Business.

(c) the following main licences, permits and authorisations:

Raufoss plant

ISO 14001/2004 certification
Manufacturing permit

Vetlanda plant

ISO 14001/2004 certification
ISO 9001:2008 certification
Environmental protection license Vetlanda County Council
Functional control of Ventilation - Vetlanda County Council

(d) the following main contracts, agreements, leases, commitments and understandings

- the Seller will make its best efforts to transfer the real estate contract lease for the Raufoss plant which is held by Profilanlegg ANS to the Purchaser (Profilanlegg ANS will be majority owned by the Purchaser following Completion),

- make its best efforts to transfer to the Purchaser the existing contracts entered into with die manufacturers for the purpose of die manufacturing for the Raufoss plant,

- make its best efforts to transfer to the Purchaser the existing contract entered into with Benteler Raufoss for the supply of billets.

(e) the following customer, credit and other records: ;

Raufoss plant

All of the customers currently served by the Raufoss plant. [CONFIDENTIAL]. The following is a list of the main customers serviced by Hydro's Raufoss plant to be divested together with the respective turnover generated by each of these customers in 2011:

Customer	Sales (excl VAT) Million EUR	Percentage of Total Turnover	Country

[CONFIDENTIAL]

Vetlanda plant

The two main customers serviced by Hydro's Vetlanda plant to be divested together with the respective turnover generated by each of these customers in 2012 is set out below:

Customer	Sales (excl VAT) Million EUR	Percentage of Total Turnover	Country

[CONFIDENTIAL]

(f) the following Personnel:

Raufoss plant

A list of the personnel working at the Raufoss plant which are part of the SAE Divestment Business is enclosed as Annex 1 [CONFIDENTIAL ANNEX].

Vetlanda plant

A list of the personnel working at the Vetlanda plant, which are, at the request of the Purchaser, a part of the SAE Divestment Business is enclosed as Annex 2 [CONFIDENTIAL ANNEX].

(g) the following Key Personnel:

Business/Sales
[CONFIDENTIAL]

Raufoss
[CONFIDENTIAL]

HAP AB
[CONFIDENTIAL]

A Hold Separate Manager will be appointed by Hydro among the Key Personnel at the Effective Date.

(h) the arrangements for the supply with the following products or services by Seller or Affiliated Undertakings for a transitional period after Closing:

Hydro and its Affiliated Undertakings commit, at the option of the Purchaser of the Divestment Business, to:

- enter into a temporary supply or toll-manufacturing agreement with the Purchaser for the non-exclusive supply or toll-manufacturing of billets on same or similar terms to the supply contract between Hydro Primary Metal and the new Joint Venture which will come into force upon Completion for a term of up to [CONFIDENTIAL],
- enter into a temporary supply agreement for metal price hedging services on terms to be agreed with the Purchaser for a period of up to [CONFIDENTIAL] months,
- enter into a temporary supply agreement for the supply of electricity for the Raufoss and Vetlanda plants (which is currently sourced through a scheme in conjunction with Hydro Energy) on terms to be agreed with the Purchaser for a period of up to [CONFIDENTIAL] months,

- provide to the Purchaser certain support services, namely IT services (including IT software), logistics and customer services (back office) for a period of up to [CONFIDENTIAL] months on terms to be agreed with the Purchaser.

3. The Divestment Business shall not include:

For the sake of clarity and completion, Hydro Aluminium Profiler AS, which owns the Raufoss plant, also has responsibility for a value-added facility in Finland, Hydro Aluminium Salko Oy. The legal owner of Hydro Aluminium Salko Oy is Hydro Aluminium A.S, not Hydro Aluminium Profiler AS. Hydro Aluminium Salko Oy currently sells, fabricates and paints profiles sourced from both the Raufoss and Magnor plants. Hydro Aluminium Salko Oy is part of the business to be retained by the Joint Venture and it is specifically excluded from the commitments.

In addition, Hydro Aluminium Profiler AS also operates a smaller extrusion plant located in Magnor, Norway. This plant which has a 7 inch press as well as anodizing and fabrication capabilities, is to be retained by the Joint Venture and is also specifically excluded from the commitments.

ANNEX 1 […]
ANNEX 2 […]

By hand and by fax: 00 32 2 296 4301
European Commission
DG Competition
Merger Registry
Place Madou / Madouplein 1
1210 Saint-Josse-ten-Noode / Sint-Joost-ten-Node
Belgique / België

Case M. 6756 – Orkla ASA / Norsk Hydro ASA

COMMITMENTS TO THE EUROPEAN COMMISSION

Pursuant to Article 6(2) of Council Regulation (EC) No. 139/2004 as amended (the "***Merger Regulation***"), Orkla ASA ("***Orkla***") and Norsk Hydro ASA ("***Hydro***") (the "***Parties***") hereby provide the following Commitments (the "***MPE Commitments***") in order to enable the European Commission (the "***Commission***") to declare the creation of a full-function joint venture under the joint control of Orkla and Norsk Hydro which will own and operate the soft alloy extrusion businesses of each of Orkla's wholly-owned subsidiary, Sapa Holding AB ("***Sapa***"), and Hydro, including their respective building systems and precision tubing activities, compatible with the common market and the EEA Agreement by its decision pursuant to Article 6(1)(b) of the Merger Regulation of the Merger Regulation (the "***Decision***").

The Parties will provide separate commitments with respect to the divestment of activities related to its soft-alloy extrusion plant in Raufoss (the "***SAE Commitments***").

The MPE Commitments shall take effect upon the date of adoption of the Decision. The scope of the Parties' respective obligations under the MPE Commitments depends on the time at which the divestment will take place: i.e. prior to or post Completion.

This text shall be interpreted in the light of the Decision to the extent that the Commitments are attached as conditions and obligations, in the general framework of Community law, in particular in the light of the Merger Regulation, and by reference to the Commission Notice on remedies acceptable under Council Regulation (EC) No 139/2004 and under Commission Regulation (EC) No 802/2004.

Section A. Definitions

For the purpose of the MPE Commitments, the following terms shall have the following meaning:

"Affiliated Undertakings": undertakings controlled by the Parties and/or by the ultimate parents of the Parties, including the JV, whereby the notion of control shall be interpreted pursuant to Article 3 Merger Regulation and in the light of the Commission Consolidated Jurisdictional Notice under Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings.

"Closing": the transfer of the legal title of the Divestment Business to the Purchaser.

"Completion": the completion of the transaction to create a joint venture between Orkla and Hydro.

"Divestment Business": the business or businesses as defined in Section B and the Schedule that the Parties commit to divest.

"Divestiture Trustee": one or more natural or legal person(s), independent from the Parties, who is approved by the Commission and appointed by the Parties and who has received from the Parties the exclusive Trustee Mandate to sell the Divestment Business to a Purchaser at no minimum price.

"Effective Date": the date of adoption of the Decision.

"First Divestiture Period": the period of [SAPA CONFIDENTIAL] from the Effective Date.

"Hold Separate Manager": the person appointed by the Parties for the Divestment Business to manage the day-to-day business under the supervision of the Monitoring Trustee.

"Hydro": Norsk Hydro ASA incorporated under the laws of Norway, with its registered office at Drammensveien 260, PO Box 980 Skøyen, NO-0240, Oslo, Norway.

"Joint Venture": the proposed joint venture between Orkla and Hydro which the Commission is currently reviewing under Case COMP/M.6756.

"Key Personnel": all personnel necessary to maintain the viability and competitiveness of the Divestment Business, as listed in the Schedule.

"Monitoring Trustee": one or more natural or legal person(s), independent from the Parties, who is approved by the Commission and appointed by the Parties, and who has the duty to monitor the Parties' compliance with the conditions and obligations attached to the Decision.

"MPE": multi-port extrusions, being the products sold by the Divestment Business.

"Orkla": incorporated under the laws of Norway, with its registered office at Karenslyst allé 6, PO Box 423 Skøyen, NO-0213, Oslo, Norway.

"Personnel": all personnel currently employed by the Divestment Business, including Key Personnel, staff seconded to the Divestment Business, shared personnel and the additional personnel listed in the Schedule.

"Purchaser": the entity approved by the Commission as acquirer of the Divestment Business in accordance with the criteria set out in Section D.

"Sapa": Sapa Holding AB, a wholly-owned subsidiary of Orkla, in which all of Orkla's aluminium interests are housed.

"Seller": means Orkla via its Sapa subsidiary, if prior to Completion, or the Joint Venture, if post Completion.

"Trustee(s)": the Monitoring Trustee and the Divestiture Trustee.

"Trustee Divestiture Period": the period of [SAPA CONFIDENTIAL] from the end of the First Divestiture Period.

Section B. The Divestment Business

Commitment to divest

In order to restore effective competition, Seller commits to divest, or procure the divestiture of the Divestment Business by the end of the Trustee Divestiture Period as a going concern to a purchaser and on terms of sale approved by the Commission in accordance with the procedure described in paragraph 15. To carry out the divestiture, Seller commits to find a purchaser and to enter into a final binding sale and purchase agreement for the sale of the Divestment Business within the First Divestiture Period. If Seller has not entered into such an agreement at the end of the First Divestiture Period, Seller shall grant the Divestiture Trustee an exclusive mandate to sell the Divestment Business in accordance with the procedure described in paragraph 23 in the Trustee Divestiture Period.

The Parties shall be deemed to have complied with this commitment if, by the end of the Trustee Divestiture Period, Seller has entered into a final binding sale and purchase agreement, if the Commission approves the Purchaser and the terms in accordance with the procedure described in paragraph 15 and if the closing of the sale of the Divestment Business takes place within a period not exceeding 3 months after the approval of the purchaser and the terms of sale by the Commission.

In order to maintain the structural effect of the Commitments, the Parties shall, for a period of 10 years after the Effective Date, not acquire direct or indirect influence over the whole or part of the Divestment Business, unless the Commission has previously found that the structure of the market has changed to such an extent that the absence of influence over the Divestment Business is no longer necessary to render the proposed concentration compatible with the common market.

Structure and definition of the Divestment Business

The Divestment Business consists of the MPE production facility located in Harderwijk in the Netherlands, currently 100% owned by Sapa. This represents all of Sapa's MPE manufacturing capacity and sales and marketing activity in the EEA. The Divestment Business also includes, at the option of the Purchaser, Sapa's North American Applications Centre, located at Louisville, Kentucky, in the USA, also owned 100% by Sapa. The present legal and functional structure of the Divestment Business as operated to date is described in the Schedule. The Divestment Business, described in more detail in the Schedule, includes

all tangible and intangible assets (including intellectual property rights subject to assignment), which contribute to the current operation or are necessary to ensure the viability and competitiveness of the Divestment Business;

all licences, permits and authorisations issued by any governmental organisation for the benefit of the Divestment Business;

all contracts, leases, commitments and customer orders of the Divestment Business; all customer, credit and other records of the Divestment Business (items referred to under (A)-(C) hereinafter collectively referred to as *Assets*");

the Personnel; and

the benefit, for a transitional period of up to six months after Closing and on terms and conditions equivalent to those at present afforded to the Divestment Business, of all current arrangements under which Orkla or Affiliated Undertakings supply products or services to the Divestment Business, as detailed in the Schedule, unless otherwise agreed with the Purchaser.

Section C. Related commitments

Preservation of Viability, Marketability and Competitiveness

From the Effective Date until Closing, Seller shall preserve the economic viability, marketability and competitiveness of the Divestment Business, in accordance with good business practice, and shall minimise as far as possible any risk of loss of competitive potential of the Divestment Business. In particular Seller undertakes:

not to carry out any act upon its own authority that might have a significant adverse impact on the value, management or competitiveness of the Divestment Business or that might alter the nature and scope of activity, or the industrial or commercial strategy or the investment policy of the Divestment Business;

to make available sufficient resources for the development of the Divestment Business, on the basis and continuation of the existing business plans

to take all reasonable steps, including appropriate incentive schemes (based on industry practice), to encourage all Key Personnel to remain with the Divestment Business.

Hold-separate obligations of Parties

The Seller commits, from the Effective Date until Closing, to keep the Divestment Business separate from the businesses it is retaining and ensure that Key Personnel of the Divestment Business – including the Hold Separate Manager – have no involvement in any business retained and vice versa. Seller shall also ensure that the Personnel do not report to any individual outside the Divestment Business. By derogation from the commitment in this paragraph:

VI.1.1.A the Seller shall be entitled to obtain R&D services from NAAC until the first of Completion or Closing; and

VI.1.1.B the Divestment Business shall, to the extent necessary, be able to obtain the services described in Paragraph 2(I) of the Schedule for the period defined in that paragraph.

Until Closing, Seller shall assist the Monitoring Trustee in ensuring that the Divestment Business is managed as a distinct and saleable entity separate from the businesses retained by it. The Parties shall appoint a Hold Separate Manager who shall be responsible for the management of the Divestment Business, under the supervision of the Monitoring Trustee. The Hold Separate Manager shall manage the Divestment Business independently and in the best interest of the business with a view to ensuring its continued economic viability, marketability and competitiveness and its independence from the businesses retained by the Parties.

Ring-fencing

Seller shall implement all necessary measures to ensure that it does not after the Effective Date obtain any business secrets, know-how, commercial information, or any other information of a confidential or proprietary nature relating to the Divestment Business. In particular, the participation of the Divestment Business in a central information technology network shall be severed to the extent possible, without compromising the viability of the Divestment Business. Seller may obtain information relating to the Divestment Business which is reasonably necessary for the divestiture of the Divestment Business or whose disclosure to Seller is required by law.

Non-solicitation clause

The Parties undertake, subject to customary limitations, not to solicit, and to procure that Affiliated Undertakings do not solicit, the Key Personnel transferred with the Divestment Business for a period of one year after Closing.

Due Diligence

In order to enable potential purchasers to carry out a reasonable due diligence of the Divestment Business, Seller shall, subject to customary confidentiality assurances and dependent on the stage of the divestiture process:

provide to potential purchasers sufficient information as regards the Divestment Business;

provide to potential purchasers sufficient information relating to the Personnel and allow them reasonable access to the Personnel.

Reporting

Seller shall submit written reports in English on potential purchasers of the Divestment Business and developments in the negotiations with such potential purchasers to the Commission and the Monitoring Trustee no later than 10 days after the end of every month following the Effective Date (or otherwise at the Commission's request).

The Parties shall inform the Commission and the Monitoring Trustee on the preparation of the data room documentation and the due diligence procedure and shall submit a copy of an information memorandum to the Commission and the Monitoring Trustee before sending the memorandum out to potential purchasers.

Section D. The Purchaser

In order to ensure the immediate restoration of effective competition, the Purchaser, in order to be approved by the Commission, must:

be independent of and unconnected to the Parties;

have the financial resources, proven expertise and incentive to maintain and develop the Divestment Business as a viable and active competitive force in competition with the Parties and other competitors;

neither be likely to create, in the light of the information available to the Commission, *prima facie* competition concerns nor give rise to a risk that the implementation of the Commitments will be delayed, and must, in particular, reasonably be expected to obtain all necessary approvals from the relevant regulatory authorities for the acquisition of the Divestment Business (the before-mentioned criteria for the purchaser hereafter the "Purchaser Requirements").

The final binding sale and purchase agreement shall be conditional on the Commission's approval. When Seller has reached an agreement with a purchaser, it shall submit a fully documented and reasoned proposal, including a copy of the final agreement(s), to the Commission and the Monitoring Trustee. The Parties must be able to demonstrate to the Commission that the purchaser meets the Purchaser Requirements and that the Divestment Business is being sold in a manner consistent with the Commitments. For the approval, the Commission shall verify that the purchaser fulfils the Purchaser Requirements and that the Divestment Business is being sold in a manner consistent with the Commitments. The Commission may approve the sale of the Divestment Business without one or more Assets or parts of the Personnel, if this does not affect the viability and competitiveness of the Divestment Business after the sale, taking account of the proposed purchaser.

Section E. Trustee

I. Appointment Procedure

The Parties shall appoint a Monitoring Trustee to carry out the functions specified in the Commitments for a Monitoring Trustee. If Seller has not entered into a binding sales and purchase agreement one month before the end of the First Divestiture Period or if the Commission has rejected a purchaser proposed by the Parties at that time or thereafter, they shall appoint a Divestiture Trustee to carry out the functions specified in the Commitments for a Divestiture Trustee. The appointment of the Divestiture Trustee shall take effect upon the commencement of the Trustee Divestment Period.

The Trustee shall be independent of the Parties, possess the necessary qualifications to carry out its mandate, for example as an investment bank or consultant or auditor, and shall neither have nor become exposed to a conflict of interest. The Trustee shall be remunerated by the Parties in a way that does not impede the independent and effective fulfilment of its mandate. In particular, where the remuneration package of a Divestiture Trustee includes a success premium linked to the final sale value of the Divestment Business, the fee shall also be linked to a divestiture within the Trustee Divestiture Period.

Proposal by the Parties

No later than one week after the Effective Date, the Parties shall submit a list of one or more persons whom the Parties propose to appoint as the Monitoring Trustee to the Commission for approval. No later than one month before the end of the First Divestiture Period, the Parties shall submit a list of one or more persons whom they propose to appoint as Divestiture Trustee to the Commission for approval. The proposal shall contain sufficient information for the Commission to verify that the proposed Trustee fulfils the requirements set out in paragraph 16 and shall include:

the full terms of the proposed mandate, which shall include all provisions necessary to enable the Trustee to fulfil its duties under these Commitments;

the outline of a work plan which describes how the Trustee intends to carry out its assigned tasks;

an indication whether the proposed Trustee is to act as both Monitoring Trustee and Divestiture Trustee or whether different trustees are proposed for the two functions.

Approval or rejection by the Commission

The Commission shall have the discretion to approve or reject the proposed Trustee(s) and to approve the proposed mandate subject to any modifications it deems necessary for the Trustee to fulfil its obligations. If only one name is approved, the Parties shall appoint or cause to be appointed, the individual or institution concerned as Trustee, in accordance with the mandate approved by the Commission. If more than one name is approved, the Parties shall be free to choose the Trustee to be appointed from among the names approved. The Trustee shall be appointed within one week of the Commission's approval, in accordance with the mandate approved by the Commission.

New proposal by the Parties

If all the proposed Trustees are rejected, the Parties shall submit the names of at least two more individuals or institutions within one week of being informed of the rejection, in accordance with the requirements and the procedure set out in paragraphs 15 and 18.

Trustee nominated by the Commission

If all further proposed Trustees are rejected by the Commission, the Commission shall nominate a Trustee, whom the Parties shall appoint, or cause to be appointed, in accordance with a trustee mandate approved by the Commission.

II. Functions of the Trustee

The Trustee shall assume its specified duties in order to ensure compliance with the Commitments. The Commission may, on its own initiative or at the request of the Trustee or the Parties, give any orders or instructions to the Trustee in order to ensure compliance with the conditions and obligations attached to the Decision.

Duties and obligations of the Monitoring Trustee

The Monitoring Trustee shall:

propose in its first report to the Commission a detailed work plan describing how it intends to monitor compliance with the obligations and conditions attached to the Decision.

oversee the on-going management of the Divestment Business with a view to ensuring its continued economic viability, marketability and competitiveness and monitor compliance by the Parties with the conditions and obligations attached to the Decision. To that end the Monitoring Trustee shall:

monitor the preservation of the economic viability, marketability and competitiveness of the Divestment Business, and the keeping separate of the Divestment Business from the business retained by the Parties and the Joint Venture, in accordance with paragraphs 5 and 6 of the Commitments;

supervise the management of the Divestment Business as a distinct and saleable entity, in accordance with paragraph 7 of the Commitments;

(i) in consultation with the Parties, determine all necessary measures to ensure that Seller does not after the effective date obtain any business secrets, knowhow, commercial information, or any other information of a confidential or proprietary nature relating to the Divestment Business, in particular strive for the severing of the Divestment Business' participation in a central information technology network to the extent possible, without compromising the viability of the Divestment Business, and (ii) decide whether such information may be disclosed as the disclosure is reasonably necessary to allow Seller to carry out the divestiture or as the disclosure is required by law;

monitor the splitting of assets and the allocation of Personnel between the Divestment Business and Seller or Affiliated Undertakings;

assume the other functions assigned to the Monitoring Trustee under the conditions and obligations attached to the Decision;

propose to the Parties such measures as the Monitoring Trustee considers necessary to ensure the Parties' compliance with the conditions and obligations attached to the Decision, in particular the maintenance of the full economic viability, marketability or competitiveness of the Divestment Business, the holding separate of the Divestment Business and the non-disclosure of competitively sensitive information;

review and assess potential purchasers as well as the progress of the divestiture process and verify that, dependent on the stage of the divestiture process, (a) potential purchasers receive sufficient information relating to the Divestment Business and the Personnel in particular by reviewing, if available, the data room documentation, the information memorandum and the due diligence process, and (b) potential purchasers are granted reasonable access to the Personnel;

provide to the Commission, sending the Parties a non-confidential copy at the same time, a written report within 15 days after the end of every month. The report shall cover the operation and management of the Divestment Business so that the Commission can assess whether the business is held in a manner consistent with the Commitments and the progress of the divestiture process as well as potential purchasers. In addition to these reports, the Monitoring Trustee shall promptly report in writing to the Commission, sending the Parties a non-confidential copy at the same time, if it concludes on reasonable grounds that the Parties are failing to comply with these Commitments;

within one week after receipt of the documented proposal referred to in paragraph 15, submit to the Commission a reasoned opinion as to the suitability and independence of the proposed purchaser and the viability of the Divestment Business after the Sale and as to whether the Divestment Business is sold in a manner consistent with the conditions and obligations attached to the Decision, in particular, if relevant, whether the Sale of the Divestment Business without one or more Assets or not all of the Personnel affects the viability of the Divestment Business after the sale, taking account of the proposed purchaser.

Duties and obligations of the Divestiture Trustee

Within the Trustee Divestiture Period, the Divestiture Trustee shall sell at no minimum price the Divestment Business to a purchaser, provided that the Commission has approved both the purchaser and the final binding sale and purchase agreement in accordance with the procedure laid down in paragraph 14. The Divestiture Trustee shall include in the sale and purchase agreement such terms and conditions as it considers appropriate for an expedient sale in the Trustee Divestiture Period. In particular, the Divestiture Trustee may include in the sale and purchase agreement such customary representations and warranties and indemnities as are reasonably required to effect the sale. The Divestiture Trustee shall protect the legitimate financial interests of the Parties, subject to the Parties' unconditional obligation to divest at no minimum price in the Trustee Divestiture Period.

In the Trustee Divestiture Period (or otherwise at the Commission's request), the Divestiture Trustee shall provide the Commission with a comprehensive monthly report written in English on the progress of the divestiture process. Such reports shall be submitted within 15 days after the end of every month with a simultaneous copy to the Monitoring Trustee and a non-confidential copy to the Parties.

III. Duties and obligations of the Parties

The Parties shall provide and shall cause its advisors to provide the Trustee with all such cooperation, assistance and information as the Trustee may reasonably require to perform its tasks. The Trustee shall have full and complete access to any of the Parties' or the Divestment Business' books, records, documents, management or other personnel, facilities, sites and technical information necessary for fulfilling its duties under the Commitments and the Parties and the Divestment Business shall provide the Trustee upon request with copies of any document. The Parties and the Divestment Business shall make available to the Trustee one or more offices on their premises and shall be available for meetings in order to provide the Trustee with all information necessary for the performance of its tasks.

The Parties shall provide the Monitoring Trustee with all managerial and administrative support that it may reasonably request on behalf of the management of the Divestment Business. This shall include all administrative support functions relating to the Divestment Business which are currently carried out at headquarters level. The Parties shall provide and shall cause its advisors to provide the Monitoring Trustee, on request, with the information submitted to potential purchasers, in particular give the Monitoring Trustee access to the data room documentation and all other information granted to potential purchasers in the due diligence procedure. The Parties shall inform the Monitoring Trustee on possible purchasers, submit a list of potential purchasers, and keep the Monitoring Trustee informed of all developments in the divestiture process.

The Parties shall grant or procure Affiliated Undertakings to grant comprehensive powers of attorney, duly executed, to the Divestiture Trustee to effect the sale, the Closing and all actions and declarations which the Divestiture Trustee considers necessary or appropriate to achieve the sale and the Closing, including the appointment of advisors to assist with the sale process. Upon request of the Divestiture Trustee, the Parties shall cause the documents required for effecting the sale and the Closing to be duly executed.

The Parties shall indemnify the Trustee and its employees and agents (each an "<u>Indemnified Party</u>") and hold each Indemnified Party harmless against, and hereby agrees that an Indemnified Party shall have no liability to the Parties for any liabilities arising out of the performance of the Trustee's duties under the Commitments, except to the extent that such liabilities result from the wilful default, recklessness, gross negligence or bad faith of the Trustee, its employees, agents or advisors.

At the expense of the Parties, the Trustee may appoint advisors (in particular for corporate finance or legal advice), subject to the Parties' approval (this approval not to be unreasonably withheld or delayed) if the Trustee considers the appointment of such advisors necessary or appropriate for the performance of its duties and obligations under the Mandate, provided that any fees and other expenses incurred by the Trustee are reasonable. Should the Parties refuse to approve the advisors proposed by the Trustee the Commission may approve the appointment of such advisors instead, after having heard the Parties. Only the Trustee shall be entitled to issue instructions to the advisors. Paragraph 28 shall apply mutatis mutandis. In the Trustee Divestiture Period, the Divestiture Trustee may use advisors who served the Parties during the Divestiture Period if the Divestiture Trustee considers this in the best interest of an expedient sale.

IV. <u>Replacement, discharge and reappointment of the Trustee</u>

If the Trustee ceases to perform its functions under the Commitments or for any other good cause, including the exposure of the Trustee to a conflict of interest:

the Commission may, after hearing the Trustee, require the Parties to replace the Trustee; or

the Parties, with the prior approval of the Commission, may replace the Trustee.

If the Trustee is removed according to paragraph 30, the Trustee may be required to continue in its function until a new Trustee is in place to whom the Trustee has effected a full hand over of all relevant information. The new Trustee shall be appointed in accordance with the procedure referred to in paragraphs 15-20.

Beside the removal according to paragraph 30, the Trustee shall cease to act as Trustee only after the Commission has discharged it from its duties after all the Commitments with which the Trustee has been entrusted have been implemented. However, the Commission may at any time require the reappointment of the Monitoring Trustee if it subsequently appears that the relevant remedies might not have been fully and properly implemented.

Section F. The Review Clause

The Commission may, where appropriate, in response to a request from the Parties showing good cause and accompanied by a report from the Monitoring Trustee:

Grant an extension of the time periods foreseen in the Commitments, or

Waive, modify or substitute, in exceptional circumstances, one or more of the undertakings in these Commitments.

Where the Parties seek an extension of a time period, it shall submit a request to the Commission no later than one month before the expiry of that period, showing good cause. Only in exceptional circumstances shall the Parties be entitled to request an extension within the last month of any period.

…………….……………

duly authorised for and on behalf of

Orkla ASA

………………….………

duly authorised for and on behalf of

Norsk Hydro ASA

SCHEDULE

The Divestment Business as operated to date has the following legal and functional structure:

The Divestment Business (Sapa's Harderwijk MPE business) is currently part of Sapa Profiles NL B.V. and the assets related to the Divestment Business are mainly held by Sapa Profiles NL B.V. ("**Sapa Profiles**"). Sapa Profiles is 100% owned by Sapa. For a description of the management/organisational structure of Sapa's Harderwijk MPE business, please see below.

In order to facilitate its transfer to the Purchaser, the Divestment Business will be separated through:

a) transfer of the relevant assets and liabilities located at the level of Sapa Profiles and relating to the Divestment Business through a legal demerger (*juridische afsplitsing*) into a newly – by Sapa Profiles - to be incorporated entity ("**Newco**") combined with an asset and liability transfer to Newco of other assets and liabilities located at the level of other Sapa group entities; or

b) individual transfer of all assets and liabilities relating to the Investment Business to an Orkla group company incorporated to that extent or, alternatively, to a third party directly.

The Parties propose that Sapa's North American Application Centre (NAAC) facility in Louiseville, Kentucky in the USA, which currently provides research and development capabilities to the Harderwijk MPE business, will be included within the Divestment Business. The inclusion of the NAAC within the Divestment Business is at the option of the Purchaser.

Following paragraph 4 of these Commitments, the Divestment Business includes, but is not limited to:

the following main tangible assets:

- the physical part of the plant used for the production of MPEs including all production equipment (all of which is all owned by the Divestment Business) located at Industrieweg 15,3846 BB Harderwijk, the Netherlands and the property on which the plant is located. Internal divisions, a separate entrance and goods dock will be constructed at the current plant to allow the current MPE and Sapa general profiles businesses to be operated separately. Outside space for storage of billets, scrap and parking will also be allocated to the Divestment Business. Transfer of interest in the land to the Purchaser will be by sale or long-term lease at market rates, at the option of the Purchaser;

- the principal tangible assets included within the Divestment Business which are required for the manufacture of MPEs are:

    - 1800T 7" press (3500-4000 MT capacity);

    - zinc arc spray equipment;

  - flux coating equipment (2000 MT); and
  - cut-to-length equipment (2 high speed, 2 medium speed, 5 conventional speed).

- The land and premises currently used to house the NAAC facility located at 4301 Produce Road, Louisville, Kentucky, 40218-3099, USA, including all testing and other equipment and other assets located within the NAAC, which are currently owned by Sapa and which are needed to provide the R&D support currently provided to the Harderwijk MPE business, including but not limited to:
  - general metallurgical laboratory services;
  - light optical microscopy;
  - scanning electron microscopy;
  - X-Ray microanalysis;
  - controlled atmosphere brazing furnaces;
  - corrosion testing SWAAT cabinets;
  - prototype flux coating line.
- all other tangible assets which are needed to operate the Divestment Business in the way it is currently operated.

the following main intangible assets:

- Licensed patents in relation to:
  - aluminium alloys with optimum combinations of Formability, Corrosion Resistance and Hot Workability, and Methods of Use;
  - aluminium Alloy with Intergranular Corrosion Resistance, Methods of Manufacturing and its Use; and

  Note that these patents, which relate to NEXCOR technology, are currently licensed by Alcoa to Sapa. Sapa will seek to assign these licences to the Purchaser of the Divestment Business.

- the rights to use the NEXCOR name in relation to products produced by the Divestment Business using the relevant technology.
- all expertise and know-how with regard to R&D projects and pipeline products and developments currently held by the NAAC facility in relation to MPEs supplied by the Divestment Business.

There are no other intangible assets such as brand names or intellectual property rights used in conducting the Divestment Business.

the following main licences, permits and authorisations:

- Quality management system - ISO TS 16949:2009
- Environmental management system – ISO 14001:2004
- WVO license/permit Harderwijk 2004
- Integrated environmental permit
- Permit under the Environmental Management Act; and
- all other licenses, permits and authorisations which are needed to operate the Divestment Business in the way it is currently operated.

the following main contracts, agreements, leases, commitments and understandings:

Suppliers

- all supplier arrangements which are needed to operate the Divestment Business in the way it is currently operated;

Customers

- customer contracts and/or relationships with the following customers:
    - [SAPA CONFIDENTIAL].

the following customer, credit and other records:

- all customer, credit and other records which are needed to operate the Divestment Business in the way it is currently operated will be transferred with the Divestment Business;

the following Personnel:

- the employees working at the Divestment Business plant who fulfil a range of functions including production, manufacture, IT, research and development and Human Resources as set out in more detail in the organisation chart at Annex 1 (Organisation Chart);

the following Key Personnel based at Harderwijk in the Netherlands:

- [SAPA CONFIDENTIAL] (Plant Manager);
- [SAPA CONFIDENTIAL] (Production Manager);

- [SAPA CONFIDENTIAL] (Sales/Marketing Manager);
- [SAPA CONFIDENTIAL] (Financial Controller);
- [SAPA CONFIDENTIAL] (Engineering Manager);
- [SAPA CONFIDENTIAL] (Applications Engineer/Research and Development);
- [SAPA CONFIDENTIAL] (Quality manager);
- [SAPA CONFIDENTIAL] (EHS Manager);
- [SAPA CONFIDENTIAL] (Sales);
- [SAPA CONFIDENTIAL] (Logistics and planning);
- [SAPA CONFIDENTIAL] (Press Engineer);
- [SAPA CONFIDENTIAL] (Die Shop Manager);
- [SAPA CONFIDENTIAL] (Maintenance Manager);
- [SAPA CONFIDENTIAL] (Maintenance Employee);
- [SAPA CONFIDENTIAL] (Maintenance Employee);
- [SAPA CONFIDENTIAL] (Maintenance/Electrical Employee);
- [SAPA CONFIDENTIAL] (Shiftleader);
- [SAPA CONFIDENTIAL] (Shiftleader); and
- all other Personnel needed to operate the Divestment Business in the way it is currently operated;

the employees of the NAAC in the USA are as follows:

- [SAPA CONFIDENTIAL] (Manager)
- [SAPA CONFIDENTIAL] (Applications Engineer)
- [SAPA CONFIDENTIAL] (Materials Specialist)
- [SAPA CONFIDENTIAL] (Laboratory Technician)
- [SAPA CONFIDENTIAL] (Laboratory Assistant)

the arrangements for the supply with the following products or services by Seller or Affiliated Undertakings for a transitional period after Closing to secure the handover of such services:

- IT services, financial back office services, local IT service support, Human Resources and Purchasing support currently provided by Sapa Profiles Harderwijk. These arrangements are uncomplicated and can be easily provided by the Purchaser but Sapa would be willing to provide these services until the transfer to a Purchaser takes place and for an appropriate period to secure the handover of such services;

- the use of certain facilities and capabilities (caustic facilities, air compressors, nitrogen tanks, billet and scrap handling equipment) which are currently shared with Sapa Profiles, until such facilities and capabilities are installed on a standalone basis at the Divestment Business;

- The NAAC currently provides support to Sapa's MPE plants in Harderwijk and in Monterrey (Mexico). The Monterrey MPE plant will continue to receive R&D support and services from NAAC, as it does currently, until either Closing or Completion, whichever happens earlier. After either Closing or Completion has taken place, the Monterrey MPE plant will need to source these services elsewhere.

The Divestment Business shall not include:

Certain members of Sapa Senior Management that currently oversee a number of regional businesses including the Divestment Business. Specifically, the following individuals, who are all based in the USA, will not be included:

- [SAPA CONFIDENTIAL] – Operations Manager for SHET's business worldwide;

- [SAPA CONFIDENTIAL] – HR/EHS Manager for SHET's business worldwide.

The Parties have included within the Divestment Business all the personnel it requires in order to operate and compete effectively as a standalone business.

ANNEX 1 […]

Competition Bureau Canada
Bureau de la concurrence Canada

Enforcement Guidelines

Merger Enforcement Guidelines

Canada

This publication is not a legal document. It contains general information and is provided for convenience and guidance in applying the *Competition Act*.

This publication replaces the following Competition Bureau publications:
Enforcement Guidelines — *Merger Enforcement Guidelines*, September 01, 2004
Bulletin — *Efficiencies in Merger Review*, March 2, 2009

For information on the Competition Bureau's activities, please contact:

Information Centre
Competition Bureau
50 Victoria Street
Gatineau QC K1A 0C9

Tel.: 819-997-4282
Toll free: 1-800-348-5358
TTY (for hearing impaired): 1-800-642-3844
Fax: 819-997-0324
Website: www.competitionbureau.gc.ca

This publication can be made available in alternative formats upon request. Contact the Competition Bureau's Information Centre at the numbers listed above.

This publication is also available online in HTML at:
www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03420.html

Web Services Centre
Industry Canada
C.D. Howe Building
235 Queen Street
Ottawa, ON Canada
K1A 0H5
Email: info@ic.gc.ca

Cat. No. Iu54-41/2011E-PDF
ISBN 978-100-17992-6

2011-10-06

Aussi offert en français sous le titre Fusions – Lignes directrices pour l'application de la loi.

TABLE OF CONTENTS

FOREWORD

The Competition Bureau ("the Bureau") has issued these guidelines to provide general direction on its analytical approach to merger review. The guidelines describe, to the extent possible, how the Bureau analyzes merger transactions. Given that merger law applies to a wide variety of factual circumstances, these guidelines are not applied rigidly. As such, this document sets out the Bureau's general approach to merger review and is not a binding statement of how the analysis is carried out in any particular case. The specific facts of a case, as well as the nature of the information and data available, determine how the Bureau assesses a proposed transaction and may sometimes require methodologies other than those noted here.

Merging parties are encouraged to contact the Bureau at an early stage to discuss proposed transactions, and should obtain appropriate legal advice when contemplating a merger.[1] The final interpretation of the *Competition Act* (the "Act") rests with the Competition Tribunal ("the Tribunal") and the courts.[2]

These guidelines supersede previous merger enforcement guidelines and statements made by the Commissioner of Competition ("the Commissioner") or other Bureau officials. These guidelines also supersede the Bureau's *Bulletin on Efficiencies in Merger Review*. The Bureau may revisit certain aspects of these guidelines in the future based on amendments to the Act, decisions of the Tribunal and the courts, developments in the economic literature and the Bureau's case experience.

PART 1: DEFINITION OF MERGER

1.1 Section 91 of the Act defines a "merger" as "...the acquisition or establishment, direct or indirect, by one or more persons, whether by purchase or lease of shares or assets, by amalgamation or by combination or otherwise, of control over or significant interest in the whole or a part of a business of a competitor, supplier, buyer or other person."

1.21 This definition covers any manner in which control over, or a significant interest in, the whole or a part of a business of another person is acquired or established.[3] While these guidelines focus primarily on mergers of firms that supply competing products (horizontal mergers), section 91 also captures mergers of firms that do not compete (non-horizontal mergers, addressed in Part 11, below).

1 See also the Bureau's *Merger Review Process Guidelines*, *Procedures Guide for Notifiable Transactions and Advance Ruling Certificates under the* Competition Act and *Fee and Service Standards Handbook for Mergers and Merger-Related Matters*.

2 *Competition Act*, R.S.C. 1985, c. C-34.

3 As outlined in the Bureau's Competitor Collaboration Guidelines, paragraph 1.2(*a*), a transaction that does not fall within the definition of "merger" may in some instances be subject to review under the civil provision in section 90.1 of the Act. Parties who are uncertain as to whether an agreement will be assessed as a merger or a competitor collaboration are encouraged to consult the *Competitor Collaboration Guidelines* and to contact the Bureau at the earliest opportunity to discuss how the Bureau is likely to assess such an agreement if pursued.

Control

1.3 Acquisition of control constitutes a merger under section 91. With respect to corporations, section 2(4) of the Act defines "control" to mean *de jure* (legal) control—that is, a direct or indirect holding of more than 50 percent of the votes that may be cast to elect directors of the corporation, and which are sufficient to elect a majority of such directors. With respect to partnerships, section 2(4) provides that a partnership is controlled by a person when the person holds an interest in the partnership that entitles the person to receive more than 50 percent of the profits of the partnership or more than 50 percent of its assets on dissolution.

Significant Interest

1.4 The Act does not define what constitutes a "significant interest," as referenced in section 91, leaving this concept to be construed within the broader context of the Act as a whole.

1.5 When determining whether an interest is significant, the Bureau considers both the quantitative nature and qualitative impact of the acquisition or establishment of the interest. Given that the Act is concerned with firms' competitive market behaviour, a "significant interest" in the whole or a part of a business is held qualitatively when the person acquiring or establishing the interest (the "acquirer") obtains the ability to materially influence the economic behaviour of the target business, including but not limited to decisions relating to pricing, purchasing, distribution, marketing, investment, financing and the licensing of intellectual property rights.

1.6 The factors that may be relevant to the Bureau's analysis of whether a particular minority shareholding, an interest in a combination, agreement or other relationship or interest confers material influence (as per paragraph 1.5) include the following:

- voting rights attached to the acquirer's shareholdings or interest in a combination;
- the status of the acquirer of partnership interests (e.g., general or limited partner) and the nature of the rights and powers attached to the partnership interest;
- the holders and distribution of the remaining shares or interests (whether the target business is widely or closely held, and whether the acquirer will be the largest shareholder);
- board composition[4] and board meeting quorum, attendance and historical voting patterns (whether the acquirer will be able to carry or block votes in a typical meeting);
- the existence of any special voting or veto rights attached to the acquirer's shares or interests (e.g., the extent of shareholder approval rights for non-ordinary-course transactions);
- the terms of any shareholder or voting agreements;

4 This includes both the total number of directors and the number of directors who are the acquirer's nominees.

- the dividend or profit share of the minority interest as compared to the acquirer's equity ownership share;
- the extent, if any, of the acquirer's influence over the selection of management or of members of key board committees;
- the status and expertise of the acquirer relative to that of other shareholders;
- the services (management, advisory or other) the acquirer is providing to the business, if any;
- the put, call or other liquidity rights, if any, that the acquirer has and may use to influence other shareholders or management;
- the access the acquirer has, if any, to confidential information about the business; and
- the practical extent to which the acquirer can otherwise impose pressure on the business's decision-making processes.

It is generally the combination of factors – not the presence or absence of a single factor – that is determinative in the Bureau's assessment of material influence.

Notifiable Transactions

1.7 In the absence of any evidence to the contrary, the Bureau presumes that notifiable transactions described in Part IX of the Act constitute the acquisition or establishment of a significant interest in the whole or a part of a business. A transaction is notifiable where the relevant transaction-size and party-size thresholds are exceeded and, in the case of a share acquisition[5], where the shareholding threshold (voting interest of more than 35% for a private corporation or more than 20% for a public corporation) is also exceeded.

Share Acquisitions

1.8 Share acquisitions (whether or not they are notifiable) fall within the scope of section 91 when the acquirer obtains the ability to materially influence the economic behaviour of a business by purchasing shares or other securities. When assessing whether a particular minority shareholding confers material influence, the Bureau conducts a case-by-case analysis of the relationship between the acquirer and the target business, and of the various mechanisms through which the acquirer might exercise influence.

1.9 In the case of *voting shares*, the Bureau considers that a significant interest in a corporation exists when one or more persons directly or indirectly hold enough voting shares

5 Where the transaction involves the acquisition of an interest in a combination, a further threshold also applies. Such a transaction will be notifiable only if the person or persons acquiring the interest, together with their affiliates, would be entitled to receive more than 35% of the profits of the combination (more than 50% if they are already entitled to more than 35%), or 35% of its assets on dissolution (more than 50% if they are already entitled to more than 35%).

- to obtain a sufficient level of representation on the board of directors to materially influence that board, with reference to the factors outlined in paragraph 1.6 and any other relevant factors; or
- to block special or ordinary resolutions of the corporation.

1.10 The Bureau will also consider whether voting shares give the person or persons who hold them the ability to exercise material influence through other mechanisms, with reference to the factors outlined in paragraph 1.6 and any other relevant factors. In the absence of other relationships, direct or indirect ownership of less than 10 percent of the voting interests in a business does not generally constitute ownership of a significant interest.[6] While inferences about situations that result in a direct or indirect holding of between 10 percent and 50 percent of voting interests are more difficult to draw, a larger voting interest is ordinarily required to materially influence a private company than a widely held public company. The merger notification requirements in Part IX of the Act, referred to in paragraph 1.7 above, are triggered at a voting interest of more than 35 percent for private corporations and of more than 20 percent for public corporations.[7]

1.11 When a transaction involves the purchase of *non-voting* shares,[8] the Bureau examines whether the holder of the minority interest can materially influence the economic behaviour of the business despite its inability to vote its shares, with reference to the factors outlined in paragraph 1.6 and any other relevant factors.

1.12 In the case of *convertible securities* or *options*, a significant interest may be acquired or established when these securities are first purchased or created, or at the time they are converted or exercised.[9] To determine whether a purchase constitutes a significant interest, the Bureau examines the nature of and circumstances in which the rights (or potential rights) attached to these securities may be exercised, and the influence that the acquirer may possess through their exercise, or threat of exercise, with reference to the factors outlined in paragraph 1.6 and any other relevant factors.

6 This position is consistent with other Canadian statutes. See, for example, *Bank Act*, S.C. 1991, c. 46, s. 8. (See also *Cooperative Credit Associations Act*, S.C. 1991, c. 48, s. 9; *Insurance Companies Act*, S.C. 1991, c. 47, s. 8; and *Trust and Loan Companies Act*, S.C. 1991, c. 45, s. 8.) The Bureau typically requires disclosure of all holdings that account for 10 percent or more of the voting interests in a business, and may seek information respecting other minority holdings in the course of a merger review.

7 The pre-merger notification provisions are discussed in the Bureau's *Procedures Guide for Notifiable Transactions and Advance Ruling Certificates under the* Competition Act and the *Interpretation Guidelines for Notifiable Transactions under Part IX of the* Competition Act.

8 When *non-voting* shares are convertible (for example, into voting shares), they will also be assessed under paragraph 1.12.

9 A convertible security is a bond, debenture, preferred share or other security that may be exchanged by the owner, usually for common shares of the same company, in accordance with specified conversion terms. An option is a right to buy or sell specific securities or properties at a specified price within a specified time.

Asset Acquisitions

1.13 Asset transactions (whether or not they are notifiable) that generally fall within the scope of section 91 include the purchase or lease of an unincorporated division, plant, distribution facilities, retail outlet, brand name or intellectual property rights from the target company. The Bureau treats the acquisition of any of these essential assets, in whole or in part, as the acquisition or establishment of a significant interest in that business. Further, acquiring a subset of the assets of a business that is capable of being used to carry on a separate business is also considered to be the acquisition or establishment of a significant interest in the business.

Increasing an Existing Interest in a Business

1.14 Persons already holding a significant interest in the whole or a part of a business may trigger the merger provisions of the Act by acquiring or establishing a materially greater ability to influence the economic behaviour of the business.

Interlocking Directorates

1.15 An interlocking directorate may arise where a director of one firm is an employee, executive, partner, owner or member of the board of directors of a second firm, or has another interest in the business of the second firm. An interlocking directorate is generally of interest under section 92 of the Act only when the interlocked firms are competitors, are vertically related, or produce complementary or related products.

1.16 Interlocking directorates may be features of transactions that otherwise qualify as mergers. For example, an interlock results from the merger of firms A and B when an executive of A sits on the board of firm C, and C competes with B. Interlocking directorates may be features of minority interest transactions; for example, a firm that acquires a minority interest in its competitor may also obtain rights to nominate one or more directors to its competitor's board. An interlocking directorate would rarely qualify, in and of itself, as the establishment of a significant interest.

1.17 When assessing whether an interlocked director has the ability to materially influence the economic behaviour of the interlocked firm(s), the Bureau's focus is typically on the access that an interlocked director has to confidential information, and on the director's voting and veto rights in the context of the board composition, quorum and voting rules, including attendance and historical voting patterns.

Other Considerations

1.18 A significant interest can be acquired or established under shareholder agreements, management contracts, franchise agreements and other contractual arrangements involving corporations, partnerships, joint ventures, combinations and other entities, depending on the terms of the arrangements. In addition, loan, supply and distribution arrangements that are not ordinary-course transactions and that confer the ability to materially influence the economic behaviour of the target business (for example, financing arrangements and terms of default relating to such arrangements; long-term contractual arrangements or pre-existing long-term business relationships) may constitute a merger within the meaning of section 91.

1.19 When determining whether an acquisition or establishment of a significant interest constitutes a merger, the Bureau examines the relationship between the parties prior to the transaction or event establishing the interest, the likely subsequent relationship between the parties, the access that an acquirer has and obtains to confidential business information of the target business, and evidence of the acquirer's intentions to affect the behaviour of that business.

PART 2: THE ANTI-COMPETITIVE THRESHOLD

Overview

2.1 As set out in section 92(1) of the Act, the Tribunal may make an order when it finds that a merger "prevents or lessens, or is likely to prevent or lessen, competition substantially." A substantial prevention or lessening of competition results only from mergers that are likely to create, maintain or enhance the ability of the merged entity, unilaterally or in coordination with other firms, to exercise market power.

2.2 In general, when evaluating the competitive effects of a merger, the Bureau's primary concerns are price and output. The Bureau also assesses the effects of the merger on other dimensions of competition, such as quality, product choice, service, innovation and advertising—especially in markets in which there is significant non-price competition. To simplify the discussion, unless otherwise indicated, the term "price" in these guidelines refers to all aspects of firms' actions that affect the interests of buyers. References to an increase in price encompass an increase in the nominal price, but may also refer to a reduction in quality, product choice, service, innovation or other dimensions of competition that buyers value.

2.3 These guidelines describe the analytical framework for assessing market power from the perspective of a seller of a product or service ("product," as defined in section 2(1) of the Act). Market power of sellers is the ability of a firm or group of firms to profitably maintain prices above the competitive level for a significant period of time. The jurisprudence establishes that it is the *ability* to raise prices, not whether a price increase is likely, that is determinative.

2.4 The Bureau also applies this analytical framework to its assessment of the market power of the buyers of a product. Market power of buyers is the ability of a single firm (monopsony power) or a group of firms (oligopsony power)[10] to profitably depress prices paid to sellers (by reducing the purchase of inputs, for example) to a level that is below the competitive price for a significant period of time. Part 9, below, sets out the Bureau's approach to situations of monopsony power.

10 Oligopsony power occurs where market power in the relevant purchasing market is exercised by a coordinated group of buyers. Except where otherwise indicated in these guidelines, the term "monopsony" includes situations of oligopsony.

2.5 The Bureau analyzes competitive effects under two broad headings: unilateral exercise of market power and coordinated exercise of market power. The same merger may involve both a unilateral and a coordinated exercise of market power.

2.6 A unilateral exercise of market power can occur when a merger enables the merged firm to profitably sustain higher prices than those that would exist in the absence of the merger, without relying on competitors' accommodating responses.

2.7 A coordinated exercise of market power can occur when a merger reduces the competitive vigour in a market by, for example, removing a particularly aggressive competitor or otherwise enabling or enhancing the ability of the merged firm to coordinate its behaviour with that of its competitors. In these situations, higher post-merger prices are profitable and sustainable because other competitors in the market have accommodating responses.

2.8 When a merger is not likely to have market power effects, it is generally not possible to demonstrate that the transaction will likely prevent or lessen competition substantially, even though the merger might have implications for other industrial policy objectives that are beyond the scope of the Act.

Lessening of Competition

2.9 A merger may substantially lessen competition when it enables the merged firm, unilaterally or in coordination with other firms, to sustain materially higher prices than would exist in the absence of the merger by diminishing existing competition. This typically occurs with horizontal mergers when there is direct or existing overlap between the operations of the merging firms. This can also occur with non-horizontal mergers, such as those that foreclose rivals from accessing inputs to production.

Prevention of Competition

2.10 Competition may be substantially prevented when a merger enables the merged firm, unilaterally or in coordination with other firms, to sustain materially higher prices than would exist in the absence of the merger by hindering the development of anticipated future competition. This typically occurs when there is no or limited direct overlap between the merging firms' existing businesses, but direct competition between those businesses was expected to develop or increase in the absence of the merger. It may also occur when there is direct overlap between the merging parties' existing business(es) and the competitive effectiveness of one of the merging firms was expected to increase absent the merger, for example, because of the introduction of an improved product.

2.11 In these circumstances, the Bureau examines whether, absent the merger, timely entry or expansion[11] by either of the merging firms would likely occur on a sufficient scale and with sufficient scope to prevent incumbents from exercising market power.[12] "Timely"

11 Throughout these guidelines, the term "entry" also refers to expansion by existing firms.

12 The terms "timely," "likely" and "sufficient" are discussed in further detail in Part 7, below.

means that such entry would have occurred within a reasonable period of time, given the characteristics and dynamics of the market in question.[13] "Likely" refers to the expectation that entry by one of the merging firms would occur. The Bureau also considers whether effective entry by rival firms is likely, and the impact of such rival entry or expansion on prices. "Sufficient" means that, in the absence of the merger, entry by one of the merging firms would have caused prices to materially decrease. It also encompasses a scenario in which the threat of such entry has prevented a material price increase from occurring. The Bureau may examine a merger in terms of prevention of competition when the merger forestalls the entry plans of the acquirer, the target or a potential competitor, or when the merger removes independent control of capacity or an asset that provides or was likely to provide an important source of competitive discipline.

2.12 The following are examples of mergers that may result in a substantial prevention of competition:

- the acquisition of a potential entrant or of a recent entrant that was likely to expand or become a more vigorous competitor;
- an acquisition by the market leader that pre-empts a likely acquisition of the same target by a competitor;
- the acquisition of an existing business that would likely have entered the market in the absence of the merger;
- an acquisition that prevents expansion into new geographic markets;
- an acquisition that prevents the pro-competitive effects associated with new capacity; and
- an acquisition that prevents or limits the introduction of new products.

Substantiality

2.13 When the Bureau assesses whether a merger is likely to prevent or lessen competition substantially, it evaluates whether the merger is likely to provide the merged firm, unilaterally or in coordination with other firms, with the ability to materially influence price. The Bureau considers the likely magnitude and duration of any price increase that is anticipated to follow from the merger. Generally speaking, the prevention or lessening of competition is considered to be "substantial" in two circumstances:

- the price of the relevant product(s) would likely be materially higher in the relevant market than it would be in the absence of the merger ("material price increase"); and
- sufficient new entry would not occur rapidly enough to prevent the material price increase, or to counteract the effects of any such price increase.

13 Since the harm occasioned by a merger that substantially prevents competition may be sustained over the long term, the Bureau may consider longer time frames when assessing the effects of a prevention of competition than it does when assessing post-merger entry (see Part 7, below).

2.14 The Bureau does not consider a numerical threshold for the material price increase.[14] Instead, it bases its conclusions about whether the prevention or lessening of competition is substantial on an assessment of market-specific factors that could have a constraining influence on price following the merger. Additionally, where the merging firms, individually or collectively, have pre-existing market power, smaller impacts on competition resulting from the merger will meet the test of being substantial.

PART 3: ANALYTICAL FRAMEWORK

3.1 In determining whether a merger is likely to create, maintain or enhance market power, the Bureau must examine the competitive effects of the merger. This exercise generally involves defining the relevant markets and assessing the competitive effects of the merger in those markets. Market definition is not necessarily the initial step, or a required step, but generally is undertaken. The same evidence may be relevant and contribute to both the definition of relevant markets and the assessment of competitive effects. Merger review is often an iterative process in which evidence respecting the relevant market and market shares is considered alongside other evidence of competitive effects, with the analysis of each informing and complementing the other.

3.2 The overall objective of market definition in merger analysis is to identify the set of products that customers consider to be substitutes for those produced by the merging firms and the set or sets of buyers that could potentially face increased market power owing to the merger. Market definition, and the measurement of market share and concentration in the relevant market, is not an end in itself. Consistent with this, section 92(2) of the Act precludes the Tribunal from concluding that a merger is likely to prevent or lessen competition substantially solely on the basis of evidence of concentration or market share. The ultimate inquiry is not about market definition, which is merely an analytical tool – one that defies precision and can thus vary in its usefulness – to assist in evaluating effects. Rather, the ultimate inquiry is about whether a merger prevents or lessens competition substantially. That said, when reviewing a merger, market definition generally sets the context for the Bureau's assessment of the likely competitive effects of a merger.

3.3 In some cases, it may be clear that a merger will not create, preserve or enhance market power under any plausible market definition. Alternatively, it may be clear that anti-competitive effects would result under all plausible market definitions. In both such circumstances, the Bureau need not reach a firm conclusion on the precise metes and bounds of the relevant market(s). Additionally, when a completed merger has resulted in a material price increase, the Bureau may rely on evidence of that increase, taking into account other relevant factors. Cases may also arise in which the choice among several plausible market definitions may have a significant impact on

14 A material price increase is distinct from (and will generally be less than) the "significant and non-transitory price increase" that is used to define relevant markets, as described in Part 4, below. What constitutes a "materially greater" price varies with the industry and the context. For purposes of the statement above, materiality includes not only the magnitude and scope but also the sustainability of the price increase.

market share. In such cases, there may be a greater need for evidence regarding likely competitive effects that is not based on market share and concentration. While the Bureau may elect not to define markets in cases in which other reliable evidence of competitive effects is available, the Bureau will normally identify one or more relevant markets in which competition is prevented or lessened, in any merger enforcement action.

3.4 Section 93 of the Act sets out a non-exhaustive list of discretionary factors that the Tribunal may consider when determining whether a merger prevents or lessens competition substantially, or is likely to do so.[15] These factors, which are largely qualitative, may be relevant to the Bureau's assessment of market definition or of the competitive effects of a merger, or both. These factors are discussed in detail in Parts 4 and 6, below.[16]

3.5 The Bureau may also assess competitive effects from a quantitative perspective using various economic tools. The Bureau has discretion in determining which economic and other analytical tools it uses in particular cases. As the economic tools evolve, so will the Bureau's analytical approach.

3.6 The tools the Bureau uses to assess competitive effects also depend heavily on the facts of each case as well as on the availability of qualitative and quantitative evidence. Qualitative evidence may come from documents created by the merging parties in the ordinary course of business or from first-hand observations of the industry by customers or other market participants. Quantitative evidence may be derived from statistical analyses of price, quantity, costs or other data maintained by the merging parties and/or third parties. In all cases, the Bureau assesses the reliability, robustness and probative value of the evidence gathered.

15 Section 93 provides that the Tribunal "may" have regard to the listed factors, while section 93(*h*) permits the Tribunal to consider any other relevant factor. The Bureau does not consider the section 93 factors in a linear fashion. Rather, these factors form part of the analysis of competitive effects, to the extent they are relevant in a particular case. The Bureau encourages parties in their submissions to focus only on the factors and evidence that are relevant to the assessment of the impact of their merger on competition, rather than to treat the section 93 factors as a "checklist" to address in every case.

16 See also Part 7 on barriers to entry (section 93(*d*)) and Part 13 on "failing firm" (section 93(*b*)).

PART 4: MARKET DEFINITION

Overview

4.1 When the Bureau assesses relevant markets, it does so from two perspectives: the product dimension and the geographic dimension. As a general principle, the Bureau does not assume that the merging parties operate in the same relevant market(s), even when there appears to be some overlap between their products and the geographic areas in which they conduct business. In addition, the relevant market(s) being analyzed for competitive effects may not necessarily correspond to the product categories or service areas established by the merging firms or their rivals for operational purposes.

4.2 Market definition is based on substitutability, and focuses on demand responses to changes in relative prices after the merger. The ability of a firm or group of firms to raise prices without losing sufficient sales to make the price increase unprofitable ultimately depends on buyers' willingness to pay the higher price.[17] The ability of competitive suppliers to respond to a price increase is also important when assessing the potential for the exercise of market power, but the Bureau examines such responses later in the analysis—either when identifying the participants in the relevant market or when examining entry into the relevant market.

4.3 Conceptually, a relevant market is defined as the smallest group of products, including at least one product of the merging parties, and the smallest geographic area, in which a sole profit-maximizing seller (a "hypothetical monopolist") would impose and sustain a small but significant and non-transitory increase in price ("SSNIP") above levels that would likely exist in the absence of the merger.[18] In most cases, the Bureau considers a five percent price increase to be significant and a one-year period to be non-transitory. Market characteristics may support using a different price increase or time period.

4.4 The market definition analysis begins by postulating a candidate market for each product of the merging parties. For each candidate market, the analysis proceeds by determining whether a hypothetical monopolist controlling the group of products in that candidate market would profitably impose a SSNIP, assuming the terms of sale of all other products remained constant.[19] If the price increase would likely cause buyers to switch their purchases to other products in sufficient quantity to render the price increase unprofitable, the postulated candidate market is not the relevant market, and the next-best substitute is added to the candidate market.[20] The analysis

17 The Bureau typically considers product and geographic substitutes that are included in a single relevant market to be "acceptable" within the meaning of section 93(*c*) of the Act. When products within a relevant market are differentiated, some may be closer substitutes than others.

18 A market may consist of a single homogeneous product or a group of differentiated products.

19 Changes in terms of sale of other products in response to the merger are accounted for in the analysis of competitive effects and entry.

20 The next-best substitute is the product that would account for the greatest diversion in demand by buyers

then repeats by determining whether a hypothetical monopolist controlling the set of products in the expanded candidate market would profitably impose a SSNIP. This process continues until the point at which the hypothetical monopolist would impose and sustain the price increase for at least one product of the merging parties in the candidate market. In general, the smallest set of products in which the price increase can be sustained is defined as the relevant product market.

4.5 The same general approach applies to assessing the geographic scope of the market. In this case, an initial candidate market is proposed for each location where a merging party produces or sells the relevant products. As above, if buyers are likely to switch their purchases to sellers in more distant locations in sufficient quantities to render a SSNIP by a hypothetical monopolist unprofitable, the location that is the next-best substitute is added to the candidate market. This process continues until the smallest set of areas over which a hypothetical monopolist would impose and sustain the price increase is identified.

4.6 The base price used to postulate a price increase is typically the prevailing price in the relevant market. The Bureau may elect not to use the prevailing price when market conditions (absent the merger) would likely result in a lower or higher price in the future.[21]

4.7 In general, the base price used to postulate a price increase is whatever is ordinarily considered to be the price of the product in the sector of the industry (e.g., manufacturing, wholesale, retail) being examined.

4.8 In some circumstances, sellers may identify and charge different prices to various targeted sets of buyers ("price discrimination"). Sellers are able to price discriminate when targeted buyers cannot effectively switch to other products or geographic locations, and cannot engage in arbitrage with other buyers by taking advantage of price differences. When price discrimination is feasible, it may be appropriate to define relevant markets with reference to the characteristics of the buyers who purchase the product (assuming they can be delineated) or to the particular locations of the targeted buyers.

4.9 The factors the Bureau considers when analyzing the product and geographic dimensions of market definition are set out below.

---

in response to the postulated price increase, assuming that the product is available in unlimited quantities at constant prices.

21 When the evidence suggests a change in the future price (absent the merger) can be predicted with confidence, the Bureau may delineate markets based on the likely future price, even when that future price cannot be predicted precisely.

Product Market Definition

4.10 For the purpose of product market definition, what matters is not the identity of sellers, but the characteristics of the products and buyers' ability or willingness to switch from one product to another in response to changes in relative prices.[22] A relevant product market consists of a given product of the merging parties and all substitutes required for a SSNIP to be profitable.

4.11 When detailed data on the prices and quantities of the relevant products and their substitutes are available, statistical measures may be used to define relevant product markets. Demand elasticities indicate how buyers change their consumption of a product in response to changes in the product's price (own-price elasticity) or in response to changes in the price of another identified product (cross-price elasticity). While cross-price elasticities do not in themselves directly measure the ability of a firm to profitably raise prices, they are particularly useful when determining whether differentiated products are substitutes for one another and whether such products are part of the same relevant market.

4.12 Whether or not reliable statistical evidence on demand elasticities is available, the Bureau considers factors that provide evidence of substitutability, including evidence from market participants and the functional indicators highlighted below.

4.13 The views, strategies and behaviour of buyers are often reliable indicators of whether buyers would likely switch to other products in response to a SSNIP. For example, the Bureau examines what buyers have done in the past and what they are likely to do in the future as options become available, for instance, through advances in technology. Information from industry surveys and industry participants, such as competitors and manufacturers of the relevant product, is also taken into account. This information advances the analysis by providing details on historical developments (including the past behaviour of the merging parties and their rivals) and likely future developments in the industry. Pre-existing documents prepared by the merging parties in the ordinary course of business can also be very useful in this regard.

4.14 Various functional indicators help to determine what products are considered substitutes, including end use, physical and technical characteristics, price relationships and relative price levels, as well as buyer switching costs, as discussed below. Buyers may not view products purchased for similar end uses as substitutes. Therefore, functional interchangeability is not sufficient to warrant inclusion of two products in the same relevant market. In general, when buyers place a high value on the actual or perceived unique physical or technical characteristics of a product (including warranties, post-sales service and order turnaround time), it may be necessary to define distinct relevant markets based on these characteristics.

22 In this context, switching refers to "economic substitutability," defined as a change in consumption patterns in response to a price change, holding all other factors constant.

4.15 Switching costs may discourage a sufficient number of buyers from purchasing products that are functionally interchangeable, thereby allowing a hypothetical monopolist to impose a SSNIP. Products are not included in the same relevant market when costs that must be incurred by buyers are sufficient to render switching unlikely in response to a SSNIP. Examples include costs for buyers to retool, re-package, undertake product testing, adapt marketing materials and strategies, terminate a supply contract, learn new procedures or convert essential equipment. Other costs include the expense (and risk) buyers must incur when a product fails to satisfy expectations, which may damage a buyer's reputation as a reseller, or require the shutdown of a production line.

4.16 A relevant market may consist of a group of diverse products that are not themselves substitutes for each other. This occurs when a sole profit-maximizing seller would increase the price of the group of products because a sufficient number of buyers would not respond to the price increase by purchasing the various components separately from different sellers. This reaction may occur when there are significant transaction costs associated with using a number of sellers, including transportation costs and the time required to negotiate with multiple sellers. In these circumstances, the Bureau's examination includes an assessment of these transaction costs, as well as buyers' propensity to purchase a number of products from a single seller and the extent to which they have in the past broken up their purchases of a group of products in response to relative price changes.

Geographic Market Definition

4.17 For the purpose of geographic market definition, what matters is not the identity of the sellers, but buyers' ability or willingness to switch their purchases in sufficient quantity from suppliers in one location to suppliers in another, in response to changes in relative prices. A relevant geographic market consists of all supply points that would have to be included for a SSNIP to be profitable, assuming that there is no price discrimination (as described in paragraph 4.8 above). When price discrimination is present (and buyers and third parties are unable to arbitrage between low and high price areas), geographic markets are defined according to the location of each targeted group of buyers.

4.18 When defining the boundaries of geographic markets, the Bureau generally relies on evidence of substitutability, including evidence from market participants and the functional indicators described below and, when available, empirical analysis.

4.19 The views, strategies and behaviour of buyers in a given geographic area are often reliable indicators of whether buyers would likely switch their purchases to sellers located in other geographic areas in the event of a SSNIP. For example, the Bureau examines what buyers have done in the past and what they are likely to do in the future as options become available through, for instance, advances in technology. Industry surveys and the views, strategies and behaviour of industry participants also inform the analysis by providing information on how buyers of a relevant product in one geographic area respond or have responded to changes in the price, packaging or servicing of the relevant product in another geographic area. The extent to which merging parties and other sellers take distant sellers into account in their business plans, marketing strategies and other documentation can also be a useful indicator for geographic market definition.

4.20 Various functional indicators can assist in determining whether geographic areas are considered to be substitutes, including particular characteristics of the product, switching costs, transportation costs, price relationships and relative price levels, shipment patterns and foreign competition.

4.21 Several price and non-price factors could affect buyers' ability or willingness to consider distant options. Non-price factors include the fragility or perishability of the relevant product, convenience, frequency of delivery, and the reliability of service or delivery.

4.22 As with product market definition, high switching costs may discourage buyers from substituting between geographic areas. In addition, transportation costs play a central role in defining the geographic scope of relevant markets because they directly affect price. For example, when the price of the relevant product in a distant area plus the cost of transporting it to a candidate geographic market exceeds the price in the candidate market including a SSNIP, the relevant market does not generally include the products of sellers located in the distant area.[23]

4.23 Evidence that prices in a distant area have historically either exceeded or been lower than prices in the candidate geographic market by more than the transportation costs may indicate that the two areas are in separate relevant markets, for reasons that go beyond transportation costs.[24] However, before reaching this conclusion, the Bureau determines whether a SSNIP in the candidate geographic market may change the pricing differential to the point that distant sellers may be able to constrain a SSNIP.

4.24 Significant shipments of the relevant product from a distant area into an area in which a price increase is being postulated may suggest that the distant area is in the relevant geographic market. However, pre-merger shipment patterns do not, by themselves, establish the constraining effect of distant sellers and may be insufficient to justify broadening the geographic market. The Bureau undertakes further analysis to determine whether shipments from the distant area would make the SSNIP unprofitable.

23 However, distant firms that have excess capacity may in certain circumstances be willing to ship to another market, even when the net price received is less than the price in their own market.

24 For example, the existence of tariffs or other trade-related factors may create price differentials.

Foreign Competition

4.25 Buyers' willingness or ability to turn to foreign sellers may be affected by buyers' tastes and preferences, and by border-related considerations. Buyers may be less willing or able to switch to foreign substitutes when faced with factors such as exchange rate risk, local licensing and product approval regulations, industry-imposed standards, or initiatives to "buy local" owing to difficulties or uncertainties when crossing the border. Conversely, buyers may be more willing to turn to foreign substitutes when they have ample information about foreign products and how to source them, when foreign sellers or their products have already been placed on approved sourcing lists, or when technology licensing agreements, strategic alliances or other affiliations exist between domestic buyers and foreign firms.

4.26 When it is clear that the sales area of the merging parties and that of foreign sellers both belong in the relevant market (because sufficient buyers would be willing to respond to a SSNIP by turning to these sellers), the boundaries of the market are expanded beyond Canada to include the locations of foreign sellers.[25]

Delineating Geographic Boundaries

4.27 The geographic locations of buyers and sellers are relevant to delineating boundaries, particularly when markets are local or regional in nature. The underlying assumption is that profit-maximizing firms make decisions about where to locate based on the density of their buyer base and try to avoid cannibalizing their own sales when they have two or more locations in close proximity. In this way, demand responses are still key determinants of market boundaries. The Bureau may use spatial competition analysis to help delineate the boundaries of localized geographic markets.[26] The methodology for applying spatial competition analysis depends on the characteristics of the industry and the market under consideration.

4.28 It is important to emphasize that market boundaries in respect of either product or geographic markets are not precise in many instances. In addition, constraints on a merged firm's pricing behaviour can come from both inside and outside the relevant market as defined. These issues are discussed further below.

---

25 See section 93(*a*) of the Act. In addition to its relevance to market definition, the extent to which foreign products or foreign competitors provide or are likely to provide effective competition is evaluated in the context of the analysis described in Parts 5, 6 and 7, below.

26 When using spatial competition analysis, the Bureau identifies all locations (such as stores, branches, hubs and outlets) of both the merging parties and their product market competitors, to determine how firms' physical locations are situated relative to one another.

PART 5: MARKET SHARES AND CONCENTRATION

5.1 When engaged in a market definition exercise, the Bureau identifies participants in a relevant market to determine market shares and concentration levels. Such participants include (1) current sellers of the relevant products in the relevant geographic markets and (2) sellers that would begin selling the relevant products in the relevant geographic markets if the price were to rise by a SSNIP. In the latter case, the Bureau considers a firm to be a participant in a relevant market when it does not require significant sunk investments to enter or exit the market and would be able to rapidly and profitably divert existing sales or capacity to begin supplying the market in response to a SSNIP (a "supply response").[27] The Bureau considers situations in which competitive sellers would need to incur significant sunk investments, or would not be able to respond rapidly, in the analysis of entry (see Part 7, below).

Calculating Market Shares

5.2 The Bureau calculates market shares for all sellers who have been identified as participants in the relevant market.

5.3 Market shares can be measured in various ways, for example in terms of dollar sales, unit sales, capacity or, in certain natural resource industries, reserves.[28] When calculating market shares, the Bureau uses the best indicators of sellers' future competitive significance. In cases in which products are undifferentiated or homogeneous (i.e., have no unique physical characteristics or perceived attributes), and firms are all operating at full capacity, market shares based on dollar sales, unit sales and capacity should yield similar results. In such situations, the basis of measurement depends largely on the availability of data.

5.4 When firms producing homogeneous products have excess capacity, market shares based on capacity may best reflect a firm's relative market position and competitive influence in the market. Excess capacity may be less relevant to calculating market shares when it is clear that some of a firm's unused capacity does not have a constraining influence in the relevant market (e.g., because the capacity is high-cost capacity or the firm is not effective in marketing its product). When a regulated or historical incumbent firm is facing deregulation or enhanced competition, shares based on new customer acquisitions may be a better indicator of competitive vigor than are shares based on existing customers.

5.5 As the level of product differentiation in a relevant market increases, market shares calculated on the basis of dollar sales, unit sales and capacity increasingly differ. For

27 When merging firms compete across several markets and face the same competitors in each, the Bureau may use an aggregate description of these markets simply as a matter of convenience.

28 Throughout these guidelines, the term "capacity" means the ability to *produce* or *sell* a product. Capacity to sell refers to marketing and distribution capabilities, such as a sales force, distribution networks and other related infrastructure.

example, if most of the excess capacity in the relevant market were held by discount sellers in a highly differentiated market, the market shares of these sellers calculated on the basis of total capacity would be greater than if they were calculated on the basis of actual unit or dollar sales. In this case, market shares based on total capacity would be a misleading indicator of the relative market position of the discount sellers.[29] In such circumstances, dollar sales may be the better indicator of the size of the total market and of the relative positions of individual firms. Because unit sales may also provide important information about relative market positions, the Bureau often requests both dollar sales and unit sales data from the merging parties and other sellers.[30]

5.6 The Bureau generally includes the total output or total capacity of current sellers located within the relevant market in the calculation of the total size of the market and the shares of individual competitors. However, when a significant proportion of output or capacity is committed to business outside the relevant market and is not likely to be available to the relevant market in response to a SSNIP, the Bureau generally does not include this output or capacity in its calculations.

5.7 For firms that participate in the market through a supply response, the Bureau only includes in the market share calculations the output or capacity that would likely become available to the relevant market without incurring significant sunk investments.

Market Share and Concentration Thresholds

5.8 Consistent with section 92(2) of the Act, information that demonstrates that market share or concentration is likely to be high is not, in and of itself, sufficient to justify a conclusion that a merger is likely to prevent or lessen competition substantially. However, information about market share and concentration can inform the analysis of competitive effects when it reflects the market position of the merged firm relative to that of its rivals. In the absence of high post-merger market share and concentration, effective competition in the relevant market is generally likely to constrain the creation, maintenance or enhancement of market power by reason of the merger.

5.9 The Bureau has established the following thresholds to identify and distinguish mergers that are unlikely to have anti-competitive consequences from those that require a more detailed analysis:

29 Similar results occur as the level of differentiation between sellers increases. For instance, two firms may operate with the same capacity (e.g., number of trucks) but have significantly different revenue streams (because one firm may have many buyers along a truck route, i.e., route density). In such cases, market shares based on capacity and revenues provide different information about relative market positions.

30 While publicly available or readily observable information may be useful for estimating market shares, when credible and possible, the Bureau relies on transaction-level data from individual market participants as the most accurate measure of market shares.

- The Commissioner generally will not challenge a merger on the basis of a concern related to the unilateral exercise of market power when the post-merger market share of the merged firm would be less than 35 percent.
- The Commissioner generally will not challenge a merger on the basis of a concern related to a coordinated exercise of market power when
  - the post-merger market share accounted for by the four largest firms in the market (known as the four-firm concentration ratio or CR4) would be less than 65 percent; or
  - the post-merger market share of the merged firm would be less than 10 percent.

5.10 Mergers that give rise to market shares or concentration that exceed these thresholds are not necessarily anti-competitive. Under these circumstances, the Bureau examines various factors to determine whether such mergers would likely create, maintain or enhance market power, and thereby prevent or lessen competition substantially.

5.11 When other information suggests that current market shares do not reflect the competitive role of one of the merging parties relative to its rivals, the Bureau considers this information when determining whether a merger is likely to prevent or lessen competition substantially. In all cases, examining market shares and concentration is only one part of the Bureau's analysis of competitive effects.

5.12 In addition to the level of market shares or concentration in the relevant market, the Bureau examines the distribution of market shares across competitors and the extent to which market shares have changed or remained the same over a significant period of time.

5.13 All else being equal, the likelihood that a number of firms may be able to bring about a price increase through coordinated behaviour increases as the level of concentration in a market rises and as the number of firms declines.[31] In contrast, coordinated behaviour becomes increasingly difficult as the number or size of firms that have the ability to increase output increases.

5.14 When evaluating market share information, the Bureau considers the nature of the market and the impact of forthcoming change and innovation on the stability of existing market shares.[32] While a small incremental increase in concentration following a merger may suggest that the merger is not likely to have a significant impact on the

31 In addition to the CR4, the Bureau may examine changes in the Herfindahl-Hirschman Index ("HHI") (calculated by summing the squares of the individual market shares of all market participants) to observe the relative change in concentration before and after a merger. While the change in HHIs may provide useful information about changes in the market structure, the Bureau does not use HHI levels to delineate any safe harbour threshold.

32 For example, historical or existing market shares may be less relevant in bidding markets in which rapid fluctuations in market shares are more common. In such cases, the analysis focuses on the likely future effectiveness of independent sources of competition, regardless of their current shares. Bidding and bargaining markets are discussed in additional detail under "Unilateral Effects" in Part 6.

market, the Bureau assesses the growth expectations for one or both of the merging parties to determine whether the merger may eliminate an important competitive force.

PART 6: ANTI-COMPETITIVE EFFECTS

6.1 As noted in Part 3, above, the Bureau may consider market definition and competitive effects concurrently in a dynamic and iterative analytical process. When the market share and concentration thresholds listed in paragraph 5.9, above, are exceeded or when other information suggests that a merger may prevent or lessen competition substantially, the Bureau's assessment of competitive effects based on quantitative analysis and the application of relevant factors, including the factors listed in section 93 of the Act, takes on greater importance. Such an assessment falls under the broad categories of unilateral effects and coordinated effects, as described below.

6.2 When it is clear that the level of effective competition that is to remain in the relevant market is not likely to be reduced as a result of the merger, this alone generally justifies a conclusion not to challenge the merger.

6.3 To determine the ability and effectiveness of remaining competitors to constrain an exercise of market power by the merged firm, the Bureau examines existing forms of rivalry, such as discounting and other pricing strategies, distribution and marketing methods, product and package positioning, and service offerings. Whether the market shares of firms are stable or fluctuate over time is also relevant, as is the extent to which product differentiation affects the degree of direct competition among firms. Further, the Bureau assesses whether competitors are likely to remain as vigorous and effective as they were prior to the merger.

6.4 The extent and quality of excess capacity held by merging and non-merging firms provides useful information about whether the merger could result in the exercise of market power. Excess capacity held by rivals to the merged firm improves their ability to expand output should the merged firm attempt to exercise market power. On the other hand, when the merged firm holds a significant share of excess capacity in the relevant market, this may discourage rivals from expanding.

6.5 The Bureau assesses the competitive attributes of the target business to determine whether the merger will likely result in the removal of a vigorous and effective competitor.[33] In addition to the forms of rivalry discussed above, the Bureau's assessment includes consideration of whether one of the merging parties:

33 See section 93(*f*) of the Act. A firm that is a vigorous and effective competitor often plays an important role in pressuring other firms to compete more intensely with respect to existing products or in the development of new products. A firm does not have to be among the larger competitors in a market in order to be a vigorous and effective competitor. Small firms can exercise an influence on competition that is disproportionate to their size. Mavericks (described in "Coordinated Effects," in Part 6, below) are one type of vigorous and effective competitor.

- has a history of not following price increases or market stabilizing initiatives by competitors, or of leading price reductions;
- provides unique service, warranty or other terms to the market;
- has recently expanded capacity or has plans to do so;
- has recently made gains in market share or is in a position to do so; or
- has recently acquired intellectual property rights or other inputs, or has developed product features that enhance its ability to compete in the market, or will soon do so.

6.6 While the removal of a vigorous and effective competitor through a merger is likely to prevent or lessen competition to some degree, it may not, in itself, provide a sufficient basis for a decision to challenge the merger. Additionally, when a firm removed through a merger is not a vigorous or effective competitor (e.g., owing to financial distress, or declining technologies or markets), this fact is relevant to, but not determinative of, a decision not to challenge a merger.

6.7 The Bureau evaluates the general nature and extent of change and innovation in a market.[34] In addition to assessing the competitive impact of technological developments in products and processes, the Bureau examines change and innovation in relation to distribution, service, sales, marketing, packaging, buyer tastes, purchase patterns, firm structure, the regulatory environment and the economy as a whole.

6.8 The pressures exerted by change and innovation on competitors in a market (including the merging parties) may be such that a material price increase is unlikely to be sustainable, especially when technology or a merger reduces barriers to entry or stimulates or accelerates the change or innovation in question. Such pressures may have important implications for efficient markets in the medium to long term.

6.9 A merger may facilitate the exercise of market power by impeding the process of change and innovation. For example, when a merger eliminates an innovative firm that presents a serious threat to incumbents, the merger may hinder or delay the introduction of new products, processes, marketing approaches, and aggressive research and development initiatives or business methods.

Unilateral Effects

6.10 By placing pricing and supply decisions under common control, a merger can create an incentive to increase price and restrict supply or limit other dimensions of competition. A unilateral exercise of market power occurs when the merged firm can profitably sustain a material price increase without effective discipline from competitive responses by rivals.

6.11 When buyers can choose from among many sellers offering comparable products, a firm's ability to profitably increase its price is limited by buyers diverting their

34 See section 93(*g*) of the Act.

purchases to substitute products in response to the price increase. When two firms in a market merge and the price of one firm's product(s) rises, some demand may be diverted to product(s) of the firm's merger partner, thereby increasing the overall profitability of the price increase and providing the impetus to raise the price. As such, the elimination of competition between firms as a result of a merger may lessen competition substantially.

6.12 Unilateral effects can occur in various market environments, defined by the primary characteristics that distinguish the firms within those markets and determine the nature of their competition. Three types of market environment are described below.

Firms in Differentiated Product Industries

6.13 In markets in which products are differentiated, a merger may create, enhance or maintain the ability of the merged firm to exercise market power unilaterally when the product offerings of the merging parties are close substitutes for one another. In such circumstances, the Bureau assesses how the merger may change the pricing incentives of the individual firms.

6.14 Any firm considering increasing the prices for its products faces a trade-off between higher profits on the sales that it continues to make following the price increase and the profits that it loses on sales that it no longer makes following the price increase, as buyers switch to other firms and/or other products. Any sales that were previously lost to the firm's merging partner will be captured by the merged firm ("diverted sales"). Thus, the incentives to raise prices after the merger are greater the more closely the products of the merging firms compete with each other, and the larger the profit margins on these diverted sales.

6.15 The closeness of competition between the merging firms' products may be measured by the diversion ratio between them.[35] The value of the diverted sales from one merging firm depends on the volume of diverted sales and the profit margin on the diverted sales. The greater the value of the diverted sales, the greater the incentive the merged firm has to raise prices.

6.16 The incentive to raise prices following the merger will typically be greater when the products of the merging firms are close substitutes for a significant number[36] of buyers, when the merger removes a vigorous and effective competitor from the market, or when buyers are not very sensitive to price increases.[37] These are not the only circumstances, however, when the Bureau may be concerned with potential unilateral effects post-merger.

35 The diversion ratio between firm A's product and firm B's product is equal to the fraction of sales lost by firm A to firm B when firm A raises the price of its product. Similarly, the diversion ratio between firm B's product and firm A's product is equal to the fraction of sales lost by firm B to firm A when firm B raises the price of its product. The diversion ratios between firms A and B need not be symmetric.

36 A significant number" in this context need not approach a majority.

37 Buyer sensitivity to price increases may but need not be measured by the own-price elasticity of demand.

6.17 Even when the merging firms are found to have an incentive to increase price after the merger, the likelihood of the merger preventing or lessening competition substantially also depends on the responses of buyers and rival firms. In addition to considering the value of sales currently diverted to rivals, the Bureau evaluates the likely competitive responses of rivals, including whether rivals in the market are likely to expand production, reposition their products or extend their product line to discipline unilateral market power that would otherwise occur as a result of the merger.[38] The Bureau also considers existing sellers that may only occupy a particular niche within the relevant market and whether they provide an alternative for a sufficient number of buyers. In addition, the likelihood and likely impact of entry is considered.

6.18 When assessing the extent of competition between the products of the merging firms, the Bureau examines, among other possible factors, past buyer-switching behaviour in response to changes in relative prices, information based on buyer preference surveys, win-loss records, and estimates of own-price and cross-price elasticities.[39]

Firms in Homogeneous Product Industries

6.19 A post-merger price increase may be profitable if the merger were to remove a seller to whom buyers would otherwise turn in response to a price increase. In markets in which products are relatively undifferentiated (that is, they are homogeneous), such a price increase is more likely to be profitable

- the greater the share of the relevant market the merged firm accounts for;
- the lower the margin on the output that the merged firm withholds from the market to raise price;
- the less sensitive buyers are to price increases; and
- the smaller the response of other sellers offering close substitutes.

6.20 The response of other sellers will be smaller when they have insufficient capacity to increase sales to replace the output withheld by the merged firm post-merger, or substantial amounts of capacity are committed to other buyers under long-term contracts, and capacity cannot be expanded quickly and at relatively low cost. Therefore, the Bureau examines, among other factors, whether capacity constraints limit the effectiveness of remaining sellers by impeding their ability to make their products available in sufficient quantities to counter an exercise of market power by the merged firm.

Bidding and Bargaining Markets

6.21 In some markets, sellers may interact with buyers through bidding or bargaining for the right to supply. Buyers may negotiate with multiple sellers as a means of using one seller to obtain a better price from another seller. Such interactions may take the form of a pure auction or involve repeated rounds of negotiation with a select group

38 This requires a determination of whether expansion, repositioning or product line extension will likely be deterred by risk, sunk costs or other entry barriers.

39 Refer to definitions of own-price and cross-price elasticity in paragraph 4.11, above.

of sellers. A merger between two sellers will prevent buyers from playing these two sellers off against each other to obtain a better price.

6.22 The extent to which this loss of competition will affect the price paid by the buyer depends on how close the merging firms are to each other relative to other bidders and potential suppliers in meeting the buyer's requirements. When there are many bidders or potential suppliers that are equally or similarly situated as the merging parties, a merger involving two sellers is unlikely to prevent or lessen competition substantially.[40]

Coordinated Effects

6.23 A merger may prevent or lessen competition substantially when it facilitates or encourages coordinated behaviour among firms after the merger. The Bureau's analysis of these coordinated effects entails determining how the merger is likely to change the competitive dynamic in the market such that coordination is substantially more likely or effective. A lessening or prevention of competition may result from coordinated behaviour even when the coordination does not involve all the firms in the market.

6.24 Coordination involves interaction by a group of firms (including the merged firm) that is profitable for each firm because of each firm's accommodating reactions to the conduct of the others. Coordinated behaviour may relate to price, service levels, allocation of customers or territories, or any other dimension of competition.

6.25 Coordinated behaviour may involve tacit understandings that are not explicitly negotiated or communicated among firms. Tacit understandings arise from mutual yet independent recognition that firms can, under certain market conditions, benefit from competing less aggressively with one another. Coordinated behaviour may also involve express agreements among firms to compete less vigorously or to refrain from competing. Such agreements may raise concerns under the conspiracy and bid-rigging provisions of the Act.

6.26 Coordinated behaviour is likely to be sustainable only in the following circumstances:

- when firms are able to
  - individually recognize mutually beneficial terms of coordination;
  - monitor one another's conduct and detect deviations from the terms of coordination; and
  - respond to any deviations from the terms of coordination through credible deterrent mechanisms;[41] and

40 As noted in footnote 32 above, historical or existing market shares may be less relevant in bidding markets.

41 These responses, typically known as punishments, may take the form of lowering prices in the relevant market or in other markets.

- when coordination will not be threatened by external factors, such as the reactions of existing and potential competitors not part of the coordinating group of firms or the reactions of buyers.

6.27 Competition is likely to be prevented or lessened substantially when a merger materially increases the likelihood of coordinated behaviour when none existed before, or materially increases the extent or effectiveness of coordination beyond that which already exists. When making this assessment, the Bureau considers a number of factors, including the presence of factors necessary for successful coordination and those that are conducive to coordination. The mere presence of such factors, however, is not sufficient to conclude that there are competition concerns. Rather, at issue is whether the merger impacts these factors in such a way that makes coordination or more effective coordination more likely.

Market Concentration and Entry Barriers

6.28 Market power typically arises in markets characterized by concentration and high barriers to entry. Market concentration is generally a necessary but not sufficient condition for a merger to prevent or lessen competition substantially through coordinated effects. Firms in a concentrated market typically find it easier and less costly to engage in coordinated behaviour because it is easier for members of a small group of firms to recognize terms of coordination, and to monitor one another's conduct and detect and respond to deviations. Barriers to entry are also relevant, since coordinated behaviour among competitors in a concentrated market would unlikely be sustainable if raising prices were to lead to significant effective entry.

Indicia Suggesting that Market Conditions are Conducive to Coordination

6.29 In its analysis of competitive effects, the Bureau examines whether market conditions would likely allow coordinated behaviour to be sustainable after the merger, with reference to the criteria outlined in paragraph 6.26, above. While the presence of certain market conditions (often referred to as facilitating factors) may suggest the ability of firms to overcome impediments to coordinated behaviour, neither the absence nor the presence of any single factor or group of factors determines whether competition is likely to be prevented or lessened substantially.

6.30 When examining whether firms are likely able to independently recognize mutually beneficial terms of coordination, the Bureau considers, among other factors, the degree of product differentiation and cost symmetries among firms. Recognizing terms of coordination that all firms find profitable is easier when products are less differentiated and when firms have similar cost structures. Complex products and differences in product offerings and cost structure tend to make it more difficult for firms to reach profitable terms of coordination. Similarly, markets with rapid and frequent product innovations, or that are in a period of rapid growth, are less conducive to coordinated behaviour.

6.31 Profit-maximizing firms have an incentive to deviate from coordinated behaviour when the expected profits from deviating are greater than the expected profits from engaging in coordination. Therefore, when evaluating whether coordination is likely, the Bureau considers whether certain firms have stronger incentives to deviate as well as factors that could affect incentives to deviate, such as the size and frequency of transactions. When individual transactions are large and infrequent relative to total market demand, deviations from coordinated behaviour are more profitable, making effective coordinated behaviour less likely. Additionally, when individual transactions are large relative to a single firm's total output, this will increase that firm's incentive to deviate from coordinated behaviour.[42]

6.32 The Bureau also considers whether firms can monitor and detect deviations from coordinated behaviour. When so doing, the Bureau evaluates the degree of market transparency that exists. When information about prices, rival firms and market conditions is readily available to market participants, it is easier for rivals to monitor one another's behaviour, which in turn makes effective coordination more likely. The existence of industry organizations that facilitate communication and dissemination of information among market participants may also make it easier for firms to coordinate their behaviour. A complex, multi-stage procurement process may affect the ability of firms to detect deviations from coordinated agreements. Also relevant to the analysis is the stability of firms' underlying costs, as well as the predictability of demand. When costs fluctuate, it may be difficult to detect whether a price change represents a deviation from coordinated behaviour or whether it is a response to a change in cost conditions, which, in turn, makes effective coordination less likely. It may similarly be difficult to detect whether a price change represents a deviation from coordinated behaviour when demand fluctuates unexpectedly.

6.33 The Bureau's evaluation of whether firms can impose credible punishments includes assessing the degree of multi-market exposure among firms and of excess capacity.[43] When firms participate in multiple geographic or product markets, there are greater opportunities for them to discourage deviation from coordinated behaviour because there is broader scope for punishing deviations. Similarly, excess capacity held by firms within the coordinating group can allow such firms to oversupply the market when they detect deviations from the coordinated price, thereby discouraging deviations and making coordination more likely. However, excess capacity may also provide firms with an incentive and an ability to deviate from coordinated behaviour by selling products at lower prices. This could, in turn, make coordinated behaviour less likely. It is therefore important to consider which firms, if any, hold excess capacity as well as their individual economic incentives. A firm may also adopt pricing policies, such

42 These examples assume that coordination does not involve a customer allocation scheme.

43 This includes information about levels of service, innovation initiatives, product quality, product choice and levels of advertising. Market transparency is typically increased by posted pricing, circulation of price books, product, service or packaging standardization, exchanges of information regarding matters such as pricing, output, innovation, bids won and lost, and advertising levels, through a trade association, trade publication or otherwise, public disclosure of this information by buyers or through government sources, and "meet the competition" or "most favoured customer" clauses in contracts.

as most-favoured customer clauses, that commit it to following a low-pricing strategy when other firms reduce their prices.

6.34 A history of collusion or coordination in the market is also relevant to the Bureau's analysis, because previous and sustained collusive or coordinated behaviour indicates that firms have successfully overcome the hurdles to effective coordinated behaviour in the past.

Impact of the Merger on Coordinated Behaviour

6.35 When assessing whether a merger increases the likelihood of coordination, the Bureau considers whether the merger changes the competitive dynamic in a market so as to make coordinated behaviour among firms more likely or effective. A merger that changes the competitive dynamic among firms may lead to coordinated behaviour when none existed prior to the merger, or may materially increase the extent or effectiveness of coordination beyond that which already exists in a market. The Bureau determines whether market conditions are conducive to coordination before the merger and whether the merger is likely to increase the likelihood of coordination. The Bureau also identifies the constraints on coordinated behaviour that existed before the merger to determine whether the merger reduces or eliminates those constraints.

6.36 In highly concentrated markets, effective coordination may be constrained by the number of firms that exist before the merger. A merger could remove this constraint by reducing the number of rivals to the point that the profitability of coordination makes coordination a more achievable strategy than it was prior to the merger.

6.37 When firms differ greatly from one another, effective coordination may be constrained by their inability to behave in a way that each finds profitable. When the effect of the merger is to reduce or eliminate asymmetries between the merged firm and its key rivals, firms may find it easier to coordinate their behaviour in a way that is profitable for each coordinating firm after the merger. Conversely, a merger may increase asymmetries between the merged firm and its rivals, thereby making coordinated behaviour less profitable and therefore less likely.

6.38 Effective coordination may be constrained before the merger by the activities of a particularly vigorous and effective competitor (a "maverick"). A maverick is a firm that plays a disruptive role and provides a stimulus to competition in the market. An acquisition of a maverick may remove this constraint on coordination and, as such, increase the likelihood that coordinated behaviour will be effective.

6.39 Alternatively, a merger may not remove a maverick but may instead inhibit a maverick's ability to expand or enter, or otherwise marginalize its competitive significance, thereby increasing the likelihood of effective coordination.

PART 7: ENTRY

7.1 A key component of the Bureau's analysis of competitive effects is whether timely entry[44] by potential competitors would likely occur on a sufficient scale and with sufficient scope to constrain a material price increase in the relevant market. In the absence of impediments to entry, a merged firm's attempt to exercise market power, either unilaterally or through coordinated behaviour with its rivals, is likely to be thwarted by entry of firms that

- are already in the relevant market and can profitably expand production or sales;
- are not in the relevant market but operate in other product or geographic markets and can profitably switch production or sales into the relevant market; or
- can profitably begin production or sales into the relevant market de novo.

Conditions of Entry

7.2 Entry is only effective in constraining the exercise of market power when it is viable. When entry is likely, timely and sufficient in scale and scope, an attempt to increase prices is not likely to be sustainable as buyers of the product in question are able to turn to the new entrant as an alternative source of supply.

Timeliness

7.3 The Bureau's assessment of the conditions of entry involves determining the time that it would take for a potential entrant to become an effective competitor in response to a material price increase that is anticipated to arise as a result of the merger. In general, the longer it takes for potential entrants to become effective competitors, the less likely it is that incumbent firms will be deterred from exercising market power. For that deterrent effect to occur, entrants must react and have an impact on price in a reasonable period of time. In the Bureau's analysis, the beneficial effects of entry on prices in this market must occur quickly enough to deter or counteract any material price increase owing to the merger, such that competition is not likely to be substantially harmed.

Likelihood

7.4 When determining whether future entry is likely to occur, the Bureau generally starts by assessing firms that appear to have an entry advantage. While other potential sources of competition may also be relevant, typically the most important sources of potential competition are the following:

- fringe firms already in the market;
- firms that sell the relevant product in adjacent geographic areas;

44 As noted previously, throughout these guidelines, the term "entry" also refers to expansion by existing firms. The same factors that constrain new entrants also often constrain significant expansion by fringe firms, even though in many cases expansion costs for existing firms may be lower than entry costs for a new entrant.

- firms that produce products with machinery or technology that is similar to that used to produce the relevant product;
- firms that sell in related upstream or downstream markets;
- firms that sell through similar distribution channels; and
- firms that employ similar marketing and promotional methods.

7.5 A history of entry into and exit from a particular market provides insight into the likelihood of entry occurring in a timely manner and on a sufficient scale to counteract an exercise of market power by a merged firm. It is, however, not the sole determinant of whether this would likely occur.

7.6 The Bureau seeks to determine the extent that entry is likely, given the commitments that potential entrants must make, the time required to become effective competitors, the risks involved and the likely rewards. The Bureau considers any delay or loss that potential entrants expect to encounter before becoming effective competitors, and the resulting sunk costs and risk associated with such entry that reduce the likelihood that entry will occur or be successful. The Bureau also considers the expectations that potential entrants may have of incumbent responses to entry, as well as the likelihood that customers will support an entrant's investments or guarantee it a needed volume of sales. When assessing the likelihood of entry, the Bureau evaluates profitability at post-entry prices, taking into account the effect that new supply would have on market prices. These prices are often the pre-merger price levels. For instance, if a competitor was able to enter a market only on a scale that is below the minimum viable scale, the Bureau would not consider such entry to be likely, since the entrant would be unable to achieve the annual level of sales necessary to achieve profitability at post-entry prices.

Sufficiency

7.7 When considering whether entry is likely to be on a scale and scope that would be sufficient to deter or counteract a material price increase, the Bureau examines what would be required from potential competitors who choose to enter. The Bureau will also consider any constraints or limitations on new entrants' capacities or competitive effectiveness. Entry by firms that seek to differentiate themselves by establishing a niche to avoid direct competition with the merged firm may also not be sufficient to constrain an exercise of market power.

Types of Barriers to Entry

7.8 Barriers to entry affect the timeliness, likelihood and sufficiency of entry. They can take many forms, ranging from absolute restrictions that preclude entry, to sunk costs and other factors that raise the costs and risks associated with entry and thereby deter it.[45] While, in some cases, each individual "barrier" may be insufficient alone to impede entry, the Bureau considers the collective influence of all barriers which, when taken together, can effectively deter entry.

45 While commencing a business may in some cases be easy, new entrants may find it difficult to survive for a variety of reasons, including the strategic behaviour of incumbents.

Regulatory Barriers

7.9 The types of barriers identified in section 93(*d*) of the Act—namely tariff and non-tariff barriers to international trade, interprovincial barriers to trade and regulatory control over entry—can provide incumbents with absolute cost advantages over potential entrants, presenting considerable and, in some cases, insurmountable impediments to entry.

Sunk Costs

7.10 Substantial sunk costs directly affect the likelihood of entry and constitute a significant barrier to entry. Costs are sunk when they are not recoverable if the firm exits the market. In general, since entry decisions are typically made in an environment in which success is uncertain, the likelihood of significant future entry decreases as the absolute amount of sunk entry costs relative to the estimated rewards of entry increases. The Bureau's assessment of sunk costs also focuses on the time required to become an effective competitor and the probability of success, and whether these factors justify making the required investments.

7.11 New entrants must often incur various start-up sunk costs, such as acquiring market information, developing and testing product designs, installing equipment, engaging personnel and setting up distribution systems. New entrants may also face significant sunk costs owing to the need to

- make investments in market-specific assets and in learning how to optimize the use of these assets;
- overcome product differentiation-related advantages enjoyed by incumbents; or
- overcome disadvantages presented by the strategic behaviour of incumbents.

7.12 These potential sources of sunk costs can create significant impediments to entry when they require that potential entrants factor greater costs into their decision-making relative to incumbents who can ignore such costs in their pricing decisions because they have already made their sunk cost commitment.

7.13 The investment required to establish a reputation as a reliable or quality seller is also a sunk cost, constituting a barrier to entry when it is an important element in attracting buyers, particularly in industries in which services are an important element of the product. Under these circumstances, the time to establish a good reputation may make profitable entry more difficult, and therefore delay the competitive impact that an entrant may have in the marketplace.

7.14 Long-term exclusive contracts with automatic renewals, rights of first refusal, most favoured customer or "meet or release" clauses or termination fees may constitute barriers to entry. Contracts with attributes that limit buyer switching may make it difficult for firms to gain a sufficient buyer base to be profitable in one or more markets (even when barriers to entry in the industry are otherwise relatively low) and can thus make entry unattractive. The deterring effects of such contracts are more pronounced when, for example, economies of density or scale are important and make it difficult for new or smaller firms to achieve a minimum efficient scale of operations.

Other Factors That Deter Entry

7.15 In markets in which economies of scale are significant, entry on a small scale may be difficult unless the entrant can successfully exploit a niche. Conversely, entry in such markets on a large scale may expand available capacity to supply beyond market demand, thereby depressing market prices and making entry less attractive.

7.16 Market maturity can also impede entry. Entry may be less difficult and time-consuming in the start-up and growth stages of a market, when the dynamics of competition generally change more rapidly. Mature markets exhibit flat or declining demand, making it more difficult for potential entrants to profitably enter the business because the entrants' sales have to come from existing rivals.

7.17 Other cost advantages for incumbents that may deter entry include those related to transportation costs, control over access to scarce or non-duplicable resources such as technology, land, natural resources and distribution channels, network effects, and capital costs.[46]

PART 8: COUNTERVAILING POWER

8.1 When determining whether a merger is likely to result in a material price increase, the Bureau assesses whether buyers are able to constrain the ability of a seller to exercise market power. This may occur when, for example,

- they can self-supply through vertical integration into the upstream market;
- the promise of substantial orders can induce expansion of an existing smaller supplier and/or can sponsor entry by a potential supplier not currently in the market;
- they can refuse to buy other products produced by the seller;
- they can refuse to purchase the seller's products in other geographic markets where the competitive conditions are different; or
- they can impose costs on the seller (for example, by giving less favourable retail placement to the merged entity's products).

8.2 The Bureau does not presume that a buyer has the ability to exercise countervailing power merely by virtue of its size. There must be evidence that a buyer, regardless of size, will have the ability and incentive to constrain an exercise of market power by the merged firm. Evidence of prior dealings between the buyer and one or more of the merging parties that tends to demonstrate the buyer's relative bargaining strength is of particular relevance. The Bureau also considers the extent to which

46 The need to raise capital may have a significant impact on the likelihood and timeliness of entry.

the merger affects the buyer's ability and incentive to exercise countervailing power. When a merger eliminates a supplier whose presence contributed significantly to a buyer's historical bargaining strength, the buyer may no longer be able to exercise countervailing power after the merger.

8.3 When price discrimination is a feature of the relevant market, it may be possible for some but not all buyers to counter the effects of an exercise of market power. For example, a merged firm may be able to increase prices to buyers that do not have the option to vertically integrate their operations, while other buyers with this option may be able to resist such a price increase. Where only a subset of buyers is able to counter a price increase or other exercise of market power, the Bureau will generally find that countervailing power is insufficient to prevent the merged firm from exercising market power in the relevant market.

PART 9: MONOPSONY POWER

9.1 A merger of competing buyers may create or enhance the ability of the merged firm, unilaterally or in coordination with other firms, to exercise monopsony power. The Bureau is generally concerned with monopsony power when a buyer holds market power in the relevant purchasing market, such that it has the ability to decrease the price of a relevant product below competitive levels with a corresponding reduction in the overall quantity of the input produced or supplied in a relevant market, or a corresponding reduction in any other dimension of competition.[47]

9.2 Consistent with its general analytical framework for merger review, the Bureau considers both market definition-based and other evidence of competitive effects in monopsony cases. The conceptual basis used for defining relevant markets is, mirroring the selling side, the hypothetical monopsonist test. A relevant market is defined as the smallest group of products and the smallest geographic area in which a sole profit-maximizing buyer (a "hypothetical monopsonist") would impose and sustain a significant and non-transitory price decrease below levels that would likely exist in the absence of the merger. The relevant product market definition question is thus whether suppliers, in response to a decrease in the price of an input, would switch to alternative buyers or reposition or modify the product they sell in sufficient quantity to render the hypothetical monopsonist's price decrease unprofitable.

9.3 In order to determine market shares and concentration levels, the Bureau compares the size of the purchases of the relevant product by the merging parties with the total sales of the relevant product. When the merging parties represent only a small percentage of the total purchases of the relevant product, the Bureau generally considers the suppliers to be well-placed to forego sales to the merging parties in

47 Cases where the supply curve is perfectly inelastic, such that a price decrease below competitive levels does not result in a decrease in output but only a wealth transfer, may also give rise to concerns. This scenario should be understood to be generally included in the category of monopsony. Similarly, an output effect is not required in monopoly cases.

favour of other buyers when faced with an attempt to lower prices. As a general rule, the Bureau will not challenge a merger based on monopsony (or oligopsony) power concerns where shares of the relevant upstream market held by the merging parties (and their competitors, in an oligopsony case) fall below the market share safe harbours set out in Part 5 of these guidelines. When the merging parties account for a significant portion of purchases of the relevant product and exceed these market share safe harbours, then it is more likely that the merging parties could exercise monopsony power. In this case, the Bureau considers barriers to entry that may limit or negate the ability of a new buyer to purchase the product, or of an existing buyer to expand its purchases (see Part 7 for a detailed discussion of the Bureau's approach to assessing entry).

9.4 When the merged firm accounts for a significant portion of purchases of the relevant product, and barriers to buying the input are high, the factors that the Bureau considers when attempting to determine whether the merged firm is likely to have the ability to exercise monopsony power include the following:

- whether the merged firm can restrict its purchases by an amount that is large enough to reduce the relevant product's price in the market;
- whether upstream supply of the relevant product is characterized by a large number of sellers and low barriers to entry into buying such that the normal selling price of a supplier is likely competitive;
- whether it seems likely that certain suppliers will exit the market or otherwise reduce production, or will reduce investments in new products and processes in response to the anticipated price decrease;
- whether a reduction in the merged firm's purchases of the relevant (input) product is likely to reduce the profits earned by the merged firm in downstream output markets, and, if so, whether the downstream output profit reduction is large enough to reduce the merged firm's incentive to restrict its purchases; and
- whether a reduction in the merged firm's purchases of the relevant product is likely to reduce its access to adequate supply of the relevant product in the long run.

9.5 When available, the Bureau considers empirical evidence to analyze the effect of historical changes in supply on price and quantity as part of the assessment of whether the merging parties would have the ability to exercise monopsony power.

PART 10: MINORITY INTEREST TRANSACTIONS AND INTERLOCKING DIRECTORATES

10.1 Part 1, above, outlines the factors the Bureau considers when determining whether a minority interest transaction or interlocking directorate confers the requisite level of influence to constitute a merger. Additionally, a minority interest or interlocking directorate may be ancillary to a merger that the Bureau is otherwise reviewing (e.g., when one of the merging parties holds a minority interest in a third competitor prior to the merger).[48] This Part outlines the Bureau's approach to minority interest transactions where the Bureau has jurisdiction under the merger provisions of the Act.

10.2 The Bureau's analysis of minority interests and interlocks that are determined to be mergers under Part 1 of these guidelines involves two distinct steps:

- First, the Bureau conducts a preliminary examination of the transaction as a full merger between the acquirer and the target firm. This exercise is used to screen out benign cases. When the Bureau concludes that a full merger would not likely prevent or lessen competition substantially[49], then a more detailed analysis of the minority interest or interlocking directorate is not generally required.
- When, based on its preliminary examination, the Bureau determines that a full merger would raise possible competition concerns, it then moves to the second step in its analysis, in which it (1) examines the specific nature and impact of the minority shareholding and/or interlocking directorate; and (2) conducts a detailed examination of the likely competitive effects arising from the minority shareholding and/or interlocking directorate.

10.3 A minority interest or interlocking directorate may impact competition by affecting the pricing or other competitive incentives of the target, the acquirer or both. Note that, with respect to interlocking directorates, the Bureau is not generally concerned when board representation in these circumstances occurs solely through "independent" directors when the businesses do not compete.

48 As noted in paragraph 1.16, above, an interlocking directorate alone would rarely constitute a merger although it could; however, interlocks are often features of partial interest transactions that otherwise qualify as a merger. The Bureau considers features of any interlock in its assessment of the competitive effects of a merger. Of particular relevance are the following factors: relationship between the interlocked firms, the role and duty of the interlocked director toward the interlocked firms, board composition and the position of the interlocked director on the boards, information to which the interlocked director has access, any special powers of the interlocked director, including voting or veto rights, and any contractual or practical mechanisms that the interlocked director might use to influence firm policies or decision-making.

49 As noted below in paragraph 12.3, in reviewing a full merger the Bureau may make an assessment of whether the efficiency gains that are likely to be brought about by the merger will be greater than and will offset the anti-competitive effects of that merger. By contrast, minority interest transactions typically do not involve the integration of firms and therefore efficiency gains are not typically considered by the Bureau in reviewing minority interests.

10.4 When assessing the target's pricing or other competitive incentives, the Bureau first considers whether, by virtue of its ability to materially influence the economic behaviour of the target business, the acquirer or interlocked director may induce the target business to compete less aggressively. The Bureau also considers the extent of such influence and the likelihood that competition will be prevented or lessened as a result of its exercise.

10.5 Second, the Bureau considers whether the transaction provides the acquirer or the firm with the interlocked director access to confidential information about the target business. In particular, the Bureau examines the likelihood that such access may facilitate coordination between the two firms, may affect the unilateral competitive conduct of the firm that receives the information, or both.

10.6 With respect to the acquirer, the Bureau considers whether a minority interest or interlock may result in a change to the acquirer's pricing or other competitive incentives. A firm that holds a minority position in a target business that is a competitor might have a reduced incentive to compete with the target business because if the acquirer raises its price and consequently loses sales, it will benefit, through its minority interest, from sales that flow to the target business. In effect, the acquirer will recapture some of the sales diverted to the target business and may thus have a greater incentive to raise its own price than it would absent the minority interest. In its assessment, the Bureau considers the extent of diversion between the acquiring and target firms' products and the profits earned on these diverted sales. The Bureau also examines the likelihood, significance and impact of any such change to the incentives of the acquirer.

PART 11: NON-HORIZONTAL MERGERS

11.1 A horizontal merger is a merger between firms that supply competing products. By contrast, non-horizontal mergers involve firms that do not supply competing products. The two main types of non-horizontal mergers are vertical mergers and conglomerate mergers. A vertical merger is a merger between firms that produce products at different levels of a supply chain (e.g., a merger between a supplier and a customer). A conglomerate merger is a merger between parties whose products do not compete, actually or potentially[50], and are not vertically related. Conglomerate mergers may involve products that are related because they are complementary (e.g., printers and ink cartridges),[51] or because customers buy them together owing to purchasing economies of scale or scope.

50 Mergers between potential competitors are dealt with as prevention of competition cases. See paragraphs 2.10-2.12 above.

51 That is, the goods are economic complements, such that the quantity demanded of one product decreases as the price of the other increases.

11.2 Non-horizontal mergers are generally less likely to prevent or lessen competition substantially than are horizontal mergers. This is because non-horizontal mergers may not entail the loss of competition between the merging firms in a relevant market. Non-horizontal mergers also frequently create significant efficiencies.[52] However, non-horizontal mergers may reduce competition in some circumstances, as outlined below.

11.3 The civil provisions of the Act may be available to address conduct by the merged firm that constitutes a refusal to deal, an abuse of dominance or other reviewable conduct. However, where the Bureau is able to remedy or enjoin a merger that is likely to substantially prevent or lessen competition, it will generally do so in preference to pursuing post-merger remedies under other provisions of the Act.

Unilateral Effects of Non-Horizontal Mergers

11.4 A non-horizontal merger may harm competition if the merged firm is able to limit or eliminate rival firms' access to inputs or markets, thereby reducing or eliminating rival firms' ability or incentive to compete. The ability to affect rivals (and, by extension, competition) in this manner is referred to in these guidelines as "foreclosure."

11.5 Foreclosure may be partial when the merged firm, for example, raises its price to a downstream competitor, thereby raising its rival's costs. Foreclosure may be complete when the merged firm, for example, refuses to supply a downstream competitor.

11.6 When examining the likely foreclosure effects of a non-horizontal merger transaction, the Bureau considers three inter-related questions: (1) whether the merged firm has the ability to harm rivals; (2) whether the merged firm has the incentive (i.e., whether it is profitable) to do so; and (3) whether the merged firm's actions would be sufficient to prevent or lessen competition substantially.

11.7 In the case of vertical mergers, the Bureau looks at four main categories of foreclosure:

- total input foreclosure, which occurs when the merged firm refuses to supply an input to rival manufacturers that compete with it in the downstream market;
- partial input foreclosure, which occurs when the merged firm increases the price it charges to supply an input to rival manufacturers that compete with it in the downstream market;[53]

52 For example, a vertical merger may allow the merged firm to remove or "internalize" existing double marginalization, since there is no longer any need for a mark-up on goods from the upstream firm to its downstream merger partner. With conglomerate mergers, the merged firm may be able to internalize the positive effect of a decrease in the price of one complementary product on the sales of another complementary product. This in turn may increase the output of both products, which is, all other things being equal, pro-competitive.

53 Foreclosure may also be accomplished through non-price means. For example, a merged firm may adopt product standards that are incompatible with those used by rivals, thus requiring rivals to invest in new standards in order to continue to purchase the merged firm's product or making it impossible for rivals to use

- total customer foreclosure, which occurs when the merged firm refuses to purchase inputs from an upstream rival; and
- partial customer foreclosure, which occurs when the merged firm is a distributor and can disadvantage upstream rivals in the distribution/resale of their products.

11.8 In the case of a conglomerate merger, the Bureau considers whether the combination of products in related markets will confer upon the merged firm the ability and incentive to leverage a strong market position from one market to another by means of tying products together. For example, the merged firm may harm its rivals by refusing to sell one product to customers unless customers also buy a second product from it. Assuming that rivals do not sell the same range of products as the merged firm, such tying may foreclose rivals by reducing their ability to compete, thereby preventing or lessening competition substantially.

Coordinated Effects of Non-Horizontal Mergers

11.9 The Bureau also considers whether a non-horizontal merger increases the likelihood of coordinated interaction among firms:

- A merger that leads to a high degree of vertical integration between an upstream market and a downstream retail market, or increases the degree of existing vertical integration, can facilitate coordinated behaviour by firms in the upstream market by making it easier to monitor the prices rivals charge upstream. Vertical mergers could also facilitate coordinated behaviour by firms in a downstream market by increasing transparency (by enabling firms to observe increased purchases of inputs) or by providing additional ways to discourage or punish deviations (by limiting the supply of inputs).
- A conglomerate merger may facilitate coordination by increasing the degree of multi-market exposure among firms (see paragraph 6.33, above).

PART 12: THE EFFICIENCY EXCEPTION

Overview

12.1 Section 96 of the Act provides an efficiency exception to the provisions of section 92. When a merger creates, maintains or enhances market power, section 96(1) creates a trade-off framework in which efficiency gains that are likely to be brought about by a merger are evaluated against the anti-competitive effects that are likely to result. It should be noted that the Bureau's approach is to expeditiously identify those few transactions that may raise material competition concerns and provide quick clearance for remaining transactions to provide commercial certainty and allow parties to achieve any efficiencies as quickly as possible. Consistent with that approach, a thorough assessment of efficiency claims is unnecessary in the vast majority of the Bureau's merger reviews.

the merged firm's product altogether.

12.2 As the starting point, when determining the relevant anti-competitive effects for the purpose of performing the trade-off, the Bureau recognizes the significance of all of the objectives set out in the statutory purpose clause contained in section 1.1 of the Act.

12.3 The Bureau, in appropriate cases and when provided in a timely manner with the parties' evidence substantiating their case, makes an assessment of whether the efficiency gains that are likely to be brought about by a merger will be greater than and will offset the anti-competitive effects arising from that merger, and will not necessarily resort to the Tribunal for adjudication of the issue. However, the parties must be able to validate efficiency claims to allow the Bureau to ascertain the nature, magnitude, likelihood and timeliness of the asserted gains, and to credit (or not) the basis on which the claims are being made.

12.4 In general, categories of efficiencies that are relevant to the trade-off analysis in merger review include the following:

- allocative efficiency: the degree to which resources available to society are allocated to their most valuable use;
- technical (productive) efficiency: the creation of a given volume of output at the lowest possible resource cost; and
- dynamic efficiency: the optimal introduction of new products and production processes over time.

12.5 These categories are examined in reference to both gains in efficiency and anti-competitive effects (which include losses in efficiency).

12.6 For the purpose of the trade-off analysis in litigated proceedings before the Tribunal, the Bureau must show the anti-competitive effects of a merger. As outlined in more detail in paragraph 12.13 below, the merging parties must show all other aspects of the trade-off, including the nature, magnitude, likelihood and timeliness of efficiency gains, and whether such gains are greater than and offset the anti-competitive effects. Whether or not a case proceeds to litigation, the Bureau seeks information from the merging parties and other sources to evaluate gains in efficiencies and anti-competitive effects.

12.7 By incorporating an explicit exception for efficiency gains, Parliament has indicated that the assessment of the competitive effects of the merger under section 92 of the Act is to be segregated from the evaluation of efficiency gains under section 96. That said, cost savings from substantiated efficiency gains may be relevant to the analysis under section 92 of whether the merger is likely to prevent or lessen competition substantially in the following limited sense: the Bureau considers whether, as a result of true cost savings (discussed below under "Types of Efficiencies Generally Included in the Trade-Off"), the parties to the merger are better positioned to compete in a competitive market or are less likely to engage in coordinated behaviour.[54]

12.8 Where efficiencies may be material, merging parties are encouraged to make their efficiency submissions to the Bureau as early as possible in the merger review process. This facilitates an expeditious assessment of the nature, magnitude, likelihood and timeliness of the efficiency gains and of the trade-off between relevant efficiency gains and anti-competitive effects. Having detailed information regarding efficiency claims at an early stage of the process will facilitate the preparation of focused follow-up information requests and/or the targeted use of other information-gathering mechanisms and, subject to confidentiality restrictions, enable the Bureau to test the claims during its market contacts regarding the merger. Submissions regarding anticipated efficiency gains may also assist the Bureau in understanding the rationale underlying the proposed transaction.

Gains in Efficiency

12.9 To be considered under section 96(1), it must be demonstrated that the efficiency gains "would not likely be attained if the order (before the Tribunal) were made." This involves considering the nature of potential orders that may be made, including those that may apply to the merger in its entirety or are limited to parts of the merger. Each of the anticipated efficiency gains is then assessed to determine whether these gains would likely be attained by alternative means if the potential orders are made. Where the order sought is limited to parts of a merger, efficiency gains that are not affected by the order are not included in the trade-off analysis.

12.10 To facilitate the Bureau's review of efficiency claims, parties should provide detailed and comprehensive information that substantiates the precise nature, magnitude, likelihood and timeliness of their alleged efficiency gains, as well as information relating to deductions from gains in efficiency, such as the costs associated with implementing the merger. The information should specifically address the likelihood that such gains would be achieved and why those gains would not likely be achieved if the potential Tribunal orders were made.

12.11 Typically, the Bureau uses industry experts to assist in its evaluation of efficiency claims. To assess efficiency claims, Bureau officers and economists, as well as experts retained by the Bureau, require access to detailed financial and other information.[55] To enable the objective verification of anticipated efficiency gains, efficiency claims should be substantiated by documentation prepared in the ordinary course of business, wherever possible. This includes plant and firm-level accounting statements, internal

54 The impact of efficiencies on a firm's cost structure may render coordination more difficult by enhancing its incentive to compete more vigorously.

55 This includes all pre-existing merger planning documents. Additional information that may be relevant includes (1) information on efficiencies realized from previous mergers involving similar assets; (2) pre-merger documents relating to product and process innovation; and (3) information related to economies of scale, including minimum efficient scale, and economies of scope in production.

studies, strategic plans, integration plans, management consultant studies and other available data. The Bureau may also require physical access to certain facilities and will likely require documents and information from operations-level personnel who can address, among other matters, how their business is currently run and areas where efficiencies would likely be realized.

12.12 Section 96(2) requires the Tribunal to consider whether the merger is likely to bring about gains in efficiency described in section 96(1) that will result in (1) a significant increase in the real value of exports; or (2) a significant substitution of domestic products for imported products. To assist this analysis, firms operating in markets that involve international trade should provide the Bureau with information that establishes that the merger will lead them to increase output owing to greater exports or import substitution.[56]

Burden on the Parties

12.13 The parties' burden includes proving that the gains in efficiency

- are likely to occur. In other words, the parties must provide a detailed explanation of how the merger or proposed merger would allow the merged firm to achieve the gains in efficiency. In doing so, the parties must specify the steps they anticipate taking to achieve the gains in efficiency, the risks involved in achieving these gains and the time and costs required to achieve them.
- are brought about by the merger or proposed merger (i.e., that they are merger-specific). The test under section 96(1) is whether the efficiency gains would likely be realized in the absence of the merger. Thus, if certain gains in efficiency would likely be achieved absent the merger, those gains are not counted for the purposes of the trade-off.
- are greater than and offset the anti-competitive effects. The parties must provide a quantification of the gains in efficiency and a detailed and robust explanation of how the quantification was calculated. They should also, to the extent relevant, provide any information on qualitative efficiencies. While the burden is ultimately on the parties to establish that the gains in efficiency are greater than and offset the anti-competitive effects, in appropriate cases and when provided in a timely manner with the parties' evidence substantiating their case, the Bureau undertakes its own internal assessment of the trade-off before deciding whether to challenge a merger at the Tribunal.
- would not likely be attained if an order under section 92 were made. Gains in efficiency that would likely be achieved, even if an order prohibiting all or part of the merger were made, are not counted for the purposes of section 96.[57]

56 Increased output in this context is generally only possible with an associated decrease in price.

57 For example, if remedying a substantial prevention or lessening of competition required divestitures only in certain markets, cost savings resulting from the rationalization of head office facilities would not be included in the trade-off, assuming that such savings would be achievable despite the divestitures. A portion of head office cost savings may be relevant in this example only if the parties can clearly demonstrate that those cost savings

Types of Efficiencies Generally Included in the Trade-Off: Gains in Productive Efficiency

12.14 Productive efficiencies result from real cost savings in resources, which permit firms to produce more output or better quality output from the same amount of input. In many cases, such efficiencies can be quantifiably measured, objectively ascertained, and supported by engineering, accounting or other data, subject to a discount, as appropriate, for likelihood in practice. Timing differences in the realization of these savings are accounted for by discounting to the present value.

12.15 Productive efficiencies include the following:

- cost savings at the product, plant and multi-plant levels;
- savings associated with integrating new activities within the firm;[58] and
- savings arising from transferring superior production techniques and know-how from one of the merging parties to the other.[59]

12.16 Information respecting gains in efficiency that relate to cost savings should be broken down according to whether they are one-time savings or a recurring savings. When considering cost savings, the Bureau examines claims related to the following:

- economies of scale: savings that arise from product- and plant-level reductions in the average unit cost of a product through increased production;
- economies of scope: savings that arise when the cost of producing more than one product at a given level of output is reduced by producing the products together rather than separately;
- economies of density: savings that arise from more intensive use of a given network infrastructure;
- savings that flow from specialization, the elimination of duplication, reduced downtime, a smaller base of spare parts, smaller inventory requirements and the avoidance of capital expenditures that would otherwise have been required;
- savings that arise from plant specialization, the rationalization of various administrative and management functions (e.g., sales, marketing, accounting, purchasing, finance, production), and the rationalization of research and development activities; and
- savings that relate to distribution, advertising and raising capital.

---

would not be achievable if the proposed remedy is granted. Only those gains in efficiency that will be forgone as a result of the remedy will be counted.

58 These include reduced transaction costs associated with contracting for inputs, distribution and services that were previously performed by third parties, but exclude pecuniary savings such as those related to bringing idle equipment into use if such idle capacity will be transferred from the merged firm to third parties.

59 While such legitimate production-related savings may exist, it will generally be difficult to demonstrate that efficiencies will arise owing to "superior management," that savings are specifically attributable to management performance or that they would not likely be sought and attained through alternative means.

Types of Efficiencies Generally Included in the Trade-Off: Gains in Dynamic Efficiency

12.17 The Bureau also examines claims that the merger has or is likely to result in gains in dynamic efficiency, including those attained through the optimal introduction of new products, the development of more efficient productive processes, and the improvement of product quality and service. When possible, the assessment of dynamic efficiencies is conducted on a quantitative basis. This is generally the case if there is information presented by the parties to suggest that a decrease in production costs as a result of an innovation in production technology or an increase in demand for the parties' products as a result of product innovation (leading to a new or improved product) is likely. To supplement quantitative information or where quantitative information is absent, the Bureau conducts a qualitative assessment.

12.18 The specific environment of the industry in question is important in the Bureau's analysis of the competitive effects of a merger on innovation. In light of the complexities and uncertainties associated with the assessment of dynamic efficiency claims, irrespective of the industry, certain types of industry information (in addition to that considered in paragraphs 12.10 and 12.11, above) can be particularly beneficial to the Bureau's assessment of a merger's impact on innovation as they relate to, for example, verifiability, likelihood of success and timeliness. Historical information on the effect of previous mergers in the industry on innovation may be insightful.[60] Such information may relate to a merger's impact on the nature and scope of research and development activities, innovation successes relating to new or existing products or production processes, and the enhancement of dynamic competition.[61] In addition, and only when applicable, the Bureau encourages parties to provide detailed explanations regarding plans to utilize substitute or complementary technologies so as to increase innovation.

Types of Efficiencies Generally Included in the Trade-Off: Deductions to Gains

12.19 Once all efficiency claims have been valued, the costs of retooling and other costs that must be incurred to achieve efficiency gains are deducted from the total value of the efficiency gains that are considered pursuant to section 96(1). Integrating two complex, ongoing operations with different organizational cultures can be a costly undertaking and ultimately may be unsuccessful. Integration costs are deducted from the efficiency gains.[62]

Types of Efficiencies Generally Excluded from the Trade-Off

12.20 Not all efficiency claims qualify for the trade-off analysis. The Bureau excludes the following:

---

60 Such information may be useful even when previous mergers did not necessarily involve any of the merging parties, since Bureau staff will examine the effect of past industry mergers on innovation through various sources of information, including industry experts and interviews with competitors.

61 In this context, dynamic competition refers to competition based on the successive introduction of new or better products over time.

62 Losses in dynamic efficiency described in paragraph 12.31, below, may also be deducted from gains in efficiency at this stage of the analysis, provided they are not double-counted.

- gains that would likely be attained in any event through alternative means if the potential orders were made (examples include internal growth, a merger with a third party,[63] a joint venture, a specialization agreement, and a licensing, lease or other contractual arrangement);[64]
- gains that would not be affected by an order, when the order sought is limited to part of a merger;
- gains that are redistributive in nature, as provided in section 96(3) of the Act (examples include gains anticipated to arise from increased bargaining leverage that enables the merging parties to extract wage concessions or discounts from suppliers that are not cost-justified, and tax-related gains);[65]
- gains that are achieved outside Canada (examples include productive efficiency gains arising from the rationalization of the parties' facilities located outside Canada that do not benefit the Canadian economy);[66] and
- savings resulting from a reduction in output, service, quality or product choice.

Anti-Competitive Effects

12.21 Section 96(1) requires efficiency gains to be evaluated against "the effects of any prevention or lessening of competition that will result or is likely to result from the merger or proposed merger." The effects to be considered are not limited to resource allocation effects and include all the anti-competitive effects that are likely to arise from a merger, having regard to all of the objectives of the Act. Determination of the relevant anti-competitive effects depends upon the particular circumstances of the merger in question and the markets affected by the merger.

12.22 The Bureau examines all relevant price and non-price effects, including negative effects on allocative, productive and dynamic efficiency; redistributive effects; and effects on service, quality and product choice.

12.23 In addition to direct effects in the relevant market, the Bureau also considers price and non-price effects in interrelated markets. For example, mergers that are likely to

63 Consideration will only be given to alternative merger proposals that could reasonably be considered practical given the business realities faced by the merging firms.

64 The market realities of the industry in question will be considered in determining whether particular efficiencies could reasonably be expected to be achieved through non-merger alternatives. This includes growth prospects for the market in question, the extent of excess capacity in the market, and the extent to which the expansion can be carried out in increments.

65 Discounts from a supplier resulting from larger orders that would enable the supplier to achieve economies of scale, reduced transaction costs or other savings may qualify, to the extent that the savings by the supplier can be substantiated. Mere redistribution of income from the supplier to the merged firm in the form of volume or other discounts is not an efficiency.

66 A rationalization of the parties' facilities located outside of Canada where it could be established that these efficiencies would likely result in lower prices in Canada is an example of how such gains in efficiency from non-Canadian sources could accrue to the Canadian economy. The issue is whether the efficiency gains will benefit the Canadian economy rather than the nationality of ownership of the company.

result in increased prices and lower output can impair industries that use the merged firm's products as inputs.

12.24 Some examples of potential anti-competitive effects that can result from a merger are described below. This list is not intended to be exhaustive. While, in some cases, the negative impacts of a merger may be difficult to measure, all of the relevant anti-competitive effects of a merger are considered for the purposes of the trade-off. When anti-competitive effects (such as redistributive effects and non-price effects) cannot be quantified, they are considered from a qualitative perspective.

Price Effects: Loss of Allocative Efficiency (Deadweight Loss)

12.25 A merger that results in a price increase generally brings about a negative resource allocation effect (referred to as "deadweight loss"), which is a reduction in total consumer and producer surplus within Canada. This reflects a loss of allocative efficiency that is contrary to promoting the efficiency and adaptability of the Canadian economy.

12.26 In view of the difficulties associated with estimating the magnitude of a material price increase that is likely to be brought about by a merger and other variables, various estimates of the deadweight loss are usually prepared over a range of price increases and market demand elasticities.

12.27 The estimate of deadweight loss generally includes the following:

- losses to consumer surplus resulting from reductions in output owing to the merger;
- losses in producer surplus that arise when market power is being exercised in the relevant market prior to the merger[67]; and
- losses to consumer and producer surplus anticipated to result in interrelated markets.[68]

Price Effects: Redistributive Effects

12.28 Price increases resulting from an anti-competitive merger cause a redistributive effect ("wealth transfer") from buyers to sellers. Providing buyers with competitive prices and product choices is an objective of the Act.

Non-Price Effects: Reduction in Service, Quality, Choice

12.29 A substantial prevention or lessening of competition resulting from a merger can have a negative impact on service, quality, product choice and other dimensions of

67 When pre-merger conditions are not competitive, the deadweight loss arising from a merger may be significantly understated if this loss to producer surplus is not taken into account.

68 For example, when the products produced by the merged firm include intermediate goods that are used as inputs in other products, price increases in the intermediate goods can contribute to allocative inefficiency in interrelated markets.

competition that buyers value. Considering these effects is consistent with ensuring that buyers are provided with competitive prices and product choices.

Non-Price Effects: Loss of Productive Efficiency

12.30 Mergers that prevent or lessen competition substantially can also reduce productive efficiency, as resources are dissipated through x-inefficiency[69] and other distortions.[70] For instance, x-inefficiency may arise when firms, particularly in monopoly or near monopoly markets, are insulated from competitive market pressure to exert maximum efforts to be efficient.

Non-Price Effects: Loss of Dynamic Efficiency

12.31 Mergers that result in a highly concentrated market may reduce the rate of innovation, technological change and the dissemination of new technologies with a resulting opportunity loss of economic surplus.[71]

The Trade-Off

12.32 To satisfy the section 96 trade-off, the efficiency gains must both "be greater than and offset" the relevant anti-competitive effects.

12.33 The "greater than" aspect of the test requires that the efficiency gains be more extensive or of a larger magnitude than the anti-competitive effects. The "offset" aspect requires that efficiency gains compensate for the anti-competitive effects. The additional requirement to "offset" makes it clear that it is not sufficient for parties to show that efficiency gains merely, marginally or numerically exceed the anti-competitive effects to satisfy the section 96 trade-off. How significant this additional requirement may be has yet to be tested by the Tribunal and the courts.

12.34 Both the efficiency gains and the anti-competitive effects can have quantitative (measured) and qualitative aspects to them, and both the "greater than" and "offset" standards apply to all anti-competitive effects. To enable appropriate comparisons to be made, timing differences between measured future anticipated efficiency gains and measured anti-competitive effects are addressed by discounting to the present value.

12.35 Merging parties intending to invoke the efficiencies exception are encouraged to address how they propose that qualitative and quantitative gains and effects be evaluated for the purpose of performing the "greater than and offset" aspect of the

69 "X-inefficiency" typically refers to the difference between the maximum (or theoretical) productive efficiency achievable by a firm and actual productive efficiency attained.

70 For example, increased market power can lead to rent-seeking behaviour (such as lobbying) which can cause real economic resources to be consumed in activities directed towards redistributing income, rather than used in producing real output.

71 Losses in dynamic efficiency may be considered under anti-competitive effects or may be deducted from gains in efficiency at the outset, as indicated in paragraph 12.20.

trade-off; and to explain how and why the gains "compensate for" the anti-competitive effects.[72]

PART 13: FAILING FIRMS AND EXITING ASSETS

Business Failure and Exiting Assets

13.1 Among the factors that are relevant to an analysis of a merger and its effects on competition, section 93(*b*) lists "whether the business, or a part of the business, of a party to the merger or proposed merger has failed or is likely to fail." The opening clause of section 93 makes it clear that this information is to be considered "in determining, for the purpose of section 92, whether or not a merger or proposed merger prevents or lessens, or is likely to prevent or lessen, competition substantially." The impact that a firm's exit can have in terms of matters other than competition is generally beyond the scope of the assessment contemplated by section 93(*b*).

13.2 Probable business failure does not provide a defence for a merger that is likely to prevent or lessen competition substantially. Rather, the loss of the actual or future competitive influence of a failing firm is not attributed to the merger if imminent failure is probable and, in the absence of a merger, the assets of the firm are likely to exit the relevant market. Merging parties intending to invoke the failing firm rationale are encouraged to make their submissions in this regard as early as possible.

13.3 A firm is considered to be failing if:

- it is insolvent or is likely to become insolvent;[73]
- it has initiated or is likely to initiate voluntary bankruptcy proceedings; or
- it has been, or is likely to be, petitioned into bankruptcy or receivership.

13.4 In assessing the extent to which a firm is likely to fail, the Bureau typically seeks the following information:

- the most recent, audited, financial statements, including notes and qualifications in the auditor's report;
- projected cash flows;
- whether any of the firm's loans have been called, or further loans/line of credit advances at viable rates have been denied and are unobtainable elsewhere;
- whether suppliers have curtailed or eliminated trade credit;

72 The burden is ultimately on the parties to undertake the entire trade-off analysis and establish that the gains in efficiency are greater than and offset the anti-competitive effects.

73 Technical insolvency occurs when liabilities exceed the realizable value of assets, or when a firm is unable to pay its liabilities as they come due.

- whether there have been persistent operating losses or a serious decline in net worth or in the firm's assets;[74]
- whether such losses have been accompanied by an erosion of the firm's relative position in the market;
- the extent to which the firm engages in "off-balance-sheet" financing (such as leasing);
- whether the value of publicly-traded debt of the firm has significantly dropped;
- whether the firm is unlikely to be able to successfully reorganize pursuant to Canadian or foreign bankruptcy legislation, the Companies' Creditors Arrangement Act, or through a voluntary arrangement with its creditors.

13.5 These considerations are equally applicable to failure-related claims concerning a division or a wholly-owned subsidiary of a larger enterprise. However, in assessing submissions relating to the failure of a division or subsidiary, particular attention is paid to transfer pricing within the larger enterprise, intra-corporate cost allocations, management fees, royalty fees, and other matters that may be relevant in this context. The value of such payments or charges is generally assessed in relation to the value of equivalent arm's-length transactions.

13.6 Matters addressed in financial statements are ordinarily considered to be objectively verified when these statements have been audited or prepared by a person who is independent of the firm that is alleging failure. The Bureau's assessment of financial information includes a review of historic, current and projected income statements and balance sheets. The reasonableness of the assumptions underlying financial projections is also reviewed in light of historic results, current business conditions and the performance of other businesses in the industry.

Alternatives to the Merger

13.7 Before concluding that a merger involving a failing firm or division is not likely to result in a substantial lessening or prevention of competition, the Bureau assesses whether any of the following alternatives to the merger exist and are likely to result in a materially greater level of competition than if the proposed merger proceeds.

Acquisition by a Competitively Preferable Purchaser

13.8 The Bureau assesses whether there exists a third party whose purchase of the failing firm, division or productive assets is likely to result in a materially higher level of competition in the market.[75] In addition, such a third party ("competitively preferable purchaser") must be willing to pay a price which, net of the costs associated with

74 Persistent operating losses may not be indicative of failure, particularly in a "start-up" situation, in which such losses may be normal and indeed anticipated.

75 The Bureau considers whether the third party is capable of exercising a meaningful influence in the market. When an alternative buyer does not intend to keep the failing firm's assets in the relevant market, the Bureau assesses the extent to which the market power arising from the original merger proposal is likely to be less than if the alternative merger proceeds.

making the sale,[76] would be greater than the proceeds that would flow from liquidation, less the costs associated with such liquidation (referred to as the "net price above liquidation value").[77] Where it is determined that a competitively preferable purchaser exists, it can generally be expected that, if the proposed merger under review cannot be completed, the target will either seek to merge with that competitively preferable purchaser, or remain in the market. If the Bureau is not satisfied that a thorough search for a competitively preferable purchaser has been conducted, the Bureau will require the involvement of an independent third party (such as an investment dealer, trustee or broker who has no material interest in either of the merging parties or the proposal in question) to conduct such a search before the failing firm rationale is accepted.

Retrenchment/Restructuring

13.9 Where it appears that the firm is likely to remain in the market rather than sell to a competitively preferable purchaser or liquidate, it is necessary to determine whether this alternative to the proposed merger is likely to result in a materially greater level of competition than if the proposed merger proceeds. The retrenchment or restructuring of a failing firm may prevent failure and enable it to survive as a meaningful competitor by narrowing the scope of its operations, for instance, by downsizing or withdrawing from the sale of certain products or from certain geographic areas.

Liquidation

13.10 Where the Bureau is able to confirm that there are no competitively preferable purchasers for the failing firm and that there are no feasible and likely retrenchment scenarios, it assesses whether liquidation of the firm is likely to result in a materially higher level of competition in the market than if the merger in question proceeds. In some cases, liquidation can facilitate entry into a market by enabling actual or potential competitors to compete for the failing firm's customers or assets to a greater degree than if the failing firm merged with the proposed acquirer.

76 These costs include matters such as ongoing environmental liabilities, tax liabilities, commissions relating to the sale and severance and other labour-related costs.

77 Liquidation value is defined as the sale price of assets as a result of bankruptcy or foreclosure proceedings.

HOW TO CONTACT THE COMPETITION BUREAU

Anyone wishing to obtain additional information about the *Competition Act*, the *Consumer Packaging and Labelling Act* (except as it relates to food), the *Textile Labelling Act*, the *Precious Metals Marking Act* or the program of written opinions, or to file a complaint under any of these acts should contact the Competition Bureau's Information Centre:

Web site

www.competitionbureau.gc.ca

Address

Information Centre
Competition Bureau
50 Victoria Street
Gatineau, Quebec K1A 0C9

Telephone

Toll-free: 1-800-348-5358
National Capital Region: 819-997-4282
TTY (for hearing impaired) 1-800-642-3844

Facsimile

819-997-0324

Government of Canada Gouvernement du Canada

COMPETITION BUREAU REACHES AGREEMENT TO PRESERVE COMPETITION IN TWO B.C. FORESTRY MARKETS

News Release

OTTAWA, December 7, 2004 -- The Competition Bureau filed a consent agreement today with the Competition Tribunal, addressing competition concerns in the merger of West Fraser Timber Co. Ltd (West Fraser) and Weldwood of Canada Ltd. (Weldwood). The agreement enables the forestry companies to merge while preserving choice for independent timber harvesters, wood re-manufacturers and log sellers in the northern and southern parts of British Columbia. "It's a good outcome for competition," said Robert Lancop, Assistant Deputy Commissioner of Competition. "We've addressed the issues raised by this transaction without the need for costly and uncertain litigation." After reviewing the proposed transaction, the Bureau had concerns that it could result in a substantial lessening of competition in two local markets. The agreement requires that West Fraser and Weldwood sell their saw mill interests in Babine Forest Products

Limited, in Burns Lake and Decker Lake (Babine Timber Limited), and associated forest tenures. West Fraser also agreed to surrender certain timber harvesting rights in the Williams Lake to 100 Mile House area. The surrender will permit an offering of new forest tenures which will remove significant barriers to competition and allow a new player to enter the market or an existing one to expand its capacity. "In this case, the parties will be able to realize cost savings arising from consolidation while preserving the benefits of competition in the supply of timber," said Mr. Lancop. The agreement provides that if West Fraser is unable to sell the assets as agreed, a trustee will be appointed to complete the sales. The Competition Bureau is an independent law enforcement agency that promotes and maintains fair competition so that all Canadians can benefit from competitive prices, product choice and quality service. It oversees the application of the Competition Act, the Consumer Packaging and Labelling Act, the Textile Labelling Act and the Precious Metals Marking Act. - 30 - For media enquiries, please contact: Tim Weil Director of Strategic Communications Communications Branch (819) 953-9271 For general enquiries, please contact: Information Centre Competition Bureau (819) 997-4282 1-800-348-5358

Date modified:

2004-12-07

Government of Canada Gouvernement du Canada

Round table on monopsony and buyer power

Directorate for Financial and Enterprise Affaires Competition Committee

For Official Use

Organization for Economic Co-operation and Development

Note by Canada

JT03253147

Complete document available on OLIS in its original format

This note is submitted by Canada to the Competition Committee For Discussion at its forthcoming meeting to be held on 21-23 October 2008.

The Canadian Competition Bureau (the "Bureau") is pleased to provide the following discussion of the roundtable topic "Monopsony and Buyer Power".

On this page

1. Definition

1.1 What types of power exercised by buyers have raised antitrust concerns in your jurisdiction? Please define the different types of buyer power that are relevant.

The Bureau is generally concerned with monopsony power as it is defined by the OECD (Organisation for Economic Co-operation and Development); that is, where the price of an input is depressed below the competitive level such that it results in a decrease in the overall quantity of the input produced or supplied in a relevant market. [1] This concern exists regardless of whether that market power is exercised by a single buyer, a coordinating group of buyers, or a buyer that is not otherwise the only buyer in a market (a dominant buyer). In this sense, the Bureau is also generally concerned with what is referred to by the OECD (Organisation for Economic Co-operation and Development) as "oligopsony power". When considering likely output decreases as a result of a price decrease below competitive levels, the Bureau will take into account any type of quality-adjusted decrease in output [2] or a corresponding diminishment in any other dimension of competition. Also, when considering price decreases, the Bureau will take into account any change in terms of trade that amounts to a price decrease.

The Bureau's concern with monopsony power has typically arisen in merger reviews. There has, to date, been no litigated case involving monopsony power in a merger [3] but there have been negotiated settlements that, at least in part, have been designed to address such concerns. [4]

The Bureau's concern about bargaining power (as defined by the OECD (Organisation for Economic Co-operation and Development): power to reduce input prices but not so much so that prices fall below competitive levels) primarily (but not exclusively) arises in the context of buyer cartels. Such cartels fall under the conspiracy provisions of the Canadian *Competition Act* and as such are subject to the requirements of that provision, including the requirement that the buyer cartel prevent or lessen competition unduly. The Bureau has carried out a number of investigations into such cartels. [5]

As to bargaining power in unilateral conduct cases, in order for bargaining power to amount to abuse, it must be engaged in by a dominant firm, must constitute a practice of anti-competitive acts in that its purpose is an intended exclusionary, disciplinary or predatory effect on a competitor(s), and that the effect of this is or is likely to be a substantial lessening or prevention of competition. To date, there have been no abuse investigations involving bargaining power that have involved lower input prices. It is unlikely that lower input prices would, in isolation, meet the requirement of a practice of anti-competitive acts.

1.2 What is (are) the appropriate definition(s) of buyer power? What is the relationship between monopsony power, oligopsony power, bargaining power, and countervailing power?

The Bureau considers buyer power to be a general term that includes within it monopsony power, oligopsony power, and bargaining power. Countervailing power is used to mean the power to discipline an exercise of market power, monopsony power or bargaining power, and so the term countervailing power might be applied to either sellers or buyers.

Monopsony power is understood to mean those instances where a price decrease is such that it falls below competitive levels and there is a corresponding reduction in the input supplied or a corresponding diminishment in any other dimension of competition. As noted in footnote 1, here and throughout this submission, monopsony includes within its meaning situations where supply is perfectly inelastic such that a decrease in price below competitive levels does not result in a decrease in output. As is the case when examining downstream market power, the Bureau generally considers such price and output decreases in a relevant market. As noted above, monopsony power is generally used by the Bureau to include within its meaning oligopsony power.

Bargaining power means the power to decrease prices but those price decreases are such that they do not fall below competitive levels, and so the price decrease is associated with increased purchases of the input, rather than decreased purchases.

Countervailing power is normally the expression used when considering whether an act, such as a merger, is likely to result in the ability to sustain a material price increase and the Bureau assesses whether one or more buyers have a countervailing ability to constrain that exercise of market power. Conversely, in the case of monopsony, oligopsony or bargaining power, one or more sellers may have a countervailing ability to constrain the exercise of monopsony, oligopsony, or bargaining power.

2. Identifying buyer power

2.1 What determines the extent to which a buyer can exercise monopsony power? Bargaining power? Other types of buyer power?

10. A necessary condition for an exercise of monopsony power is that the input be supplied in a market characterised by an upward-sloping supply curve in the relevant range of production.

The fewer selling options there are, the more likely it is that a large buyer or a coordinating group of buyers will be able to exercise either monopsony or bargaining power. What will largely determine whether the resulting price decrease remains above competitive levels will be the extent of selling options. The fewer the selling options, the more likely it is the bargaining power will extend to monopsony power.

2.2 What metrics can, and have been used, to identify monopsony power? Bargaining power? Other types of buyer power? What are their strengths and weaknesses?

The Bureau first determines whether it is likely a firm has buyer power. [6] It then tries to determine whether that buyer power is likely to entail the special case of monopsony power. This involves the inherently difficult exercise of trying to determine whether prices are competitive or not.

The first step in assessing whether an entity is likely to have buyer power is typically a determination of the relevant market in which the entity makes its purchases. The conceptual basis used for defining markets is, mirroring the selling side, the hypothetical monopsonist test. Conceptually, a relevant market is defined as the smallest group of products and the smallest geographic area in which a sole profit-maximising buyer ("hypothetical monopsonist") would impose and sustain a significant and non-transitory price decrease below levels that would likely exist in the absence of the act in question (for example, a merger). The relevant product market definition question is thus whether suppliers, in response to a decrease in the price of an input, would be able to profitably switch to alternative buyers or modify the input they sell in sufficient quantity to render the hypothetical monopsonist's input price decrease unprofitable.

Buyers currently buying the input in question will generally be considered participants in the relevant market. Buyers not currently buying the input may be considered participants in the relevant market provided, in the event of a small but significant input price decrease, the buyer would buy the input and the seller would sell it. It is of note that buyers need not participate in the same downstream market in which the buyer at issue (for example, the merging parties) participates. For example, a grocery story likely participates in a local market for the sale of groceries, but it may purchase a food input, such as corn, from a producer that may have regional, national and even international buyers for the sale of its product.

Once the relevant market is known and its buyers identified, the size of the entity's purchases of the input relative to its suppliers' total sales of the input in the relevant market is determined. If the entity only accounts for a small percentage of its suppliers' sales in the relevant market, these suppliers are generally considered well placed to forgo sales to the entity in favour of other buyers when faced with an attempt to lower input prices.

If the entity accounts for a significant portion of input purchases, barriers to entry into buying are considered.

If the entity accounts for a significant portion of input purchases and barriers to buying the input are high, likely factors for consideration when trying to distinguish between bargaining and monopsony power include as follows:

- The shape of the supply curve in the relevant range of output: As noted above, upward-sloping supply curves are a necessary condition for monopsony power. If there is evidence that supply is highly elastic over a relevant period of time, the Bureau is less likely to pursue a monopsony power case. Relevant considerations when evaluating the shape of the supply curve include any factors, such as pre-existing contracts, that may influence the time it takes for supply to adjust to new demand conditions.

- Whether upstream supply of the input is characterised by a large number of sellers and low barriers to entry such that the normal selling price of a supplier is likely competitive.
- Whether it seems likely that certain suppliers will exit the market in response to the anticipated price decrease or will scale back production.
- Where possible, empirical techniques for analysing the effect of historical changes in supply on price and quantity to help determine whether monopsony power exists.

18. If it appears that monopsony power is possible (including the case where the supply curve is perfectly inelastic), the likelihood of such power actually being exercised may be considered. Factors relevant to this include the possibility of an exercise in monopsony power jeopardizing a long-run source of supply, and the possible costs to the potential monopsonist of decreased output in the downstream market that may follow decreased input purchases.

2.3 What is the relevance of market definition for identifying monopsony power? Bargaining power?

Market definition is relevant for identifying both monopsony and bargaining power, and is used by the Bureau in the manner described above.

dentifying relevant markets is of particular importance in monopsony cases since the decrease in input production of concern need only occur within the relevant market. It need not occur more generally. For example, a grain purchaser may be able to exercise monopsony power in its grain purchases in a region of Canada. That region of Canada is a relevant geographic market because grain producers located therein would not be able to discipline a decrease in grain prices by selling to other buyers or geographic locations. Grain production in other markets, say, for example, those located outside of Canada, may, however, increase output in response to the decrease in output in the relevant market of concern. This, however, would not be a consideration when assessing the likelihood of monopsony power in the relevant market of concern (except to the extent that it may influence the potential monopsonist's incentives to exercise monopsony power in the first place). Where the Bureau is concerned with monopsony power (where, again, this includes the case where the supply curve is perfectly inelastic so that there is no decrease in output as a result of a decrease in price below competitive levels), it is only concerned with monopsony power in the identified relevant market (this also means that there need not be a decrease in output in the corresponding downstream market). This position is consistent with inefficiencies arising from such behaviour more generally. Economic theory suggests that an output decrease in response to monopsony power in one relevant upstream market that results in output increases in other relevant upstream markets is typically the result of inefficient substitution towards less efficient producers.

2.4 What issues arise in adapting the hypothetical monopolist test to define markets to identify monopsony and/or bargaining power?

21. The main issue in adapting the hypothetical monopolist test to define markets to identify monopsony and/or bargaining power arises in regard to product market definition. Since the hypothetical monopsonist test is applied from the perspective of sellers and the buyers to whom they can sell, the relevant product market definition question is whether suppliers, in response to a decrease in the price of an input, would be able to profitably switch to alternative buyers or modify the input they sell in sufficient quantity to render the input price decrease unprofitable to the buyer. This opens the door to the possibility that the product market would consist of products that are otherwise unrelated or, from the buyer's perspective, not substitutes. For example, if grain suppliers could discipline a grain price decrease by switching to fruit production, this would imply that, for the purposes of assessing the likelihood of monopsony power, grain and fruit are in the same product market. [7]

22. While this is technically correct, the time and money required by sellers to switch into the production of other products so as to discipline a price decrease are often either too costly and/or take too long to be an effective discipline. Consequently, while it is possible that relatively modest changes to an input so as to expand suppliers' selling options can be achieved at little cost and time, and so would be a consideration, the Bureau's more likely focus in regard to market definition in upstream cases is geographic, whereby alternative locations and the buyers in those locations are identified.

3. Welfare effects

3.1 What are the welfare effects of the exercise of the different kinds of buyer power? How does the exercise of the different types of power by a buyer affect input suppliers and consumers of the

firm exercising the buyer power? Do the welfare effects of the exercise of buyer power depend on the market structure downstream?

23. Monopsony power will generally result in allocative inefficiency in the upstream market in which it takes place. [8] The decrease in input purchases can also result in decreased downstream output with corresponding higher prices, which will adversely affect downstream consumers. Such an effect in the downstream may not arise, however, since that market may be competitive such that a decrease in output by one participant does not have any impact on market price and output. Under Canadian law, there need not be harm by way of a price or output effect in the downstream market in order for an exercise of monopsony power to be considered harmful. Consequently, it is typically sufficient that there be a reduction in output (or a corresponding decrease in another dimension of competition) in the upstream market in order for an antitrust concern to arise.

As noted above, however, the downstream market structure can impact the profitability of an exercise of monopsony power and, in turn, the potential monopsonist's incentive to reduce input purchases. In competitive downstream markets, the only downstream effect of decreased input purchases and the corresponding decrease in downstream output will be lost downstream market share. This will reduce, although not necessarily eliminate, the incentive to exercise monopsony power. Reduced input purchases may nonetheless be profitable for the firm if the benefit of the cost savings upstream outweighs the costs associated with decreased market share downstream.

Cases of non-conspiracy related abuse of bargaining power are normally (but not necessarily exclusively) considered under section 79 of the Canadian *Competition Act*. Under this section the Bureau considers (1) whether a firm is dominant; (2) whether the firm has engaged in a practice acts intended to exclude, discipline or predate a competitor; and (3) whether the practice has resulted in a substantial prevention or lessening of competition in a market. That market can be either the upstream market in which input purchases are made or the downstream market in which product based on those inputs are sold. The practice of anti-competitive act(s) at issue would be assessed to see whether it likely has the effect of substantially lessening or preventing competition in the relevant market by way of creating, enhancing or preserving the dominant firm's market power.

Acts that result only in transfers of wealth among various market participants as a result of lower prices that either do not constitute monopsony power (where monopsony power includes those situations where the supply curve is perfectly inelastic such that a decrease in price below competitive levels only entails a transfer) that has the effect of substantially lessening or preventing competition, or do not ultimately result in substantially lessened or prevented competition as a result of an adverse effect on a competitor, generally do not raise antitrust concerns in Canada. The exception to this arises under the cartel provisions, where conspiracies to lower prices that do not necessarily amount to prices below competitive levels may be found to warrant investigation.

3.2 With respect to conduct that increases buyer power, what welfare effects suggest that such conduct should be a concern of competition policy? If the conduct increases buyer power but does not result in an increase in prices for downstream consumers, should it be enjoined? Why?

As noted in the response above, under the abuse provisions, anti-competitive conduct that increases buyer power is only a concern if the intended effect is an exclusionary, disciplinary or predatory effect on a competitor such that there is a substantial lessening of competition in the market in which that competitor participates or otherwise would have participated. If the conduct increases buyer power but does not, through the mechanism described above, result in created, enhanced or preserved market power, the required elements of the Canadian abuse of dominance provisions would not be met and the conduct could not be enjoined. If the market of concern is the downstream market, the required elements of the abuse provisions will normally entail an increase in downstream consumer prices (or a negative effect on some non-price element of competition, such as quality). If the market of concern is the upstream market for the purchase of inputs, prices to consumers need not necessarily increase for the conduct to be considered anti-competitive, but upstream input prices would typically have to fall below competitive levels.

3.3 What are the welfare effects of the secondary line price discrimination implied by the cycle hypotheses, perhaps augmented by a waterbed effect? Is the change in downstream market structure necessarily harmful for consumers? If not, on what basis can consumer welfare improving cycles be distinguished from those that are deleterious?

The Canadian abuse provisions do not have an efficiency defence, but business justifications that are pro-competitive will be considered when assessing particular conduct. Such a justification can overcome the reasonably foreseeable effects of the conduct if the firm(s) can show that those anti-competitive effects were not the overall purpose of that conduct. The Bureau considers credible efficiency or pro-competitive rationales to generally fall into one of two categories: activities that minimise costs of production or operation, independent of the elimination or discipline of a rival; and activities that improve a firm’s product, service, or some other aspect of the firm’s business. Consequently, in order for a change in downstream market structure, which may result from secondary line price discrimination implied by the cycle hypotheses, to be considered harmful, it must be the case that the intended purpose of the discrimination was the exclusion or disciplining of competitors (as opposed to some pro-competitive rationale), and that such exclusion/disciplining results in enhanced downstream market power. A simple observation of price discrimination in the input market would not normally be sufficient to conclude any anti-competitive effect.

3.4 Under what circumstances is a waterbed effect possible?

The Bureau has no experience with waterbed effect cases. The OECD (Organisation for Economic Co-operation and Development) notes that a waterbed effect arises if the effect of the exercise of the bargaining power is to increase the input price paid by other buyers. Such a case would only be subject to the Canadian *Competition Act* if a dominant firm engaged in an act that relatively increased its competitors' input costs (a theory of raising rivals' costs) through a practice of anti-competitive act, such that the intended effect of the act was to exclude or discipline their market participation. Merely being able to negotiate relatively more favourable prices does not typically meet these requirements.

3.5 What should be, and is, the legal status of the exercise of the different types of buyer power? Why?

As noted above, acts that result only in transfers of wealth among various market participants as a result of lower prices that either do not constitute monopsony power (where monopsony power includes those situations where the supply curve is perfectly inelastic such that a decrease in price below competitive levels only entails a transfer) that has the effect of substantially lessening or preventing competition, or do not ultimately result in substantially lessened or prevented competition as a result of an adverse effect on a competitor generally do not raise antitrust concerns in Canada.

4. Buyer power and conduct

4.1 Horizontal mergers. When and why does a horizontal merger create buyer power that gives rise to competition policy concerns? Can the creation of buyer power, in particular countervailing power, be a benefit of a horizontal merger?

As described above, as to buyer power, the Bureau is generally concerned with horizontal mergers that create, enhance or preserve monopsony power. The Bureau is generally not concerned with bargaining power unless it is an anti-competitive means by which a competitor's costs are raised such that it is excluded or disciplined with the net result that there is a substantial lessening or prevention of competition in a well-defined market. While such cases are typically considered under the abuse provisions, the Bureau does not rule out the possibility of such a consideration under the merger provisions.

The Bureau, when considering countervailing power in the merger context, normally considers it from the perspective of existing entities being able to discipline a possible exercise of market power by merging parties. It does not typically consider the creation of countervailing power through a merger as one of the benefits of that merger.

4.2 Vertical restraints. What are the implications of buyer power for the competitive analysis of vertical restraints? Does buyer power give rise to competitive concerns regarding buyer-led

vertical restraints? What kinds of vertical restraints can, and have, raised concerns because of buyer power? Can buyer power and vertical restraints result in welfare-reducing foreclosure?

The vertical cases involving the buying of inputs with which the Bureau typically concerns itself involve the driving up of input prices to competitors by engaging in a practice of anti-competitive acts. Examples of such vertical acts might include the pre-emption of scarce inputs by a variety of means, including exclusive deals with the main suppliers of the relevant input. [9] In such a way, buyer-led vertical restraints can give rise to competitive concerns. While the Bureau generally acknowledges that differences in the relative costs of inputs to a dominant firm versus that to its rivals might be to the rivals' disadvantage, the Bureau does not generally consider the achievement of such relative cost differences by way of a dominant firm simply being able to negotiate a lower input price, to be an anti-competitive act.

For an act to be considered anti-competitive, it must be found to be for the purpose of an intended negative effect on a competitor that is exclusionary, disciplinary, or predatory. Such acts could include exclusive dealing, bundling, tying and so forth. As noted above, exclusive dealing in the purchase of scarce inputs was the basis of the *Nielsen* case. In examining the purpose of the act, the Bureau takes into account the fact that a non-monopsony price reduction in input prices can be pro-competitive and so efficiency enhancing.

The Bureau is generally of the opinion that buyer power and vertical restraints can result in welfare-reducing foreclosure. While this is the case, it should be noted that the abuse provisions do not provide for an efficiencies defence.

4.3 Predatory bidding. Predatory bidding might create buyer market power. It involves overbidding for inputs in the short-run to reduce the profitability and induce the exit of competing firms that use the input in order to create monopsony power in the long-run. Under what circumstances is predatory bidding profitable and harmful? What should be the legal standard for a finding of anticompetitive predatory bidding?

To date, the Bureau has not investigated any matter involving predatory bidding. While the Bureau has considered matters where the price of a scarce input to competitors was increased, for example, through pre-emption or exclusive dealing, the Bureau has generally been concerned with the consequent impact the exclusion or disciplining of rivals would have on the downstream, rather than upstream, market (which, as noted above, is not to say that downstream effect is strictly necessary for the Bureau to have an issue). As noted above, however, the Bureau is generally concerned with monopsony power and its creation, and so would investigate matters involving allegations of predatory bidding.

The Bureau generally considers predatory bidding, as described above (and so ignoring any possible effect in the downstream market), to be profitable if its net effect, upon the exclusion of competitors, is a lower price paid for inputs than that which would otherwise have prevailed absent the bidding by an amount sufficiently large and/or for a period sufficiently long so as to allow the predating bidder to recoup the costs of the higher input prices it paid. If such bidding does not lead to a substantial lessening or prevention of competition by way of created, preserved or enhanced market power downstream, or enhanced market power upstream by way of creation of monopsony power, the bidding would not generally be considered abusive by the Bureau.

4.4 Raising Rivals' Costs (RRC (Raising Rivals' Costs)) overbuying. RRC (Raising Rivals' Costs) overbuying involves a downstream firm increasing its purchases of an input to raise demand and therefore the price of the input, with the intent of raising the cost of its rivals in the downstream market. Under what circumstances is RRC (Raising Rivals' Costs) overbuying profitable and harmful? What should be the legal standard for a finding of anticompetitive RRC (Raising Rivals' Costs) overbuying?

The Bureau considers RRC (Raising Rivals' Costs) overbuying to be profitable to the firm engaging in it, if the net effect of the exclusion or the disciplining of rival firms whose costs have been raised is a higher downstream price than that which would have prevailed absent the overbuying by an amount sufficiently large and/or for a period sufficiently long so as to recoup the costs of the higher input price. If having also found that the intended purpose of the overbuying was exclusion or disciplining, rather than some pro-competitive rationale, the Bureau will generally consider created or enhanced downstream market power to be the result of abuse.

4.5 Buyer groups. Under what circumstances does the formation of agreements, arrangements, and institutions that facilitate collective purchasing by buyers raise antitrust concerns? What should be the legal standard for the determination that a buyer group should be enjoined due to competition policy concerns?

Monopsony power and also bargaining power that result from the formation of a cartel will generally raise concerns under the conspiracy provisions of the Canadian *Competition Act*.

Footnotes

1 Cases where the supply curve is perfectly inelastic such that a price decrease below competitive levels does not result in a decrease in output but only a transfer may also give rise to concerns. This scenario should be understood to be generally included in the category of monopsony.

2 In such a situation, output would deteriorate not in terms of output, but rather in terms of quality.

3 In a hearing regarding the merger of meat rendering companies, the Competition Tribunal, while examining the merger from the selling side, indicated that it could analyse the competitive effects of the merger from the perspective of either a monopsonist or a monopolist, and that no significant difference resulted from the two characterisations (*The Director of Investigation and Research v. Hillsdown (Holdings) Canada Ltd*., et al., Reasons and Order, Competition Tribunal, March 9, 1992).

4 See, for example, “Competition Bureau reaches agreement to preserve competition in two B.C. forestry markets”, Media Release, Competition Bureau, Ottawa, December 7, 2004.

5 See, for example, “Competition Bureau Concludes Inquiry into Snow Crab Processing in Newfoundland and Labrador”, Media Release, Competition Bureau, Ottawa, December 17, 2004.

6 Which is as defined above and so subject to the note contained in footnote 1.

7 It may also be the case that buyers who participate in wholly different downstream markets will be relevant purchasers in the upstream market. For example, a buyer who purchases corn for flour production may participate in the same market as a buyer who purchases corn for ethanol production.

8 Where the supply curve is perfectly inelastic, there will be no allocative inefficiency resulting from a decrease in price below competitive levels. As noted in footnote 1 and elsewhere in this submission, such a situation may still give rise to concerns.

9 Director of *Investigation & Research v. D&B Co. of Canada*, Reasons for Order, Competition Tribunal, 1995 (“Nielsen”).

Date modified:

2015-11-05

Government of Canada Gouvernement du Canada

Archived — Acquisition of Better Beef by Cargill Limited

Technical Backgrounder

August 2005

This technical backgrounder summarizes the main findings of the Competition Bureau's review of the acquisition of the Better Beef Group of Companies ("Better Beef") by Cargill Limited ("Cargill").

Readers are advised to exercise caution in interpreting the Competition Bureau's assessment of this transaction. Enforcement decisions are made on a case-by-case basis and the conclusions discussed in this backgrounder are specific to this merger and are not binding on the Commissioner in any future matters. The legal requirements of section 29 of the *Competition Act* (The "Act") and the Bureau's policies and practices regarding the treatment of confidential information limit its ability to disclose certain information obtained during the course of a merger review.

In March 2005, Cargill contacted the Bureau regarding its interest in acquiring Better Beef and the matter was made public by the parties in mid-April. The proposed transaction was classified as "very complex" under the Bureau's service standards and a formal inquiry was commenced pursuant to section 10(1)(b) of the Act. Documents and written returns of information were compelled from the parties and competing beef packers through the use of formal powers available under Section 11 of the *Competition Act*.

In conducting its inquiry, the Bureau obtained relevant information and views from a number of third party sources including feedlot owners, farmers, industry associations, cattle brokers and grocery retailers, as well as federal and provincial government officials through an extensive series of meetings and interviews. In addition, the Bureau retained two independent experts, one in the field of agricultural economics and the other in industrial organization.

After a thorough investigation, econometric work and careful analysis and consideration of all of the available evidence, submissions and representations received, the Bureau concluded that a merger of Cargill and Better Beef was not likely to result in a substantial prevention or lessening of competition in any relevant market.

In reviewing the competitive impacts of the merger, the Bureau was cognizant of the effects of border issues affecting the flow of Canadian cattle and beef products. The relevant events are:

- May 20, 2003 - Following the discovery of Canada’s first case of bovine spongiform encephalopathy ("BSE") the Canada/U.S. border closed to the movement of live cattle and beef products from Canada;
- August 8, 2003 - The U.S. partially lifted the ban on Canadian beef, allowing imports of cuts of Canadian boneless beef from cattle under 30 months of age;
- December 2004 - The U.S. Department of Agriculture ("USDA") declared Canada a "minimal-risk region", effective March 7, 2005. The

USDA rule would have allowed Canada to resume shipping cattle under 30 months of age to the U.S.;

- March 2, 2005 - Following litigation opposing the USDA rule in the U.S. District Court of Montana, a judge of the Billings Division issued an interim injunction preventing the USDA rule from coming into effect until a later date, when the case would be heard;
- July 14, 2005 - The interim injunction issued by the judge of the Billings Division was overturned by the 9th U.S. District Court. The Canada/U.S. border was immediately open to cattle under 30 months of age. The judge of the Billings Division was to hear the case on July 27, 2005 for a permanent injunction against both live cattle and all beef imports from Canada. The July 27, 2005 hearing was adjourned, pending the judge's review of the written reasons of the 9th U.S. Circuit Court; and
- July 18, 2005 - The first shipment of cattle under 30 months of age since May 2003 crossed the Canada/U.S. border. The border has remained open since that time. However, exporting cattle to the U.S. involves increased costs and restrictions relative to the situation prior to May 20, 2003.

The Parties

Cargill is one of Canada's largest agricultural merchandisers and processors with interests in meat, egg, malt and oilseed processing, livestock feed, salt manufacturing, as well as crop input products, grain handling and merchandising. Cargill owns a fully integrated beef packing facility located in High River, Alberta which has slaughter, beef processing, rendering and hide operations. This facility produces beef products such as boxed beef and by-products. [1] Cargill also operates two multi-species case-ready meat packing facilities in Toronto, Ontario and Chambly, Quebec.

Better Beef operates an integrated beef packing facility in Guelph, Ontario, the largest such facility in Eastern Canada. The main product of the Better Beef's Guelph facility is boxed beef. Other related businesses include a feedlot and two multi-species case-ready meat packing facilities in Guelph and Stoney Creek, Ontario.

Industry Overview

Participants in the beef value chain include the following:

- Cattle producers who operate cow-calf, farming, ranching, or backgrounding operations;
- Cattle feeders, or feedlots, who purchase, then feed cattle until they reach slaughter weight for sale to beef packers;
- Integrated beef packers, such as Cargill and Better Beef, who slaughter cattle, fabricate, package and market beef products; and
- Grocery, food service and further processing sectors who purchase beef products from packers and make these products available to consumers either on retail shelves as meat or further processed products, or at food service establishments.

In addition to Better Beef and Cargill, other Canadian packers include Lakeside Packers in Brooks, Alberta, owned by IBP Tyson in the U.S. and XL Foods, with beef packing plants in Moose Jaw, Saskatchewan and Calgary, Alberta. In Ontario, there are two smaller facilities in the Toronto area: Ryding-Regency and St. Helens.

As integrated beef packers, Cargill and Better Beef are involved in four sectors of the industry (i) beef procurement, (ii) the production and disposition of hides and rendering source products (iii) the production, distribution and sale of boxed beef and (iv) case ready beef.

Focus of the Bureau’s Inquiry

With respect to boxed beef, all evidence and views obtained during the merger examination confirmed that since the U.S. border opened in August 2003 to boneless beef exports from cattle under 30 months of age, a North American market and price was re-established for boxed beef, trim and grind. Accordingly the Bureau concluded that the acquisition of Better Beef by Cargill would not result in a substantial prevention or lessening of competition in boxed beef. A similar conclusion was reached with respect to hides and rendering source products. Hence, the Bureau’s inquiry was focused on the impact of the proposed merger on the ‘upstream’ issue of cattle procurement and the ‘downstream’ issue of case ready beef.

Cattle Procurement

The focus of this aspect of the Bureau’s examination was on whether the transaction would enhance the parties’ market power when acting as buyers of cattle. In this context, market power means the ability of a single firm or group of firms to profitably depress prices paid to sellers to a level that is below the competitive price for a significant period of time.

Relevant Product Market

The relevant upstream product market is the procurement of fed cattle, or slaughter cattle under 30 months of age. [2] Fed cattle are steers and heifers that have reached an optimum slaughter weight of 1,200 to 1,400 pounds. Most will have been on a special feed of concentrates and grains for 90 to 120 days prior to slaughter.

Relevant Geographic Market

In defining the relevant geographic market, it was necessary to consider the extent to which the Better Beef plant in Guelph participates in the procurement of cattle in western Canada (the area with the largest concentration of fed cattle in Canada) and the extent to which packing plants in the U.S. are part of the relevant market.

The Bureau examined the potential impact of the merger on cattle procurement as far west as Alberta. However, because of its closer geographic proximity to the Better Beef plant in Guelph and its dependency on out-of-province slaughter capacity, particular attention was paid to the potential impact on the cattle industry in Manitoba.

In analyzing this issue, the Bureau examined available evidence with respect to (i) inter-provincial and trans-U.S. border cattle flows, (ii) source of origin procurement data for major Canadian packers (iii) transportation costs and (iv) pricing data. This analysis included the period prior to May 20, 2003 when the border with the U.S. was open to cattle trade, the period from May 20, 2003 to July 13, 2005 when the border was closed to all cattle trade, and the brief period since the re-opening of the border to the movement of fed cattle, from July 14, 2005 to the present.

Based on this analysis, the Bureau established that there are two relevant geographic markets: (1) Western Canada (including Manitoba) plus certain U.S. northern plains states and (2) Eastern Canada plus certain northeastern U.S. states. The distance from Better Beef's facility to cattle producers in Manitoba and other western provinces was key to this finding. The Bureau's analysis also established that, during the period when the border with the U.S. was closed to all cattle trade, the two relevant geographic markets were: (1) Western Canada (including Manitoba) and (2) Eastern Canada. When the border was closed, even at the peak of Better Beef's purchases of fed cattle in Western Canada, the volume Better Beef procured there was modest in proportion to Better Beef's own overall requirements, the total volume of fed cattle in the entire Western Canada herd, and even in proportion to the Manitoba herd. For example, in 2004 Better Beef's purchases of fed cattle in Alberta were negligible and their purchases in Manitoba were less than 10% of Manitoba's total fed cattle inventory.

Finally, claims that Better Beef had a disproportionately large effect on price determination, both in Manitoba, and perhaps as far west as Alberta were not supported by the empirical evidence. This analysis has led to the conclusion that, even if the Canada/U.S. border closed again to the movement of fed cattle, the effects of the merger would not be significant enough to result in a substantial prevention or lessening of competition in the procurement of fed cattle.

Market Share and Concentration

Even though both Cargill and Better Beef were both purchasing Manitoba cattle, the direct competitive overlap was limited. For example, some of Better Beef's purchases were of "heavy" cattle, for which Cargill was less willing to bid. Better Beef provided an additional limited option to a small number of Manitoba producers during the period of the border closure. With the border re-opened, there will be continuing competition remaining in Canada from other Canadian and US based packing plants.

Barriers to Entry

There are barriers to entry into beef packing, including the need to secure a suitable site location. However, there is small-scale entry, construction of new slaughter facilities and further planned entry in Western Canada.

Substantial Prevention or Lessening of Competition

Based on the experience to date, even with additional costs and restrictions on exports to the U.S., the merger is unlikely to result in a substantial prevention or lessening of competition in cattle procurement.

Case Ready

The relevant product market is case-ready beef, which is boxed beef that has been further cut, fabricated and packaged into servings suitable for display and sale in retail stores. An important consideration in the Bureau's analysis, however, is the fact that not all retailers use case-ready beef and many retain their own in-store meat cutting capability.

The geographic market for case-ready beef is limited due to shelf life and transportation costs. The Bureau found that the broadest definition of the relevant market for case ready beef are the provinces of Ontario and Quebec, where both Cargill and Better Beef operate plants.

Findings and Conclusions

- Cargill's two case-ready plants in eastern Canada are dedicated to one large grocery retailer under long-term contract. The only other existing case-ready competitor in Eastern Canada is a smaller supplier with a plant located in Quebec.
- Economies of scale and establishing customer relationships were identified as potential barriers to entry. However, market contacts revealed that entry into this market is feasible and that there are

established industry participants who appear to be well placed to enter the market or expand their existing operations.

- Market contacts with a broad cross-section of grocery retailers revealed a lack of concern on their part with respect to the possible impact of the proposed merger on case ready beef. Retailers indicated that they possess sufficient countervailing power including the ability to do their own meat cutting to counter the potential of market power accruing to merged entity. They were of the view that entry into the market is feasible.
- Despite the large market share that the merged entity will possess, the threat of entry and countervailing power on the part of retail grocery firms make it unlikely that the merger will result in a substantial prevention or lessening of competition in the case ready market.

Conclusion

The Bureau is satisfied that the transaction does not provide the grounds necessary to warrant an application to the Competition Tribunal under section 92 of the *Act* to challenge the proposed merger.

Footnotes

1 Boxed beef refers to sub-primal or smaller cuts such as shoulders and loins that are vacuum packed at the packing plant and shipped in card board boxes, primarily to retailers.

2 Fed cattle yield wholesale cuts of beef products, typically vacuum packed, sold as boxed beef and ultimately available on grocery shelves. Products from fed cattle include such cuts as rib, loin and chuck.

Date modified:

2015-11-05

Horizontal Merger Guidelines

U.S. Department of Justice

and the

Federal Trade Commission

Issued: August 19, 2010

Table of Contents

1. Overview

These Guidelines outline the principal analytical techniques, practices, and the enforcement policy of the Department of Justice and the Federal Trade Commission (the "Agencies") with respect to mergers and acquisitions involving actual or potential competitors ("horizontal mergers") under the federal antitrust laws.[1] The relevant statutory provisions include Section 7 of the Clayton Act, 15 U.S.C. § 18, Sections 1 and 2 of the Sherman Act, 15 U.S.C. §§ 1, 2, and Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45. Most particularly, Section 7 of the Clayton Act prohibits mergers if "in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly."

The Agencies seek to identify and challenge competitively harmful mergers while avoiding unnecessary interference with mergers that are either competitively beneficial or neutral. Most merger analysis is necessarily predictive, requiring an assessment of what will likely happen if a merger proceeds as compared to what will likely happen if it does not. Given this inherent need for prediction, these Guidelines reflect the congressional intent that merger enforcement should interdict competitive problems in their incipiency and that certainty about anticompetitive effect is seldom possible and not required for a merger to be illegal.

These Guidelines describe the principal analytical techniques and the main types of evidence on which the Agencies usually rely to predict whether a horizontal merger may substantially lessen competition. They are not intended to describe how the Agencies analyze cases other than horizontal mergers. These Guidelines are intended to assist the business community and antitrust practitioners by increasing the transparency of the analytical process underlying the Agencies' enforcement decisions. They may also assist the courts in developing an appropriate framework for interpreting and applying the antitrust laws in the horizontal merger context.

These Guidelines should be read with the awareness that merger analysis does not consist of uniform application of a single methodology. Rather, it is a fact-specific process through which the Agencies, guided by their extensive experience, apply a range of analytical tools to the reasonably available and reliable evidence to evaluate competitive concerns in a limited period of time. Where these Guidelines provide examples, they are illustrative and do not exhaust the applications of the relevant principle.[2]

---

[1] These Guidelines replace the Horizontal Merger Guidelines issued in 1992, revised in 1997. They reflect the ongoing accumulation of experience at the Agencies. The Commentary on the Horizontal Merger Guidelines issued by the Agencies in 2006 remains a valuable supplement to these Guidelines. These Guidelines may be revised from time to time as necessary to reflect significant changes in enforcement policy, to clarify existing policy, or to reflect new learning. These Guidelines do not cover vertical or other types of non-horizontal acquisitions.

[2] These Guidelines are not intended to describe how the Agencies will conduct the litigation of cases they decide to bring. Although relevant in that context, these Guidelines neither dictate nor exhaust the range of evidence the Agencies may introduce in litigation.

The unifying theme of these Guidelines is that mergers should not be permitted to create, enhance, or entrench market power or to facilitate its exercise. For simplicity of exposition, these Guidelines generally refer to all of these effects as enhancing market power. A merger enhances market power if it is likely to encourage one or more firms to raise price, reduce output, diminish innovation, or otherwise harm customers as a result of diminished competitive constraints or incentives. In evaluating how a merger will likely change a firm's behavior, the Agencies focus primarily on how the merger affects conduct that would be most profitable for the firm.

A merger can enhance market power simply by eliminating competition between the merging parties. This effect can arise even if the merger causes no changes in the way other firms behave. Adverse competitive effects arising in this manner are referred to as "unilateral effects." A merger also can enhance market power by increasing the risk of coordinated, accommodating, or interdependent behavior among rivals. Adverse competitive effects arising in this manner are referred to as "coordinated effects." In any given case, either or both types of effects may be present, and the distinction between them may be blurred.

These Guidelines principally describe how the Agencies analyze mergers between rival suppliers that may enhance their market power as sellers. Enhancement of market power by sellers often elevates the prices charged to customers. For simplicity of exposition, these Guidelines generally discuss the analysis in terms of such price effects. Enhanced market power can also be manifested in non-price terms and conditions that adversely affect customers, including reduced product quality, reduced product variety, reduced service, or diminished innovation. Such non-price effects may coexist with price effects, or can arise in their absence. When the Agencies investigate whether a merger may lead to a substantial lessening of non-price competition, they employ an approach analogous to that used to evaluate price competition. Enhanced market power may also make it more likely that the merged entity can profitably and effectively engage in exclusionary conduct. Regardless of how enhanced market power likely would be manifested, the Agencies normally evaluate mergers based on their impact on customers. The Agencies examine effects on either or both of the direct customers and the final consumers. The Agencies presume, absent convincing evidence to the contrary, that adverse effects on direct customers also cause adverse effects on final consumers.

Enhancement of market power by buyers, sometimes called "monopsony power," has adverse effects comparable to enhancement of market power by sellers. The Agencies employ an analogous framework to analyze mergers between rival purchasers that may enhance their market power as buyers. See Section 12.

2. Evidence of Adverse Competitive Effects

The Agencies consider any reasonably available and reliable evidence to address the central question of whether a merger may substantially lessen competition. This section discusses several categories and sources of evidence that the Agencies, in their experience, have found most informative in predicting the likely competitive effects of mergers. The list provided here is not exhaustive. In any given case, reliable evidence may be available in only some categories or from some sources. For each category of evidence, the Agencies consider evidence indicating that the merger may enhance competition as well as evidence indicating that it may lessen competition.

2.1 Types of Evidence

2.1.1 Actual Effects Observed in Consummated Mergers

When evaluating a consummated merger, the ultimate issue is not only whether adverse competitive effects have already resulted from the merger, but also whether such effects are likely to arise in the future. Evidence of observed post-merger price increases or other changes adverse to customers is given substantial weight. The Agencies evaluate whether such changes are anticompetitive effects resulting from the merger, in which case they can be dispositive. However, a consummated merger may be anticompetitive even if such effects have not yet been observed, perhaps because the merged firm may be aware of the possibility of post-merger antitrust review and moderating its conduct. Consequently, the Agencies also consider the same types of evidence they consider when evaluating unconsummated mergers.

2.1.2 Direct Comparisons Based on Experience

The Agencies look for historical events, or “natural experiments,” that are informative regarding the competitive effects of the merger. For example, the Agencies may examine the impact of recent mergers, entry, expansion, or exit in the relevant market. Effects of analogous events in similar markets may also be informative.

The Agencies also look for reliable evidence based on variations among similar markets. For example, if the merging firms compete in some locales but not others, comparisons of prices charged in regions where they do and do not compete may be informative regarding post-merger prices. In some cases, however, prices are set on such a broad geographic basis that such comparisons are not informative. The Agencies also may examine how prices in similar markets vary with the number of significant competitors in those markets.

2.1.3 Market Shares and Concentration in a Relevant Market

The Agencies give weight to the merging parties’ market shares in a relevant market, the level of concentration, and the change in concentration caused by the merger. See Sections 4 and 5. Mergers that cause a significant increase in concentration and result in highly concentrated markets are presumed to be likely to enhance market power, but this presumption can be rebutted by persuasive evidence showing that the merger is unlikely to enhance market power.

2.1.4 Substantial Head-to-Head Competition

The Agencies consider whether the merging firms have been, or likely will become absent the merger, substantial head-to-head competitors. Such evidence can be especially relevant for evaluating adverse unilateral effects, which result directly from the loss of that competition. See Section 6. This evidence can also inform market definition. See Section 4.

2.1.5 Disruptive Role of a Merging Party

The Agencies consider whether a merger may lessen competition by eliminating a “maverick” firm, i.e., a firm that plays a disruptive role in the market to the benefit of customers. For example, if one of the merging firms has a strong incumbency position and the other merging firm threatens to disrupt market conditions with a new technology or business model, their merger can involve the loss of actual or potential competition. Likewise, one of the merging firms may have the incentive to take the lead in price cutting or other competitive conduct or to resist increases in industry prices. A firm that may discipline prices based on its ability and incentive to expand production rapidly using available capacity also can be a maverick, as can a firm that has often resisted otherwise prevailing industry norms to cooperate on price setting or other terms of competition.

2.2 Sources of Evidence

The Agencies consider many sources of evidence in their merger analysis. The most common sources of reasonably available and reliable evidence are the merging parties, customers, other industry participants, and industry observers.

2.2.1 Merging Parties

The Agencies typically obtain substantial information from the merging parties. This information can take the form of documents, testimony, or data, and can consist of descriptions of competitively relevant conditions or reflect actual business conduct and decisions. Documents created in the normal course are more probative than documents created as advocacy materials in merger review. Documents describing industry conditions can be informative regarding the operation of the market and how a firm identifies and assesses its rivals, particularly when business decisions are made in reliance on the accuracy of those descriptions. The business decisions taken by the merging firms also can be informative about industry conditions. For example, if a firm sets price well above incremental cost, that normally indicates either that the firm believes its customers are not highly sensitive to price (not in itself of antitrust concern, see Section 4.1.3[3]) or that the firm and its rivals are engaged in coordinated interaction (see Section 7). Incremental cost depends on the relevant increment in output as well as on the time period involved, and in the case of large increments and sustained changes in output it may include some costs that would be fixed for smaller increments of output or shorter time periods.

Explicit or implicit evidence that the merging parties intend to raise prices, reduce output or capacity, reduce product quality or variety, withdraw products or delay their introduction, or curtail research and development efforts after the merger, or explicit or implicit evidence that the ability to engage in such conduct motivated the merger, can be highly informative in evaluating the likely effects of a merger. Likewise, the Agencies look for reliable evidence that the merger is likely to result in efficiencies. The Agencies give careful consideration to the views of individuals whose responsibilities, expertise, and experience relating to the issues in question provide particular indicia of reliability. The financial terms of the transaction may also be informative regarding competitive effects. For example, a purchase price in excess of the acquired firm's stand-alone market value may indicate that the acquiring firm is paying a premium because it expects to be able to reduce competition or to achieve efficiencies.

---

3 High margins commonly arise for products that are significantly differentiated. Products involving substantial fixed costs typically will be developed only if suppliers expect there to be enough differentiation to support margins sufficient to cover those fixed costs. High margins can be consistent with incumbent firms earning competitive returns.

2.2.2 Customers

Customers can provide a variety of information to the Agencies, ranging from information about their own purchasing behavior and choices to their views about the effects of the merger itself.

Information from customers about how they would likely respond to a price increase, and the relative attractiveness of different products or suppliers, may be highly relevant, especially when corroborated by other evidence such as historical purchasing patterns and practices. Customers also can provide valuable information about the impact of historical events such as entry by a new supplier.

The conclusions of well-informed and sophisticated customers on the likely impact of the merger itself can also help the Agencies investigate competitive effects, because customers typically feel the consequences of both competitively beneficial and competitively harmful mergers. In evaluating such evidence, the Agencies are mindful that customers may oppose, or favor, a merger for reasons unrelated to the antitrust issues raised by that merger.

When some customers express concerns about the competitive effects of a merger while others view the merger as beneficial or neutral, the Agencies take account of this divergence in using the information provided by customers and consider the likely reasons for such divergence of views. For example, if for regulatory reasons some customers cannot buy imported products, while others can, a merger between domestic suppliers may harm the former customers even if it leaves the more flexible customers unharmed. See Section 3.

When direct customers of the merging firms compete against one another in a downstream market, their interests may not be aligned with the interests of final consumers, especially if the direct customers expect to pass on any anticompetitive price increase. A customer that is protected from adverse competitive effects by a long-term contract, or otherwise relatively immune from the merger's harmful effects, may even welcome an anticompetitive merger that provides that customer with a competitive advantage over its downstream rivals.

> *Example 1:* As a result of the merger, Customer C will experience a price increase for an input used in producing its final product, raising its costs. Customer C's rivals use this input more intensively than Customer C, and the same price increase applied to them will raise their costs more than it raises Customer C's costs. On balance, Customer C may benefit from the merger even though the merger involves a substantial lessening of competition.

2.2.3 Other Industry Participants and Observers

Suppliers, indirect customers, distributors, other industry participants, and industry analysts can also provide information helpful to a merger inquiry. The interests of firms selling products complementary to those offered by the merging firms often are well aligned with those of customers, making their informed views valuable.

Information from firms that are rivals to the merging parties can help illuminate how the market operates. The interests of rival firms often diverge from the interests of customers, since customers normally lose, but rival firms gain, if the merged entity raises its prices. For that reason, the Agencies do not routinely rely on the overall views of rival firms regarding the competitive effects of the merger. However, rival firms may provide relevant facts, and even their overall views may be instructive, especially in cases where the Agencies are concerned that the merged entity may engage in exclusionary conduct.

> *Example 2:* Merging Firms A and B operate in a market in which network effects are significant, implying that any firm's product is significantly more valuable if it commands a large market share or if it is interconnected with others that in aggregate command such a share. Prior to the merger, they and their rivals voluntarily interconnect with one another. The merger would create an entity with a large enough share that a strategy of ending voluntary interconnection would have a dangerous probability of creating monopoly power in this market. The interests of rivals and of consumers would be broadly aligned in preventing such a merger.

3. Targeted Customers and Price Discrimination

When examining possible adverse competitive effects from a merger, the Agencies consider whether those effects vary significantly for different customers purchasing the same or similar products. Such differential impacts are possible when sellers can discriminate, e.g., by profitably raising price to certain targeted customers but not to others. The possibility of price discrimination influences market definition (see Section 4), the measurement of market shares (see Section 5), and the evaluation of competitive effects (see Sections 6 and 7).

When price discrimination is feasible, adverse competitive effects on targeted customers can arise, even if such effects will not arise for other customers. A price increase for targeted customers may be profitable even if a price increase for all customers would not be profitable because too many other customers would substitute away. When discrimination is reasonably likely, the Agencies may evaluate competitive effects separately by type of customer. The Agencies may have access to information unavailable to customers that is relevant to evaluating whether discrimination is reasonably likely.

For price discrimination to be feasible, two conditions typically must be met: differential pricing and limited arbitrage.

First, the suppliers engaging in price discrimination must be able to price differently to targeted customers than to other customers. This may involve identification of individual customers to which different prices are offered or offering different prices to different types of customers based on observable characteristics.

> *Example 3:* Suppliers can distinguish large buyers from small buyers. Large buyers are more likely than small buyers to self-supply in response to a significant price increase. The merger may lead to price discrimination against small buyers, harming them, even if large buyers are not harmed. Such discrimination can occur even if there is no discrete gap in size between the classes of large and small buyers.

In other cases, suppliers may be unable to distinguish among different types of customers but can offer multiple products that sort customers based on their purchase decisions.

Second, the targeted customers must not be able to defeat the price increase of concern by arbitrage, e.g., by purchasing indirectly from or through other customers. Arbitrage may be difficult if it would void warranties or make service more difficult or costly for customers. Arbitrage is inherently impossible for many services. Arbitrage between customers at different geographic locations may be impractical due to transportation costs. Arbitrage on a modest scale may be possible but sufficiently costly or limited that it would not deter or defeat a discriminatory pricing strategy.

4. Market Definition

When the Agencies identify a potential competitive concern with a horizontal merger, market definition plays two roles. First, market definition helps specify the line of commerce and section of the country in which the competitive concern arises. In any merger enforcement action, the Agencies will normally identify one or more relevant markets in which the merger may substantially lessen competition. Second, market definition allows the Agencies to identify market participants and measure market shares and market concentration. See Section 5. The measurement of market shares and market concentration is not an end in itself, but is useful to the extent it illuminates the merger's likely competitive effects.

The Agencies' analysis need not start with market definition. Some of the analytical tools used by the Agencies to assess competitive effects do not rely on market definition, although evaluation of competitive alternatives available to customers is always necessary at some point in the analysis.

Evidence of competitive effects can inform market definition, just as market definition can be informative regarding competitive effects. For example, evidence that a reduction in the number of significant rivals offering a group of products causes prices for those products to rise significantly can itself establish that those products form a relevant market. Such evidence also may more directly predict the competitive effects of a merger, reducing the role of inferences from market definition and market shares.

Where analysis suggests alternative and reasonably plausible candidate markets, and where the resulting market shares lead to very different inferences regarding competitive effects, it is particularly valuable to examine more direct forms of evidence concerning those effects.

Market definition focuses solely on demand substitution factors, i.e., on customers' ability and willingness to substitute away from one product to another in response to a price increase or a corresponding non-price change such as a reduction in product quality or service. The responsive actions of suppliers are also important in competitive analysis. They are considered in these Guidelines in the sections addressing the identification of market participants, the measurement of market shares, the analysis of competitive effects, and entry.

Customers often confront a range of possible substitutes for the products of the merging firms. Some substitutes may be closer, and others more distant, either geographically or in terms of product attributes and perceptions. Additionally, customers may assess the proximity of different products differently. When products or suppliers in different geographic areas are substitutes for one another to varying degrees, defining a market to include some substitutes and exclude others is inevitably a simplification that cannot capture the full variation in the extent to which different products compete against each other. The principles of market definition outlined below seek to make this inevitable simplification as useful and informative as is practically possible. Relevant markets need not have precise metes and bounds.

Defining a market broadly to include relatively distant product or geographic substitutes can lead to misleading market shares. This is because the competitive significance of distant substitutes is unlikely to be commensurate with their shares in a broad market. Although excluding more distant substitutes from the market inevitably understates their competitive significance to some degree, doing so often provides a more accurate indicator of the competitive effects of the merger than would the alternative of including them and overstating their competitive significance as proportional to their shares in an expanded market.

> *Example 4:* Firms A and B, sellers of two leading brands of motorcycles, propose to merge. If Brand A motorcycle prices were to rise, some buyers would substitute to Brand B, and some others would substitute to cars. However, motorcycle buyers see Brand B motorcycles as much more similar to Brand A motorcycles than are cars. Far more cars are sold than motorcycles. Evaluating shares in a market that includes cars would greatly underestimate the competitive significance of Brand B motorcycles in constraining Brand A's prices and greatly overestimate the significance of cars.

Market shares of different products in narrowly defined markets are more likely to capture the relative competitive significance of these products, and often more accurately reflect competition between close substitutes. As a result, properly defined antitrust markets often exclude some substitutes to which some customers might turn in the face of a price increase even if such substitutes provide alternatives for those customers. However, a group of products is too narrow to constitute a relevant market if competition from products outside that group is so ample that even the complete elimination of competition within the group would not significantly harm either direct customers or downstream consumers. The hypothetical monopolist test (see Section 4.1.1) is designed to ensure that candidate markets are not overly narrow in this respect.

The Agencies implement these principles of market definition flexibly when evaluating different possible candidate markets. Relevant antitrust markets defined according to the hypothetical monopolist test are not always intuitive and may not align with how industry members use the term "market."

Section 4.1 describes the principles that apply to product market definition, and gives guidance on how the Agencies most often apply those principles. Section 4.2 describes how the same principles apply to geographic market definition. Although discussed separately for simplicity of exposition, the principles described in Sections 4.1 and 4.2 are combined to define a relevant market, which has both a product and a geographic dimension. In particular, the hypothetical monopolist test is applied to a group of products together with a geographic region to determine a relevant market.

4.1 Product Market Definition

When a product sold by one merging firm (Product A) competes against one or more products sold by the other merging firm, the Agencies define a relevant product market around Product A to evaluate the importance of that competition. Such a relevant product market consists of a group of substitute products including Product A. Multiple relevant product markets may thus be identified.

4.1.1 The Hypothetical Monopolist Test

The Agencies employ the hypothetical monopolist test to evaluate whether groups of products in candidate markets are sufficiently broad to constitute relevant antitrust markets. The Agencies use the hypothetical monopolist test to identify a set of products that are reasonably interchangeable with a product sold by one of the merging firms.

The hypothetical monopolist test requires that a product market contain enough substitute products so that it could be subject to post-merger exercise of market power significantly exceeding that existing absent the merger. Specifically, the test requires that a hypothetical profit-maximizing firm, not subject to price regulation, that was the only present and future seller of those products ("hypothetical monopolist") likely would impose at least a small but significant and non-transitory increase in price ("SSNIP") on at least one product in the market, including at least one product sold by one of the merging firms.[4] For the purpose of analyzing this issue, the terms of sale of products outside the candidate market are held constant. The SSNIP is employed solely as a methodological tool for performing the hypothetical monopolist test; it is not a tolerance level for price increases resulting from a merger.

Groups of products may satisfy the hypothetical monopolist test without including the full range of substitutes from which customers choose. The hypothetical monopolist test may identify a group of products as a relevant market even if customers would substitute significantly to products outside that group in response to a price increase.

> *Example 5:* Products A and B are being tested as a candidate market. Each sells for $100, has an incremental cost of $60, and sells 1200 units. For every dollar increase in the price of Product A, for any given price of Product B, Product A loses twenty units of sales to products outside the candidate market and ten units of sales to Product B, and likewise for Product B. Under these conditions, economic analysis shows that a hypothetical profit-maximizing monopolist controlling Products A and B would raise both of their prices by ten percent, to $110. Therefore, Products A and B satisfy the hypothetical monopolist test using a five percent SSNIP, and indeed for any SSNIP size up to ten percent. This is true even though two-thirds of the sales lost by one product when it raises its price are diverted to products outside the relevant market.

When applying the hypothetical monopolist test to define a market around a product offered by one of the merging firms, if the market includes a second product, the Agencies will normally also include a third product if that third product is a closer substitute for the first product than is the second product. The third product is a closer substitute if, in response to a SSNIP on the first product, greater revenues are diverted to the third product than to the second product.

> *Example 6:* In Example 5, suppose that half of the unit sales lost by Product A when it raises its price are diverted to Product C, which also has a price of $100, while one-third are diverted to Product B. Product C is a closer substitute for Product A than is Product B. Thus Product C will normally be included in the relevant market, even though Products A and B together satisfy the hypothetical monopolist test.

The hypothetical monopolist test ensures that markets are not defined too narrowly, but it does not lead to a single relevant market. The Agencies may evaluate a merger in any relevant market

---

4 If the pricing incentives of the firms supplying the products in the candidate market differ substantially from those of the hypothetical monopolist, for reasons other than the latter's control over a larger group of substitutes, the Agencies may instead employ the concept of a hypothetical profit-maximizing cartel comprised of the firms (with all their products) that sell the products in the candidate market. This approach is most likely to be appropriate if the merging firms sell products outside the candidate market that significantly affect their pricing incentives for products in the candidate market. This could occur, for example, if the candidate market is one for durable equipment and the firms selling that equipment derive substantial net revenues from selling spare parts and service for that equipment.

satisfying the test, guided by the overarching principle that the purpose of defining the market and measuring market shares is to illuminate the evaluation of competitive effects. Because the relative competitive significance of more distant substitutes is apt to be overstated by their share of sales, when the Agencies rely on market shares and concentration, they usually do so in the smallest relevant market satisfying the hypothetical monopolist test.

> *Example 7:* In Example 4, including cars in the market will lead to misleadingly small market shares for motorcycle producers. Unless motorcycles fail the hypothetical monopolist test, the Agencies would not include cars in the market in analyzing this motorcycle merger.

4.1.2 Benchmark Prices and SSNIP Size

The Agencies apply the SSNIP starting from prices that would likely prevail absent the merger. If prices are not likely to change absent the merger, these benchmark prices can reasonably be taken to be the prices prevailing prior to the merger.[5] If prices are likely to change absent the merger, e.g., because of innovation or entry, the Agencies may use anticipated future prices as the benchmark for the test. If prices might fall absent the merger due to the breakdown of pre-merger coordination, the Agencies may use those lower prices as the benchmark for the test. In some cases, the techniques employed by the Agencies to implement the hypothetical monopolist test focus on the difference in incentives between pre-merger firms and the hypothetical monopolist and do not require specifying the benchmark prices.

The SSNIP is intended to represent a "small but significant" increase in the prices charged by firms in the candidate market for the value they contribute to the products or services used by customers. This properly directs attention to the effects of price changes commensurate with those that might result from a significant lessening of competition caused by the merger. This methodology is used because normally it is possible to quantify "small but significant" adverse price effects on customers and analyze their likely reactions, not because price effects are more important than non-price effects.

The Agencies most often use a SSNIP of five percent of the price paid by customers for the products or services to which the merging firms contribute value. However, what constitutes a "small but significant" increase in price, commensurate with a significant loss of competition caused by the merger, depends upon the nature of the industry and the merging firms' positions in it, and the Agencies may accordingly use a price increase that is larger or smaller than five percent. Where explicit or implicit prices for the firms' specific contribution to value can be identified with reasonable clarity, the Agencies may base the SSNIP on those prices.

> *Example 8:* In a merger between two oil pipelines, the SSNIP would be based on the price charged for transporting the oil, not on the price of the oil itself. If pipelines buy the oil at one end and sell it at the other, the price charged for transporting the oil is implicit, equal to the difference between the price paid for oil at the input end and the price charged for oil at the output end. The relevant product sold by the pipelines is better described as "pipeline transportation of oil from point A to point B" than as "oil at point B."

---

[5] Market definition for the evaluation of non-merger antitrust concerns such as monopolization or facilitating practices will differ in this respect if the effects resulting from the conduct of concern are already occurring at the time of evaluation.

Example 9: In a merger between two firms that install computers purchased from third parties, the SSNIP would be based on their fees, not on the price of installed computers. If these firms purchase the computers and charge their customers one package price, the implicit installation fee is equal to the package charge to customers less the price of the computers.

Example 10: In Example 9, suppose that the prices paid by the merging firms to purchase computers are opaque, but account for at least ninety-five percent of the prices they charge for installed computers, with profits or implicit fees making up five percent of those prices at most. A five percent SSNIP on the total price paid by customers would at least double those fees or profits. Even if that would be unprofitable for a hypothetical monopolist, a significant increase in fees might well be profitable. If the SSNIP is based on the total price paid by customers, a lower percentage will be used.

4.1.3 Implementing the Hypothetical Monopolist Test

The hypothetical monopolist's incentive to raise prices depends both on the extent to which customers would likely substitute away from the products in the candidate market in response to such a price increase and on the profit margins earned on those products. The profit margin on incremental units is the difference between price and incremental cost on those units. The Agencies often estimate incremental costs, for example using merging parties' documents or data the merging parties use to make business decisions. Incremental cost is measured over the change in output that would be caused by the price increase under consideration.

In considering customers' likely responses to higher prices, the Agencies take into account any reasonably available and reliable evidence, including, but not limited to:

- how customers have shifted purchases in the past in response to relative changes in price or other terms and conditions;
- information from buyers, including surveys, concerning how they would respond to price changes;
- the conduct of industry participants, notably:
  - o sellers' business decisions or business documents indicating sellers' informed beliefs concerning how customers would substitute among products in response to relative changes in price;
  - o industry participants' behavior in tracking and responding to price changes by some or all rivals;
- objective information about product characteristics and the costs and delays of switching products, especially switching from products in the candidate market to products outside the candidate market;
- the percentage of sales lost by one product in the candidate market, when its price alone rises, that is recaptured by other products in the candidate market, with a higher recapture percentage making a price increase more profitable for the hypothetical monopolist;
- evidence from other industry participants, such as sellers of complementary products;

- legal or regulatory requirements; and
- the influence of downstream competition faced by customers in their output markets.

When the necessary data are available, the Agencies also may consider a “critical loss analysis” to assess the extent to which it corroborates inferences drawn from the evidence noted above. Critical loss analysis asks whether imposing at least a SSNIP on one or more products in a candidate market would raise or lower the hypothetical monopolist’s profits. While this “breakeven” analysis differs from the profit-maximizing analysis called for by the hypothetical monopolist test in Section 4.1.1, merging parties sometimes present this type of analysis to the Agencies. A price increase raises profits on sales made at the higher price, but this will be offset to the extent customers substitute away from products in the candidate market. Critical loss analysis compares the magnitude of these two offsetting effects resulting from the price increase. The “critical loss” is defined as the number of lost unit sales that would leave profits unchanged. The “predicted loss” is defined as the number of unit sales that the hypothetical monopolist is predicted to lose due to the price increase. The price increase raises the hypothetical monopolist’s profits if the predicted loss is less than the critical loss.

The Agencies consider all of the evidence of customer substitution noted above in assessing the predicted loss. The Agencies require that estimates of the predicted loss be consistent with that evidence, including the pre-merger margins of products in the candidate market used to calculate the critical loss. Unless the firms are engaging in coordinated interaction (see Section 7), high pre-merger margins normally indicate that each firm’s product individually faces demand that is not highly sensitive to price.[6] Higher pre-merger margins thus indicate a smaller predicted loss as well as a smaller critical loss. The higher the pre-merger margin, the smaller the recapture percentage necessary for the candidate market to satisfy the hypothetical monopolist test.

Even when the evidence necessary to perform the hypothetical monopolist test quantitatively is not available, the conceptual framework of the test provides a useful methodological tool for gathering and analyzing evidence pertinent to customer substitution and to market definition. The Agencies follow the hypothetical monopolist test to the extent possible given the available evidence, bearing in mind that the ultimate goal of market definition is to help determine whether the merger may substantially lessen competition.

4.1.4 Product Market Definition with Targeted Customers

If a hypothetical monopolist could profitably target a subset of customers for price increases, the Agencies may identify relevant markets defined around those targeted customers, to whom a hypothetical monopolist would profitably and separately impose at least a SSNIP. Markets to serve targeted customers are also known as price discrimination markets. In practice, the Agencies identify price discrimination markets only where they believe there is a realistic prospect of an adverse competitive effect on a group of targeted customers.

> *Example 11:* Glass containers have many uses. In response to a price increase for glass containers, some users would substitute substantially to plastic or metal containers, but baby food manufacturers would not. If a

---

[6] While margins are important for implementing the hypothetical monopolist test, high margins are not in themselves of antitrust concern.

> hypothetical monopolist could price separately and limit arbitrage, baby food manufacturers would be vulnerable to a targeted increase in the price of glass containers. The Agencies could define a distinct market for glass containers used to package baby food.

The Agencies also often consider markets for targeted customers when prices are individually negotiated and suppliers have information about customers that would allow a hypothetical monopolist to identify customers that are likely to pay a higher price for the relevant product. If prices are negotiated individually with customers, the hypothetical monopolist test may suggest relevant markets that are as narrow as individual customers (see also Section 6.2 on bargaining and auctions). Nonetheless, the Agencies often define markets for groups of targeted customers, i.e., by type of customer, rather than by individual customer. By so doing, the Agencies are able to rely on aggregated market shares that can be more helpful in predicting the competitive effects of the merger.

4.2 Geographic Market Definition

The arena of competition affected by the merger may be geographically bounded if geography limits some customers' willingness or ability to substitute to some products, or some suppliers' willingness or ability to serve some customers. Both supplier and customer locations can affect this. The Agencies apply the principles of market definition described here and in Section 4.1 to define a relevant market with a geographic dimension as well as a product dimension.

The scope of geographic markets often depends on transportation costs. Other factors such as language, regulation, tariff and non-tariff trade barriers, custom and familiarity, reputation, and service availability may impede long-distance or international transactions. The competitive significance of foreign firms may be assessed at various exchange rates, especially if exchange rates have fluctuated in the recent past.

In the absence of price discrimination based on customer location, the Agencies normally define geographic markets based on the locations of suppliers, as explained in subsection 4.2.1. In other cases, notably if price discrimination based on customer location is feasible as is often the case when delivered pricing is commonly used in the industry, the Agencies may define geographic markets based on the locations of customers, as explained in subsection 4.2.2.

4.2.1 Geographic Markets Based on the Locations of Suppliers

Geographic markets based on the locations of suppliers encompass the region from which sales are made. Geographic markets of this type often apply when customers receive goods or services at suppliers' locations. Competitors in the market are firms with relevant production, sales, or service facilities in that region. Some customers who buy from these firms may be located outside the boundaries of the geographic market.

The hypothetical monopolist test requires that a hypothetical profit-maximizing firm that was the only present or future producer of the relevant product(s) located in the region would impose at least a SSNIP from at least one location, including at least one location of one of the merging firms. In this exercise the terms of sale for all products produced elsewhere are held constant. A single firm may operate in a number of different geographic markets, even for a single product.

Example 12: The merging parties both have manufacturing plants in City X. The relevant product is expensive to transport and suppliers price their products for pickup at their locations. Rival plants are some distance away in City Y. A hypothetical monopolist controlling all plants in City X could profitably impose a SSNIP at these plants. Competition from more distant plants would not defeat the price increase because supplies coming from more distant plants require expensive transportation. The relevant geographic market is defined around the plants in City X.

When the geographic market is defined based on supplier locations, sales made by suppliers located in the geographic market are counted, regardless of the location of the customer making the purchase.

In considering likely reactions of customers to price increases for the relevant product(s) imposed in a candidate geographic market, the Agencies consider any reasonably available and reliable evidence, including:

- how customers have shifted purchases in the past between different geographic locations in response to relative changes in price or other terms and conditions;
- the cost and difficulty of transporting the product (or the cost and difficulty of a customer traveling to a seller's location), in relation to its price;
- whether suppliers need a presence near customers to provide service or support;
- evidence on whether sellers base business decisions on the prospect of customers switching between geographic locations in response to relative changes in price or other competitive variables;
- the costs and delays of switching from suppliers in the candidate geographic market to suppliers outside the candidate geographic market; and
- the influence of downstream competition faced by customers in their output markets.

4.2.2 Geographic Markets Based on the Locations of Customers

When the hypothetical monopolist could discriminate based on customer location, the Agencies may define geographic markets based on the locations of targeted customers.[7] Geographic markets of this type often apply when suppliers deliver their products or services to customers' locations. Geographic markets of this type encompass the region into which sales are made. Competitors in the market are firms that sell to customers in the specified region. Some suppliers that sell into the relevant market may be located outside the boundaries of the geographic market.

The hypothetical monopolist test requires that a hypothetical profit-maximizing firm that was the only present or future seller of the relevant product(s) to customers in the region would impose at least a SSNIP on some customers in that region. A region forms a relevant geographic market if this price increase would not be defeated by substitution away from the relevant product or by arbitrage,

---

[7] For customers operating in multiple locations, only those customer locations within the targeted zone are included in the market.

e.g., customers in the region travelling outside it to purchase the relevant product. In this exercise, the terms of sale for products sold to all customers outside the region are held constant.

> *Example 13:* Customers require local sales and support. Suppliers have sales and service operations in many geographic areas and can discriminate based on customer location. The geographic market can be defined around the locations of customers.

> *Example 14:* Each merging firm has a single manufacturing plant and delivers the relevant product to customers in City X and in City Y. The relevant product is expensive to transport. The merging firms' plants are by far the closest to City X, but no closer to City Y than are numerous rival plants. This fact pattern suggests that customers in City X may be harmed by the merger even if customers in City Y are not. For that reason, the Agencies consider a relevant geographic market defined around customers in City X. Such a market could be defined even if the region around the merging firms' plants would not be a relevant geographic market defined based on the location of sellers because a hypothetical monopolist controlling all plants in that region would find a SSNIP imposed on all of its customers unprofitable due to the loss of sales to customers in City Y.

When the geographic market is defined based on customer locations, sales made to those customers are counted, regardless of the location of the supplier making those sales.

> *Example 15:* Customers in the United States must use products approved by U.S. regulators. Foreign customers use products not approved by U.S. regulators. The relevant product market consists of products approved by U.S. regulators. The geographic market is defined around U.S. customers. Any sales made to U.S. customers by foreign suppliers are included in the market, and those foreign suppliers are participants in the U.S. market even though located outside it.

5. Market Participants, Market Shares, and Market Concentration

The Agencies normally consider measures of market shares and market concentration as part of their evaluation of competitive effects. The Agencies evaluate market shares and concentration in conjunction with other reasonably available and reliable evidence for the ultimate purpose of determining whether a merger may substantially lessen competition.

Market shares can directly influence firms' competitive incentives. For example, if a price reduction to gain new customers would also apply to a firm's existing customers, a firm with a large market share may be more reluctant to implement a price reduction than one with a small share. Likewise, a firm with a large market share may not feel pressure to reduce price even if a smaller rival does. Market shares also can reflect firms' capabilities. For example, a firm with a large market share may be able to expand output rapidly by a larger absolute amount than can a small firm. Similarly, a large market share tends to indicate low costs, an attractive product, or both.

5.1 Market Participants

All firms that currently earn revenues in the relevant market are considered market participants. Vertically integrated firms are also included to the extent that their inclusion accurately reflects their competitive significance. Firms not currently earning revenues in the relevant market, but that have committed to entering the market in the near future, are also considered market participants.

Firms that are not current producers in a relevant market, but that would very likely provide rapid supply responses with direct competitive impact in the event of a SSNIP, without incurring significant sunk costs, are also considered market participants. These firms are termed "rapid entrants." Sunk costs are entry or exit costs that cannot be recovered outside the relevant market. Entry that would take place more slowly in response to adverse competitive effects, or that requires firms to incur significant sunk costs, is considered in Section 9.

Firms that produce the relevant product but do not sell it in the relevant geographic market may be rapid entrants. Other things equal, such firms are most likely to be rapid entrants if they are close to the geographic market.

> *Example 16:* Farm A grows tomatoes halfway between Cities X and Y. Currently, it ships its tomatoes to City X because prices there are two percent higher. Previously it has varied the destination of its shipments in response to small price variations. Farm A would likely be a rapid entrant participant in a market for tomatoes in City Y.

> *Example 17:* Firm B has bid multiple times to supply milk to School District S, and actually supplies milk to schools in some adjacent areas. It has never won a bid in School District S, but is well qualified to serve that district and has often nearly won. Firm B would be counted as a rapid entrant in a market for school milk in School District S.

More generally, if the relevant market is defined around targeted customers, firms that produce relevant products but do not sell them to those customers may be rapid entrants if they can easily and rapidly begin selling to the targeted customers.

Firms that clearly possess the necessary assets to supply into the relevant market rapidly may also be rapid entrants. In markets for relatively homogeneous goods where a supplier's ability to compete depends predominantly on its costs and its capacity, and not on other factors such as experience or reputation in the relevant market, a supplier with efficient idle capacity, or readily available "swing" capacity currently used in adjacent markets that can easily and profitably be shifted to serve the relevant market, may be a rapid entrant.[8] However, idle capacity may be inefficient, and capacity used in adjacent markets may not be available, so a firm's possession of idle or swing capacity alone does not make that firm a rapid entrant.

5.2 Market Shares

The Agencies normally calculate market shares for all firms that currently produce products in the relevant market, subject to the availability of data. The Agencies also calculate market shares for other market participants if this can be done to reliably reflect their competitive significance.

Market concentration and market share data are normally based on historical evidence. However, recent or ongoing changes in market conditions may indicate that the current market share of a particular firm either understates or overstates the firm's future competitive significance. The Agencies consider reasonably predictable effects of recent or ongoing changes in market conditions when calculating and interpreting market share data. For example, if a new technology that is important to long-term competitive viability is available to other firms in the market, but is not available to a particular firm, the Agencies may conclude that that firm's historical market share

---

[8] If this type of supply side substitution is nearly universal among the firms selling one or more of a group of products, the Agencies may use an aggregate description of markets for those products as a matter of convenience.

overstates its future competitive significance. The Agencies may project historical market shares into the foreseeable future when this can be done reliably.

The Agencies measure market shares based on the best available indicator of firms' future competitive significance in the relevant market. This may depend upon the type of competitive effect being considered, and on the availability of data. Typically, annual data are used, but where individual transactions are large and infrequent so annual data may be unrepresentative, the Agencies may measure market shares over a longer period of time.

In most contexts, the Agencies measure each firm's market share based on its actual or projected revenues in the relevant market. Revenues in the relevant market tend to be the best measure of attractiveness to customers, since they reflect the real-world ability of firms to surmount all of the obstacles necessary to offer products on terms and conditions that are attractive to customers. In cases where one unit of a low-priced product can substitute for one unit of a higher-priced product, unit sales may measure competitive significance better than revenues. For example, a new, much less expensive product may have great competitive significance if it substantially erodes the revenues earned by older, higher-priced products, even if it earns relatively few revenues. In cases where customers sign long-term contracts, face switching costs, or tend to re-evaluate their suppliers only occasionally, revenues earned from recently acquired customers may better reflect the competitive significance of suppliers than do total revenues.

In markets for homogeneous products, a firm's competitive significance may derive principally from its ability and incentive to rapidly expand production in the relevant market in response to a price increase or output reduction by others in that market. As a result, a firm's competitive significance may depend upon its level of readily available capacity to serve the relevant market if that capacity is efficient enough to make such expansion profitable. In such markets, capacities or reserves may better reflect the future competitive significance of suppliers than revenues, and the Agencies may calculate market shares using those measures. Market participants that are not current producers may then be assigned positive market shares, but only if a measure of their competitive significance properly comparable to that of current producers is available. When market shares are measured based on firms' readily available capacities, the Agencies do not include capacity that is committed or so profitably employed outside the relevant market, or so high-cost, that it would not likely be used to respond to a SSNIP in the relevant market.

> *Example 18:* The geographic market is defined around customers in the United States. Firm X produces the relevant product outside the United States, and most of its sales are made to customers outside the United States. In most contexts, Firm X's market share will be based on its sales to U.S. customers, not its total sales or total capacity. However, if the relevant product is homogeneous, and if Firm X would significantly expand sales to U.S. customers rapidly and without incurring significant sunk costs in response to a SSNIP, the Agencies may base Firm X's market share on its readily available capacity to serve U.S. customers.

When the Agencies define markets serving targeted customers, these same principles are used to measure market shares, as they apply to those customers. In most contexts, each firm's market share is based on its actual or projected revenues from the targeted customers. However, the Agencies may instead measure market shares based on revenues from a broader group of customers if doing so would more accurately reflect the competitive significance of different suppliers in the relevant market. Revenues earned from a broader group of customers may also be used when better data are thereby available.

5.3 Market Concentration

Market concentration is often one useful indicator of likely competitive effects of a merger. In evaluating market concentration, the Agencies consider both the post-merger level of market concentration and the change in concentration resulting from a merger. Market shares may not fully reflect the competitive significance of firms in the market or the impact of a merger. They are used in conjunction with other evidence of competitive effects. See Sections 6 and 7.

In analyzing mergers between an incumbent and a recent or potential entrant, to the extent the Agencies use the change in concentration to evaluate competitive effects, they will do so using projected market shares. A merger between an incumbent and a potential entrant can raise significant competitive concerns. The lessening of competition resulting from such a merger is more likely to be substantial, the larger is the market share of the incumbent, the greater is the competitive significance of the potential entrant, and the greater is the competitive threat posed by this potential entrant relative to others.

The Agencies give more weight to market concentration when market shares have been stable over time, especially in the face of historical changes in relative prices or costs. If a firm has retained its market share even after its price has increased relative to those of its rivals, that firm already faces limited competitive constraints, making it less likely that its remaining rivals will replace the competition lost if one of that firm's important rivals is eliminated due to a merger. By contrast, even a highly concentrated market can be very competitive if market shares fluctuate substantially over short periods of time in response to changes in competitive offerings. However, if competition by one of the merging firms has significantly contributed to these fluctuations, perhaps because it has acted as a maverick, the Agencies will consider whether the merger will enhance market power by combining that firm with one of its significant rivals.

The Agencies may measure market concentration using the number of significant competitors in the market. This measure is most useful when there is a gap in market share between significant competitors and smaller rivals or when it is difficult to measure revenues in the relevant market. The Agencies also may consider the combined market share of the merging firms as an indicator of the extent to which others in the market may not be able readily to replace competition between the merging firms that is lost through the merger.

The Agencies often calculate the Herfindahl-Hirschman Index ("HHI") of market concentration. The HHI is calculated by summing the squares of the individual firms' market shares,[9] and thus gives proportionately greater weight to the larger market shares. When using the HHI, the Agencies

---

[9] For example, a market consisting of four firms with market shares of thirty percent, thirty percent, twenty percent, and twenty percent has an HHI of 2600 ($30^2 + 30^2 + 20^2 + 20^2 = 2600$). The HHI ranges from 10,000 (in the case of a pure monopoly) to a number approaching zero (in the case of an atomistic market). Although it is desirable to include all firms in the calculation, lack of information about firms with small shares is not critical because such firms do not affect the HHI significantly.

consider both the post-merger level of the HHI and the increase in the HHI resulting from the merger. The increase in the HHI is equal to twice the product of the market shares of the merging firms.[10]

Based on their experience, the Agencies generally classify markets into three types:

- Unconcentrated Markets: HHI below 1500
- Moderately Concentrated Markets: HHI between 1500 and 2500
- Highly Concentrated Markets: HHI above 2500

The Agencies employ the following general standards for the relevant markets they have defined:

- *Small Change in Concentration:* Mergers involving an increase in the HHI of less than 100 points are unlikely to have adverse competitive effects and ordinarily require no further analysis.
- *Unconcentrated Markets:* Mergers resulting in unconcentrated markets are unlikely to have adverse competitive effects and ordinarily require no further analysis.
- *Moderately Concentrated Markets:* Mergers resulting in moderately concentrated markets that involve an increase in the HHI of more than 100 points potentially raise significant competitive concerns and often warrant scrutiny.
- *Highly Concentrated Markets:* Mergers resulting in highly concentrated markets that involve an increase in the HHI of between 100 points and 200 points potentially raise significant competitive concerns and often warrant scrutiny. Mergers resulting in highly concentrated markets that involve an increase in the HHI of more than 200 points will be presumed to be likely to enhance market power. The presumption may be rebutted by persuasive evidence showing that the merger is unlikely to enhance market power.

The purpose of these thresholds is not to provide a rigid screen to separate competitively benign mergers from anticompetitive ones, although high levels of concentration do raise concerns. Rather, they provide one way to identify some mergers unlikely to raise competitive concerns and some others for which it is particularly important to examine whether other competitive factors confirm, reinforce, or counteract the potentially harmful effects of increased concentration. The higher the post-merger HHI and the increase in the HHI, the greater are the Agencies' potential competitive concerns and the greater is the likelihood that the Agencies will request additional information to conduct their analysis.

---

10 For example, the merger of firms with shares of five percent and ten percent of the market would increase the HHI by 100 ($5 \times 10 \times 2 = 100$).

6. Unilateral Effects

The elimination of competition between two firms that results from their merger may alone constitute a substantial lessening of competition. Such unilateral effects are most apparent in a merger to monopoly in a relevant market, but are by no means limited to that case. Whether cognizable efficiencies resulting from the merger are likely to reduce or reverse adverse unilateral effects is addressed in Section 10.

Several common types of unilateral effects are discussed in this section. Section 6.1 discusses unilateral price effects in markets with differentiated products. Section 6.2 discusses unilateral effects in markets where sellers negotiate with buyers or prices are determined through auctions. Section 6.3 discusses unilateral effects relating to reductions in output or capacity in markets for relatively homogeneous products. Section 6.4 discusses unilateral effects arising from diminished innovation or reduced product variety. These effects do not exhaust the types of possible unilateral effects; for example, exclusionary unilateral effects also can arise.

A merger may result in different unilateral effects along different dimensions of competition. For example, a merger may increase prices in the short term but not raise longer-term concerns about innovation, either because rivals will provide sufficient innovation competition or because the merger will generate cognizable research and development efficiencies. See Section 10.

6.1 Pricing of Differentiated Products

In differentiated product industries, some products can be very close substitutes and compete strongly with each other, while other products are more distant substitutes and compete less strongly. For example, one high-end product may compete much more directly with another high-end product than with any low-end product.

A merger between firms selling differentiated products may diminish competition by enabling the merged firm to profit by unilaterally raising the price of one or both products above the pre-merger level. Some of the sales lost due to the price rise will merely be diverted to the product of the merger partner and, depending on relative margins, capturing such sales loss through merger may make the price increase profitable even though it would not have been profitable prior to the merger.

The extent of direct competition between the products sold by the merging parties is central to the evaluation of unilateral price effects. Unilateral price effects are greater, the more the buyers of products sold by one merging firm consider products sold by the other merging firm to be their next choice. The Agencies consider any reasonably available and reliable information to evaluate the extent of direct competition between the products sold by the merging firms. This includes documentary and testimonial evidence, win/loss reports and evidence from discount approval processes, customer switching patterns, and customer surveys. The types of evidence relied on often overlap substantially with the types of evidence of customer substitution relevant to the hypothetical monopolist test. See Section 4.1.1.

Substantial unilateral price elevation post-merger for a product formerly sold by one of the merging firms normally requires that a significant fraction of the customers purchasing that product view products formerly sold by the other merging firm as their next-best choice. However, unless pre-merger margins between price and incremental cost are low, that significant fraction need not approach a majority. For this purpose, incremental cost is measured over the change in output that would be caused by the price change considered. A merger may produce significant unilateral effects for a given product even though many more sales are diverted to products sold by non-merging firms than to products previously sold by the merger partner.

> *Example 19:* In Example 5, the merged entity controlling Products A and B would raise prices ten percent, given the product offerings and prices of other firms. In that example, one-third of the sales lost by Product A when its price alone is raised are diverted to Product B. Further analysis is required to account for repositioning, entry, and efficiencies.

In some cases, the Agencies may seek to quantify the extent of direct competition between a product sold by one merging firm and a second product sold by the other merging firm by estimating the diversion ratio from the first product to the second product. The diversion ratio is the fraction of unit sales lost by the first product due to an increase in its price that would be diverted to the second product. Diversion ratios between products sold by one merging firm and products sold by the other merging firm can be very informative for assessing unilateral price effects, with higher diversion ratios indicating a greater likelihood of such effects. Diversion ratios between products sold by merging firms and those sold by non-merging firms have at most secondary predictive value.

Adverse unilateral price effects can arise when the merger gives the merged entity an incentive to raise the price of a product previously sold by one merging firm and thereby divert sales to products previously sold by the other merging firm, boosting the profits on the latter products. Taking as given other prices and product offerings, that boost to profits is equal to the value to the merged firm of the sales diverted to those products. The value of sales diverted to a product is equal to the number of units diverted to that product multiplied by the margin between price and incremental cost on that product. In some cases, where sufficient information is available, the Agencies assess the value of diverted sales, which can serve as an indicator of the upward pricing pressure on the first product resulting from the merger. Diagnosing unilateral price effects based on the value of diverted sales need not rely on market definition or the calculation of market shares and concentration. The Agencies rely much more on the value of diverted sales than on the level of the HHI for diagnosing unilateral price effects in markets with differentiated products. If the value of diverted sales is proportionately small, significant unilateral price effects are unlikely.[11]

Where sufficient data are available, the Agencies may construct economic models designed to quantify the unilateral price effects resulting from the merger. These models often include independent price responses by non-merging firms. They also can incorporate merger-specific efficiencies. These merger simulation methods need not rely on market definition. The Agencies do not treat merger simulation evidence as conclusive in itself, and they place more weight on whether their merger simulations consistently predict substantial price increases than on the precise prediction of any single simulation.

---

[11] For this purpose, the value of diverted sales is measured in proportion to the lost revenues attributable to the reduction in unit sales resulting from the price increase. Those lost revenues equal the reduction in the number of units sold of that product multiplied by that product's price.

A merger is unlikely to generate substantial unilateral price increases if non-merging parties offer very close substitutes for the products offered by the merging firms. In some cases, non-merging firms may be able to reposition their products to offer close substitutes for the products offered by the merging firms. Repositioning is a supply-side response that is evaluated much like entry, with consideration given to timeliness, likelihood, and sufficiency. See Section 9. The Agencies consider whether repositioning would be sufficient to deter or counteract what otherwise would be significant anticompetitive unilateral effects from a differentiated products merger.

6.2 Bargaining and Auctions

In many industries, especially those involving intermediate goods and services, buyers and sellers negotiate to determine prices and other terms of trade. In that process, buyers commonly negotiate with more than one seller, and may play sellers off against one another. Some highly structured forms of such competition are known as auctions. Negotiations often combine aspects of an auction with aspects of one-on-one negotiation, although pure auctions are sometimes used in government procurement and elsewhere.

A merger between two competing sellers prevents buyers from playing those sellers off against each other in negotiations. This alone can significantly enhance the ability and incentive of the merged entity to obtain a result more favorable to it, and less favorable to the buyer, than the merging firms would have offered separately absent the merger. The Agencies analyze unilateral effects of this type using similar approaches to those described in Section 6.1.

Anticompetitive unilateral effects in these settings are likely in proportion to the frequency or probability with which, prior to the merger, one of the merging sellers had been the runner-up when the other won the business. These effects also are likely to be greater, the greater advantage the runner-up merging firm has over other suppliers in meeting customers' needs. These effects also tend to be greater, the more profitable were the pre-merger winning bids. All of these factors are likely to be small if there are many equally placed bidders.

The mechanisms of these anticompetitive unilateral effects, and the indicia of their likelihood, differ somewhat according to the bargaining practices used, the auction format, and the sellers' information about one another's costs and about buyers' preferences. For example, when the merging sellers are likely to know which buyers they are best and second best placed to serve, any anticompetitive unilateral effects are apt to be targeted at those buyers; when sellers are less well informed, such effects are more apt to be spread over a broader class of buyers.

6.3 Capacity and Output for Homogeneous Products

In markets involving relatively undifferentiated products, the Agencies may evaluate whether the merged firm will find it profitable unilaterally to suppress output and elevate the market price. A firm may leave capacity idle, refrain from building or obtaining capacity that would have been obtained absent the merger, or eliminate pre-existing production capabilities. A firm may also divert the use of capacity away from one relevant market and into another so as to raise the price in the former market. The competitive analyses of these alternative modes of output suppression may differ.

A unilateral output suppression strategy is more likely to be profitable when (1) the merged firm's market share is relatively high; (2) the share of the merged firm's output already committed for sale at prices unaffected by the output suppression is relatively low; (3) the margin on the suppressed output is relatively low; (4) the supply responses of rivals are relatively small; and (5) the market elasticity of demand is relatively low.

A merger may provide the merged firm a larger base of sales on which to benefit from the resulting price rise, or it may eliminate a competitor that otherwise could have expanded its output in response to the price rise.

> *Example 20:* Firms A and B both produce an industrial commodity and propose to merge. The demand for this commodity is insensitive to price. Firm A is the market leader. Firm B produces substantial output, but its operating margins are low because it operates high-cost plants. The other suppliers are operating very near capacity. The merged firm has an incentive to reduce output at the high-cost plants, perhaps shutting down some of that capacity, thus driving up the price it receives on the remainder of its output. The merger harms customers, notwithstanding that the merged firm shifts some output from high-cost plants to low-cost plants.

In some cases, a merger between a firm with a substantial share of the sales in the market and a firm with significant excess capacity to serve that market can make an output suppression strategy profitable.[12] This can occur even if the firm with the excess capacity has a relatively small share of sales, if that firm's ability to expand, and thus keep price from rising, has been making an output suppression strategy unprofitable for the firm with the larger market share.

6.4 Innovation and Product Variety

Competition often spurs firms to innovate. The Agencies may consider whether a merger is likely to diminish innovation competition by encouraging the merged firm to curtail its innovative efforts below the level that would prevail in the absence of the merger. That curtailment of innovation could take the form of reduced incentive to continue with an existing product-development effort or reduced incentive to initiate development of new products.

The first of these effects is most likely to occur if at least one of the merging firms is engaging in efforts to introduce new products that would capture substantial revenues from the other merging firm. The second, longer-run effect is most likely to occur if at least one of the merging firms has capabilities that are likely to lead it to develop new products in the future that would capture substantial revenues from the other merging firm. The Agencies therefore also consider whether a merger will diminish innovation competition by combining two of a very small number of firms with the strongest capabilities to successfully innovate in a specific direction.

The Agencies evaluate the extent to which successful innovation by one merging firm is likely to take sales from the other, and the extent to which post-merger incentives for future innovation will be lower than those that would prevail in the absence of the merger. The Agencies also consider whether the merger is likely to enable innovation that would not otherwise take place, by bringing together

---

[12] Such a merger also can cause adverse coordinated effects, especially if the acquired firm with excess capacity was disrupting effective coordination.

complementary capabilities that cannot be otherwise combined or for some other merger-specific reason. See Section 10.

The Agencies also consider whether a merger is likely to give the merged firm an incentive to cease offering one of the relevant products sold by the merging parties. Reductions in variety following a merger may or may not be anticompetitive. Mergers can lead to the efficient consolidation of products when variety offers little in value to customers. In other cases, a merger may increase variety by encouraging the merged firm to reposition its products to be more differentiated from one another.

If the merged firm would withdraw a product that a significant number of customers strongly prefer to those products that would remain available, this can constitute a harm to customers over and above any effects on the price or quality of any given product. If there is evidence of such an effect, the Agencies may inquire whether the reduction in variety is largely due to a loss of competitive incentives attributable to the merger. An anticompetitive incentive to eliminate a product as a result of the merger is greater and more likely, the larger is the share of profits from that product coming at the expense of profits from products sold by the merger partner. Where a merger substantially reduces competition by bringing two close substitute products under common ownership, and one of those products is eliminated, the merger will often also lead to a price increase on the remaining product, but that is not a necessary condition for anticompetitive effect.

> *Example 21:* Firm A sells a high-end product at a premium price. Firm B sells a mid-range product at a lower price, serving customers who are more price sensitive. Several other firms have low-end products. Firms A and B together have a large share of the relevant market. Firm A proposes to acquire Firm B and discontinue Firm B's product. Firm A expects to retain most of Firm B's customers. Firm A may not find it profitable to raise the price of its high-end product after the merger, because doing so would reduce its ability to retain Firm B's more price-sensitive customers. The Agencies may conclude that the withdrawal of Firm B's product results from a loss of competition and materially harms customers.

7. Coordinated Effects

A merger may diminish competition by enabling or encouraging post-merger coordinated interaction among firms in the relevant market that harms customers. Coordinated interaction involves conduct by multiple firms that is profitable for each of them only as a result of the accommodating reactions of the others. These reactions can blunt a firm's incentive to offer customers better deals by undercutting the extent to which such a move would win business away from rivals. They also can enhance a firm's incentive to raise prices, by assuaging the fear that such a move would lose customers to rivals.

Coordinated interaction includes a range of conduct. Coordinated interaction can involve the explicit negotiation of a common understanding of how firms will compete or refrain from competing. Such conduct typically would itself violate the antitrust laws. Coordinated interaction also can involve a similar common understanding that is not explicitly negotiated but would be enforced by the detection and punishment of deviations that would undermine the coordinated interaction. Coordinated interaction alternatively can involve parallel accommodating conduct not pursuant to a prior understanding. Parallel accommodating conduct includes situations in which each rival's response to competitive moves made by others is individually rational, and not motivated by retaliation or deterrence nor intended to sustain an agreed-upon market outcome, but nevertheless emboldens price increases and weakens competitive incentives to reduce prices or offer customers better terms. Coordinated interaction includes conduct not otherwise condemned by the antitrust laws.

The ability of rival firms to engage in coordinated conduct depends on the strength and predictability of rivals' responses to a price change or other competitive initiative. Under some circumstances, a merger can result in market concentration sufficient to strengthen such responses or enable multiple firms in the market to predict them more confidently, thereby affecting the competitive incentives of multiple firms in the market, not just the merged firm.

7.1 Impact of Merger on Coordinated Interaction

The Agencies examine whether a merger is likely to change the manner in which market participants interact, inducing substantially more coordinated interaction. The Agencies seek to identify how a merger might significantly weaken competitive incentives through an increase in the strength, extent, or likelihood of coordinated conduct. There are, however, numerous forms of coordination, and the risk that a merger will induce adverse coordinated effects may not be susceptible to quantification or detailed proof. Therefore, the Agencies evaluate the risk of coordinated effects using measures of market concentration (see Section 5) in conjunction with an assessment of whether a market is vulnerable to coordinated conduct. See Section 7.2. The analysis in Section 7.2 applies to moderately and highly concentrated markets, as unconcentrated markets are unlikely to be vulnerable to coordinated conduct.

Pursuant to the Clayton Act's incipiency standard, the Agencies may challenge mergers that in their judgment pose a real danger of harm through coordinated effects, even without specific evidence showing precisely how the coordination likely would take place. The Agencies are likely to challenge a merger if the following three conditions are all met: (1) the merger would significantly increase concentration and lead to a moderately or highly concentrated market; (2) that market shows signs of vulnerability to coordinated conduct (see Section 7.2); and (3) the Agencies have a credible basis on which to conclude that the merger may enhance that vulnerability. An acquisition eliminating a maverick firm (see Section 2.1.5) in a market vulnerable to coordinated conduct is likely to cause adverse coordinated effects.

7.2 Evidence a Market is Vulnerable to Coordinated Conduct

The Agencies presume that market conditions are conducive to coordinated interaction if firms representing a substantial share in the relevant market appear to have previously engaged in express collusion affecting the relevant market, unless competitive conditions in the market have since changed significantly. Previous express collusion in another geographic market will have the same weight if the salient characteristics of that other market at the time of the collusion are comparable to those in the relevant market. Failed previous attempts at collusion in the relevant market suggest that successful collusion was difficult pre-merger but not so difficult as to deter attempts, and a merger may tend to make success more likely. Previous collusion or attempted collusion in another product market may also be given substantial weight if the salient characteristics of that other market at the time of the collusion are closely comparable to those in the relevant market.

A market typically is more vulnerable to coordinated conduct if each competitively important firm's significant competitive initiatives can be promptly and confidently observed by that firm's rivals. This is more likely to be the case if the terms offered to customers are relatively transparent. Price transparency can be greater for relatively homogeneous products. Even if terms of dealing are not transparent, transparency regarding the identities of the firms serving particular customers can give rise to coordination, e.g., through customer or territorial allocation. Regular monitoring by suppliers of one another's prices or customers can indicate that the terms offered to customers are relatively transparent.

A market typically is more vulnerable to coordinated conduct if a firm's prospective competitive reward from attracting customers away from its rivals will be significantly diminished by likely responses of those rivals. This is more likely to be the case, the stronger and faster are the responses the firm anticipates from its rivals. The firm is more likely to anticipate strong responses if there are few significant competitors, if products in the relevant market are relatively homogeneous, if customers find it relatively easy to switch between suppliers, or if suppliers use meeting-competition clauses.

A firm is more likely to be deterred from making competitive initiatives by whatever responses occur if sales are small and frequent rather than via occasional large and long-term contracts or if relatively few customers will switch to it before rivals are able to respond. A firm is less likely to be deterred by whatever responses occur if the firm has little stake in the status quo. For example, a firm with a small market share that can quickly and dramatically expand, constrained neither by limits on production nor by customer reluctance to switch providers or to entrust business to a historically small provider, is unlikely to be deterred. Firms are also less likely to be deterred by whatever responses occur if competition in the relevant market is marked by leapfrogging technological innovation, so that responses by competitors leave the gains from successful innovation largely intact.

A market is more apt to be vulnerable to coordinated conduct if the firm initiating a price increase will lose relatively few customers after rivals respond to the increase. Similarly, a market is more apt to be vulnerable to coordinated conduct if a firm that first offers a lower price or improved product to customers will retain relatively few customers thus attracted away from its rivals after those rivals respond.

The Agencies regard coordinated interaction as more likely, the more the participants stand to gain from successful coordination. Coordination generally is more profitable, the lower is the market elasticity of demand.

Coordinated conduct can harm customers even if not all firms in the relevant market engage in the coordination, but significant harm normally is likely only if a substantial part of the market is subject to such conduct. The prospect of harm depends on the collective market power, in the relevant market, of firms whose incentives to compete are substantially weakened by coordinated conduct. This collective market power is greater, the lower is the market elasticity of demand. This collective market power is diminished by the presence of other market participants with small market shares and little stake in the outcome resulting from the coordinated conduct, if these firms can rapidly expand their sales in the relevant market.

Buyer characteristics and the nature of the procurement process can affect coordination. For example, sellers may have the incentive to bid aggressively for a large contract even if they expect strong responses by rivals. This is especially the case for sellers with small market shares, if they can realistically win such large contracts. In some cases, a large buyer may be able to strategically undermine coordinated conduct, at least as it pertains to that buyer's needs, by choosing to put up for bid a few large contracts rather than many smaller ones, and by making its procurement decisions opaque to suppliers.

8. Powerful Buyers

Powerful buyers are often able to negotiate favorable terms with their suppliers. Such terms may reflect the lower costs of serving these buyers, but they also can reflect price discrimination in their favor.

The Agencies consider the possibility that powerful buyers may constrain the ability of the merging parties to raise prices. This can occur, for example, if powerful buyers have the ability and incentive to vertically integrate upstream or sponsor entry, or if the conduct or presence of large buyers undermines coordinated effects. However, the Agencies do not presume that the presence of powerful buyers alone forestalls adverse competitive effects flowing from the merger. Even buyers that can negotiate favorable terms may be harmed by an increase in market power. The Agencies examine the choices available to powerful buyers and how those choices likely would change due to the merger. Normally, a merger that eliminates a supplier whose presence contributed significantly to a buyer's negotiating leverage will harm that buyer.

> *Example 22:* Customer C has been able to negotiate lower pre-merger prices than other customers by threatening to shift its large volume of purchases from one merging firm to the other. No other suppliers are as well placed to meet Customer C's needs for volume and reliability. The merger is likely to harm Customer C. In this situation, the Agencies could identify a price discrimination market consisting of Customer C and similarly placed customers. The merger threatens to end previous price discrimination in their favor.

Furthermore, even if some powerful buyers could protect themselves, the Agencies also consider whether market power can be exercised against other buyers.

> *Example 23:* In Example 22, if Customer C instead obtained the lower pre-merger prices based on a credible threat to supply its own needs, or to sponsor new entry, Customer C might not be harmed. However, even in this case, other customers may still be harmed.

9. Entry

The analysis of competitive effects in Sections 6 and 7 focuses on current participants in the relevant market. That analysis may also include some forms of entry. Firms that would rapidly and easily enter the market in response to a SSNIP are market participants and may be assigned market shares. See Sections 5.1 and 5.2. Firms that have, prior to the merger, committed to entering the market also will normally be treated as market participants. See Section 5.1. This section concerns entry or adjustments to pre-existing entry plans that are induced by the merger.

As part of their full assessment of competitive effects, the Agencies consider entry into the relevant market. The prospect of entry into the relevant market will alleviate concerns about adverse competitive effects only if such entry will deter or counteract any competitive effects of concern so the merger will not substantially harm customers.

The Agencies consider the actual history of entry into the relevant market and give substantial weight to this evidence. Lack of successful and effective entry in the face of non-transitory increases in the margins earned on products in the relevant market tends to suggest that successful entry is slow or difficult. Market values of incumbent firms greatly exceeding the replacement costs of their tangible assets may indicate that these firms have valuable intangible assets, which may be difficult or time consuming for an entrant to replicate.

A merger is not likely to enhance market power if entry into the market is so easy that the merged firm and its remaining rivals in the market, either unilaterally or collectively, could not profitably raise price or otherwise reduce competition compared to the level that would prevail in the absence of the merger. Entry is that easy if entry would be timely, likely, and sufficient in its magnitude, character, and scope to deter or counteract the competitive effects of concern.

The Agencies examine the timeliness, likelihood, and sufficiency of the entry efforts an entrant might practically employ. An entry effort is defined by the actions the firm must undertake to produce and sell in the market. Various elements of the entry effort will be considered. These elements can include: planning, design, and management; permitting, licensing, or other approvals; construction, debugging, and operation of production facilities; and promotion (including necessary introductory discounts), marketing, distribution, and satisfaction of customer testing and qualification requirements. Recent examples of entry, whether successful or unsuccessful, generally provide the starting point for identifying the elements of practical entry efforts. They also can be informative regarding the scale necessary for an entrant to be successful, the presence or absence of entry barriers, the factors that influence the timing of entry, the costs and risk associated with entry, and the sales opportunities realistically available to entrants.

If the assets necessary for an effective and profitable entry effort are widely available, the Agencies will not necessarily attempt to identify which firms might enter. Where an identifiable set of firms appears to have necessary assets that others lack, or to have particularly strong incentives to enter, the Agencies focus their entry analysis on those firms. Firms operating in adjacent or complementary markets, or large customers themselves, may be best placed to enter. However, the Agencies will not presume that a powerful firm in an adjacent market or a large customer will enter the relevant market unless there is reliable evidence supporting that conclusion.

In assessing whether entry will be timely, likely, and sufficient, the Agencies recognize that precise and detailed information may be difficult or impossible to obtain. The Agencies consider reasonably available and reliable evidence bearing on whether entry will satisfy the conditions of timeliness, likelihood, and sufficiency.

9.1 Timeliness

In order to deter the competitive effects of concern, entry must be rapid enough to make unprofitable overall the actions causing those effects and thus leading to entry, even though those actions would be profitable until entry takes effect.

Even if the prospect of entry does not deter the competitive effects of concern, post-merger entry may counteract them. This requires that the impact of entrants in the relevant market be rapid enough that customers are not significantly harmed by the merger, despite any anticompetitive harm that occurs prior to the entry.

The Agencies will not presume that an entrant can have a significant impact on prices before that entrant is ready to provide the relevant product to customers unless there is reliable evidence that anticipated future entry would have such an effect on prices.

9.2 Likelihood

Entry is likely if it would be profitable, accounting for the assets, capabilities, and capital needed and the risks involved, including the need for the entrant to incur costs that would not be recovered if the entrant later exits. Profitability depends upon (a) the output level the entrant is likely to obtain, accounting for the obstacles facing new entrants; (b) the price the entrant would likely obtain in the post-merger market, accounting for the impact of that entry itself on prices; and (c) the cost per unit the entrant would likely incur, which may depend upon the scale at which the entrant would operate.

9.3 Sufficiency

Even where timely and likely, entry may not be sufficient to deter or counteract the competitive effects of concern. For example, in a differentiated product industry, entry may be insufficient because the products offered by entrants are not close enough substitutes to the products offered by the merged firm to render a price increase by the merged firm unprofitable. Entry may also be insufficient due to constraints that limit entrants' competitive effectiveness, such as limitations on the capabilities of the firms best placed to enter or reputational barriers to rapid expansion by new entrants. Entry by a single firm that will replicate at least the scale and strength of one of the merging firms is sufficient. Entry by one or more firms operating at a smaller scale may be sufficient if such firms are not at a significant competitive disadvantage.

10. Efficiencies

Competition usually spurs firms to achieve efficiencies internally. Nevertheless, a primary benefit of mergers to the economy is their potential to generate significant efficiencies and thus enhance the merged firm's ability and incentive to compete, which may result in lower prices, improved quality, enhanced service, or new products. For example, merger-generated efficiencies may enhance competition by permitting two ineffective competitors to form a more effective competitor, e.g., by combining complementary assets. In a unilateral effects context, incremental cost reductions may reduce or reverse any increases in the merged firm's incentive to elevate price. Efficiencies also may lead to new or improved products, even if they do not immediately and directly affect price. In a coordinated effects context, incremental cost reductions may make coordination less likely or effective by enhancing the incentive of a maverick to lower price or by creating a new maverick firm. Even when efficiencies generated through a merger enhance a firm's ability to compete, however, a merger may have other effects that may lessen competition and make the merger anticompetitive.

The Agencies credit only those efficiencies likely to be accomplished with the proposed merger and unlikely to be accomplished in the absence of either the proposed merger or another means having comparable anticompetitive effects. These are termed merger-specific efficiencies.[13] Only alternatives that are practical in the business situation faced by the merging firms are considered in making this determination. The Agencies do not insist upon a less restrictive alternative that is merely theoretical.

Efficiencies are difficult to verify and quantify, in part because much of the information relating to efficiencies is uniquely in the possession of the merging firms. Moreover, efficiencies projected reasonably and in good faith by the merging firms may not be realized. Therefore, it is incumbent upon the merging firms to substantiate efficiency claims so that the Agencies can verify by reasonable means the likelihood and magnitude of each asserted efficiency, how and when each would be achieved (and any costs of doing so), how each would enhance the merged firm's ability and incentive to compete, and why each would be merger-specific.

Efficiency claims will not be considered if they are vague, speculative, or otherwise cannot be verified by reasonable means. Projections of efficiencies may be viewed with skepticism, particularly when generated outside of the usual business planning process. By contrast, efficiency claims substantiated by analogous past experience are those most likely to be credited.

Cognizable efficiencies are merger-specific efficiencies that have been verified and do not arise from anticompetitive reductions in output or service. Cognizable efficiencies are assessed net of costs produced by the merger or incurred in achieving those efficiencies.

The Agencies will not challenge a merger if cognizable efficiencies are of a character and magnitude such that the merger is not likely to be anticompetitive in any relevant market.[14] To make the requisite determination, the Agencies consider whether cognizable efficiencies likely would be sufficient to reverse the merger's potential to harm customers in the relevant market, e.g., by preventing price

---

[13] The Agencies will not deem efficiencies to be merger-specific if they could be attained by practical alternatives that mitigate competitive concerns, such as divestiture or licensing. If a merger affects not whether but only when an efficiency would be achieved, only the timing advantage is a merger-specific efficiency.

[14] The Agencies normally assess competition in each relevant market affected by a merger independently and normally will challenge the merger if it is likely to be anticompetitive in any relevant market. In some cases, however, the Agencies in their prosecutorial discretion will consider efficiencies not strictly in the relevant market, but so inextricably linked with it that a partial divestiture or other remedy could not feasibly eliminate the anticompetitive effect in the relevant market without sacrificing the efficiencies in the other market(s). Inextricably linked efficiencies are most likely to make a difference when they are great and the likely anticompetitive effect in the relevant market(s) is small so the merger is likely to benefit customers overall.

increases in that market.[15] In conducting this analysis, the Agencies will not simply compare the magnitude of the cognizable efficiencies with the magnitude of the likely harm to competition absent the efficiencies. The greater the potential adverse competitive effect of a merger, the greater must be the cognizable efficiencies, and the more they must be passed through to customers, for the Agencies to conclude that the merger will not have an anticompetitive effect in the relevant market. When the potential adverse competitive effect of a merger is likely to be particularly substantial, extraordinarily great cognizable efficiencies would be necessary to prevent the merger from being anticompetitive. In adhering to this approach, the Agencies are mindful that the antitrust laws give competition, not internal operational efficiency, primacy in protecting customers.

In the Agencies' experience, efficiencies are most likely to make a difference in merger analysis when the likely adverse competitive effects, absent the efficiencies, are not great. Efficiencies almost never justify a merger to monopoly or near-monopoly. Just as adverse competitive effects can arise along multiple dimensions of conduct, such as pricing and new product development, so too can efficiencies operate along multiple dimensions. Similarly, purported efficiency claims based on lower prices can be undermined if they rest on reductions in product quality or variety that customers value.

The Agencies have found that certain types of efficiencies are more likely to be cognizable and substantial than others. For example, efficiencies resulting from shifting production among facilities formerly owned separately, which enable the merging firms to reduce the incremental cost of production, are more likely to be susceptible to verification and are less likely to result from anticompetitive reductions in output. Other efficiencies, such as those relating to research and development, are potentially substantial but are generally less susceptible to verification and may be the result of anticompetitive output reductions. Yet others, such as those relating to procurement, management, or capital cost, are less likely to be merger-specific or substantial, or may not be cognizable for other reasons.

When evaluating the effects of a merger on innovation, the Agencies consider the ability of the merged firm to conduct research or development more effectively. Such efficiencies may spur innovation but not affect short-term pricing. The Agencies also consider the ability of the merged firm to appropriate a greater fraction of the benefits resulting from its innovations. Licensing and intellectual property conditions may be important to this enquiry, as they affect the ability of a firm to appropriate the benefits of its innovation. Research and development cost savings may be substantial and yet not be cognizable efficiencies because they are difficult to verify or result from anticompetitive reductions in innovative activities.

---

15 The Agencies normally give the most weight to the results of this analysis over the short term. The Agencies also may consider the effects of cognizable efficiencies with no short-term, direct effect on prices in the relevant market. Delayed benefits from efficiencies (due to delay in the achievement of, or the realization of customer benefits from, the efficiencies) will be given less weight because they are less proximate and more difficult to predict. Efficiencies relating to costs that are fixed in the short term are unlikely to benefit customers in the short term, but can benefit customers in the longer run, e.g., if they make new product introduction less expensive.

11. Failure and Exiting Assets

Notwithstanding the analysis above, a merger is not likely to enhance market power if imminent failure, as defined below, of one of the merging firms would cause the assets of that firm to exit the relevant market. This is an extreme instance of the more general circumstance in which the competitive significance of one of the merging firms is declining: the projected market share and significance of the exiting firm is zero. If the relevant assets would otherwise exit the market, customers are not worse off after the merger than they would have been had the merger been enjoined.

The Agencies do not normally credit claims that the assets of the failing firm would exit the relevant market unless all of the following circumstances are met: (1) the allegedly failing firm would be unable to meet its financial obligations in the near future; (2) it would not be able to reorganize successfully under Chapter 11 of the Bankruptcy Act; and (3) it has made unsuccessful good-faith efforts to elicit reasonable alternative offers that would keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition than does the proposed merger.[16]

Similarly, a merger is unlikely to cause competitive harm if the risks to competition arise from the acquisition of a failing division. The Agencies do not normally credit claims that the assets of a division would exit the relevant market in the near future unless both of the following conditions are met: (1) applying cost allocation rules that reflect true economic costs, the division has a persistently negative cash flow on an operating basis, and such negative cash flow is not economically justified for the firm by benefits such as added sales in complementary markets or enhanced customer goodwill;[17] and (2) the owner of the failing division has made unsuccessful good-faith efforts to elicit reasonable alternative offers that would keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition than does the proposed acquisition.

12. Mergers of Competing Buyers

Mergers of competing buyers can enhance market power on the buying side of the market, just as mergers of competing sellers can enhance market power on the selling side of the market. Buyer market power is sometimes called "monopsony power."

To evaluate whether a merger is likely to enhance market power on the buying side of the market, the Agencies employ essentially the framework described above for evaluating whether a merger is likely to enhance market power on the selling side of the market. In defining relevant markets, the Agencies

---

16 Any offer to purchase the assets of the failing firm for a price above the liquidation value of those assets will be regarded as a reasonable alternative offer. Liquidation value is the highest value the assets could command for use outside the relevant market.

17 Because the parent firm can allocate costs, revenues, and intra-company transactions among itself and its subsidiaries and divisions, the Agencies require evidence on these two points that is not solely based on management plans that could have been prepared for the purpose of demonstrating negative cash flow or the prospect of exit from the relevant market.

focus on the alternatives available to sellers in the face of a decrease in the price paid by a hypothetical monopsonist.

Market power on the buying side of the market is not a significant concern if suppliers have numerous attractive outlets for their goods or services. However, when that is not the case, the Agencies may conclude that the merger of competing buyers is likely to lessen competition in a manner harmful to sellers.

The Agencies distinguish between effects on sellers arising from a lessening of competition and effects arising in other ways. A merger that does not enhance market power on the buying side of the market can nevertheless lead to a reduction in prices paid by the merged firm, for example, by reducing transactions costs or allowing the merged firm to take advantage of volume-based discounts. Reduction in prices paid by the merging firms not arising from the enhancement of market power can be significant in the evaluation of efficiencies from a merger, as discussed in Section 10.

The Agencies do not view a short-run reduction in the quantity purchased as the only, or best, indicator of whether a merger enhances buyer market power. Nor do the Agencies evaluate the competitive effects of mergers between competing buyers strictly, or even primarily, on the basis of effects in the downstream markets in which the merging firms sell.

> *Example 24:* Merging Firms A and B are the only two buyers in the relevant geographic market for an agricultural product. Their merger will enhance buyer power and depress the price paid to farmers for this product, causing a transfer of wealth from farmers to the merged firm and inefficiently reducing supply. These effects can arise even if the merger will not lead to any increase in the price charged by the merged firm for its output.

13. Partial Acquisitions

In most horizontal mergers, two competitors come under common ownership and control, completely and permanently eliminating competition between them. This elimination of competition is a basic element of merger analysis. However, the statutory provisions referenced in Section 1 also apply to one firm's partial acquisition of a competitor. The Agencies therefore also review acquisitions of minority positions involving competing firms, even if such minority positions do not necessarily or completely eliminate competition between the parties to the transaction.

When the Agencies determine that a partial acquisition results in effective control of the target firm, or involves substantially all of the relevant assets of the target firm, they analyze the transaction much as they do a merger. Partial acquisitions that do not result in effective control may nevertheless present significant competitive concerns and may require a somewhat distinct analysis from that applied to full mergers or to acquisitions involving effective control. The details of the post-acquisition relationship between the parties, and how those details are likely to affect competition, can be important. While the Agencies will consider any way in which a partial acquisition may affect competition, they generally focus on three principal effects.

First, a partial acquisition can lessen competition by giving the acquiring firm the ability to influence the competitive conduct of the target firm. A voting interest in the target firm or specific governance rights, such as the right to appoint members to the board of directors, can permit such influence. Such influence can lessen competition because the acquiring firm can use its influence to induce the target firm to compete less aggressively or to coordinate its conduct with that of the acquiring firm.

Second, a partial acquisition can lessen competition by reducing the incentive of the acquiring firm to compete. Acquiring a minority position in a rival might significantly blunt the incentive of the acquiring firm to compete aggressively because it shares in the losses thereby inflicted on that rival. This reduction in the incentive of the acquiring firm to compete arises even if cannot influence the conduct of the target firm. As compared with the unilateral competitive effect of a full merger, this effect is likely attenuated by the fact that the ownership is only partial.

Third, a partial acquisition can lessen competition by giving the acquiring firm access to non-public, competitively sensitive information from the target firm. Even absent any ability to influence the conduct of the target firm, access to competitively sensitive information can lead to adverse unilateral or coordinated effects. For example, it can enhance the ability of the two firms to coordinate their behavior, and make other accommodating responses faster and more targeted. The risk of coordinated effects is greater if the transaction also facilitates the flow of competitively sensitive information from the acquiring firm to the target firm.

Partial acquisitions, like mergers, vary greatly in their potential for anticompetitive effects. Accordingly, the specific facts of each case must be examined to assess the likelihood of harm to competition. While partial acquisitions usually do not enable many of the types of efficiencies associated with mergers, the Agencies consider whether a partial acquisition is likely to create cognizable efficiencies.

Robert Porter have analysed the dynamics of cartel pricing under these conditions and Porter has applied the analysis to study an 1880s railroad cartel.[29] The outcome of interaction under these conditions involves periodic price wars, or fluctuations between periods of stable cartel pricing and noncooperative pricing.

IX. Monopsony

The exercise of market power on the buyers' side of a market – in the extreme case, a single buyer or monopsonist – leads to an inefficient outcome, just as market power does on the sellers' side of a market. The monopsony outcome is illustrated in Figure 2.10. As the monopsonist increases the amount purchased of a product, the total expenditure by the monopsonist on the product will, naturally, increase. The optimal purchase by the monopsonist maximizes the monopsonist's total value of the amount purchased (which may be the value of the product in consumption or, more commonly, the value of the product as an input into further production) minus the total expenditure. This optimum is determined by equating the marginal value of the product and the marginal expenditure of the product.

Whereas the monopsonist chooses quantity to equate its marginal value to marginal expenditure, the social optimum or surplus-maximizing quantity equates marginal value to marginal social cost (which is depicted by the supply curve, since the supply price measures the marginal social cost of production).[30] The monopsonist purchases a quantity that is too small to maximize total surplus. The distortion in the monopsony purchase arises because at any output, the marginal expenditure exceeds the supply price of the product. The marginal expenditure is higher than the supply price because to elicit an additional unit of supply the monopsonist must raise the price paid on all units, not just on the marginal unit.

The *socially* optimal transaction would involve equating the marginal value with the supply curve, or marginal social cost curve. As

29 E.J. Green and R.H. Porter, 'Noncooperative Collusion Under Imperfect Price Information,' (1984) 14 *Econometrica* 87, and R.H. Porter, 'A Study of Cartel Stability: The Joint Executive Committee, 1880–1886,' (1983) 14 *Bell Journal of Economics* 301.

30 This assumes that there are no distortions in the monoposonist's decisions other than monopsony power, e.g., that the monopsonist is not also a monopolist in an output market.

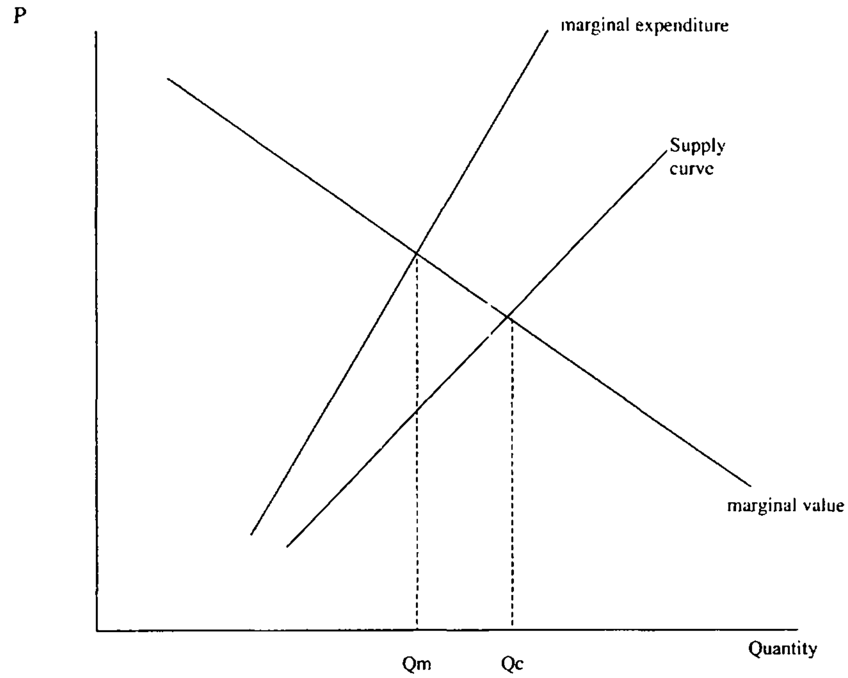


Figure 2.10
Monopsony

Figure 2.10 illustrates, the monopsonist's private optimum, equalizing marginal value with marginal expenditure, involves a quantity that is too low to maximize social welfare. Starting from zero, as the quantity purchased increases, the monopsonist gains some marginal surplus of value over expenditure and the suppliers gain some marginal surplus of expenditure (revenue) over cost. The monopsonist ignores the latter component of the marginal social value of production and as a result, like the monopolist discussed earlier in this chapter, chooses a quantity that is too small. The analysis of the monopsonist reminds us that inefficiencies associated with market power arise from insufficient quantities, not excessive prices. Low prices are not the ultimate goal of competition policy.

X. Market Definition

Market definition is key in both the law on mergers, sections 91 to 103 of the Canadian *Competition Act*, as well as in other sections of the Act,