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Date: March 10, 2021

Matter: CT-2019-005 – *The Commissioner of Competition v Parrish & Heimbecker, Limited*

<u>Direction to Counsel (from the Panel)</u>

In the course of its deliberations, the Panel has consulted the 2011 Merger Enforcement Guidelines ("**MEGs**") as well as its previous iterations. In this context, the Panel has examined the 1991 MEGs and notes that one of the issues in dispute in the present matter, that is to say the "value-added" approach, was the subject of a specific reference in the 1991 MEGs (see the excerpt attached to this Direction). Neither party put the 1991 MEGs before the Panel or referred to them in its submissions.

Since it has considered the 1991 MEGs and may take them into consideration in its analysis, the Panel invites both parties to provide any submissions they may have on the attached extract from the 1991 MEGs and its absence from subsequent iterations of the MEGs. In the course of preparing these submissions, the Panel invites counsel to consult contemporaneous secondary sources, such as academic books and journal articles. Excerpts from these sources may be attached as appendices to the submissions. The parties' submissions (without appendices) shall not exceed 3 pages and shall be served and filed by the end of the day on March 24, 2021. Given the COVID-19 pandemic and the nature of this request, which may require the parties to locate archived materials, either party can address the Tribunal if it considers that more time may be needed to prepare its submissions.

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MERGER ENFORCEMENT GUIDELINES OF THE DIRECTOR OF INVESTIGATION AND RESEARCH

Interpretation

These Guidelines supersede all previous statements made by the Director of Investigation and Research or other officials of the Bureau of Competition Policy, including Information Bulletin No. 1 (entitled The Merger Provisions), that may differ from anything stated herein.

This document is intended solely to provide enforcement guidelines. As such, it sets forth the general approach that is taken to merger review, and is not a binding statement of how discretion will be exercised in a particular situation. Specific guidance regarding a specific merger may be requested from the Bureau through its program of advisory opinions. The Guidelines are not intended to be substitute for the advice of merger counsellors. They do not represent a significant change in enforcement policy or restate the law. Final interpretation of the law is the responsibility of the Competition Tribunal and the courts.

For the sake of brevity the following abbreviations are used throughout these Guidelines:

- The Act refers to the *Competition Act*, R.S.C. 1985, c. C-34, as am. R.S.C. 1985, c. 27 (1st Supp.), ss. 187, 189; R.S.C. 1985, c. 19 (2nd Supp.), Part II; R.S.C. 1985, c. 34 (3rd Supp.), s. 8; R.S.C. 1985, c. 1 (4th Supp.), s. 11; R.S.C. 1985, c. 10 (4th Supp.), s. 18; S.C. 1990, c. 37, ss. 27–32; S.C. 1991, c. 45, ss. 547–550; S.C. 1991, c. 46, ss. 590–594; S.C. 1991, c. 47, ss. 714–717; S.C. 1992, c. 1, ss. 44–46; S.C. 1992, c. 14; S.C. 1993, c. 34, ss. 50–51.
- "The Department" refers to Consumer and Corporate Affairs Canada [now Industry Canada].
- "The Bureau" refers to the Bureau of Competition Policy, Consumer and Corporate Affairs Canada [now Industry Canada].
- "The Director" refers to the Director of Investigation and Research of the Bureau of Competition Policy.
- "The Tribunal" refers to the Competition Tribunal.
- "The Guidelines" refers to this publication i.e. Merger Enforcement Guidelines.
- References to sections of the Act are referred to as "sections".
- References to parts to these Guidelines are referred to as "parts".

2.3 — Preventing Competition

Similarly, competition can be *prevented* by conduct that is either unilateral or interdependent. Competition can be prevented as a result of unilateral behaviour where a merger enables a single firm to maintain higher prices than what would exist in absence of the merger, by hindering or impeding the development of increased competition. For example, the acquisition of an increasingly vigorous competitor in the market or of a potential entrant would likely impede the development of greater competition in the relevant market. Situations where a market leader pre-empts the acquisition of the acquiree by another competitor, or where a potential entrant acquires an existing business instead of establishing new facilities, can yield a similar result.

Competition can also be prevented where a merger will inhibit the development of greater rivalry in a market already characterized by interdependent behaviour. This can occur, for example, as a result of the acquisition of a future entrant or of an increasingly vigorous incumbent in a highly stable market.

2.4 — Substantiality

In assessing whether competition is likely to be prevented or lessened *substantially*, the Bureau generally evaluates the likely magnitude, scope and duration of any price increase that is anticipated to arise as a result of a merger. In general, a prevention or lessening of competition will be considered to be "substantial" where the price of the relevant product is likely to be materially greater, In a substantial part of the relevant market, than it would be in the absence of the merger;[9] and where this price differential would not likely be eliminated within two years[10] by new or increased competition from foreign or domestic sources. What constitutes a "materially greater" price varies from industry to industry, and may be a differential that is less than the "significant" price increase that is postulated for the purpose of market definition.

Part 3 — Market Definition

3.1 — Conceptual Framework

The first stage in the Bureau's review of a merger involves identifying the relevant market or markets in which the merging parties operate. In merger analysis, relevant markets are defined by reference to actual and potential sources of competition that constrain the exercise of market power. As a general principle, it cannot be assumed that the products of merging parties are in the same relevant market, even where there appears to be some overlapping of the products that they sell and of the geographic areas in which they operate. It may be that the "overlap" is such that the constraining influence exercised by one of the merging parties is not sufficient to warrant including the two firms in the same relevant market.

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[8]An exception would be where a firm has a market share of less than 35 percent but is able to build and entrench market power through strategic behaviour. Strategic behaviour is an example of sunk cost impediments to entry discussed in Part 2.2.1.2.

[9]This is the interpretation of "policy" taken by the Court in *The Queen v. The Producers Dairy Limited* (1966, unreported), Ont. C.A.

[10]The Court in *Hoffman-La Roche* found that to construe any particular course of pricing action as a "policy of selling" it must be established that such course of action was planned and deliberate conduct by responsible employees of the company.

Conceptually, a relevant market for merger analysis under the Act is defined in terms of the smallest group[11] of products and smallest geographic area in relation to which sellers, if acting as a single firm (a "hypothetical monopolist") that was the only seller of those products in that area, could profitably impose and sustain a significant and nontransitory price increase above levels that would likely exist in the absence of the merger.

The assessment of whether a significant and nontransitory price increase would likely be made unprofitable involves an examination of likely responses from sources of product and geographic competition, on both the demand and supply sides of the market. On the demand side, it is necessary to evaluate the extent to which:

(i) buyers would likely switch to substitute products; and,

(ii) buyers would likely switch to the same product sold in other areas. On the supply side, it is necessary to evaluate the extent to which:

(iii) new entry would likely occur through the construction of facilities,[12] or as a result of sellers of other products adapting existing facilities, to commence production[13] of the product or a substitute; and,

(iv) sellers of the product or of a substitute who are located in distant areas would likely divert their product into the area in question.

In most contexts, the Bureau considers a 5 percent price increase to be significant, and a one year period to be nontransitory. However, a different price increase or time period may be employed where the Director is satisfied that the application of the 5 percent or one year thresholds would not reflect market realities.[14] For example, a larger price increase may be required where rigid application of the 5 percent threshold would fail to identify an obvious horizontal relationship between the merging parties. Situations where a 5 percent price increase involving products purchased by consumers would be measured in cents rather than in dollars occasionally fall within this category. Conversely, a lower postulated price increase may be appropriate where the products are particularly good substitutes for one another, relative to other substitutes. The price in relation to which the increase is postulated is the price that would likely prevail in the absence of the merger.[15]

The potential constraining influence of competition from sellers who would not likely respond to the postulated price increase in the relevant market within the postulated period of

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[11] A concession which induces customers to acquire other products from the supplier may raise issues under the "tied selling" provision in section 77 of the Act.

[12] This particular supply response is considered subsequent to market definition, in the assessment of ease of entry.

[13] The word "production" is employed for simplicity. The supply responses contemplated throughout these Guidelines are not confined to manufacturers. For example, a wholesaler that does not carry a particular product may begin to do so in response to a significant and nontransitory price increase.

[14] The objective of market definition is to define the smallest market in which a substantial prevention or lessening of competition would be possible. A 5 percent threshold is generally sufficient for this purpose. In the course of reviewing particular mergers, Bureau staff may request information about likely responses to larger price increases in order to gain a better appreciation of market dynamics and of the nature of the responses that would be elicited by a 5 percent price increase. Cf. part 2.4 of these Guidelines.

[15] The "significant" price increase postulated is therefore net of inflation and other common variables.

time[16] is considered subsequent to market definition, in connection with the assessment of future entry into the market. For the purposes of assessing what would likely occur over a nontransitory period in response to the threshold price increase, it is assumed that buyers and sellers in the industry immediately become aware of the price increase.

Markets are typically defined in terms of the smallest group of products and geographic area in relation to which a significant and nontransitory price increase can be profitably[17] imposed, because this is generally where a merger is most likely to adversely affect competition. However, circumstances may arise in which it will be appropriate to define broader markets. For example, an exception to the smallest market principle may be made to include product or geographic substitutes on the fringe of the market that would not likely be able to constrain a significant and nontransitory price increase by the hypothetical monopolist, but that obviously compete, as a matter of commercial reality, with the products in the relevant market.

In some circumstances, sellers[18] can identify and discriminate against particular buyers within a relevant market who would not likely switch to product or geographic substitutes available elsewhere within the relevant market, in response to a significant and nontransitory price increase. Where sellers could profitably impose a significant and nontransitory price increase in relation to customized products or products sold in specific geographic areas, additional, narrower, relevant markets, consisting of these products, may be defined.[19] Examples of buyers who may be particularly susceptible to such discrimination include buyers who do not purchase in sufficiently large quantities to justify switching to a more distant source of supply; and buyers who would incur substantial retooling, repackaging or marketing costs, if forced to switch to a substitute product. For price discrimination to be successful, it cannot be possible for other buyers to arbitrage by profitably purchasing and reselling to the buyers who may be the subject of discrimination.

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[16] A period of less than one year is not generally considered to be appropriate for the purpose of defining markets, because even sellers of products that actually constrain the ability of the respective merging parties to raise a price above the prevailing pre-merger level may require several months to recognize and respond to an attempted price increase. A period longer than one year is not generally considered to be appropriate because sellers that would require more than this amount of time to respond to an increase in the price of a product generally do not exercise a significant constraining influence on the price of that product.

[17] This condition ensures that markets will not be defined around narrow segments consisting of products purchased by buyers who would not be willing to switch to another source of supply in the event of a significant and nontransitory price increase, but who either cannot be identified by sellers in the market or cannot be subjected to price discrimination confined to them alone. In such cases, it can be expected that sellers will not risk losing greater profits earned on sales to buyers who would likely switch, by attempting to reap additional profits from buyers who would not likely switch. For the purposes of its analysis, the Bureau assumes that there is no price regulation.

[18] As is indicated in part 2.1 of these Guidelines, a merger can also raise concerns about market power on the buying side. In such a case, the term "hypothetical monopsonist" would be substituted for "hypothetical monopolist", and "significant and nontransitory price decrease" would be substituted for "significant and nontransitory price increase".

[19] For example, in one case Bureau staff concluded that glass containers competed in a broad relevant market that included various other rigid wall containers, such as aluminum and steel cans, and certain types of plastic containers. However, within this relevant market, Bureau staff found that there were several additional, narrower relevant markets, consisting of customized products such as wine bottles, pickle jars and soluble coffee jars. It was determined that purchasers of these products could be the subject of price discrimination, because they would not be prepared to switch to an alternative rigid wall packaging product in the event of a 5 percent price increase with respect to their customized glass containers. As employed here, the term "price discrimination" means a sale of the relevant product to two or more different purchasers at two or more different prices. This is broader than what is contemplated by section 50(1)(a) of the Act.

In general, the base price that is employed in postulating a significant and nontransitory price increase is whatever is ordinarily considered to be the price of the product at the stage of the industry (e.g., manufacturing, wholesale, retail) being examined. This is typically the cumulative value of the product, inclusive of the value added (mark-up) at the industry level in question. However, in certain industries, the value added is billed as a separate fee, and no mark-up is applied to the product in relation to which the service (or other value added) is performed. In such cases, the price increase will usually be postulated in relation to the fee. Situations where there is no standard industry billing practice, or generally recognized base price, will be considered on a case by case basis. Where a merger would likely lead to an increase in the cumulative or value added price, but not to an increase in the price at which the product is ultimately purchased by consumers, this fact will be taken into account subsequent to the market definition stage, in the exercise of the Director's discretion to challenge the merger. A similar approach is taken where an increase in the price of an intermediate product would not likely translate into an increase in the price of the downstream product.

Although the approach to delineating the product and geographic bounds of the market is addressed in two distinct discussions below, sources of product and geographic competition must be considered together, because they are interacting dimensions of one market.[20]

3.2 — The Product Dimension

3.2.1 — General Approach

The following approach to relevant market analysis is applied separately to each of the products in relation to which the merging parties appear to compete or are likely to compete. The analysis of the product scope of specific relevant markets commences by focusing upon what would happen if one of the merging parties attempted to impose a significant and nontransitory price increase in relation to the product. 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 product that is the next best substitute[21] will be added to the relevant market. The Bureau will then ask what would happen if the seller of this product and the merging party in question, acting as a hypothetical monopolist, attempted to impose a significant and nontransitory price increase with respect to the two products in the group. The process of adding the product that is the next best substitute for the products already included within the market continues until it would be possible for the sellers of these products, acting as a hypothetical monopolist, to profitably impose and sustain a significant price increase for a non-transitory period of time.

3.2.2 — Evaluative Criteria

In assessing the nature and magnitude of likely supply and demand responses to a future price increase in the context of particular cases, all relevant information is considered. How-

[20] To illustrate, it may be that the sellers who are being considered as the sole seller of product A in area X could not profitably impose and sustain a significant and nontransitory price increase, due to the existence of an additional seller of product A in area Y and/or due to the existence of a seller of product B in area X. In order to determine whether the market should be expanded to include product A, from area Y, and/or product B, from area X, these sources of competition must be assessed together. If the latter is the next best substitute for product A in area X, the relevant market will be expanded solely in product terms, whereas if the former is the next best substitute, the relevant market will be expanded in geographic terms only. If the market is ultimately expanded to include both products, and the presence of the next best substitute, product C in area Z, would prevent the postulated 5% price increase from being profitably imposed, then the market would have to be expanded in both geographic and product terms.

[21] The Director considers the "next best substitute" to be the product that would account for the largest percentage of the volume that would be lost by the hypothetical monopolist.