COMPETITION TRIBUNAL
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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

WRITTEN SUBMISSION OF THE COMMISSIONER OF COMPETITION

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1. On March 10, 2021, the Tribunal sent a direction to the counsel stating that it has considered Merger Enforcement Guidelines ("**MEGs**") published in 1991. The Panel invited the parties to provide any submissions regarding the specific reference in the 1991 MEGs to the "value-added" approach and its absence from subsequent iterations of the MEGs published in 2004 and 2011.

2. The Tribunal directed the parties to make written submissions of no more than three pages, which are to be provided by April 7, 2021. This is the Commissioner's written submission in response to the Tribunal's direction.

3. After searching Library and Archives Canada for relevant files as well as speaking with officers involved with drafting the 2004 MEGs, the Commissioner did not identify a particular reason why the paragraph discussing the value-added approach was not explicitly described in subsequent iterations of the MEGs.

4. The commentary found from members of the bar regarding the 2004 MEGs is silent on the value-added paragraph as well, but is generally consistent in that the 2004 MEGs "reflect an incremental evolution to the 1991 MEGs with new and significantly expanded commentary on coordinated effects, prevention of competition cases, and updated guidance regarding efficiencies."[1]

5. The Canadian Bar Association's 19 page submission on the draft 2004 MEGs is silent on this issue as well.[2]

6. As can be seen from the attached commentary and submissions from the CBA, the focus of the changes from the 1991 MEGs related to expanding guidance with respect to substantive issues. In particular, the Bureau wanted to emphasize that merger review is not a linear process beginning with market definition, but is instead

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[1] "New merger enforcement guidelines in Canada strike harmony with the EU and US", Global Competition Review, A. Neil Campbell and John F Clifford. "Canadian merger enforcement guidelines", The Antitrust Review of the Americas 2005, Richard Annan. "Canadian Merger Review: New MEGs Released in Draft for Public Comment", www.stikemanelliot.com, Susan Hutton.

[2] Submissions on the Competition Bureau's Draft *Merger Enforcement Guidelines*, National Competition Law Section, Canada Bar Association, May 2004.

an iterative process in which market definition is only one factor the Bureau takes into account when investigating potential competitive harm. The Bureau also sought to update its guidance on efficiencies given the Superior Propane jurisprudence on this issue.

7. In an interview prior to the publication of the 2004 MEGs, then Commissioner, Konrad von Finckenstein, suggested a need for the Bureau's merger guidelines to be more "user-friendly" and that they are "pretty difficult to read at the moment" and "full of jargon". [3] Given this context, it is understandable that the specific reference to analyzing mergers involving competitors in intermediary industries was removed.

8. Even though the explicit reference was removed, the concept remains embedded in the MEGs. In particular, a significant change in the 2004 MEGs was to explain that "market definition is based on substitutability and focuses on demand responses to changes in relative prices"—in other words, the focus of the market definition exercise is on dimensions of competition that buyers value.

9. This is further reinforced in how the 2004 MEGs and, most recently, the 2011 MEGs articulate the concept of price for the purposes of evaluating competitive effects. The 2011 MEGs define price in a way that contemplates the value-added approach, specifically in Part 2 which state that "In general, when evaluating the competitive effects of a merger, the Bureau's concerns are price and output". It reads that "to simplify the discussion, unless otherwise indicated, the term "price" in these guidelines refers to all aspects of firms' actions that affect the interest 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".[4]

10. This language provides latitude on what price is analyzed in a merger. In this case, as the evidence demonstrates, the basis component of the net price paid to the

[3] Focus-Canada: An interview with Konrad von Finckenstein, Global Competition Review, May 1, 2003.
[4] Competition Bureau Merger Enforcement Guidelines ("2011 MEGs"), October 6, 2011, para. 2.2.

farmers for their grain, is a dimension of competition that farmers value. The basis is observable, contractable, and is reflective of the service and competition that occurs at local elevators to handle farmers' grain.

11. The MEGs are published to provide general direction of the Bureau's analytical approach to merger review and the Commissioner's approach in this application is consistent with all iterations of the MEGs. However, as the foreword to the MEGs notes: "Given that merger law applies to a wide variety of factual circumstances, these guidelines are not applied rigidly. As such, the [MEGs] 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 asses a proposed transaction and may sometimes require methodologies other than those noted here."[5]

ATTORNEY GENERAL OF CANADA
Department of Justice Canada
Competition Bureau Legal Services
Place du Portage, Phase I
50 rue Victoria, 22nd floor
Fax : 819-953-9267

Jonathan Hood
647-625-6782
jonathan.hood@canada.ca

Ellé Nekiar
819-994-4045
elle.nekiar@canada.ca

Counsel to the Commissioner

[5] 2011 MEGs, Forward.

New merger enforcement guidelines in Canada strike harmony with the EU and US

A Neil Campbell and John F Clifford, McMillan Binch LLP Toronto, Canada

The Canadian Competition Bureau (the 'Bureau') updated its Merger Enforcement Guidelines ('MEGs') in September 2004. The MEGs reflect incremental evolution of the Bureau's 1991 Merger Enforcement Guidelines, with new coverage of "unilateral effects", significantly expanded commentary on "coordinated effects", detailed discussion of "prevention of competition" cases, and updated guidance regarding the efficiencies defence. These innovations generally reflect mainstream micro-economic thinking and are consistent with the approaches of Canada's key trading partners, the United States and the European Union. Readers familiar with EU and US merger guidelines will find the MEGs a comfortable read.

However, the Bureau has also included tantalisingly oblique references that suggest controversial "raising rivals' costs" and "portfolio effects" theories may be employed, without providing guidance on how such issues will be analysed. In addition, the Bureau continues to demonstrate (some would say unwarranted) hostility towards product differentiation and efficiencies.

Unilateral effects

The MEGs discussion of unilateral effects generally is consistent with modern economic theory and the current approaches followed in Canada, the EU and US. Indeed, the MEGs adopt the two major sub-categories in the US Merger Guidelines: "Firms Distinguished Primarily By Their Capacities" and "Firms Distinguished Primarily By Their Products". The former focuses on the traditional high unilateral market share scenario which has grounded much of the Bureau's enforcement activities, but the latter is more relevant in the many industries where products are differentiated.

By focusing on whether products of the merging parties are (or are not) particularly close substitutes within a market containing various differentiated products, an attempt is made to predict whether a price increase of one party's products would (or would not) become profitable once the firm can capture the portion of switching customers who would select the product of the other merging party. The MEGs also properly acknowledge that ease of repositioning, which is analysed analogously to supply/entry responses in other contexts, may discipline a unilateral exercise of market power that would otherwise be expected to occur. While such an approach should not be controversial in principle, the recent *Oracle/PeopleSoft* decision in the US underscores the importance of probative evidence and rigorous analysis in order to prove that unilateral anti-competitive effects are likely to occur in a concrete case.

Coordinated effects

Despite relatively sparse jurisprudence on coordinated behaviour in Canada, coordinated effects are a major focus of merger review in the US, EU and, increasingly, Canada. Thus the extensive discussion of these issues is a most welcome addition to the MEGs.

The MEGs have converged on the EU and US terminology of "coordinated effects" as a replacement for the references to "interdependent behaviour" in the Bureau's 1991 guidelines. The substantive discussion is almost entirely new and is heavily inspired by the US approach as well as the discussion in the EU's 2004 merger guidelines. The main improvements include a clear explication of the fundamental economic framework for establishing anti-competitive harm, the linking of relevant analytical factors to the essential framework elements, and attention to causation issues.

The MEGs embrace the widely accepted Stigler framework for assessing the likelihood that cooperative behaviour will occur in an oligopolistic industry. The final version of the MEGs improved upon the consultation draft that had placed substantial emphasis on so-called "facilitating factors". By focusing on a lengthy and loose factor list that would generate some "hits" in most industries, there was a risk that Bureau staff would have been encouraged to develop concerns about coordinated behaviour that were not explicitly organised and linked through probative evidence and analysis to the four necessary elements in the Stigler model. There was a widespread perception that this had occurred in previous cases. Canada has now joined the EU and US agencies in abandoning this type of checklist approach. The MEGs instead identify the key factors that will be examined during the assessment of each of the Stigler conditions. For example, product homogeneity, market transparency and cost symmetries are the main considerations in determining whether formation of a cooperative understanding is likely to be possible.

While the term causation is not used, the Bureau (like its counterparts in the EU and US) acknowledges that there is no basis for interfering with a proposed merger on the basis of coordinated effects unless there is a linkage between the transaction and the creation or enhancement of the ability of the merged firm to exercise market power in conjunction with accommodating responses from other significant competitors in an oligopolistic industry. The causation requirement is fundamental in any coordinated effects analysis because an agency must be able to either: identify how a merger enables such market power to begin to be exercised when it previously has not been; or demonstrate that there will likely be a substantial increase in the magnitude of coordinated effects where such market power is already believed to exist pre-merger.

Safe harbours

The MEGs maintain the safe-harbour thresholds from the 1991 guidelines, which slightly suggest a greater tolerance for concentration in Canada than in the EU and US. Generally, mergers which result in a combined market share of 35 per cent will not be challenged on the basis of unilateral effects

concerns; coordinated effects will be of concern only if the merger results in a CR4 ratio of more than 65 per cent and the post-merger market share of the merged entity is more than 10 per cent. Herfindahl-Hirschman indices may be observed (particularly in the context of a coordinated effects analysis), but are not used in Canada as a safe-harbour threshold.

Prevention of competition

Since its 1991 guidelines, the Bureau has acquired significant experience with cases where the anti-competitive effects are expected to arise from a prevention of future competition rather than a lessening of current competition. Like the EU and US guidelines, the MEGs outline the approach used for assessing prevention of competition issues and include several scenarios in which these concerns would be expected to arise. Moreover, the MEGs properly note the importance of assessing the extent of any pre-existing market power and determining whether other potential entrants would face entry barriers (an essential condition for market power concerns to arise) that would not have deterred entry by one of the merging parties.

Additional factors for assessing competitive effects

Borrowing from the EU merger guidelines, the MEGs contain a concise new section devoted to countervailing power as well as several references to excess capacity and product differentiation.

The new discussion of buyer power is brief but valuable, particularly since it addresses one of the arguments that companies most commonly raise when dealing with sizeable buyers in a commercial or industrial market. The MEGs indicate conditions where this can be expected to be effective (eg where a buyer can switch to other sellers in response to an exercise of market power), but also correctly note the limitations of countervailing power arguments in situations where sellers can price discriminate between customers.

The MEGs contain fragmented references in several areas where excess capacity is relevant to the assessment of competitive effects. While it would have been useful to present an integrated discussion of this topic, significant substantive guidance has been provided. Moreover, the potential negative impacts of excess capacity in respect of entry deterrence or punishment of deviations from coordinated behaviour have been accompanied by a recognition that under-utilised capacity may also provide incentives for the merging parties and rivals to increase rather than restrict output.

As with excess capacity, references to product differentiation are sprinkled throughout the competitive effects discussion and would have benefited from consolidated treatment under an identifiable heading. More importantly, while the MEGs have moderated some of the references in earlier consultation drafts of the guidelines, there are still signs that the Bureau maintains an unwarranted hostility towards this important dimension of competition in the modern economy.

Vertical and conglomerate mergers

Unlike the EU and US merger guidelines, the MEGs contain discussion (albeit brief) about vertical and conglomerate mergers.

The section on vertical mergers is essentially unchanged from the 1991 guidelines, which is surprising given the renewed attention being paid to vertical mergers in various jurisdictions and the increasing prominence of raising rivals' costs theories of competitive harm. The MEGs continue to focus on two relatively rare theories of harm: increased barriers to entry resulting from the need for two-stage entry; and upstream coordination facilitated by forward integration into retailing. However, the MEGs also contain a brief footnote indicating that a vertical merger "could substantially lessen or prevent competition by foreclosing access to inputs or distribution channels, thereby raising the costs of rivals." It is not a surprise to see such a reference, particularly since the Bureau has been receptive to raising rivals' costs concerns in the past. However, the absence of any substantive guidance or clear analytical framework is disappointing.

Conglomerate mergers receive even less attention in the updated MEGs. The only theory of anti-competitive harm articulated in the MEGs is that such a transaction may pre-empt entry that would otherwise have occurred (which will be assessed using the general framework for analysis of prevention of competition cases). However, there again is a footnote reference suggesting that issues relating to complementary product mergers (presumably a reference to "portfolio effects" theories) may also be considered.

Efficiencies

The Competition Act contains an efficiency defence, which in essence says that a merger should not be blocked if gains in efficiencies resulting from the merger outweigh the anti-competitive effects. The recent *Superior Propane* case, which the Commissioner of Competition challenged (through two appeals) and lost based on efficiency-saving arguments, was one of the motivating reasons for the Bureau to update the merger guidelines. (Controversially, the Bureau abandoned the 1991 guidelines approach to efficiencies when the *Superior Propane* merger was challenged).

The MEGS make clear that the onus is on the merger parties to identify and quantify any gains in efficiency and to satisfy the Commissioner that the gains outweigh anti-competitive effects. All gains in productive and dynamic efficiencies will be considered, and the gains need not benefit only consumers. But, gains that are merely distributive in nature or would likely be achieved through alternative means than the merger will be discounted. Efficiency gains also will be assessed having regard to the so-called "purposes test" in Section 1.1 of the Competition Act, which may result in the value of the gain being enhanced or discounted in light of distributive effects within the economy. (Section 1.1 of the Act identifies a number of purposes of the Act including ensuring that small and medium-sized enterprises have an equitable opportunity to participate in the Canadian economy.)

The discussion about efficiencies in the MEGs is written in a tone and style which sets it apart from the balance of the document, evidencing a continued hostility by the Commissioner to willingly apply the defence to save mergers to monopoly or near-monopoly, even though that was the court ordered result in *Superior Propane*. Paradoxically, the EU and US merger guidelines appear to reflect more openness to consider efficiency arguments. However, lacking the underpinning of a statutory efficiency defence, EU and US regulators make clear in their respective guidelines that efficiencies can never save a merger to monopoly or near-monopoly and the Bureau's relatively strict interpretations are therefore not far removed in practical effect from those of its EU and US counterparts.

The MEGs are based on years of in-depth experience with merger review and, for the most part, sound economic thinking. They properly focus on the necessity of a coherent theory of anti-competitive harm as the basis for finding a substantial lessening or prevention of competition. The increased recognition of causation requirements is also welcome and will hopefully be accompanied by attention to the need for probative evidence in order to establish that anti-competitive effects are likely to flow from a merger. Although sometimes dense and jargon-filled, the MEGs are a very useful, modern resource for the antitrust practitioner.

The MEGs are available on the Bureau's website at http://competition.ic.gc.ca/epic/internet/incb-bc.nsf/en/h_ct01255e.html. ■

Canadian merger enforcement guidelines

Richard Annan
Goodmans LLP

The Canadian Competition Bureau ('the Bureau') has recently issued for comment its draft revised merger enforcement guidelines ('RMEGs').[1] In the first update since their original publication in March 1991, the draft RMEGs exhibit greater convergence with US merger enforcement policy, while retaining some distinctly Canadian policy choices reflective of the provisions of the Canadian Competition Act ('the Act'). The RMEGs are also largely consistent with the new merger control guidelines of the European Commission. The RMEGs are expected to be finalised by the fall of 2004.

The first part of this chapter will briefly outline the RMEGs, highlighting some of the changes from the existing Merger Enforcement Guidelines ('MEGs').[2] The second part will discuss some of the similarities and differences between the Canadian merger enforcement guidelines with those of the United States and Europe.

Overview of the RMEGs

Anti-competitive threshold

The Competition Tribunal may issue an order when it finds that a merger has or is likely to prevent or lessen competition substantially. The RMEGs indicate that this test is satisfied where a merger is likely to create or enhance the ability of the merged firm, alone or in concert with other firms, to exercise market power. Market power by a seller is defined as the ability of a single firm or group of firms to profitably maintain prices above the competitive level for a significant period of time.[3]

According to the MEGs and the RMEGs, competition will be lessened or prevented substantially if the price of the relevant product is likely to be materially greater in a substantial part of the relevant market as a result of the merger. This condition means that material price increases could be less than the typical 5 per cent price increase used for market definition purposes. Both the MEGs and RMEGs indicate that if existing or new competitors will likely eliminate the ability to materially increase price within two years of the exercise of market power, the substantiality element of the test will not be met.

The RMEGs provide somewhat greater detail than the MEGs on what the Bureau would consider to be a prevention of competition resulting from the merger. The Bureau may examine a merger as a 'prevent case' when either the acquirer or the acquiree has entry or expansion plans that are eliminated because of the merger. Mergers that prevent expansion into new geographic markets, the introduction of new products, or prevent pro-competitive effects of new capacity are new examples cited in the RMEGs that will warrant investigation.

Market definition

The first step in the analysis is to identify economic markets that could be the subject of the exercise of market power. As noted by the Competition Tribunal[4], relevant markets defined for anti-trust purposes may not correspond to the way that industry participants have defined their markets for business purposes. Relevant markets have both product and geographic dimensions.

Both the existing MEGs and the RMEGs use the hypothetical monopolist paradigm to define product and geographic markets. The idea is to identify the smallest group of products and the smallest geographical area in which a single seller (the 'hypothetical monopolist') would profitably impose a significant price increase for an extended period of time. In both the existing MEGs and the RMEGs, the significant price increase used in the test is generally 5 per cent and the time period used is one year.

The existing MEGs indicate that the assessment of the profitability of a significant price increase depends on the likely responses from buyers and sellers in the one year period. The RMEGs however, indicate that relevant market definition focuses solely on responses from buyers to changes in relative prices. Responses from sellers are considered later in the analysis, either as firms identified as currently in the relevant market or as likely future entrants. This approach more accurately reflects actual Bureau merger enforcement approach over the past decade than the existing MEGs. While it has the potential to lead to a greater number of relevant markets being defined, a pragmatic approach will aggregate defined markets where it makes sense to do so because of commonality of buyers and sellers and data limitations.

Both the MEGs and RMEGs note that where sellers can identify and sell to buyers who are willing to pay different prices for the same products, and that such price differentials can be maintained because buyers will not resell or trade these products in sufficient quantities, relevant markets may be defined with respect to the classes of buyers or the particular location of targeted buyers.

The RMEGs set out in detail the type of analysis and evidence that the Bureau would consider in defining relevant markets. Where detailed price and quantity data are available, it may be possible to estimate the own-price elasticity of demand, which directly measures the change in quantity demanded by buyers in response to an increase in price.[5] More commonly, this information is unavailable and the Bureau will be relying on indirect evidence of substitutability from market participants in response to a 5 per cent price increase. The views, strategies and behaviour of buyers in the past will be considered, along with functional indicators. In the case of determining which products are close substitutes, the RMEGs discuss end use, physical and technical characteristics, price relationships and switching costs faced by buyers. In the case of geographic markets, functional indicators of substitutability among geographic areas include transportation costs, shipment patterns, price relationships and foreign competition. The RMEGs include a new reference to spatial competition analysis that was accepted by the Competition Tribunal in one case[6] to determine the boundaries of local markets.

Market share and concentration

As noted above, unlike the MEGs, the RMEGs identify sellers of the relevant products in the market share stage of the analysis. Firms that currently participate in the relevant markets are included, as well as

firms that could readily and profitably sell into the relevant market without incurring significant sunk costs. This type of supply response could occur, for example, if a firm can easily reposition a product or extend its product line to compete in the relevant product market. New entrants that incur significant sunk costs are considered in the entry part of the analysis and are not assigned a market share.

Special considerations apply to foreign suppliers. The RMEGs outline a large number of factors, such as the existence of tariffs, quotas, non-tariff barriers, exchange rate fluctuations and anti-dumping actions that can impair the ability of foreign competition to participate in the relevant market.

The Act makes it clear that the Competition Tribunal cannot find that a merger substantially lessens or prevents competition based solely on the evidence of market share or concentration.[7] Nevertheless, it is an important factor. The absence of high post-merger market share or concentration means that effective competition likely remains in the relevant market sufficient to defeat the exercise of market power.

The Bureau will consider not only the current level of market share, but also how that market share has changed in the past and the potential for significant changes in the future due, for example, to changes in technology. The RMEGs note historical market share may be less relevant in bidding markets where rapid changes in market position are common.

The RMEGs retain the safeharbour market-share thresholds set out in the MEGs. The Bureau will not generally challenge a merger on the basis of a unilateral exercise of market power where the merged firm has less than 35 per cent market share. It will not generally challenge a merger on the basis of a coordinated exercise of market power when the post-merger market share accounted by the four largest firms would be less than 65 per cent[8] or when the post-merger market share of the merged entity would be less than 10 per cent. Mergers that exceed these thresholds are not necessarily anti-competitive and the Bureau will consider the other factors set out in the Act, most notably entry conditions.

Anti-competitive effects

The RMEGs contain a new section outlining in detail the two types of competitive effect analysis that the Bureau undertakes: unilateral effects and coordinated effects.[9]

A unilateral exercise of market power occurs when the merged entity can impose a material price increase without regard to a competitive response by its rivals. This is more likely when the merging firms account for a significant share of the market, since the customers of the merged firm have limited options to turn to in response to a price increase. In markets with differentiated products, a significant price increase by the merged firm may be profitable even at a less than dominant market share if the products of the merging partners are seen as very close substitutes by customers, thereby limiting the loss of sales to other firms. In markets where firms compete based on capacity, a unilateral exercise of market power may be possible where the competing firms are capacity constrained.

Coordinated effects occurs where a group of firms is able to profitably coordinate its behaviour because of each firm's accommodating reaction to the conduct of others. The Bureau assesses whether a merger makes such coordinated behaviour more likely or effective.[10] Such behaviour can involve tacit understandings on price and non-price dimensions of competition. The Bureau will consider what market conditions exist that help firms reach such understandings and that allow firms to sustain such conduct by being able to monitor one another's conduct and credibly punish firms that deviate from the understandings. The Bureau will also consider the ability to sustain such conduct in the face of reactions by non-coordinating suppliers or buyers.

The most significant change in the RMEGs compared with the MEGs is the increased emphasis and guidance given by the Bureau in its analysis of coordinated effects. This topic received little attention in the MEGs because, until recent years, the focus of the Bureau's attention had been on determining whether a merger lessened or prevented competition based on a unilateral exercise of market power.[11]

In 1998 the Bureau published the Merger Enforcement Guidelines as Applied to a Bank Merger ('BMEGs'). The BMEGs were intended to provide further guidance on the application of the MEGs to the financial services sector. They contained a more detailed explanation of coordinated effects and the factors the Bureau would consider in any such analysis. What followed was a series of cases where competition concerns were raised based in some measure on coordinated effects.[12] In the *Superior Propane* case,[13] the Competition Tribunal made a finding of a substantial lessening of competition in a number of markets based on an increased likelihood of interdependent (the equivalent of coordinated) behaviour.

The RMEGs reflect the increased attention that the Bureau is giving to competitive concerns arising from coordinated effects. This change has generated concern among competition law practitioners in Canada. The fear is that because of its small population base, Canada has many markets that are already highly concentrated and subject to some degree of oligopolistic or coordinated behaviour. In this environment, a strict application of coordinated effects analysis could lead to very active and interventionist merger enforcement. However, the RMEGs indicate the Bureau's analysis will consider how the merger changes the competitive dynamic, for example, by removing or reducing pre-merger constraints on coordination.[14] In other words, how exactly does reducing the number of market participants by one, changing the distribution of market share or the cost structure of the merging parties increase the risk for coordinated effects? The burden of proof will rest with the Bureau to demonstrate how these changes to pre-merger conditions will likely lead to anti-competitive effects.

Entry

The RMEGs continue the policy choices made by the Bureau in the MEGs on its analysis of entry conditions. Emphasis in the RMEGs is placed on the timeliness, likelihood and sufficiency of entry. In order to be relevant, entry must be on a sufficient scale to defeat a material price increase in a substantial part of the relevant market within two years of the exercise of market power. In conducting this analysis, the Bureau will make an assessment of the likelihood and sufficiency of potential entry in the two year period. The analysis will consider a host of entry conditions that can impact on the decision to enter and affect the viability of any such entry, such as the presence of substantial sunk costs, the existence of long term contracts with terms that impede customer switching, changes in technology and regulatory barriers.

The analysis of potential future entry or expansion by incumbents is a particularly difficult exercise. In two cases, the Bureau has been forced to amend or withdraw its application to contest a merger based on entry that occurred while the case was pending.[15]

Countervailing power

The RMEGs contain an important new section on countervailing market power held by buyers. The RMEGs suggests that buyer concentration can prevent the exercise of seller market power if buyers can easily switch to other suppliers, can credibly expand into upstream markets or can sponsor effective new entry due to the size of business they can offer suppliers. Where price discrimination by sellers is practised in a relevant market, market power held by large buyers may be insufficient to stop the merged entity from materially increasing price to smaller buyers accounting for a significant portion of the market.

Failing firm

The RMEGs largely repeats the MEGs in the description of how the Bureau will treat the failing firm factor in its merger assessment.

The one notable exception is the RMEGs emphasise that the firm must be failing, that other less anti-competitive alternatives to the merger do not exist, and that in the absence of the merger, the assets of the firm will likely leave the market. In the MEGs, the failing firm factor included situations where a firm wished to exit a market for reasons other than failure, such as unsatisfactory profits. The MEGs policy choice was vulnerable to strategic utilisation by merger proponents and it was very difficult to objectively verify whether in fact the assets would leave the market in the absence of the proposed transaction.

Efficiency exception

Canada is one of the few jurisdictions in the world that contain an explicit legislated trade-off between anti-competitive effects and efficiency gains. Considerable controversy has surrounded the application of this provision in Canada, raising fundamental questions about the objectives of the Competition Act.

In the MEGs, the Bureau adopted a total surplus approach where the only anti-competitive effects that are taken into account in the trade-off are those losses in surplus that result from a reduction in output, referred to by economists as the 'deadweight' loss. Under this approach, wealth transfers from buyers to sellers when prices are increased are ignored because they do not represent losses to the economy as a whole. This approach assumes that allocative efficiency is the paramount objective of the Act.

In the *Superior Propane* case, the Bureau advanced a different standard that would include a broader range of anti-competitive effects, including some portion of the wealth transfers from buyers to sellers. The Competition Tribunal in that case ultimately adopted a standard that encompassed the deadweight loss and the "socially adverse" portion of the transfer. This approach requires the Bureau to assess the socio-economic profiles of buyers and sellers to determine what value each places on income.

The Bureau has stated that in light of the *Superior Propane* jurisprudence, it supports a change in the efficiency standard to provide a more workable approach that recognizes all of the objectives of the Act, including consumer interests.[16] In the interim, the RMEGs indicate that the Bureau will consider a broader range of anti-competitive effects than the deadweight loss when performing the trade-off analysis. These effects will include redistributive effects, non-price effects in the reduction of service, quality and choice, losses of productive efficiency[17] and losses of dynamic efficiency. On the other side of the trade-off, the Bureau will also consider gains in productive and dynamic efficiency that may result from the merger.

Comparison to US merger enforcement policy

The analytical approach outlined in the RMEGs will be instantly familiar to readers of the Horizontal Merger Guidelines of the US Department of Justice and the Federal Trade Commission ('US HMGs'). The two guidelines share far more similarities than differences.

The original MEGs are already similar in approach to the US HMGs. Both use the hypothetical monopolist paradigm for market definition, both call for an extensive entry analysis and both outline many common analytical factors.

The RMEGs strengthen that convergence by providing greater detail and emphasis on coordinated effects, more detail on unilateral effects and by moving supply side substitution from market definition to the market share part of the analysis. The organization of the RMEGs also more closely resembles the US HMGs by integrating the various factors to be considered under s.93[18] of the Act into categories of competitive effects and entry conditions.

Nevertheless, differences arise because of distinct governing legislation, jurisprudence and enforcement policy choices. In relation to concentration, the Canadian safeharbour thresholds are based on market share and CR4, not the Herfindahl-Hirschman Index ('HHI') set out in the US HMGs. The RMEGs allow a material price increase to persist for up to two years before it is found to be substantial. While this concept is not included in the US HMGs, it is the case in the US that committed entry that is likely to occur, and that would be sufficient to counteract the competitive concerns, will be considered if it happens within two years.

In terms of entry, the US HMGs indicate that "entry that is sufficient to counteract the competitive effects of concern will cause prices to fall to their premerger levels or lower".[19] There is no requirement in the RMEGs that entry must drive prices to the pre-merger level, only that they eliminate a material price increase. This is consistent with Canadian jurisprudence which indicates that merger remedies do not have to return the market to a pre-merger level of competition, only that they reduce any lessening or prevention of competition below the "substantial" threshold.[20]

Efficiencies, in the US, must be large enough to reverse the potential harm to consumers caused by the merger in the relevant market, for example by preventing price increases to consumers. There is no such consumer welfare requirement in the RMEGs.

Comparison to European merger enforcement guidelines

The European guidance on merger enforcement is contained in two documents, one related to market definition[21] for merger and non-merger provisions, and another guideline on issues specific to merger review[22] (collectively, 'EU MEGs').

In terms of market definition, the EU MEGs appear to adopt a hypothetical monopolist approach since they posit a small non-transitory price increase of 5 per cent to 10 per cent and examine the degree of buyer substitution in response. However, the analysis is not limited to demand substitution but can include supply substitution at the market definition stage, if it has the same degree of immediacy and effectiveness as demand substitution. This is consistent with the current MEGs approach that includes supply responses that occur within one year in the market definition analysis, although inconsistent with the RMEGs and US HMG approach of including this type of supply response in the market share analysis after the market has been defined.

In relation to market share and concentration, the EU MEGs utilise a blended approach of the HHI and market share to delineate safeharbours. One safeharbour indicates that if the merged firm has a combined market share of less than 25 per cent, it would generally not be problematic. The equivalent Canadian safeharbour of 35 per cent is somewhat more permissive that the EU standard. There is no Canadian safeharbour based on the HHI.

The EU MEGs have an extensive discussion of unilateral (referred to as "non-coordinating") effects and coordinated effects as the two main categories of competitive harm. This discussion is very similar to that contained in the US and Canadian guidelines, and in fact is more extensive in providing guidance on coordinated effects than the RMEGs. Particular mention is made of joint ventures and cross-shareholdings in the EU MEGs in relation to the potential for coordinating effects.

The entry analysis is consistent with the US and Canadian requirements of likelihood, timeliness and sufficiency. Entry normally should occur within two years. It must be sufficiently profitable taking into account the additional output of that entry into the market.

Like the RMEGs, the EU MEGs contain a section on countervailing buyer power, although no discussion of this concept is found in the US HMGS.

Finally, in relation to efficiencies, the EU MEGs require that consumers be no worse off as a result of the merger. Efficiencies must be timely and passed on to produce benefits to consumers. This consumer welfare approach is clearly not the law in Canada at this time.

Conclusion

The RMEGs effectively update the MEGs by incorporating the jurisprudence, new economic thinking and changes in enforcement approaches that have occurred in the 13 years since their original publication. They have achieved even greater convergence with the guidelines of Canada's major trading partners, the United States and Europe. Greater enforcement convergence should improve the efficiency of cross-border merger review, reduce the potential for conflicting decisions and lower compliance costs.

Notes

1 Merger Enforcement Guidelines, Draft for Consultation", Competition Bureau, March 2004 (RMEGs)

2 "Merger Enforcement Guidelines" Director of Investigation and Research Competition Act, Information Bulletin No. 5, March 1991 (MEGs)

3 A parallel analysis follows in the case of market power held by buyers, who would have the ability to depress prices and hence output below competitive levels for a significant period of time.

4 Canada (*Commissioner of Competition) v Superior Propane Inc* CT-1998/002 2000 (Competition Tribunal) 30 August 2000 para.85, 101

5 The Competition Tribunal in *Superior Propane* indicated that the own-price elasticity of demand was the measure to be used for market definition, while cross-price elasticity of demand was a useful but indirect measure of substitutability. (ibid at para 62) Own-price elasticity measures the percentage change in quantity demanded for a given percentage change in price for a product, while cross-price elasticity measures the percentage change in quantity demanded of one good for a given percentage change in price in another good.

6 *Superior Propane*, at para 106. For an explanation of spatial analysis, see *Superior Propane* at para 87-90. In *Commissioner of Competition v Canadian Waste Services Holdings Inc* (CT file 2000/002 Decision dated March 28/01, para.76-83), the Competition Tribunal discusses the spatial analysis of the Commissioner's expert.

7 Section 92(2) of the Competition Act

8 Economists refer to this concentration measure as the CR4 ratio.

9 In the MEGs, the term interdependent behaviour is used to describe the type of conduct covered by coordinated effects as described in the RMEGs.

10 RMEGs, Para 5.17

11 The one notable exception was the acquisition of Canadian operations of Texaco by Imperial Oil. This transaction raised significant competition concerns based largely on coordinated effects. *Canada (Director of Investigation and Research) v Imperial Oil Limited* (unreported, 6 February 1990, Competition Tribunal, file CT89/3).

12 In 1998 the Bureau concluded that the proposed merger of the Royal Bank of Canada and the Bank of Montreal and the merger of the Canadian Imperial Bank of Commerce with the Toronto-Dominion Bank would substantially lessen or prevent competition. This conclusion took into account an increased likelihood of coordinated behaviour following the mergers. In Abitibi's acquisition of Donohue, coordinated effects played an important role (Statement of Grounds and Material Facts, *Commissioner of Competition v Abitibi-Consolidated Inc* unreported 22 Jan.2002 Competition Tribunal file no. CT01/9), as well as in Bayer's acquisition of Aventis (Statement of Grounds and Material Facts, *The Commissioner of Competition v Bayer AG and Aventis CropScience Holding SA* (unreported) 31 May 2002, Competition Tribunal, file no.CT02/3).

13 *Superior Propane*, at Para. 308-309

14 RMEGs, Para 5.23

15 *Director of Investigation and Research v Canadian Pacific Limited Competition Tribunal* CT-1996/002, *Director of Investigation and Research v Dennis Washington et al* (1996) unreported Competition Tribunal CT-1996/001

16 "Bill C249 An Act to Amend the Competition Act Speaking Notes for Sheridan Scott, Commissioner of Competition", before the Standing Senate Committee on Banking, Trade and Commerce, 12 May 2004

17 The idea is that some mergers creating monopolies or near monopolies may increase costs since the incentive to be cost competitive is less if the merged firm is insulated from competitive pressure.

18 Factors to be considered regarding the substantial prevention or lessening of competition.

19 HMG, section 3.0

20 Canada (*Director of Investigation and Research v Southam* [1997] 1 S.C.R. 748 para. 85

21 Commission Notice on the definition of the relevant market for the purposes of Community competition law, Official Journal of the European Union OJ C372 on 9 December1997

22 Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings, Official Journal of the European Union 5 February 2004, C31/5-C31/18

Goodmans LLP

2400-250 YONGE STREET
TORONTO, ONTARIO CANADA M5B 2M6
TEL: +1 416 979 2211
FAX: +1 416 979 1234

CONTACTS:
RICHARD ANNAN
TEL: +1 416 597 4272
RANNAN@GOODMANS.CA

WILLIAM P. ROSENFELD
TEL: +1 416 597 4145
WROSENFELD@GOODMANS.CA

DANIEL GORMLEY
TEL: +1 416 597 4111
DGORMLEY@GOODMANS.CA

WWW.GOODMANS.CA

Goodmans LLP is recognised internationally as one of Canada's premier transaction law firms. Founded in 1917, Goodmans is based in Toronto and has offices in Vancouver and Hong Kong. With over 190 lawyers, Goodmans acts as counsel to a broad range of Canadian, US and foreign enterprises, from sole proprietorships to multi-national corporations, banks and governments across virtually every sector of the economy. Goodmans offers a full range of services and expertise in all major areas of business law.

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In addition to merger review, the firm regularly advises clients in contentious matters that raise competition issues relating to the criminal and civil provisions of the Competition Act, including conspiracy, abuse of dominance, resale price maintenance, refusal to deal and deceptive marketing practices.

Canadian Merger Review:New MEGs Released in Draft for Public Comment

April 01, 2004

Susan M. Hutton

On March 25, 2004, the Canadian Competition Bureau released its highly anticipated draft revised *Merger Enforcement Guidelines* (Draft MEGs) for public comment. Once finalised this summer, they will replace the *Merger Enforcement Guidelines* first published in 1991 (1991 MEGs) as a comprehensive explanation of the Competition Bureau's merger enforcement policy under the *Competition Act* (the Act).

The revised MEGs are not intended to "reflect a shift in policy or direction" but rather to "clarify and explain the Bureau's current practice." Notably, the "safe harbour" market share thresholds established in the 1991 MEGs have not changed. Since 1991, however, there have been significant new developments in Canadian merger review, including a number of important Competition Tribunal and court decisions, as well as developments in the underlying economics. The Draft MEGs are intended to reflect these developments, and are replete with references not only to contested cases, but also to numerous uncontested cases decided - effectively - by the Commissioner.

The format of the MEGs has also changed. Gone is the step-by-step analysis of the statutorily identified "section 93 factors" relevant to the analysis of the competitive impact of a transaction. Rather, the Draft MEGs are now organized thematically. Following chapters on "Definition of Merger", "The Anti-Competitive Threshold", and "Market Definition", the factors relevant to competition are part of the discussion of "Market Share and Concentration", "Anti-Competitive Effects", "Entry", "Countervailing Power", "The Efficiency Exception", "Failing Firm", "Vertical Mergers" and "Conglomerate Mergers".

Comments on the Draft MEGs are due by May 25, 2004, and the final document will be issued in the summer of 2004.

Of particular note, the Draft MEGs contain important new insight into the Bureau's approach to, among other things:

- the definition of a "merger": significantly expanded discussion of when a minority interest can constitute a "significant interest" for merger review purposes, and of when a transaction other than an acquisition can also be viewed as a merger. While the 1991 MEGs focused on the influence of the acquirer over the acquiree through voting shares, the Draft MEGs provide additional guidance on the ways in which influence could be exercised. For example, the guidelines provide that financing arrangements and terms of default relating to such arrangements, long-term contractual arrangements or pre-existing long-term business relationships are examples of arrangements that could enable a party to materially influence management decisions of another business and may constitute a "merger" under section 91.

- the anti-competitive threshold: expanded discussion of the circumstances under which the Bureau would determine that a transaction is likely to substantially "prevent" competition. Referencing recent Competition Tribunal decisions, the Draft MEGs gives examples of mergers that may result in the prevention of competition, such as: an acquisition that prevents a rival's expansion into a new geographic market; an acquisition that precludes the pro-competitive effects of new capacity; and an acquisition that prevents a rival's expansion into new product areas.
- clarification of the test for a substantial lessening of competition: the Bureau evaluates whether the merger is likely to provide the merged entity (alone or in concert with others) with an ability to profitably sustain a material price increase in a substantial part of a market, regardless of whether the firm will be dominant, and even if the price increase in question is less than 5% (so long as it will be sustainable profitably for two years).
- recognition that increased buyer power will result in below-competitive prices when the buyer is prepared to reduce the purchase of inputs.
- market definition: clarification that markets are defined having regard only to demand-side substitution - supply side responses are relevant only to determining the participants in, or potential entrants into, a market.
- product market definition: expanded discussion of differentiated product markets, and possibility that suppliers of non-substitutable products might be in the same product market where buyers value a single source of supply.
- geographic market definition: discussion of spatial competition analysis and the process by which the Bureau delineates the boundaries of local or regional markets, where necessary for its analysis.
- anti-competitive effects: expanded discussion of the issue of coordinated effects (formerly, "interdependence"), a topic of significant interest and debate among competition lawyers and economists. The Draft MEGs include a list of factors that the Bureau will consider in its analysis of coordinated effects. These factors include: product and cost homogeneity; stability of underlying costs; market transparency; many small buyers making frequent purchases; multi-market exposure; inelasticity of demand; limited excess capacity; and a history of collusion/cooperation.
- new chapter on countervailing power, with application to both supplier and buyer power cases.
- of necessity, given the Federal Court rulings in *Superior Propane*, the Bureau's approach to the efficiencies defence has been substantially revised. In particular, the 1991 MEGs looked only at the deadweight loss to society when evaluating the anti-competitive harm, whereas the Court directed the Bureau to evaluate the anti-competitive effect of the transaction from the perspective of all of the objectives of the Act (not merely allocative efficiency). The result is a multi-faceted, and admittedly subjective, balancing that will be highly case specific. In recognition of this, the Draft MEGs encourage parties relying on the efficiencies defence to make submissions as to how the different qualitative and quantitative effects of the transaction ought to be balanced against the efficiencies expected to flow from the transaction.

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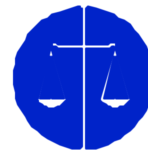

THE CANADIAN BAR ASSOCIATION
L'ASSOCIATION DU BARREAU CANADIEN

The Voice of
the Legal Profession

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profession juridique

June 2, 2004

Ms. Lourdes DaCosta
Senior Competition Law Officer
Competition Bureau
Place du Portage I
50 Victoria Street
Gatineau QC K1A 0C9

Dear Ms. DaCosta,

RE: Draft *Merger Enforcement Guidelines*

I am writing as Chair of the Canadian Bar Association National Competition Law Section (the CBA Section) concerning the Competition Bureau's March 2004 Draft *Merger Enforcement Guidelines* (the Draft MEGs).

The Draft MEGs appear to go a long way toward updating and clarifying the Bureau's approach to merger analysis and the drafters are to be commended. The purpose of our submission is to provide the Bureau with high-level, conceptual comments on certain aspects of the Draft MEGs. The CBA Section also has a number of technical comments to present to Bureau staff at a meeting currently scheduled for June 14, 2004. We trust the comments in this submission will also be discussed at that meeting.

I hope that the observations and recommendations in our submission will be helpful to the Competition Bureau in its consideration of the Draft MEGs. In the meantime, please do not hesitate to contact either Oliver Borgers (Merger Committee Chair, 416-601-7654) or Jay Holsten (Merger Committee Vice-Chair, 416-865-7523) if you have any questions.

Yours truly,

(Signed by Trevor M. Rajah on behalf of Susan S. Boughs)

Susan S. Boughs
Chair, National Competition Law Section

500 - 865 Carling, Ottawa, ONTARIO Canada K1S 5S8
Tel/Tél. : (613) 237-2925 Toll free/Sans frais : 1-800-267-8860 Fax/Télécop. : (613) 237-0185
Home Page/Page d'accueil : www.cba.org E-Mail/Courriel : info@cba.org

Submission on the Competition Bureau's Draft *Merger Enforcement Guidelines*

NATIONAL COMPETITION LAW SECTION
CANADIAN BAR ASSOCIATION

May 2004

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PREFACE

The Canadian Bar Association is a national association representing 38,000 jurists, including lawyers, notaries, law teachers and students across Canada. The Association's primary objectives include improvement in the law and in the administration of justice.

This submission was prepared by the National Competition Law Section with assistance from the Legislation and Law Reform Directorate at the National Office. The submission has been reviewed by the Legislation and Law Reform Committee and approved as a public statement of the National Competition Law Section.

Submission on the Competition Bureau's Draft *Merger Enforcement Guidelines*

I. INTRODUCTION

The National Competition Law Section of the Canadian Bar Association (the CBA Section) is pleased to provide its comments respecting the Competition Bureau's March 2004 Draft *Merger Enforcement Guidelines* (the Draft MEGs).

The CBA Section welcomes the opportunity provided by the Competition Bureau for interested parties to submit comments on the Draft MEGs, particularly given the central importance of the MEGs to Canadian competition law and policy. The Draft MEGs appear to go a long way toward updating and clarifying the Bureau's approach to merger analysis and the drafters are to be commended.

The purpose of this submission is to provide the Bureau with high-level, conceptual comments on certain aspects of the Draft MEGs. These comments concern issues that the CBA Section believes are of particular importance, and therefore merit careful consideration by the Bureau. The CBA Section also has a number of specific, and in many cases technical, comments to present to Bureau staff at a meeting with the Task Force, currently scheduled for June 14, 2004. We trust the comments in this submission will also be discussed at that meeting.

II. GENERAL COMMENTS ON THE "PURPOSE" OF THE MERGER PROVISIONS

The *Superior Propane* case, in particular the decision of the Federal Court of Appeal,[1] highlighted the potential for the *Competition Act's* purpose clause, section 1.1, to influence the interpretation of the Act's various provisions. In *Superior Propane*, section 1.1 was used to assist in the interpretation of the so-called "efficiency defence" in section 96, and in particular to determine the meaning of the word "effects" in the phrase "the effects of any prevention or lessening of competition." Significantly, the Court did not address section 1.1's interpretive effect on other provisions, and recognized that (unlike section 96) a provision may be sufficiently clear and precise as to override an ambiguous purpose clause.[2] Moreover, the Court did not cast doubt on the substantial jurisprudence interpreting other of the Act's merger provisions, including jurisprudence respecting the anti-competitive threshold in section 92 (*i.e.,* a "substantial prevention or lessening of competition" or "SPLC") and other similar thresholds (e.g., the "undue prevention or lessening of competition" in section 45).

The Tribunal in *Superior Propane* also reiterated that efficiency is the paramount objective of the merger provisions and the Court found no error in these findings. The CBA Section, therefore, believes it would be desirable for the Draft MEGs to state more clearly what appears to be implied therein, namely that the Bureau's approach to determining whether a merger is, or is likely to, result in a SPLC has not changed from the 1991 MEGs.

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1 *The Commissioner of Competition v. Superior Propane Inc. and ICG Propane Inc.*, [2001] 3 F.C. 185 (C.A.).

2 *Ibid*, at paragraph 106.

On its face, nothing in the Draft MEGs or section 93 suggests that the policy goals in section 1.1 apply directly in the context of a merger analysis other than in respect of the balancing that occurs under section 96. However, a recent Bureau news release referencing language similar to section 1.1 but making no reference to section 96 could suggest that the Bureau does not regard the application of the section 96 factors as being so limited.[3] As such, it would be desirable for the Bureau to confirm in the Draft MEGs that the section 96 factors apply directly to a merger analysis only through section 96 of the Act, forestalling the potential perception that the Act's substantive merger test – whether a merger will, or is likely to, give rise to a SPLC – has become a hybrid SPLC/public interest-type test.[4]

This confirmation is, in our view, vitally important to Canadian competition law and to preserving Canada's influence in the domain of international competition policy. A shift from an SPLC to a hybrid SPLC-public interest test would be widely perceived as a regressive development. A hybrid test would undermine the justiciability of the merger review test and diminish the certainty and predictability of the merger review process. It would run contrary to current international views on the appropriate structure of merger review regimes[5] and create divergence rather than convergence with other jurisdictions'

3 See Competition Bureau, *Bureau* Resolves *Competition Issues in Forestry Merger* (1 April 2004), in which the Bureau stated that "[t]he Competition Bureau is committed to ensuring that small and medium sized enterprises have an equitable opportunity to compete and participate in the economy".

4 See, for example, Rowley & Baker, *International Mergers: The Antitrust Process*, Vol. I (London: Sweet & Maxwell, 1996), at 4, which describes SPLC and public interest regimes, as well as market dominance regimes.

5 See, for example, Michal S. Gal, *Competition Policy for Small Market Economies* (Cambridge, MA: Harvard University Press, 2003), at 206, which identifies the SPLC and dominance tests as the two "major tests" for "merger illegality". See also Mario Monti, EU Commissioner for Competition, *Introductory Remarks to Session 2: Analytical Framework for Merger Review*, presented at International Competition Network Inaugural Conference, Naples, 28-29 September 2002, where Mr. Monti spoke of the commonality between the European dominance and U.S. SPLC tests (the former of which has since been modified following substantial debate in Europe on the appropriate merger test for Europe) and noted that, in those "exceptional" cases where "public interest criteria" are used, such criteria "should be very clearly spelt out in the law" (which, we would submit, is not the case for the section 96 factors).

regimes, most significantly in the United States and Europe.[6] Finally, the economic approach to SPLC analysis outlined in the Draft MEGs has been followed in numerous contested mergers by both the Competition Tribunal and the courts. It should be viewed, therefore, as already supporting the objectives of the Act, without need for the introduction of non-economic policy goals directly into the analysis related to SPLC.

For these reasons, we would recommend that the following language be added to paragraph 8.21 of the Draft MEGs:

> It should be noted that the examination of anti-competitive effects under section 96 of the *Competition Act* goes beyond the analysis under section 92 of whether a merger will, or is likely to, result in the creation or enhancement of the merged entity's ability, alone or in concert with other firms, to exercise market power.

III. DEFINITION OF MERGER

The Draft MEGs propose to expand the concept of "control" to include the concept of *de facto* control. This is at odds with the approach in the Act, which provides only two trigger points in merger review: the acquisition of *legal* control;[7] and the acquisition of a significant interest. The acquisition of *de facto* control over a partnership or corporation is not an acquisition of control for purposes of the Act. Moreover, as the members of the CBA Section who have had the opportunity to deal with the concept of *de facto* control under the *Investment Canada Act* know all too well, it is an ambiguous and uncertain concept. Therefore, while it is open to the Bureau to consider the notion of *de*

6 We would note in this regard that the Bureau has been a strong advocate of the ICN's objective of achieving "soft convergence" among national competition regimes. See, for example, Konrad von Finckenstein, Q.C., Commissioner of Competition (as he then was), *International Mergers and Acquisitions: Working to Reconcile National Regimes with Global Markets*, Speaker's Notes for remarks made to La Conférence de Montréal, June 28, 2002. It should also be noted that the ICN, while advocating soft convergence of competition laws (which, for reasons noted above, would seem to favour adoption of an SPLC or dominance test for mergers), has recognized that some jurisdictions continue to apply non-competition considerations in merger assessments. To the extent that such factors are taken into consideration, the ICN has recommended that the way in which they interact with competition factors should be made transparent. Such a recommendation, while falling short of recommending against inclusion of non-competition factors, may minimize the potential negative effects arising from the use of non-competition factors in a merger analysis. See the ICN's Recommended Practice for Merger Notification Procedures, in particular Comment 3 of Part B of the Recommended Practice for Transparency.

7 *Competition Act*, s. 2(4) control is defined only for partnerships and corporations, and the Section acknowledges that it is an open question whether other definitions of control may be drawn upon in the case of other types of entities.

facto control in determining whether there has been an acquisition of a significant interest, we fail to see how adding this concept clarifies the determination of whether a "significant interest" has been "acquired". We would therefore recommend that the Bureau abandon the *de facto* control concept and focus instead on setting out the meaning of "significant interest," the legal term used in section 91.

While the Bureau's working definition of "significant interest" in paragraph 1.6 of the Draft MEGs ("the ability to materially influence the economic behaviour") accurately and succinctly captures the legislative intent behind the use of the word "significant", it does not grapple with the word "interest". An "interest" in a business is commonly understood to mean ownership of an economic interest, i.e. an *investment* in a business. A supply contract may well enable the supplier to materially influence the economic behaviour of its customer, without the supplier having an "interest" in the customer's business as that term is commonly understood. The Bureau's approach in paragraphs 1.14 and 1.15 therefore results in a degree of uncertainty in the analysis of such situations and should be clarified.

IV. THE ANTI-COMPETITIVE THRESHOLD

Among the most significant changes in the Draft MEGs is the elimination of the 5 per cent price increase guideline for assessing whether a merger will, or is likely to, result in an SPLC. We believe that the removal of this reference is unnecessary, unhelpful, and inconsistent with the goals of providing greater guidance and transparency. The reference to the 5 percent price increase guideline in the 1991 MEGs leaves open the possibility that an assessment of a given market may disclose that some amount other than 5 per cent is more appropriate for the purposes of this determination. In practice, however, the 5 per cent threshold is helpful as a general guideline, for example in a preliminary assessment of a merger's potential impact on competition prior to there having been an opportunity, by the parties, their counsel or the

Bureau, to carry out a more detailed assessment.[8] Unless the Bureau has itself abandoned this approach we would recommend that the Draft MEGs maintain use of the 5 per cent price increase threshold. If the Bureau has abandoned this approach, we would strongly recommend that it reconsider its position.

We further note an inconsistency in the Draft MEGs with respect to abandonment of the 5 per cent price increase guideline for market power assessment purposes while retaining such a threshold for the purposes of application of the hypothetical monopolist test for market definition. In addition, the statement in footnote 22 that "materiality refers to sustainability rather than the magnitude of the price increase" contorts, in our view, the meaning of the word "material". Competition is substantially constrained when sufficient marginal customers are forced to pay prices that are higher in a degree that – if sufficient choice of supply were preserved – would affect their choice of supply, thus rendering the price increase unprofitable. The sustainability (or, put another way, the time period permitted for such substitution to take place) is a separate issue from the magnitude of a change in price that will affect customers' choices in a given context. This magnitude of price increase is already identified for purposes of market definition and is similarly appropriate for purposes of assessing a SLPC.

V. MARKET DEFINITION

The Draft MEGs state "market definition is based on substitutability and focuses on demand responses to changes in relative prices. Supply responses are also important when analyzing market power, but are examined later in the analysis."

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8 For a discussion of the importance of including concrete, numerical thresholds in guidelines, see William Blumenthal, *Clear Agency Guidelines: Lessons from 1982* (2000), 68:1 *Antitrust L.J.* 5 at 16 (discussing the reasons underlying the success of the 1982 U.S. Department of Justice merger guidelines, including: "*The Guidelines were fully specified*. Not only did the Guidelines fill in the interstices, but they filled in virtually all of the interstices—and generally not with abstract standards, but with numbers. What degree of substitutability was required for products to be included within the same market? Over what time would market responses be measured? The Guidelines were clear: under the hypothetical monopolist approach, substitutability such that a 5 percent price increase for one year would be unprofitable, with separate six-month and two-year time frames used to measure production flexibility and entry, respectively. Similar detail was provided throughout, as tests were fashioned with specific parameters. One could quarrel with the drafters' chosen specifications, but the choices were there for all to see and use.")

As noted by Daniel L. Rubinfeld in *Market Definition with Differentiated Products: The Post/Nabisco Cereal Merger*,[9] "market definition is not an end in itself." Rather, it provides a foundation on which one can evaluate likely competitive effects. Supply-side responses by "sellers that are not currently supplying the relevant market",[10] however, can just as effectively prevent a hypothetical monopolist from imposing a significant, non-transitory price increase as will the substitutability of the products.

The purpose of market definition is to identify the set of suppliers who will be in a position to discipline attempts by the merged entity to increase prices in a material degree. That is the meaning of "competition". As the Supreme Court of Canada noted in the PANS case, "[t]he aim of the market structure inquiry is to ascertain the degree of market power of the parties," which requires identifying "competitors".[11] The hypothetical monopolist test is a tool that may be of assistance in this regard, but it should not be adhered to rigidly, since there may be circumstances where a narrow focus on demand considerations is misplaced.[12]

Moreover, exclusion of supply-side responses at the market definition stage may result in an unnecessarily complicated analysis. In many cases, the methodology espoused in the Draft MEGs – identifying product markets according to demand considerations but taking (quick) supply-side responses into account only when calculating market shares and concentration – will lead to the same result.[13] In differentiated product markets, however, it can lead to an indeterminate result. In certain manufacturing industries, such as secondary steel or aluminum manufacturing (where customers may have different demands, e.g. square-shaped versus circle-shaped pieces, but suppliers are generally

9 (2000), 68 Antitrust L.J. 163, at 177.

10 Draft MEGs, paragraph 4.2.

11 *R. v Nova Scotia Pharmaceutical Society*, [1992] 2 S.C.R. 606 at 653 ("PANS").

12 Again, in *PANS*, the Supreme Court of Canada noted that "[t]he structure-behaviour framework of analysis remains merely a convenient way of approaching conspiracy problems, and it should not be seen as a rite of passage." The same is true, the CBA Section would submit, with respect to the market structure component of merger analysis.

13 See Rubinfeld, *supra*.

capable of switching between the manufacture of the different products with relative ease), the two-stage approach would require the Bureau officer to define an inordinate number of different product markets, only to aggregate the capacities and/or production of the producers involved in those "markets" for purposes of assessing market shares and concentration.[14]

The CBA Section notes further that consideration of supply-side substitution need not and should not shift the focus of the analysis from the products to the identity of suppliers.[15] The confusion the two-step approach generates at a practical level is evidenced by paragraph 4.12, which recognizes that such market shares "may understate the relative market position and competitive influence" of sellers who participate through a supply response.

At the very least, if the two-step approach is maintained, the CBA Section recommends that a paragraph be added, after paragraph 4.12, recognizing that, where supply-side considerations warrant, the practical effect of the market share calculations may be to include suppliers with fungible resources and a common set of products into a more broadly defined product market. Again, however, given the role of the MEGs to guide and clarify the thinking not only of merging parties but of Bureau staff, the CBA Section recommends that the Draft MEGs revert to a more purposive analysis of relevant product markets that serves to identify all relevant competitive conditions (including supply responses) with respect to a product or group of products.

14 Another example where, taken to its extreme, failure to consider supply-side substitution leads to excessively fragmented market definitions is knowledge-intensive companies, which sell their employees' skills rather than a pre-identified set of products. These firms have been described as "those who organize their business flexibly to respond to demand pressures, where usually most of the labour is integrated into a common pool from which resources are drawn to meet clients' needs just in time ... typically consulting companies and professional service companies (investment banks, insurance companies, etc.)." See Padillo, Dr. Atilano Jorge, *The Role of Supply-Side Substitution in the Definition of the Relevant Market in Merger Control*, National Economic Research Associate, European Commission, Madrid, 2001, at 24.

15 See Draft MEGs, paragraph 3.11.

VI. ANTI-COMPETITIVE EFFECTS

The new and expanded material in this section of the Draft MEGs is one of the most important improvements in the proposed guidelines. The Bureau quite rightly recognizes that a coherent theory of anti-competitive harm is a necessary pre-requisite for reaching a conclusion that a merger is likely to prevent or lessen competition substantially. With this in mind, the CBA Section has the following comments on Section 5 of the Draft MEGs' treatment of anti-competitive effects.

A. Unilateral Effects

The discussion of unilateral effects is generally helpful and, in the CBA Section's view, consistent with modern economic theory. However, notably absent is a discussion of the conclusions that the Bureau has arrived at in a number of relatively recent mergers that combined post-merger shares above 45 per cent ("red") are presumptively anti-competitive.[16] By contrast, shares between 35 per cent and 45 per cent ("yellow") are regarded as warranting further analysis, while post-merger shares below 35 per cent ("green") typically are regarded as not leading to a substantial prevention or lessening of competition and therefore not requiring further analysis.

In the CBA Section's view, the so-called "stoplight" system of screening mergers has been one of the most significant enforcement developments in the past few years. However, it continues to be unclear how broadly the stoplight presumptions apply. For example, do they apply outside the retail merger context? Moreover, there are many examples of mergers cleared by the Bureau where the post-merger share was in excess of 45 per cent. There are also examples of mergers that have been successfully challenged by the Bureau before the Competition Tribunal or which have been settled by consent,

16 See, for example, Letter from Commissioner to Toronto-Dominion Bank and Canada Trust (28 January 2000) and earlier letters in respect of the proposed mergers of Bank of Montreal and Royal Bank (1998) and of Canadian Imperial Bank of Commerce and Toronto-Dominion Bank (1998). See also the Commissioner's press release in respect of various transactions in the retail grocery industry (e.g., Sobey's/Oshawa Group (1999), Loblaws/Provigo (1999) and Loblaws/Oshawa Group (1999)).

where the *post-divestiture* share was above 50 per cent.[17] In such cases, the Tribunal (and the Bureau where the matter was settled by consent) must have considered that the merger would not give rise to an SPLC even though the post-divestiture share remained in the above 50 per cent range.

Finally, the CBA Section questions how rigidly a system of market share presumptions can be applied in light of section 92(2), which prohibits the Tribunal from finding that there is an SPLC based on measures of concentration or market share alone. Nonetheless, if it is the Bureau's intention to continue to apply market share presumptions such as those outlined in the bank and grocery merger cases, the CBA Section believes that it is critical that this approach to market share be outlined in the new MEGs.

B. Coordinated Effects

The Draft MEGs' treatment of co-ordinated effects is also useful, which is particularly important given the complexity of the subject matter and the fact that it is often not well understood by merging parties. However, the CBA Section also believes that the discussion can be further improved in a number of ways.

First, the CBA Section questions whether it is the Bureau's intention to give coordinated effects greater prominence in its enforcement activity, as is arguably occurring in the United States.[18] We note that in addition to the bank mergers, there have been a number of recent mergers in Canada where challenges appear to have been based, at least in part, on coordinated effects / interdependence theories.[19]

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17 See, for example, Canadian Waste (1998; 51 per cent and 58 per cent post-divestiture shares) and United Grain (2002; 41-52 per cent post-divestiture shares).

18 As highlighted in a speech given by Deborah Platt Majoras at the 2004 Langdon Hall conference, coordinated effects theory has been raised by the U.S. Department of Justice or FTC in several recent cases including *Dairy Farmers of America, UPM, Arch Coal/ Alcan/Pechiney* and *SGL Carbon*.

19 See, in particular, *Abitibi/Donahue* (CT2001/009), *Lafarge/Blue Circle* (CT 2001/004) and *United Grain* (CT 2002/001).

At a substantive level, the CBA Section believes that the Draft MEGs' discussion of "co-ordinated effects", while a significant improvement over the 1991 MEGs' sparse treatment of the subject, could be further improved. The Draft MEGs, for example, differ from the Bureau's *Merger Enforcement Guidelines as Applied to a Bank Merger* (the "Bank MEGs"), which provided that interdependent behaviour "is more likely in markets in which firms can recognize and reach a co-operative understanding, monitor one another's behaviour, and respond to any deviations from the co-operating behaviour by others."[20] The CBA Section believes this more clearly states the three necessary preconditions for interdependent or co-ordinated behaviour to be a potential concern. Indeed, the first of these prerequisites is missing from paragraph 5.19 altogether. Even the statement in the Bank MEGs, however, could more clearly recognize the central role of these three factors in the analysis.

The CBA Section is also concerned that the lengthy list of potentially relevant factors identified in paragraph 5.22 will give rise to a "laundry list" analytical approach, thereby diverting attention away from the briefer discussions of (i) conditions required for interdependent behaviour to occur and (ii) the requirement for a causal link between a merger and the creation or enhancement of coordinated market power. The potential significance of this danger is evidenced by the *Airtours* case, in which the European Commission received a salutary reminder of the importance of clear evidence and analysis of each of these issues. The CBA Section believes that the Draft MEGs would benefit from a similarly rigorous, and focused, discussion of the necessary conditions for interdependent behaviour. If the Bureau determines to keep its "list" approach, the MEGs should comment on the relative significance of various factors in the list.

C. Differentiated Products

The Draft MEGs take, in the CBA Section's view, an unwarranted negative posture towards product differentiation. This is evidenced, for example, by the statements in

20 Bank MEGs, at paragraph 65.

paragraphs 5.3 and 6.11, respectively, that "product differentiation limits the level of direct competition among firms" and constitutes a barrier to entry in the form of "advantages enjoyed by incumbents" to be overcome by new entrants.

Product differentiation is an important aspect of non-price competition that can contribute substantially to consumer welfare and economic efficiency. While product differentiation may play a role in the finding of an SPLC (*e.g.*, in a unilateral effects analysis where the merging parties' products are particularly close substitutes), there are also cases where product differentiation will support a contrary conclusion (*e.g.*, when the merging parties' products are relatively less close substitutes, and in interdependence analysis, generally). Similarly, it is incorrect to suggest that product differentiation is exclusively a barrier to entry; it can also have an enabling effect by providing opportunities for new entrants.

Accordingly, the CBA Section strongly encourages the Bureau to take a more balanced approach to product differentiation. In particular, the Draft MEGs should recognize that product differentiation is an important feature of our economy and that, for reasons described above, whether product differentiation will be a factor in support of or against a finding of a SPLC will depend on the specific circumstances of the case.

D. Innovation Markets

The CBA Section is pleased that the Draft MEGs do not follow the U.S. enforcement approach of defining so-called "innovation markets" for the purposes of merger analysis. However, we also note that the language of paragraph 5.9 of the Draft MEGs is somewhat ambiguous, and could be construed as an indication that the Bureau intends to use innovation markets in its merger analysis. Given our understanding that the Bureau was careful to omit innovation markets from its *Intellectual Property Enforcement Guidelines*, the CBA Section believes that it would be desirable for the Bureau to make it clear that paragraph 5.9 does not constitute recognition of innovation markets in Canadian

merger review under the Act (as distinct from an analysis of likely future competition in respect of the relevant product markets).

VII. THE EFFICIENCY EXCEPTION

By providing a defence for mergers that give rise to efficiencies that are greater than and offset their anticompetitive effects, Canada deliberately chose to place a greater weight on efficiencies compared to other jurisdictions, such as the United States. This approach reflects Canada's particular economic and national interests, including the small, open and export-oriented nature of the Canadian economy and the important role that efficiencies can play in promoting these interests. As such, section 96 – the "efficiency defence" – is a fundamental feature of Canadian competition law and policy.

The test for weighing efficiency gains against anti-competitive effects was substantially modified as a result of the Federal Court of Appeal's judgment in *Superior Propane*. It is not surprising that the Draft MEGs would be modified to reflect the changes flowing from that decision. At the same time, if amendments along the lines of those proposed in Bill C-249 are enacted, they will substantially modify section 96 by converting efficiencies from a defence to an otherwise anti-competitive merger to one of the many factors to be taken into consideration by the Tribunal when examining the competitive impact of a merger. Any such amendments would require the further revision of Part 8 of the Draft MEGs.

With the above in mind, the CBA Section has the following general comments in respect of the Draft MEGs' treatment of efficiencies.

First, the Draft MEGs appear to reflect an interpretation of some of the judicial guidance provided in the *Superior Propane* decisions that favours the Bureau's preferred approach to the application of section 96. The Federal Court of Appeal, however, did

not say that the approach advocated by the Commissioner in *Superior Propane* is the only approach that meets the requirements of section 96. The Court merely indicated that the balancing weights approach "seems" to meet these requirements, leaving open the possibility that there may be other acceptable approaches as well.[21] Accordingly, a more balanced description of the standards and approaches that may be acceptable under section 96 would be preferable.

Second, the value of the Draft MEGs as "guidelines" is diminished by the use of vague wording regarding the Bureau's enforcement approach for section 96. In order to clarify the Bureau's enforcement approach, we would recommend incorporating additional explanatory statements and examples. For example, paragraph 8.8 states a broad requirement for a description of the precise nature, magnitude and likelihood of claimed efficiencies. This statement would benefit from the use of numerous examples (*e.g.*, savings in controllable costs or by elimination of redundancies rather than changing the operating paradigm, complexity of steps needed to obtain synergies, similarity of merging businesses, sufficiency of financial strength to fund necessary restructuring, *etc.*).[22] Similarly, the discussion of redistributive effects in paragraphs 8.25 to 8.27 contains language that is extremely broad, stating that there are different approaches to analyzing wealth transfers and proceeding to identify only two of several such approaches. With respect to the brief discussion of one of the two approaches expressly mentioned, the socially adverse effects approach, it would be helpful to have further detail regarding the methodology the Bureau would use to assess whether a wealth transfer is likely to have socially adverse effects. Such detail could include quantification of how much of the

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21 *Superior Propane*, *supra*, at paragraph 141.

22 See Suzanne Loomer, Stephen R. Cole and John Quinn, *Quantifying Efficiency Gains in a Competition Case: Sustaining a Section 96 Defence* presented at National Conference, Canada's Changing Competition Regime, Toronto (26-27 February 2003), at 15.

transfer would be included in the assessment as well as the type of data that would be examined in order to make such a determination.[23] As for the "other", unidentified, approaches for analyzing wealth transfer, it would be helpful to identify these other approaches and to indicate the circumstances in which each particular approach might be preferred and the reasons why.

The CBA Section applauds the Bureau for articulating that it will consider efficiencies at the enforcement stage of a merger and not solely before the Tribunal. The CBA Section is concerned however that the Bureau apply settled principles on the law of efficiencies where those principles have been pronounced upon by the Tribunal. In this regard, the Bureau should not be imposing a merger specificity requirement for efficiencies, simply to be in keeping with the US merger guidelines. There are two problems with doing so. First, it is not the law. Both *Superior Propane* and *Hillsdown* make it very clear that the Act does not require that claimed gains in efficiency not be achievable in another, less anti-competitive way. As noted by the Tribunal in *Superior Propane* (no.2):

> [147] As stated in the Horizontal Merger Guidelines, claimed efficiency gains must be "merger-specific". Although those Guidelines do not elaborate, this requirement appears to mean that a claimed efficiency gain is not cognizable if it could be achieved in another, presumably less anti-competitive, way.
>
> [148] The Tribunal found that the gains in efficiency in the instant merger would not be achieved absent the merger (i.e. if the order were made) and hence could be included in the test under subsection 96(1) (Reasons, at paragraph 462). This requirement is not the same as the one used by the American enforcement agencies. After satisfying itself that the two approaches were not identical, the Tribunal noted the same distinction was addressed in Hillsdown, supra, which supported the view that the Act did not require that claimed gains in efficiency not be achievable in another, less anti-competitive way, although this was the requirement of the Commissioner's Merger Enforcement Guidelines ("MEGs").

While the MEGs are not binding on the Commissioner, the law is and as such should be duly reflected in the MEGs.

23 This would apply in the determination of the "greater than and offset" portion of the current section 96 efficiencies defense, or in the calculation of efficiencies as one of several factors in the overall analysis of whether a transaction may result in a substantial prevention or lessening of competition should Bill C-249 be passed.

Second, even if the Bureau retains this requirement, it must be made clear that theoretically possible alternative means of achieving efficiencies do not preclude real efficiencies from being properly considered. This is consistent with the CBA Section's submission on Bill C-249.[24] The language from the former MEGs addressing this point should be retained.

Finally, we note that reference is made to the dissenting views of a lay Tribunal member from *Superior Propane* regarding the consideration of anticompetitive effects from a "qualitative" perspective. That position should not be followed by the Bureau nor expressed in the MEGs as it was dissenting obiter comment and was expressly rejected by the Tribunal, whose opinion was upheld by the Federal Court of Appeal.

Anticompetitive effects should be quantified whenever possible, even if only roughly as required by the Tribunal and Federal Court of Appeal.

VIII. FAILING FIRM BUSINESS FAILURE AND EXITING ASSETS

The CBA Section is concerned that the discussion of the so-called "failing firm" defence has omitted language used in the 1991 MEGs. The omitted language made it clear that insolvency was only one circumstance in which the Bureau may find that, with the appropriate focus on comparing the post-merger world to the likely world in the future if the merger does not take place, a transaction which may have caused an SLPC based on the past, might actually have no such effect. There must be a causal link between the diminution of competition and the merger in question. If the assets of one or more of the merging parties can be shown to be likely to exit the market in any event, then the merger is not the cause of the change in competition. "Failing firm" is just one example of why

24 Submission on Bill C-249 – Proposed Amendment to the Section 96 of the *Competition Act* (Mergers Efficiency Defence), October 2003.

comparison of the merger outcome with the likely degree of competition without the merger is so important. The Bureau's assessment of the likelihood of retrenchment, or of a "prevent case", are other examples of the same general concept. The past is not always a perfect guide to the future.

As such, the CBA Section is concerned that:

- the "failing firm" analysis is without such analytical background; and
- the draft should require a competitively preferable purchase to offer "net price above liquidation value", otherwise liquidation is in fact the more likely outcome.

IX. ENHANCING THE "GUIDANCE" PROVIDED BY THE MEGS

The Draft MEGs, by definition, are intended to provide guidance to those who consult them as to how the Bureau is likely to analyze a particular transaction. For the most part, we believe that the Draft MEGs would achieve this objective. However, we also believe that there are certain changes that could be made to enhance the Draft MEGs in this regard. A number of these changes have been discussed elsewhere in this submission in the context of comments made in respect of particular substantive sections of the Draft MEGs. The following, however, are comments of a more general nature.

A. The Use of Citations

The Draft MEGs contain citations to jurisprudence and to decisions and/or positions taken by the Commissioner. While such citations can be of assistance in providing guidance to readers, we would offer two observations respecting the use of such citations:

i) Citations can only provide meaningful guidance if they include a brief description of the analysis underlying the citation. At present, there are numerous citations that provide no indication at all as to the reason for the citation, including some that do not even provide a page reference to assist the reader in identifying the

basis for the citation's inclusion in the Draft MEGs. Indeed, in some cases the CBA Section has been unable to identify the relevance of the case to the point under discussion in the Draft MEGs.

ii) Where the Commissioner's own conclusions or arguments are cited as the basis for a particular interpretation of the Act (as is done, for example, in footnotes 14 and 17 in relation to the *Seaspan* and *Bayer* cases), it should be made clear that these citations provide examples of the Bureau's enforcement approach in a particular case as distinct from representing authorities for a legal position (as is the case with jurisprudence). This could be done, for example, by including an express reference to these citations in the "Purpose" section of the Draft MEGs.

B. Expanded Discussion of Analytical Tools and Methodologies

The ability of the Draft MEGs to fulfill their guidance function would also be enhanced by the inclusion of additional discussion of significant analytical tools or methodologies that, at present, are mentioned in the Draft MEGs in a relatively cursory manner. In particular, the Draft MEGS make reference to critical loss analysis, cluster theory, spatial competition analysis, raising rivals costs and the Herfindahl-Hirschman Index ("HHI"), but provide little or no information about how they may be applicable to a proposed transaction. In particular:

i) Footnote 32 states that critical loss analysis "may" be of assistance in defining product or geographic markets, but nothing is said about whether/when the Bureau uses critical loss analysis for this purpose, nor is mention made of the fact that critical loss analysis can also be used to help determine whether a merger will, or will likely, result in an SPLC (i.e., as part of the assessment of whether a firm or group of firms, post-merger, will be able to profitably impose a material price increase);

ii) Paragraphs 3.18, 3.29 and 5.27 are similarly vague about cluster markets, spatial competition analysis and raising rivals costs, with the first and third of these referred to only indirectly in the Draft MEGs without actually naming the relevant economic concept or providing a reference to more extensive literature on the subject, nor cases in which they have been used; and

iii) Footnote 53 of the Draft MEGs states that "the Bureau may examine changes in the [HHI] … to observe the relative change in concentration before and after a merger," but goes on to state that "the Bureau does not use HHI levels as a safe harbour threshold." While it is helpful to know that the Bureau may examine HHI

> levels in its examination of a transaction, meaningful guidance would require that the Bureau identify the circumstances in which it will examine HHIs and the criteria that it will use for such examinations. In this latter regard, even if HHIs are not used as a safe harbour threshold, the Bureau must ascribe some importance to different HHI levels, otherwise it would not bother with the exercise of examining pre - and post-merger HHI levels. Thus, the reference to HHIs in the Draft MEGs begs the question, "to what levels does the Bureau refer?"

Accordingly, the CBA Section believes that the Bureau should provide a few sentences of detail about each of these tools and methodologies. This could include a brief description of each of the tools and methodologies, the circumstances under (or an example of a situation in) which they may be useful, the Bureau's perception of the tools or methodologies as credible bases for merger analysis, the extent to which they are (or are not used) by the Bureau in its merger analysis and, where possible, concrete benchmarks to assist in understanding when and how these tools and methodologies will be applied.

C. Commissioner's Commitment to the MEGs

The Commissioner's decision to resile from the MEGs in *Superior Propane* has caused some stakeholders to question the predictive value of the MEGs. As such, it would be appropriate for the Bureau to restate its commitment to the MEGs.

X. CONCLUSION

We hope that the foregoing comments will be of assistance to the Bureau in its consideration of the Draft MEGs. We would be pleased to address any questions that the Bureau has about these comments, and look forward to meeting with Bureau staff in this regard on June 14, 2004.

Focus- Canada: An interview with Konrad von Finckenstein

01 May 2003

GLOBAL COMPETITION REVIEW's editor David Samuels caught up with the chair of the Steering Group for the International Competition Network (ICN) at the Old Mill Inn during the Insight Competition Conference held in Toronto in February

GCR: After wonderful results between 1995 and 2000, the Criminal Enforcement Branch seems less successful. Has it been de-prioritised? [Editors note: in 2002 referrals to the Attorney General under criminal powers were five, with three actual charges then being laid.]

Von Finckenstein: Not at all. Criminal cases go at their own pace. There is a lot of lead-up work before any result is secured, especially in terms of work done with leniency applicants. We also want to act in a coordinated fashion with our international partners. So just because there haven't been major cases or guilty pleas doesn't illustrate a de-enforcement or de-prioritisation. We have been working steadily on these matters.

These cases come in bunches. You saw several last year [Editor's note: a reference to the 'B3 vitamins' case, in which the total fine was C$4 million]. There will be more coming in the near future.

GCR: So the low figures for 2002 don't tell the full story?

Von Finckenstein: You have to take a longer time-frame than a single year. We attach the same priority as before but the results can vary. Criminal enforcement has not been de-prioritised. You have to look at the totality of the effort, not only the convictions, to see how much work we are doing in the criminal sphere. You shouldn't measure activity only by just the tail-end; you need to look at the whole gamut of our activities in this field including education, dissuasion, and trying to get people to adopt voluntary codes and conform.

GCR: Our sources say it seems as if the Criminal Branch has turned in to 'the weaker sister'.

Von Finckenstein: The perception may be there; however it is unfounded.

GCR: Is the Bureau satisfied with the current funding structure? [Editor's note: the Bureau is partly funded through fees.]

Von Finckenstein: We are underfunded, plain and simple. We need a larger budget. We get about a quarter of our funds from fees and the rest through statutory appropriations.

It isn't enough and we need more. Especially in light of the new powers that we have been given and new responsibilities we have assumed. Telemarketing, for instance, is a huge absorber of resources. We are seeking more money but so far we haven't received any.

GCR: Do those negotiations require a lot of your personal time?

Von Finckenstein: The budgetary process in every country is difficult. There are competing priorities. While everybody is generically in favour of competition, there is no specific interest group that pushes for competition-in contrast to, say, agricultural subsidies or defence spending. We don't have a natural ally who supports our demands. It is always more difficult to raise money for a generic activity than for a specific target with a specific stakeholder group.

GCR: Despite what you say, there are bits of the Bureau that have expanded-the telemarketing team, and also your public relations function.

Von Finckenstein: The public relations expansion occurred because we believe in an enforcement continuum. We believe very strongly that if one is engaged in enforcement one doesn't only accuse people and convict them, one engages in the whole gamut of activity, especially in education, dissuasion, and voluntary compliance. As part of that one has to make clear what respondents have to comply with-ie, educate them. That requires an expanded communication function. I'm very proud of what we've done in communication. I think everybody should be doing it. If one is concentrating strictly on court work one is not doing one's enforcement job in my view.

GCR: I can't really criticise, as someone who benefits from your press department.

All the same, it is a clever trick-having too little money but nevertheless managing to make some parts of the organisation bigger, while no other part suffers.

Von Finckenstein: It really is one of the many tools one has at one's disposal to try to get compliance with the law.

GCR: The EU is saying, 'We will open the file to merger parties'-do you think others will follow this lead? Will you give parties access to the information, to things customers and competitors are saying about them?

Von Finckenstein: I am not aware of anyone complaining of a lack of transparency in our merger process. How we work is pretty well understood.

The worry I would have, assuming one builds in what you are suggesting, concerns the delay. Everybody wants a decision and they want it quickly. If one provides for access to the file, it will undoubtedly slow things down. One

also would have to make very elaborate rules for confidentiality, so as to make sure there is no disclosure of material that's protected. I'm not per se opposed to the idea. I just think it will be hard to fit with our timetable. I think that the Europeans, as they open up more under the new procedure, may find that there are costs in terms of more delays.

GCR: Why is your use of formal investigation powers in mergers on the rise [Editor's note: these powers are known as S11 requests]?

Von Finckenstein: In part because we have some bigger and more complicated mergers than ever before. We only use Section 11s where we find a lack of cooperation. When we get cooperation- when we get the information-we don't use them. We face time constraints: if we don't live up to our service standards, then it is going to be held out against us; on the other hand we can't do our job unless we have adequate information. So we use Section 11s in some cases to solve that problem.

There is an internal review process in which those working on a file explain at great length to our reviewer why and what exactly we are asking for. We also make sure that Section 11s are as targeted as possible and that we are only asking for the information that is really required to make our decision. We appreciate that assembling the information and sending it to us costs the respondents money.

GCR: Why has the Bureau ceased consulting on the scope of these orders?

Von Finckenstein: Consulting on a Section 11 is to some degree a contradiction in terms. I mean, if you don't want to disclose and the Bureau is about to make you disclose, what are we going to negotiate about?

There are exceptions: these orders are not always addressed to parties adverse in interests. In a situation where the people on the other side suggest that they would like to receive a Section 11-take the case of an umbrella organisation for instance, that feels its members might object if it supplied information on a voluntary basis-we will consult on the scope. But usually it makes very little sense to consult. We will happily cooperate afterwards- after the order has been issued-on what amounts to compliance.

GCR: The US agencies are now using the offer of a smaller second request as a carrot to encourage parties to disclose their hands earlier.

Von Finckenstein: I am all for cooperation. With reasonable people there is no problem. It is with unreasonable people that you have a problem.

GCR: You are about to review your 'MEGs' [Editor's note: 'MEGs' stands for merger enforcement guidelines]-are there any areas that you expect to have to change?

Von Finckenstein: Primarily we are going to make sure that the MEGs are still valid and haven't been taken over by developments either in economic thinking or behaviour. Second, we want to make them more user-friendly.

They are pretty difficult to read at the moment; they are full of jargon. Thirdly, once all the litigation on Superior Propane is over we will have to rewrite the part on efficiencies.

GCR: People say that the Bureau never shifts its position on a subject when it runs consultation projects. And you run a lot of consultation projects. Is this fair?

Von Finckenstein: That is balderdash. If you look at the various consultations that we've conducted, you will see that there have been considerable changes. In the last round of consultations on the Competition Act, for example, we totally dropped any idea to reform Section 45 or any change regarding abuse in the grocery sector because there was clearly no consensus on these subjects. When we were working on our intellectual property guidelines we re-wrote them considerably right to the end-as a result of the consultations. Consultations are extremely useful. We have no problem admitting that 'yes, that was our original idea but it was wrong and we have to change tack'. We don't claim to have a monopoly on wisdom. Right now we are looking at the predatory pricing guidelines. These have had a very negative reception, in light of which we are rethinking our stance. I would invite people to show us one consultation that was 'cosmetic'.

GCR: The example given to me was filing fees.

Von Finckenstein: I don't understand that. In the consultations on filing fees we demonstrated that costs have gone up- that we are not recovering the full cost but only direct costs-that we are only recovering 90 per cent.

You may then say, well, why didn't we go with a staggered filing fees?-ie, it is the size of the transaction that determines the amount of the fee. The answer is that complexity has absolutely nothing to do with size. If you have a staggered system, as they have in the US, it may be more equitable in terms of whether people are able to afford the fee, but it doesn't really reflect the amount of work that is being done on a merger file. We think it is in fact more equitable to have a uniform fee.

GCR: Does the Bureau consider the law on efficiencies, as set down in the latest Superior Propane decision, workable?

Von Finckenstein: I can't talk about this case at the moment. Until the litigation is finished I have to have no comment. [Editor's note: The Competition Bureau announced on 31 March that it will not appeal the Superior decision, but rather will seek amendment of the relevant sections of the Competition Act.]

GCR: Why does the Bureau resist the 'total welfare' approach to efficiencies, when so many economists now support it?

Von Finckenstein: I'm not going to say anything about efficiencies.

GCR: The Bureau is described as not playing fair in Tribunal cases [Editor's note: a new process in non-merger matters allegedly gives the Bureau certain 'informational advantages']. You are said to want to 'win at all costs', which people don't think is correct from a Crown counsel. Is it your fault that the playing field isn't level?

Von Finckenstein: What do I say in response? You are damned if you do and damned if you don't. There has been always an accusation that the Bureau cuts deals in the obscurity of its offices and does not use the Tribunal enough. We have used the Tribunal far more under my stewardship than under any previous Commissioner. Still some people feel we are not taking enough cases we investigate to the Tribunal. Others feel more cases should have been settled instead of being prosecuted. That's why I say you're damned if you do and damned if you don't. We build courts to use them, we appoint judges so that they adjudicate.

There are certain issues on which one can't have an agreement no matter how wellmeaning both sides are. And there are some issues where people are not willing to agree because an agreement to them means an unacceptable loss. We won't hesitate to litigate. We are not afraid to litigate. On the other hand, we always prefer to settle rather than to litigate. If a reasonable settlement is available we will take it. We've done a mixture. There are several cases- Astral being the last one-where we've actually litigated the issue fully but then settled in between the hearing and delivery of the judgment. We have no problem settling if it is a good deal.

GCR: What about the suggestion that you conduct 'trial by surprise'?

Von Finckenstein: I don't know who's been surprised by anything. If anything we are too slow in our litigation.

GCR: I suppose it's because you don't hesitate to make use of the changes in Tribunal's process.

Von Finckenstein: It is true that the Tribunal's process was changed considerably under the last amendments to the Act and hopefully it is now speedier. The rules of procedure have also been changed, although these changes are being contested right now.

GCR: Yes, it is the rules of procedure that I'm particularly referring to [Editor's note: there are two pending cases on whether the new Tribunal process constitutes due process-Canada Pipe and Sears. Sears also argues it is unconstitutional].

Von Finckenstein: The whole idea of the changes is to make the Tribunal a part of an integrated dispute resolution process.

If there are issues that can't be resolved by negotiation or through settlement, there will be a speedy resolution by a third-party.

GCR: On the reform of Section 45, the law's criminal conspiracy provisions. Do you support reform to a two-track system? [Editor's note: under such a system hard core-type activities in Canada would become a per se criminal offence while other behaviours would remain civil.]

Von Finckenstein: Section 45 provides that parties cannot agree to 'unduly lessen competition'. They can conspire to fix prices, etc as long as they don't 'unduly lessen competition'. What does that mean?

In effect, each time one has to ask not only 'Have the parties conspired to fix prices?' but also 'What has been the effect?'. So we have an economic effects test in a criminal statute. Yet the section is written so widely that any joint venture, any type of cooperation between companies, could potentially be caught. So on the one hand we have a section that is very difficult to enforce because it contains an economic test that judges, who deal with primarily with criminal law, have difficulty applying; and on the other there is a potential for catching very harmless transactions that are primarily beneficial, such as joint ventures. So the idea was put forward-many years ago, originating with Tim Kennish [Editor's note: QC, Olser Hoskins & Harcourt]- why don't we split the section? Why don't we take purely egregious conduct such as price fixing, market restrictions and output restrictions, and say, 'If parties engage in that they are guilty of a criminal offence regardless of what the effect is'? One simply shouldn't be doing these things. All other conduct will be dealt with in the civil realm and be judged on its merit. Here one can consider if the overall effect is pro-competitive or anti-competitive.

We discussed this idea as part of the run-up to C-23 [Editor's note: a competition bill passed in 2002], and there was general agreement that such a reform would be a good idea. But the devil is in the detail, in the drafting. There was clearly no agreement at all about how one would word the egregious first track. So we said: 'No, we won't put it in C-23, we'll do it in the next round.' Now we are at the next round. The parliamentary committee also recommended that we look at this type of reform. So we are trying to draft a workable section. There are three tracks really: the egregious criminal track, the less egregious civil track, and a clearance process. Which means if a party is in doubt, it can apply beforehand and we'll tell it whether we think there is a problem.

GCR: I'm surprised you can't secure agreement on what the egregious conducts are.

Von Finckenstein: I don't think there is a problem with the concept of the three parts.

The problem is that egregious conduct also results in exposure to civil liability. Under our Act you can be sued for civil damages on the strength of a proven allegation of criminal behaviour. If 'undueness' is not part of the section, there is practically no defence against strategic litigation. Assume I make the allegation that you, David Samuels, and Sally have engaged in price fixing. I make that allegation, maybe even bring a class action. You have a harmless agreement, but it contains a minor aspect that touches on price fixing. How

do we give you enough protection without reintroducing the undueness economic test? [Editor's note: 'Sally' refers to Sally Southey the Assistant Commissioner of Communications at the Bureau, who was also present.]

That's where the problem lies. We are going to soon put forward a document for consultation with specific draft language attached. We'll take into account comments from the Bar Association and whoever else, of course. It may be that after consultation we have to rewrite those drafts. This is a project that is hard to construct. One needs to have the specific provision in black and white before one can see if it works.

GCR: And when will this draft be ready?

Von Finckenstein: It is not my decision-it has to be approved by ministers and cabinet. We are shooting for June [2003].

GCR: Have you taken any steps to measure the Bureau against the eight ICN best practices on mergers? [Editor's note: Von Finckenstein is the chair of the International Competition Network, a convergence body.]

Von Finckenstein: We are in accord with them.

We looked at them after Naples, and I don't think there is any problem. But please remember, the ICN is aspirational. We are establishing optimum practices. Then it is up to each jurisdiction to measure itself against them. Bar associations and other interest groups need to exert pressure if there is a failure to comply with any point. We have so far dealt with the easy part of the issues, ie identifying them. It is up to others to look after implementation.

GCR: So you want other people to do your measuring for you?

Von Finckenstein: Absolutely. Assume the Canadian Bar Association comes forward and says, 'Look here are the ICN best practices and the Canadian system doesn't match up.' Then, by all means, they should exert pressure on the Bureau and on politicians for a change. We should adhere to these practices. I am not aware of any problem so far. As we go further and further and take more controversial steps there may be areas where we need to change. Other countries may feel the need for change from their stakeholders right now. Take the best practice re merger notification thresholds. If a country, for instance, uses market shares as a merger notification threshold, this clearly is not an objective criteria within the meaning of the best practices. A country in that situation may be asked by its stakeholders to change its provision as it does not comply with the best practice enunciated by the ICN.

GCR: What is the Bureau's stance on mergers that might be proposed within the banking industry? I am most interested in your view on mergers between banks, rather than bank-insurer etc. I am aware that there is now a three-tier system for reviewing these deals, and this will include a separate public

interest analysis (not conducted by you). Do you think Canada's politicians and consumers are more ready to accept a merger of two major domestic banks than they were in 1998?

Von Finckenstein: We have established a framework for merger review. It worked in 1998 and we see no reason why it would not work now. If a merger is announced, we will apply the framework and make a decision. However, as you know, the final decision will be up to the Minister of Finance.

GCR: Thank you.

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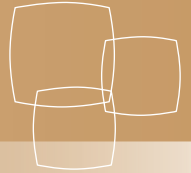
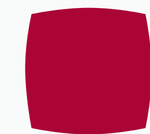
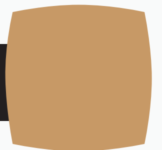
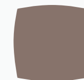
Enforcement Guidelines

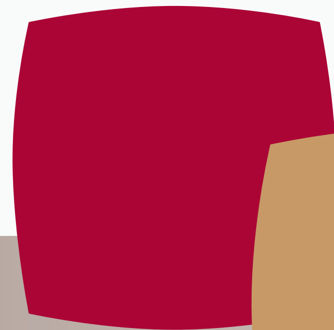


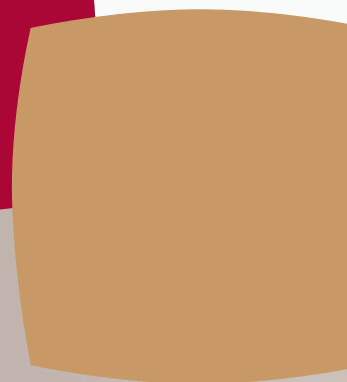


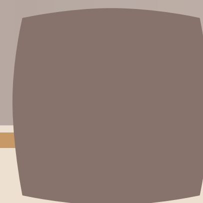
Merger Enforcement Guidelines











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For information on the Competition Bureau's activities, please contact:

Information Centre
Competition Bureau
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Gatineau QC K1A 0C9

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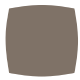
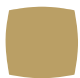


FOREWORD

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.

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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.

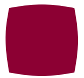
1.17 When assessing whether an interlocked director has the ability to materially influence the economic behaviour of the interlocked firm(s), the Bureau's focus is typically on the access that an interlocked director has to confidential information, and on the director's voting and veto rights in the 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.

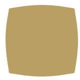
3.4 Section 93 of the Act sets out a non-exhaustive list of discretionary factors that the Tribunal may consider when determining whether a merger prevents or lessens competition substantially, or is likely to do so.[15] These factors, which are largely qualitative, may be relevant to the Bureau's assessment 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]

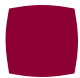
Delineating Geographic Boundaries

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.

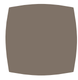
5.13 All else being equal, the likelihood that a number of firms may be able to bring about a price increase through coordinated behaviour increases as the level of concentration in a market rises and as the number of firms declines.[31] In contrast, coordinated behaviour becomes increasingly difficult 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

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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

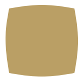
6.35 When assessing whether a merger increases the likelihood of coordination, the Bureau considers whether the merger changes the competitive dynamic in a market so as to make coordinated behaviour among firms more likely or effective. A merger that changes the competitive dynamic among firms may lead 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

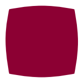
more pronounced when, for example, economies of density or scale are important and make it difficult for new or smaller firms to achieve a minimum efficient scale of operations.

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

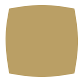
47 Cases where the supply curve is perfectly inelastic, such that a price decrease below competitive levels does not result in a decrease in output but only a wealth transfer, may also give rise to concerns. This scenario should be understood to be generally included in the category of monopsony. Similarly, 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.

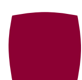
48 As noted in paragraph 1.16, above, an interlocking directorate alone would rarely constitute a merger although it could; however, interlocks are often features of partial interest transactions that otherwise qualify as a merger. The Bureau considers features of any interlock in its assessment of the 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

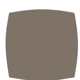
- total customer foreclosure, which occurs when the merged firm refuses to purchase inputs from an upstream rival; and
- partial customer foreclosure, which occurs when the merged firm is a distributor and can disadvantage upstream rivals in the distribution/resale of their products.

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.

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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.

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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

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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

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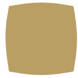
69 “X-inefficiency” typically refers to the difference between the maximum (or theoretical) productive efficiency achievable by a firm and actual productive efficiency attained.

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

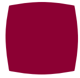
13.9 Where it appears that the firm is likely to remain in the market rather than sell to a competitively preferable purchaser or liquidate, it is necessary to determine whether this alternative to the proposed merger is likely to result in a materially greater level of competition than if the proposed 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