PUBLIC

CT-2019-005

THE COMPETITION TRIBUNAL

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

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

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

BETWEEN:

THE COMMISSIONER OF COMPETITION

Applicant

- AND -

PARRISH & HEIMBECKER, LIMITED

Respondent

SUBMISSIONS OF PARRISH & HEIMBECKER, LIMITED (DIRECTION TO COUNSEL DATED MARCH 10, 2021)

1. The excerpt from the 1991 Merger Enforcement Guidelines (MEGs) highlighted by the Tribunal reinforces P&H's position that the base price is "whatever is ordinarily considered to be the price of the product at the stage of the industry … being examined" which is "typically the cumulative value of the product, inclusive of the value added (mark-up) at the industry level in question".[1] Applying this principle here means using the transaction price between farms and grain companies as the base price.

2. The 1991 MEGs also provide support for P&H's position with respect to the size of the relevant geographic market; they state: (i) "[i]n merger analysis, relevant markets are defined by reference to actual and potential sources of competition that constrain the exercise of market power"; and (ii) "an exception to the smallest market principle may be made to include product or geographic substitutes on the fringe of the market that would not likely be able to constrain a significant and nontransitory price increase by the hypothetical monopolist, but that obviously compete, as a matter of commercial reality, with the products in the relevant market".[2]

3. The 1991 MEGs refer to an exception to the general principle that the base price should be "whatever is ordinarily considered to be the price of the product at the stage of the industry … being examined" in only limited circumstances. The exception described in the 1991 MEGs would apply if "the value added is billed as a separate fee, and no mark-up is applied to the product in relation to which the service (or other value added) is performed". These conditions precedent are not met here. Moreover, the Commissioner is not following the approach in the 1991 MEGs, even if it did apply, because he is urging the Tribunal to use a base price for market definition that is founded on an imputed price equal to only a fraction of the total value added provided by grain companies.

4. There is no separate fee for the alleged value added provided by grain companies. Farmers and grain companies do not transact business on the basis of the sale and purchase of 'grain handling services' (GHS) and any 'value add' by the grain companies to get grain to export markets occurs *after* the purchase transaction with the farmer. There is no value add to farmers and no separate fee charged by P&H for GHS. It is for this reason that Dr. Miller had to impute his 'price of GHS' (when none existed otherwise) from the cash price for the purchase of wheat and canola and why the Commissioner admitted on discovery that his alleged price for GHS is not transparent to farmers.[3] Hence, the

[1] 1991 MEGs, p. 9 **[Tab 1]**.
[2] *Ibid.* at pp. 7 and 8.
[3] Commissioner's Opening Statement, P Transcript, Vol. 1, January 6, pp. 38:13 to 39:4, P&HC, Tab 4; **CA-R-242**, P&H Read-In Brief, pp. 21-24, P&HC, Tab 7.

Commissioner's 'price of GHS' is not "whatever is ordinarily considered to be the price of the product at the stage of the industry … being examined".

5. The second condition precedent also does not exist here. A mark-up *is* applied to the product in relation to which any value added is performed by the grain companies in getting grain to export markets for sale to their customers.[4] The exception in the 1991 MEGS to using the ordinary selling price assumes that the transaction in question can be accurately partitioned into two components: where all value add – thus by construction, all firm costs and margins – can be assigned to one component while the other component – the "product" in relation to which the service is performed – is devoid of any "mark-up". The partition proposed by the Commissioner and his expert does not meet this condition. The Commissioner's imputed 'price of GHS' comprises only a fraction of the total value added by grain companies when they purchase grain from farmers in order to sell grain to their export customers.

6. The Tribunal has commented that the MEGs "represent[] the considered opinion of the Commissioner", that "[t]hat view, it goes without saying, is the view arrived at by the Commissioner following careful advice given to him by his legal and economic advisers regarding the meaning of the various provisions of the [*Competition Act* (*Act*)]" and that an extensive consultation process is followed in their preparation.[5] A review of the evolution of the MEGs confirms a deliberate and "considered" abandonment of the 1991 MEGs "value added" (VA) approach.

7. The Commissioner asserted that the 2011 MEGs "don't rule out the approach that the Commissioner has taken here".[6] In fact, that's precisely what the Commissioner did in 2004 and again in 2011. More particularly, the language describing the VA approach in the 1991 MEGs was removed by the Commissioner from the draft, updated MEGs published for consultation in March 2004 and the final version of the 2004 MEGs.[7] While, as Justice Gascon observed,[8] a value added approach was introduced into the revised U.S. HMGs issued in August 2010,[9] the Commissioner did not include a value added approach in either the draft or the final version of the new MEGs published in October 2011.[10] Justice Gascon also correctly suggested that the Commissioner is "asking the Tribunal to follow

[4] See P&H Closing Submissions, paras 31-33.
[5] *Canada (Commissioner of Competition) v Superior Propane Inc*, 2000 Comp Trib 15 at para 397.
[6] CB Transcript, Vol. 13, p. 508.
[7] See Draft 2004 MEGs, para 3.8 **[Tab 2]** and 2004 MEGs, para 3.8 **[Tab 3]**.
[8] CB Transcript, Vol. 13, p. 513.
[9] Compare 1997 HMGs, p. 7 **[Tab 4]** and 2010 HMGs, pp. 10-11 **[Tab 5]**.
[10] See Draft 2011 MEGs, para 4.7 **[Tab 6]** and 2011 MEGs, para 4.7 **[Tab 7]**.

the US [HMGs] more than the MEGs". It bears repeating, however, that the Commissioner's proposed VA approach is also not consistent with the VA approach in the HMGs.[11]

8. The current MEGs reflect 20 years of merger enforcement experience since the 1991 MEGs, during which time not a single merger was contested by the Commissioner on the basis of the VA approach, including grain, log, beef and other similar or analogous cases wherein the Commissioner (and/or the Tribunal) defined markets and assessed competitive effects using the ordinary price transacted within the industry (and a 5% SSNIP threshold), despite the existence of a futures price, a basis and/or common costs across competitors.[12] The Commissioner's decision not to re-introduce a VA approach also coincided with concerns expressed regarding the introduction of such an approach into the 2010 HMGs, including the increased risk of blocking mergers that do not contravene antitrust laws.[13]

9. The Commissioner asks the Tribunal to abandon the traditional cumulative price approach using the 5% SSNIP threshold and to instead adopt a so-called "value added" approach without precedent in the jurisprudence or enforcement guidelines of this country, or any other.[14] The Commissioner asks the Tribunal to find an SLC where his expert's average predicted price increases represent at most only [redacted] of his imputed price for canola GHS (which is [redacted] of canola cash purchase prices), and at most only [redacted] of his imputed price for wheat GHS (which is [redacted] of wheat cash purchase prices) – none of which are either material or likely.[15] The approach which the Tribunal is invited to adopt is unprecedented, ill-defined (as well as ill-conceived) and promises to have potentially harmful (including by introducing an undesirable degree of uncertainty), far-reaching, unforeseen and unintended consequences for merger law in Canada.[16] The Tribunal should decline that invitation and dismiss the Commissioner's Application.

ALL OF WHICH IS RESPECTFULLY SUBMITTED THIS 7th DAY OF APRIL 2021

BORDEN LADNER GERVAIS LLP
Lawyers for the Respondent, Parrish & Heimbecker, Limited

[11] See P&H Closing Submissions, paras 16, 55 and 63.
[12] See P&H Closing Submissions, footnote 8 and paras 65 and 93.
[13] See, e.g., Knable Gotts, "Are the New Guidelines Representational Art or Pop Art in the End?", *The Antitrust Source*, October 2010, p. 4 **[Tab 8]**; Bailey, "Comments on the 2010 Proposed Horizontal Merger Guidelines" (June 2010), pp. 5-6 **[Tab 9]**.
[14] See P&H Closing Submissions, footnote 8 and paras 49-73; Closing Oral Submissions of P&H, P Transcript, Vol. 14, pp. 900-909 and CA Transcript, Vol. 14, pp. 1062-80.
[15] See P&H Closing Submissions, paras 76 and 80.
[16] See CBA, "Submission on Merger Enforcement Guidelines Consultation" (December 10, 2010), pp. 1-2 **[Tab 10]**.

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MERGER ENFORCEMENT GUIDELINES

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PART 3
MARKET DEFINITION

3.1 CONCEPTUAL FRAMEWORK

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

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

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

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

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

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

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

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11 A market may also consist of a single homogeneous product.

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

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

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

The potential constraining influence of competition from sellers who would not likely respond to the postulated price increase in the relevant market within the postulated period of time[16] is considered subsequent to market definition, in connection with the assessment of future entry into the market. For the purposes of assessing what would likely occur over a nontransitory period in response to the threshold price increase, it is assumed that buyers and sellers in the industry immediately become aware of the price increase.

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

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

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

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

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

that obviously compete, as a matter of commercial reality, with the products in the relevant market.

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

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

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

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

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

3.2 THE PRODUCT DIMENSION

3.2.1 GENERAL APPROACH

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

3.2.2 EVALUATIVE CRITERIA

In assessing the nature and magnitude of likely supply and demand responses to a future price increase in the context of particular cases, all relevant information is considered. However, particular weight is given to the factors highlighted below, which provide indirect evidence of substitutability. Direct evidence, in the form of statistical measures of cross-elasticities of demand and supply, is rarely available. In some situations, the results of the analysis of each of these factors are not consistent with a single conclusion. When this occurs, an attempt is made to arrive at the market definition that is most supportable by the available information.

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

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

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DRAFT FOR CONSULTATION
MARCH 2004

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a constraining influence on price following the merger.[23] These factors are assessed over a two-year period from when market power is likely to be exercised, not necessarily when the merger review is taking place.[24]

PART 3 – MARKET DEFINITION

Overview

3.1 Typically, the first stage in the Bureau's review of a merger involves defining the relevant market(s) in which the merging parties operate. Relevant markets are assessed from two perspectives: the product dimension and the geographic dimension.

3.2 As a general principle, it cannot be assumed that merging parties operate in the same relevant market(s), even where 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 analysed for competitive effects may not necessarily correspond to the product categories or service areas established by the managers of the merging firms or their rivals for operational purposes.[25]

3.3 Market definition is based on substitutability and focuses on demand responses to changes in relative prices. The ability of a firm or group of firms to profitably raise price without losing sufficient output to make the price increase unprofitable ultimately depends on buyers' willingness to pay the higher price.[26] Supply responses are also important when analysing market power, but are examined later in the analysis, either when identifying the participants in the relevant market or when examining entry or expansion into the relevant market.[27]

3.4 Conceptually, a relevant market is defined in terms of the smallest group of products[28] and the smallest geographic area in which a sole profit-maximizing seller (a "hypothetical monopolist") would impose and sustain a significant and non-transitory price increase above levels that would likely exist in the absence of the merger. In most cases, the Bureau considers a five per cent price increase to be significant and a one-

[23]See for example *Superior Propane* at ¶ 311-312. See also *Canadian Waste* at ¶ 204 and ¶ 224.

[24] The Bureau may challenge a merger even when the anti-competitive effects that are foreseeable at the time of the merger may not occur until after two years of when the merger is substantially completed.

[25]See *Superior Propane* at ¶ 85, 101 and Canadian Waste at ¶ 72.

[26]Product and geographic substitutes that are included in a single relevant market are typically considered 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 to each other than others.

[27] In instances where the merging firms compete across a large number of markets and face the same competitors in each market, the Bureau may aggregate these markets as a matter of convenience.

[28] A market may consist of a single homogeneous product or a group of differentiated products.

year period to be non-transitory.[29]

3.5 The analysis focuses on what would happen if a hypothetical monopolist of a product attempted to impose a five per cent price increase. If the price increase is likely to cause buyers to switch their purchases to another product in sufficient quantity to render the price increase unprofitable, that other product is added to the candidate market. This process continues until the point at which a hypothetical monopolist would impose and sustain the price increase for each product in the candidate market. The smallest set of products in which the price increase can be sustained is defined as the relevant product market. This analysis occurs for each of the products of the merging parties.

3.6 The same approach applies to assessing the geographic scope of the market. As above, if buyers are likely to switch their purchases to suppliers located in a more distant area in sufficient quantity to render a five per cent price increase unprofitable, the more distant area 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. This analysis occurs for each of the areas where the merging parties sell the relevant products.

3.7 The base price used to postulate a price increase is generally the prevailing price in the relevant market. The Bureau may not use the prevailing price if it is likely that market conditions (absent the merger) would result in a lower or higher price in the future.[30]

3.8 In general, the base price used to postulate a price increase is whatever is ordinarily considered to be the price of the product at the stage of the industry (for example, manufacturing, wholesale, retail) being examined.

3.9 In some circumstances, sellers may identify and set different prices to targeted sets of buyers. Sellers may price discriminate when certain 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 classes of buyers or to the particular locations of the targeted buyers.[31]

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[29] Market realities may sometimes necessitate using a different price increase or time period. For example, a larger price increase may be required where using 5 per cent threshold would fail to identify an obvious horizontal relationship between the merging parties, such as situations where prices are measured in cents rather than dollars. Conversely, a lower price increase may be appropriate where the products are particularly good substitutes for one another, relative to other substitutes.

[30] As noted in *Canadian Waste* at ¶ 90-94, where the evidence suggests that a change in the future price (absent the merger) can be predicted with confidence, it is appropriate to delineate markets based on the likely future price, even if the future level of that price cannot be predicted precisely.

[31] See for example *Canadian Waste* at ¶ 78 - 80 and *Superior Propane* at ¶ 81.

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area in which a sole profit-maximizing seller (a "hypothetical monopolist") would impose and sustain a significant and non-transitory price increase above levels that would likely exist in the absence of the merger. In most cases, the Bureau considers a five per cent price increase to be significant and a one-year period to be non-transitory.[27]

3.5 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 be able to impose a five per cent price increase assuming the terms of sale of all other products remained constant. 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.[28] The analysis then repeats by determining whether a hypothetical monopolist controlling the set of products in the expanded candidate market would be able to profitably impose a five per cent price increase. 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. The smallest set of products in which the price increase can be sustained is defined as the relevant product market.

3.6 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 the merging parties produce or sell 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 five per cent price increase 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.

3.7 The base price used to postulate a price increase is generally the prevailing price in the relevant market. The Bureau may not use the prevailing price if it is likely that market conditions (absent the merger) would result in a lower or higher price in the future.[29]

3.8 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 (for example, manufacturing, wholesale, retail) being examined.

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[27] Market characteristics may sometimes necessitate using a different price increase or time period.

[28] The next-best substitute refers to the product that would represent the greatest diversion in demand by buyers in response to the postulated price increase assuming that it is available in unlimited quantities at constant prices.

[29] As noted in *Canadian Waste, supra* note 14 at ¶ 90-94, where the evidence suggests that a change in the future price (absent the merger) can be predicted with confidence, it is appropriate to delineate markets based on the likely future price, even if the future level of that price cannot be predicted precisely.

Horizontal Merger Guidelines

U.S. Department of Justice
and the
Federal Trade Commission

Issued: April 2, 1992
Revised: April 8, 1997

1.1 Product Market Definition

The Agency will first define the relevant product market with respect to each of the products of each of the merging firms. [8]

1.11 General Standards

Absent price discrimination, the Agency will delineate the product market to be a product or group of products such that a hypothetical profit-maximizing firm that was the only present and future seller of those products ("monopolist") likely would impose at least a "small but significant and nontransitory" increase in price. That is, assuming that buyers likely would respond to an increase in price for a tentatively identified product group only by shifting to other products, what would happen? If the alternatives were, in the aggregate, sufficiently attractive at their existing terms of sale, an attempt to raise prices would result in a reduction of sales large enough that the price increase would not prove profitable, and the tentatively identified product group would prove to be too narrow.

Specifically, the Agency will begin with each product (narrowly defined) produced or sold by each merging firm and ask what would happen if a hypothetical monopolist of that product imposed at least a "small but significant and nontransitory" increase in price, but the terms of sale of all other products remained constant. If, in response to the price increase, the reduction in sales of the product would be large enough that a hypothetical monopolist would not find it profitable to impose such an increase in price, then the Agency will add to the product group the product that is the next-best substitute for the merging firm's product.[9]

In considering the likely reaction of buyers to a price increase, the Agency will take into account all relevant evidence, including, but not limited to, the following:

(1) evidence that buyers have shifted or have considered shifting purchases between products in response to relative changes in price or other competitive variables;

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[8] Although discussed separately, product market definition and geographic market definition are interrelated. In particular, the extent to which buyers of a particular product would shift to other products in the event of a "small but significant and nontransitory" increase in price must be evaluated in the context of the relevant geographic market.

[9] Throughout the Guidelines, the term "next best substitute" refers to the alternative which, if available in unlimited quantities at constant prices, would account for the greatest value of diversion of demand in response to a "small but significant and nontransitory" price increase.

(2) evidence that sellers base business decisions on the prospect of buyer substitution between products in response to relative changes in price or other competitive variables;

(3) the influence of downstream competition faced by buyers in their output markets; and

(4) the timing and costs of switching products.

The price increase question is then asked for a hypothetical monopolist controlling the expanded product group. In performing successive iterations of the price increase test, the hypothetical monopolist will be assumed to pursue maximum profits in deciding whether to raise the prices of any or all of the additional products under its control. This process will continue until a group of products is identified such that a hypothetical monopolist over that group of products would profitably impose at least a "small but significant and nontransitory" increase, including the price of a product of one of the merging firms. The Agency generally will consider the relevant product market to be the smallest group of products that satisfies this test.

In the above analysis, the Agency will use prevailing prices of the products of the merging firms and possible substitutes for such products, unless premerger circumstances are strongly suggestive of coordinated interaction, in which case the Agency will use a price more reflective of the competitive price.[10] However, the Agency may use likely future prices, absent the merger, when changes in the prevailing prices can be predicted with reasonable reliability. Changes in price may be predicted on the basis of, for example, changes in regulation which affect price either directly or indirectly by affecting costs or demand.

In general, the price for which an increase will be postulated will be whatever is considered to be the price of the product at the stage of the industry being examined.[11] In attempting to determine objectively the effect of a "small but significant and nontransitory" increase in price, the Agency, in most contexts, will use a price increase of five percent lasting for the foreseeable future. However, what constitutes a "small but significant and nontransitory" increase in price will depend on the nature of the

[10] The terms of sale of all other products are held constant in order to focus market definition on the behavior of consumers. Movements in the terms of sale for other products, as may result from the behavior of producers of those products, are accounted for in the analysis of competitive effects and entry. See Sections 2 and 3.

[11] For example, in a merger between retailers, the relevant price would be the retail price of a product to consumers. In the case of a merger among oil pipelines, the relevant price would be the tariff -- the price of the transportation service.

industry, and the Agency at times may use a price increase that is larger or smaller than five percent.

1.12 *Product Market Definition in the Presence of Price Discrimination*

The analysis of product market definition to this point has assumed that price discrimination -- charging different buyers different prices for the same product, for example -- would not be profitable for a hypothetical monopolist. A different analysis applies where price discrimination would be profitable for a hypothetical monopolist.

Existing buyers sometimes will differ significantly in their likelihood of switching to other products in response to a "small but significant and nontransitory" price increase. If a hypothetical monopolist can identify and price differently to those buyers ("targeted buyers") who would not defeat the targeted price increase by substituting to other products in response to a "small but significant and nontransitory" price increase for the relevant product, and if other buyers likely would not purchase the relevant product and resell to targeted buyers, then a hypothetical monopolist would profitably impose a discriminatory price increase on sales to targeted buyers. This is true regardless of whether a general increase in price would cause such significant substitution that the price increase would not be profitable. The Agency will consider additional relevant product markets consisting of a particular use or uses by groups of buyers of the product for which a hypothetical monopolist would profitably and separately impose at least a "small but significant and nontransitory" increase in price.

1.2 Geographic Market Definition

For each product market in which both merging firms participate, the Agency will determine the geographic market or markets in which the firms produce or sell. A single firm may operate in a number of different geographic markets.

1.21 *General Standards*

Absent price discrimination, the Agency will delineate the geographic market to be a region such that a hypothetical monopolist that was the only present or future producer of the relevant product at locations in that

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satisfying the test, guided by the overarching principle that the purpose of defining the market and measuring market shares is to illuminate the evaluation of competitive effects. Because the relative competitive significance of more distant substitutes is apt to be overstated by their share of sales, when the Agencies rely on market shares and concentration, they usually do so in the smallest relevant market satisfying the hypothetical monopolist test.

> *Example 7:* In Example 4, including cars in the market will lead to misleadingly small market shares for motorcycle producers. Unless motorcycles fail the hypothetical monopolist test, the Agencies would not include cars in the market in analyzing this motorcycle merger.

4.1.2 Benchmark Prices and SSNIP Size

The Agencies apply the SSNIP starting from prices that would likely prevail absent the merger. If prices are not likely to change absent the merger, these benchmark prices can reasonably be taken to be the prices prevailing prior to the merger.[5] If prices are likely to change absent the merger, e.g., because of innovation or entry, the Agencies may use anticipated future prices as the benchmark for the test. If prices might fall absent the merger due to the breakdown of pre-merger coordination, the Agencies may use those lower prices as the benchmark for the test. In some cases, the techniques employed by the Agencies to implement the hypothetical monopolist test focus on the difference in incentives between pre-merger firms and the hypothetical monopolist and do not require specifying the benchmark prices.

The SSNIP is intended to represent a "small but significant" increase in the prices charged by firms in the candidate market for the value they contribute to the products or services used by customers. This properly directs attention to the effects of price changes commensurate with those that might result from a significant lessening of competition caused by the merger. This methodology is used because normally it is possible to quantify "small but significant" adverse price effects on customers and analyze their likely reactions, not because price effects are more important than non-price effects.

The Agencies most often use a SSNIP of five percent of the price paid by customers for the products or services to which the merging firms contribute value. However, what constitutes a "small but significant" increase in price, commensurate with a significant loss of competition caused by the merger, depends upon the nature of the industry and the merging firms' positions in it, and the Agencies may accordingly use a price increase that is larger or smaller than five percent. Where explicit or implicit prices for the firms' specific contribution to value can be identified with reasonable clarity, the Agencies may base the SSNIP on those prices.

> *Example 8:* In a merger between two oil pipelines, the SSNIP would be based on the price charged for transporting the oil, not on the price of the oil itself. If pipelines buy the oil at one end and sell it at the other, the price charged for transporting the oil is implicit, equal to the difference between the price paid for oil at the input end and the price charged for oil at the output end. The relevant product sold by the pipelines is better described as "pipeline transportation of oil from point A to point B" than as "oil at point B."

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[5] Market definition for the evaluation of non-merger antitrust concerns such as monopolization or facilitating practices will differ in this respect if the effects resulting from the conduct of concern are already occurring at the time of evaluation.

Example 9: In a merger between two firms that install computers purchased from third parties, the SSNIP would be based on their fees, not on the price of installed computers. If these firms purchase the computers and charge their customers one package price, the implicit installation fee is equal to the package charge to customers less the price of the computers.

Example 10: In Example 9, suppose that the prices paid by the merging firms to purchase computers are opaque, but account for at least ninety-five percent of the prices they charge for installed computers, with profits or implicit fees making up five percent of those prices at most. A five percent SSNIP on the total price paid by customers would at least double those fees or profits. Even if that would be unprofitable for a hypothetical monopolist, a significant increase in fees might well be profitable. If the SSNIP is based on the total price paid by customers, a lower percentage will be used.

4.1.3 Implementing the Hypothetical Monopolist Test

The hypothetical monopolist's incentive to raise prices depends both on the extent to which customers would likely substitute away from the products in the candidate market in response to such a price increase and on the profit margins earned on those products. The profit margin on incremental units is the difference between price and incremental cost on those units. The Agencies often estimate incremental costs, for example using merging parties' documents or data the merging parties use to make business decisions. Incremental cost is measured over the change in output that would be caused by the price increase under consideration.

In considering customers' likely responses to higher prices, the Agencies take into account any reasonably available and reliable evidence, including, but not limited to:

- how customers have shifted purchases in the past in response to relative changes in price or other terms and conditions;
- information from buyers, including surveys, concerning how they would respond to price changes;
- the conduct of industry participants, notably:
  - sellers' business decisions or business documents indicating sellers' informed beliefs concerning how customers would substitute among products in response to relative changes in price;
  - industry participants' behavior in tracking and responding to price changes by some or all rivals;
- objective information about product characteristics and the costs and delays of switching products, especially switching from products in the candidate market to products outside the candidate market;
- the percentage of sales lost by one product in the candidate market, when its price alone rises, that is recaptured by other products in the candidate market, with a higher recapture percentage making a price increase more profitable for the hypothetical monopolist;
- evidence from other industry participants, such as sellers of complementary products;

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Merger Enforcement Guidelines

Enforcement Guidelines

Draft for Public Consultation — June 27, 2011

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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 ultima te inquiry is not about market definition but rather about whether a merger prevents or lessens competition substantially. However, market definition often provides key information relevant to the assessment of the likely competitive effects of a merger. Accordingly, when reviewing a merger the Bureau generally defines the relevant markets.

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). Similarly, when a completed merger has resulted in a material price increase, the Bureau may rely on evidence of that increase. Cases may also arise in which the choice among several plausible market definitions may have a significant impact on market share. In such cases, the Bureau may give greater weight to evidence regarding likely competitive effects that is not based on market share and concentration. While the Bureau generally defines markets, it may elect not to do so in cases in which other reliable evidence of competitive effects is available.

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[13]. 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[14].

3.5 The Bureau may also assess competitive effects from a quantitative perspective using various economic tools. The Bureau has considerable 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.

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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[15]. 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[16]. 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 sometimes support using a different price increase or time period. For example, the Bureau may use a smaller SSNIP in defining markets where there is pre-existing market power.

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 be able to profitably impose a SSNIP, assuming the terms of sale of all other products remained constant[17]. 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[18]. The analysis then repeats by determining whether a hypothetical monopolist controlling the set of products in the expanded candidate market would be able to 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. 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 it can be predicted with confidence that market conditions (absent the merger) would result in a lower or higher price in the future[19].

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 (called "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 readily 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.

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[20]. 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 (ownprice 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. Preexisting documents prepared by the merging parties in the ordinary course of business can also be very useful in this regard.

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PART 4: MARKET DEFINITION

Overview

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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.

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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.

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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.

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4.9 The factors the Bureau considers when analyzing the product and geographic dimensions of market definition are set out below.

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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.

Are the New Guidelines Representational Art Or Pop Art in the End?

Ilene Knable Gotts

The 2010 Merger Guidelines, following in the tradition of previous Guidelines, seek to provide a representational portrait of the analytical underpinnings of current enforcement policy.[1] Such transparency is indisputably a sound objective; the agencies should be applauded for undertaking this project so that those who do not practice before the agencies on a routine basis are not misled by the existence of out-of-date Guidelines. As discussed further below, however, certain features described in the Guidelines would have benefited from more refined focus and insight rather than broad impressionistic strokes. Moreover, as with pop art, to the extent that the 2010 Guidelines contain untested methods of identifying competitive harm or deviate from established case precedent, the 2010 Guidelines run the potential of becoming out of date as these theories are later modified or rejected. Failing to reflect the case law from which the agencies derive their enforcement power, particularly as it relates to the importance of market definition, inferences from market shares, and the importance of noneconomic evidence, is perhaps too avant-garde an exercise for merger guidelines.

The original 1968 Guidelines explained where, as a matter of prosecutorial discretion, the Agencies would *not* challenge a transaction.[2] The new Guidelines similarly provide this guidance in a few new areas, for instance in footnote 14, where they recognize that consumer welfare might be better served by the agencies taking into account out-of-market efficiencies that outweigh potential harm to the delineated market and are inextricably linked to the merger. It would have been useful if the 2010 Guidelines had included more indications of where the agencies would not take action, for instance, with respect to repositioning, entry, and high margin industries. Two other areas where the 2010 Guidelines would have benefited from a more detailed explanation are the discussion of non-price effects, such as quality and variety, in Section 1; and the reduction in product "variety" and innovation concerns raised in Section 6.4.

As with earlier versions of the Guidelines, the 2010 Guidelines also discuss what information would be useful to present to the agencies. Again, such transparency is right in line with what guidelines are supposed to do. The 2010 Guidelines would have benefited as well by providing more guidance on how the agencies will weigh the various types of information they obtain rather than merely providing a comprehensive checklist.

Issuing the new Guidelines is a major step, and there is a considerable downside to including less-tried theories and methodologies or deviating substantially from established principles of law and economics. Concepts embraced in the new Guidelines but not yet widely accepted by the antitrust community or courts include the use of the upward pricing pressure model (including its

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Mrs. Gotts thanks Ramsey Shehadeh for his useful input.

[1] U.S. Dep't of Justice & Federal Trade Comm'n, Horizontal Merger Guidelines (2010) [hereinafter 2010 Guidelines], *available at* http://www.ftc.gov/os/2010/08/100819hmg.pdf.

[2] U.S. Dep't of Justice, Merger Guidelines (1968), *available at* http://www.justice.gov/atr/hmerger/11247.pdf.

The slant towards economic formulae and theories, particularly concerning the implications of margins and incremental costs also raises concerns given recent jurisprudence. As Commissioner Rosch indicates:

> [C]ourts have relied on empirical evidence instead of economic evidence, and have considered economic evidence as corroborative of that empirical evidence, if they have considered it at all. . . . Time and again, appellate courts have rejected "high" prices as a basis for inferring market or monopoly power. The district courts have likewise eschewed reliance on economic models based on margins for a variety of reasons, including their complexity, because margins are dependent on exogenous factors, or because the use of such economic simulation models, in the absence of substantial, verified efficiencies, will almost always predict a transaction will have price effects.[15]

Courts will review the entire evidentiary record—documents, data, and testimony—rather than allowing economic models and theories alone to win the day.

Finally, the modifications of the SSNIP test based on value-added profit calculations[16] could result in false positives because the set of competitors will be artificially narrowed and exclude competitive constraints on prices. For example, applying a 5 percent value added SSNIP test to the mark-up on a retail item may yield a SSNIP threshold on the final product of less than a penny in some cases. Also, this calculation is likely to raise evidentiary problems for both the government and the parties, as well as miss what should be the focus—i.e., whether there will be an impact on the price or output of the products and services actually bought by consumers.[17] The relevant product or service is what the consumer buys and at what price—not what each supplier might add to the product and at what profit to the supplier for that particular input to the finished product.

In sum, the agencies are to be commended for replacing the outdated Guidelines with a more accurate description of the types of evidence and analysis they are currently deploying. The 2010 Guidelines, though, fall a little short of the mark as a complete representational work of art in not providing a robust discussion for the business community regarding certain of the newer aspects of the 2010 Guidelines, how the various features will be balanced, and when a transaction will not be challenged by the agencies. Moreover, the new Guidelines suffer to the extent that they deviate from well-established principles, particularly in determining market definition and, ultimately, competitive harm. Pop art has its place in merger analysis—but the Merger Guidelines are not the best place for its debut. ●

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[15] Rosch Statement, *supra* note 7 (citations omitted).

[16] Although the 2010 Guidelines removed the reference to "specific contribution of value," example 10 remains.

[17] Bailey et al. Comments, *supra* note 14.

Comments on the 2010 Proposed Horizontal Merger Guidelines

Elizabeth M. Bailey
Gregory K. Leonard
Lawrence Wu*

June 3, 2010

I. The Proposed Horizontal Merger Guidelines Appropriately Shift the Focus of Merger Analysis

The proposed Horizontal Merger Guidelines ("Proposed Guidelines") appropriately shift the focus of merger analysis in five principal ways.

- First, the Proposed Guidelines describe an approach that emphasizes empirical analysis and the various types of evidence that the U.S. Department of Justice (DOJ) and the Federal Trade Commission (FTC) (collectively, "the Agencies") will consider in evaluating competitive effects. This approach clarifies that the evaluation of the likely competitive effects of a proposed transaction depends crucially on facts and other evidence that are specific to the merging parties and the markets at issue.

- Second, the Proposed Guidelines reflect a shift towards direct competitive effects analysis and away from market definition as the first step in a merger review. This is particularly important in analyses of differentiated products mergers. This shift towards an analysis of competitive effects eliminates what we view to be distortions induced by an emphasis on relevant market definition—an inefficient allocation of resources devoted to defining relevant markets and too much weight given to market shares and concentration.

- Third, the Proposed Guidelines recognize that the competitive effects of a merger potentially extend beyond price effects to include effects on innovation, product variety, product quality, and service, all of which, along with price, are determinants of consumer welfare.

* The authors are economists at NERA Economic Consulting. This comment was prepared in response to the FTC and DOJ's Request for Views on the Proposed Horizontal Merger Guidelines. The views expressed are their own and do not necessarily reflect the views of others at NERA.

From an economic perspective, the appropriate standard for the sufficiency of entry is not whether competition would replace the "scale…of one of the merging firms" but whether the scale of entry would be large enough to replace the output lost as a result of the posited post-merger output reduction. If entry can replace this posited reduction in output, then the scale of entry would be such that prices would remain at pre-merger levels post-transaction. If entry is required at the "scale…of one of the merging firms," the scale of entry would generally result in prices being pushed below pre-merger levels post-transaction.[3]

If the Agencies' competitive concern results from a belief that the parties will, post-merger, remove all of one of the merging firm's pre-merger output from the relevant market, a standard that entry must replace the "scale…of one of the merging firms" makes good sense. In our experience, however, this is rarely, if ever, the basis for the competitive concern. Competitive concerns raised by the Agencies typically are motivated by a concern about a posited post-merger output reduction that is a *portion* of the total output in the relevant market, which is, in turn, a portion, but less than all, of the output of one of the merging firms.

C. Performing a SSNIP Test Based on Value-Added Prices Focuses the Analysis Too Narrowly

The hypothetical monopolist test remains a key analytical construct for the analysis of market definition. One aspect of the test is the consideration of customer responses to a SSNIP. In Section 4.1.2, the Proposed Guidelines discuss the application of a SSNIP test in circumstances where there is no explicit price that is charged for the merging parties' value-added contribution. Example 8 suggests that, in a merger of two oil pipelines, a SSNIP would be based on the price for transporting oil from one end of the pipeline to another, rather than the price of the oil paid by the oil pipelines' customers at the delivery point. Example 9 is similar. It suggests that in a merger of two computer equipment installers that sell a bundle comprised of computers and computer installation services, the SSNIP would be based on the implicit installation fee only, rather than the price paid by customers for the installed computers.

In economic terms, this approach assumes that the product at issue is the value-added service provided by the merging parties, rather than the end product that is provided by the merging parties. In many cases, however, the value-added service is not actually purchased by customers on a standalone basis in the marketplace. Instead, the product that is actually being purchased is the end product, which, in Examples 8 and 9, is the oil delivered to customers at the end of the pipeline and the installed computer equipment, respectively. In both of the examples given, customers are not able to substitute to sellers of just the value-added service (i.e., the transportation of oil on the pipelines and the installation service only). Instead, customers make their choices from among the end products. Because the value-added service is packaged as part of the end product, the relevant product is that end product, which should be the focus of the analysis.

[3] Prices would remain at pre-merger levels if the entrant were to enter at the scale of one of the merging firms but then choose to produce a level output equal to the posited post-merger output reduction thereby choosing to operate with excess capacity. Even in this scenario, the competitive dynamics post-merger are "over-improved" relative to pre-merger conditions and thus the proposed standard for sufficiency of entry in the Proposed Guidelines is overly stringent.

In addition, focusing the analysis on the value-added service or product would present practical issues. One practical issue is that the approach will complicate any merger involving sellers of intermediate goods, distributors, and even retailers. For example, in an analysis of grocery stores, should the SSNIP test be based on the store's markup for, say, milk, rather than the price of milk? A second practical issue is that empirical data on the value-added product or service will be substantially more difficult to obtain or estimate. A third practical issue is that customers will have more knowledge about the end product and the price that they pay for that, as the end product is the product that is actually being purchased. In general, it is unlikely that interviews or surveys of customers on products or services they do not actually purchase would be informative or reliable.

D. Cost Savings and Output-Enhancing Efficiencies Should be Integrated into the Competitive Effects Analysis

The competitive effects discussion in the Proposed Guidelines should include an integrated assessment of cost efficiencies and output-enhancing activities that affect overall prices or output since these are as much a "competitive effect" of the merger as is any price effect due to reduced rivalry. Indeed, the Proposed Guidelines are already written in a way that makes consideration of efficiencies a natural part of a broader competitive effects analysis. For example, the efficiencies section (see Section 10) contemplates the potential for the merged entity to be a stronger competitor or to create a firm that can offer customers lower prices.

In the end, if the goal of merger review is to protect consumer welfare, a competitive effects analysis that leaves efficiencies for a separate review is flawed in that it implicitly gives lesser weight to the procompetitive role that the merged firm may play in the market post-transaction. It would also be useful for the Proposed Guidelines to discuss explicitly how the Agencies will analyze a transaction in which there is a tradeoff between reduced rivalry and an efficiency. This analysis may be particularly complex in a situation where the efficiency involves increased innovation or an improvement in product quality.

III. Conclusions

By emphasizing the Agencies' actual practice, empirical focus, and emphasis on competitive effects, the Proposed Guidelines are informative and useful. We appreciate the Agencies' efforts to improve transparency and to explain their approach to merger review. We also appreciate the Agencies' commitment to evaluating mergers based on sound legal and economic principles.

There are, however, four areas in which the Proposed Guidelines could be further revised or clarified. They relate to whether market shares can be used to evaluate the degree of substitutability across products or firms, whether the sufficiency of new entry normally requires evidence that the entrant has at least the scale and strength of one of the merging parties, whether it is appropriate to analyze customers' responses to a SSNIP based on an increase in value-added prices, and whether cost savings and output-enhancing efficiencies are properly integrated into the competitive effects analysis rather than being treated separately in a subsequent step.

THE CANADIAN BAR ASSOCIATION
L'ASSOCIATION DU BARREAU CANADIEN

Submission on Merger Enforcement Guidelines Consultation

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Submission on
Merger Enforcement Guidelines Consultation

I. INTRODUCTION

The National Competition Law Section of the Canadian Bar Association (CBA Section) welcomes the opportunity to respond to the Competition Bureau's open consultation announced on September 7, 2010 with respect to the *Merger Enforcement Guidelines* (MEGs) published in 2004. The CBA Section supports the continuing efforts of the Bureau to articulate its enforcement policies.

II. EXECUTIVE SUMMARY

While not binding as a matter of law, the competition bar and the business community have come to expect that the Bureau will generally follow the MEGs in its analytical approach to merger review and case triage. It is important, therefore, that the MEGs reflect both the body of Canadian merger and related jurisprudence and the approach used by the Bureau in the merger review process, to foster the Bureau's goals of transparency and predictability. Moreover, the MEGs approach is often adopted in other contexts[1] and cases[2]. As such, the MEGs are important in substance. Significant changes to the MEGs are capable of starting a chain reaction of revisions to other guidelines, and reconsideration in merger and related cases. This interrelationship needs to be kept in mind should material amendments proceed.

The CBA Section commends the Bureau, however, for raising the issue of whether the MEGs should be revised at this time. The MEGs were most recently amended and reissued in 2004.

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1 See, for example, Competition Bureau, *Competitor Collaboration Guidelines* (Ottawa: Industry Canada, 2009); Competition Bureau, *Predatory Pricing Enforcement Guidelines* (Ottawa: Industry Canada, 2008); Competition Bureau, *Enforcement Guidelines on the Abuse of Dominance* (Ottawa: Industry Canada, 2001); Competition Bureau, *Intellectual Property Enforcement Guidelines* (Ottawa: Industry Canada, 2000); and Competition Bureau, *Price Discrimination Enforcement Guidelines* (Ottawa: Industry Canada, 1993).

2 See, for example, *B-Filer Inc. et al. v. The Bank of Nova Scotia*, 2006 Comp. Trib. 42; i (1997), 73 C.P.R. (3d) 1 (Comp. Trib.); and *R. v. Clarke Transport Canada Inc.* (1995), 64 C.P.R. (3d) 289 (Ont. Gen. Div.).

Subsequently, the Bureau issued a new bulletin on Merger Efficiencies in 2009. There has been no Canadian merger jurisprudence dealing with the analytical approach to merger review and merger efficiencies since 2004. There has been a decision in an abuse of dominance case, but this decision did not affect the substantive approach embodied in the current MEGs[3]. Similarly there has been no amendment to the substantive merger provisions of the *Competition Act*. However, during this same period, the United States, France, the United Kingdom, the European Community[4], and perhaps other countries, have all issued guidelines dealing either with merger review or with competitor collaborations which are analyzed in a fashion similar to merger review. The Bureau itself issued the *Competitor Collaboration Guidelines* in late 2009. Moreover, there are continuous developments in economics that are put into play in the cases reviewed by the Mergers Branch of the Competition Bureau. Unlike the slow and steady pace of changes in the Canadian legal principles applicable to substantive merger review, the changes in the laws of other countries and in the economic approach to merger review are rapid, and arguably less stable. This too must be kept in mind before amending the MEGs in the absence of any corresponding legislative change, and any serious or obvious flaws in the current paradigm.

In summary, the CBA Section believes that the MEGs could usefully be revised at this time, but that substantial amendments are not required.[5] In this submission, the CBA Section identifies provisions that the Bureau should consider amending, expanding on or adding. The CBA Section encourages the Bureau to continue to clarify any changes in its approach to substantive merger review and the application of the principles articulated in the MEGs, and to consult with the competition bar and business community in this regard.

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3 *Canada (Commissioner of Competition) v. Canada Pipe Co*. (2005), 40 C.P.R. (4th) 453 (Comp. Trib); rev'd (2006), 49 C.P.R. (4th) 241, 2006 FCA 233 ("*Canada Pipe*")

4 See, for example, United States Department of Justice and Federal Trade Commission, *Horizontal Merger Guidelines* (Washington: U.S. Department of Justice and Federal Trade Commission, 2010) (the "U.S. Guidelines"); Directorate for competition policy, consumer affairs and fraud control, *Lignes directrices relatives au contrôle des concentrations: Procédure et analyse* (Paris: Ministère de l'économie des finances et de l'industrie, 2007); United Kingdom Office of Fair Trading and United Kingdom Competition Commission, *Merger Assessment Guidelines* (London: Office of Fair Trading and Competition Commission, 2010) (the "U.K. Guidelines"); and EC, *Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings* [2004] OJ, C 31/5 (the "E.C. Guidelines").

5 For greater certainty, the CBA Section does not intend to detract from its earlier submissions recommending changes to certain aspects of drafts of the MEGs and *Efficiencies Bulletin* that were not ultimately accepted in the final versions of those publications.