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Comments on
Merger Enforcement Guidelines
Draft for Consultation March 2004

1. This draft is a superb attempt to clarify and bring up to date the previous version of the MEG's in light of developments in the law, and the experience in merger practice since the publication of the previous version. Two examples of guideline principles usefully clarified by this draft are the following: The potential price increase resulting from a merger is to be measured against the pre-merger price level, rather than the competitive price level. And substitution on the supply side of a market enters into the determination of which suppliers are in a market, rather than the market definition itself, which focuses on demand substitutability. (This latter point had been clear in the U.S. Horizontal Merger Guidelines but was not as clear in the previous version of the Canadian MEG's.)

   My comments follow the order of the guidelines:

2. [2.6]: Logically, this should refer to "a unilateral increase in the exercise of market power …" since as section 2.8 very usefully points out it is a potential increase in price with the merger that is at issue, not the level of the price.

3. [2.12 and footnote 22] "Substantial" is defined as "material". The relevant definition of "material" is

   > "of evidence or a fact: significant or influential, esp. in having affected a person's decision-making; (*spec.* in *U.S. Law*) having a logical connection with the facts at issue." (Oxford English Dictionary).

   I don't find that the word "substantial" is clarified at all by defining it as "material". It is clear that the attempt is to clarify the degree of the effect, rather than refer to the relevance component of the definition of "material", but one is not left with a clearer idea of how large "substantial" is.

The first sentence of footnote 22,

> "A material price increase is distinct from (and can be lower or higher than) the "significant and nontransitory price increase" that is used to define relevant markets as described below."

is important: It cannot possibly that the "substantial" is – like "significant" -- generally interpreted as five percent or more: Suppose that it were. Then the application of section 92 would be restricted to mergers that result in a price increase of at least 5 percent. But any such merger is a merger to monopoly under the hypothetical monopolist test since if the parties would raise price by 5 percent through the actual merger then a hypothetical single seller of only the parties' products could profitably raise price by 5 percent. That is, an interpretation of "substantial" as 5 percent given the existing interpretation of "significant" as 5 percent would be tantamount to a market share of 100 percent of the relevant product market as a requirement for challenging a merger.

It follows from this argument that "substantial" must generally be *less than* five percent, if it is to be consistent with the combination of (a) the hypothetical monopolist test; (b) the interpretation of "significant" as 5 percent in the hypothetical monopolist test; and (c) market share thresholds of less than 100 percent. This is again awkward, because in everyday language the word "substantial" usually connotes a higher magnitude than "significant".

Again, I haven't a resolution to this dilemma, but I think that it is important. A respondent could possibly challenge the entire market definition approach of the MEG's as being inconsistent with section 92. If the court accepted that "substantial" means at least as large as "significant", then the conclusion that the MEG's are inconsistent with section 92 would be inescapable.

4. The second sentence of footnote 22 states:

> "In this context, materiality refers to the sustainability rather than the magnitude of the price increase."

This cannot be the meaning that is intended. The entire discussion is about magnitude, not sustainability. Materiality is always about magnitude. Perhaps the following would be better "In the present context, materiality includes not only the magnitude but also the sustainability of the price increase."

5. [3.3] The second sentence is awkward. It is logically impossible to profitably raise price while losing sufficient output to make the price increase unprofitable. I would suggest "The ability of a firm or group of firms to raise price without losing sufficient output as to make the price increase …" Also, this gets rid of the split infinitive.

6. [3.16] First sentence is awkward. Suggested rewording: Even some products purchased for similar end uses are not close substitutes …

7. [3.18] Autoparts would be a helpful example in a footnote (*Chrysler*).

8. [3.20] Geographical market definition can be quite confusing. I think that it is important to say that the starting point is to identify a particular set of buyers that might be harmed by a merger and to keep a tight focus on whether the set of buyers is harmed or not.

   This is a more basic starting point than "first determining whether a relevant geographical market for a given product is local, regional national or international". One example I have in mind is radio advertising. For local advertisers purchasing time slots, the relevant geographic market is quite different than for national advertisers, since in a small town near a large city the national advertisers would find stations broadcasting from the city to be close substitutes for the small town stations.

9. [footnote 41]. I suggest removing the reference to shipping pattern evidence in *Canadian Waste*. At ¶ 71-72 in that case the Tribunal describes the shipment of wastes from Toronto to Michigan as shipment <u>out</u> <u>of</u> the location of the buyers (and therefore as not helpful in terms of evidence). It is true that in general shipments out of a region where a set of buyers is located might not be helpful in terms of evidence as to whether those buyers would have available competitive alternatives in the event of a merger. But the *product* in Canadian Waste was not waste; it was disposal of waste. The evidence of trucks travelling to Michigan was in fact evidence of the product being shipped <u>into</u> the Toronto area. The Tribunal was confused on this point, and I think that the reference to the case will be confusing to practitioners.

10. [3.26] The phrase in the first sentence "suggest that both areas are in the same relevant market" might be interpreted to indicate that areas A and B are either in the same market for mergers or they are not. But they may both be in the relevant market where the merging firms and the set of buyers of concern are located in A; but not in the relevant market for a merger in area B. I think that the phrase would be better as "may suggest that the distant area is in the geographic market".

11. [footnote 39] This may be better as "However, it is recognized that …"

12. [4.1] Does "participate in the market through a supply response" mean "that would participate if price rose by a significant amount for a non-transitory period"? This alternative phrasing may be clearer and in any case the conditional tense seems necessary.

13. [5.10] I think that "without regard to the accommodating responses of its rivals" would be better stated as "without a coordinated response by firms in the market". In a unilateral exercise, a merging party will rationally take account of the fact that its rivals will set higher prices in response to the expectation of higher prices by the merged firm (in the case of price-setting

firms) and may rely on this accommodation by the rivals. That is, the substantial exercise of market power by the merged firm may, even in a unilateral theory, rely on the firm's rational expectation of a price increase by its rivals.

14. The section on efficiencies is a bit defensive or negative. In footnote 92,

> "While existing jurisprudence provides some guidance on the principles for interpreting and applying section 96, it does not prescribe how the trade-off is to be carried out in all cases."

is negative. In Guidelines, it is more helpful to say that the existing jurisprudence does provide substantial direction for how the trade-off is to be carried out and to provide guidelines summarizing the positive guidance to be gained. (Practitioners know that existing jurisprudence rarely provides an exact answer to anything for all cases.)

15. In 8.26 and 8.27, the well-developed methodology of the Tribunal in quantifying the adverse portion of the transfer and the alternative approach of considering the redistribution "from a qualitative perspective" discussed by the dissenting member in *Superior Propane*" are set out in parallel. This seems inappropriate. The majority decision in *Superior Propane* is implementable, and is part of the law. To set it out in parallel with a dissenting opinion leaves the impression that the Bureau is agnostic on the efficiencies issue in *Superior Propane* and may even attach equal weight to the dissenting opinion. I think that the Bureau must avoid any suggestion that it will change the law by applying its own views rather the law, i.e. the case decisions.

16. The alternative approach is called "qualitative" but in fact once the harm to consumers of a merger and the benefits to suppliers from a merger have been estimated (where data allow this) then a decision that the merger should not be allowed is a quantitative decision about the appropriate weights on shareholder gains and consumer losses. Professor Townley's balancing weights approach makes this clear. This approach was central in *Superior Propane* and received the mark of approval by the Federal Court of Appeal in that case.

17. I would urge the Bureau to mention the balancing weights approach as useful in the tradeoff analysis. Where possible, this involves evidence on the impact of a merger on consumers and producers, determination of the critical level for the relative weights (see the discussion of the balancing weights approach in *Superior Propane*); and then evidence on why the actual weights should be within the range for which the merger is acceptable.

18. All of these steps are performed in *Superior Propane*. *Superior Propane* is the most up-to-date law on the trade-off, and provides a very useful methodology for parties that are relying on section 96. In guidelines such as

these, I would suggest that where the law provides such a methodology, providing a guide to the methodology is essential. Instead, this draft of the guidelines state, in 8.35:

> Merging parties intending to invoke the efficiencies exception are encouraged to address how they propose that qualitative and quantitative gains and effects be combined and weighed for the purpose of performing both the "greater than" and "offset" aspects of the trade-off; and to explain how and why the gains compensate for" the anti-competitive effects.

This is a request that "you tell us how you're going to make the trade-off", instead of specific guidance on implementing an approach that is already in the law. This is the only major flaw in this draft. Otherwise, I think that the draft is superb.