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BY E-MAIL

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Ms. Lourdes DaCosta
Senior Competition Law Officer,
Mergers Branch
Competition Bureau Canada
50 Victoria Street
Place du Portage, Phase I
Gatineau, QC K1A OC9

Dear Ms. DaCosta:

Re: Draft Revised Merger Enforcement Guidelines

I write with respect to the draft revised Merger Enforcement Guidelines (the "draft MEGs") circulated for comment earlier this spring by the Competition Bureau. My comments are strictly my own, and not on behalf of my firm or any client.

I commend the Bureau for taking the time to consider revisions to the current Merger Enforcement Guidelines (the "current MEGs"). It is evident that much thought has gone into the draft MEGs. Revisions to take into account the lessons from the Bureau's experience as well as recent economic learning will be of considerable assistance to firms that are considering mergers as well as to the competition bar. Recognizing that the MEGs are not law or binding on the Commissioner or the Competition Tribunal, I will confine my comments to the following two key proposed changes in the draft MEGs that I respectfully suggest should be considered further:

(a) the omission of consideration of supply responses at the market definition stage of the analysis; and

(b) the omission of consideration of the magnitude of a postulated price increase when assessing whether an impact on competition is substantial.

Supply Side Responses Should Continue to be Considered at the Market Definition Stage of the Analysis

The draft MEGs state, at ¶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. 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. [emphasis added]

This is a significant change from the current MEGs that include consideration of supply responses at the market definition stage. When discussing market definition, the current MEGs provide:[1]

> On the supply side, it is necessary to evaluate the extent to which: (iii) new entry would likely occur ... as a result of sellers of other products adapting existing facilities, to commence production 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.

For the following reasons, this proposed change to the current MEGs is very significant and has the potential to lead to over-aggressive merger enforcement due to artificially narrow definition of antitrust markets.

The definition of the relevant product and geographic market, while not necessarily determinative, sets the stage for the analysis that follows. The use of the hypothetical monopolist test is intended to determine approximate market boundaries in which competition occurs. As markets are defined in order to consider the impact on future transactional relationships within the market, it is important that potential responses by both buyers and sellers in the market be considered. By excluding potential seller responses, and responses of other firms that have the potential to be sellers in the market, the Bureau could arrive at market definitions that were narrower than if such responses were taken into account. This approach risks having the Bureau's analysis proceed upon an erroneously and narrowly defined market that in most cases would increase the prospect of the Bureau concluding that there was a basis to challenge a merger under section 92 of the *Competition Act.*

The following discussion demonstrates how the erroneous exclusion of a supplier by the adoption of an artificially narrow geographic market could lead to an incorrect conclusion that a merger would likely substantially lessen or prevent competition. If a supplier was included at some point in the geographic market definition analysis, the iterative nature of the hypothetical monopolist test would involve asking if competitors outside of the postulated geographic market could discipline a hypothetical price increase

[1] Page 12 of PDF version of Megs. The reference to construction of facilities has been deleted in accordance with footnote 12 of the MEGs.

by a hypothetical monopolist. This may involve adding one or more competitors of that supplier to the hypothetical geographic market, and competitors of those competitors. If the supplier was not included in the postulated geographic market, such competitors might not be added to the market if they were viewed as too distant to discipline the other firms in the postulated geographic market. Excluding a particular supplier may therefore lead to the erroneous exclusion of other suppliers. The overall effect would be a market that is much narrower than might be assumed to be the case as a result of excluding only one supplier. Consequently, the error introduced by this process could be much larger than expected. Further, because market definitions, once arrived at, are generally treated as workably accurate, the error could remain undetected throughout the merger review process.

The approach in the current MEGs of considering supply responses at the market definition stage is more likely to facilitate merger reviews that reach the correct conclusion.

A Substantial Impact on Competition Should Include a Price Increase of Sufficient Magnitude

In discussing the concept of substantiality, the draft MEGs state, at ¶2.12 and 2.13:

> 2.12 When the Bureau assesses whether competition is likely to be substantially prevented or lessened, it evaluates whether the merger is likely to provide the merged entity (alone or in concert with others) with an ability to materially influence price.[18] Generally speaking, the prevention or lessening of competition is considered to be substantial" where:
>
> - the price of the relevant product(s) or service(s) [hereafter "product(s)"], is likely to be materially greater in a substantial part of the relevant market[19] than it would be in the absence of the merger [hereafter "material price increase"],[20]; and
> - the material price increase is not likely to be eliminated by existing or new competitors within two years.[21]
>
> 2.13 The Bureau does not impose a numerical threshold for the material price increase that is likely to arise when a merger creates or enhances market power.[22] Instead, its conclusions about whether a lessening or prevention of competition is substantial are based on an assessment of market-specific factors listed in section 93 that could have

> 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] [emphasis added]

In footnote 22, as referenced in the above passage, the draft MEGs state:

> 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. In this context, materiality refers to the sustainability rather than the magnitude of the price increase. [emphasis added]

Conversely, the current MEGs state, with regard to the concept of substantiality, at ¶2.4, page 11(pdf):

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

Footnote 9 from the above-cited passage states:

> This price differential will be referred to as "a material price increase" for the remainder of these Guidelines. Given that relevant markets are ordinarily defined on the basis of a 5 percent test, price increases of 5 percent or greater will occur across the entire relevant market, whereas lesser price increases may occur in only a part of the relevant market.

The draft MEGs, if adopted, would result in mergers being analyzed with less rigor, and with a greater reliance on a structural analysis (as opposed to structure plus predicted effects). In my view this would be a mistake for the following reasons.

First, it should be necessary for the Commissioner to prove more something more than a predicted price increase, of no specified magnitude, in order to succeed in the Competition Tribunal on a section 92 merger challenge. No merger should be blocked if nothing more than a *de minimis* price increase is proved (or even alleged).

Also, merger analysis is not an exact science. Errors can be expected. There should therefore be some margin of safety to ensure that governmental intervention in the markets does not needlessly stifle legitimate market activity.

Further, it is important to note that other part of the analysis described in the draft MEGs call for some indication of the magnitude of the predicted price increase. For example, in ¶6.3 of the draft MEGs there is discussion concerning the time that it would take for a competitor would respond to a price increase. This necessarily involves consideration of the incentives for the competitor to respond. All other things being equal, a competitor is more likely to respond to a 5% price increase than a 1% price increase (assuming that a 1% predicted price increase was material – which is doubtful in most if not all cases).

Another example of the draft MEGs calling for a magnitude of predicted price increase is in ¶5.16 where the concept of the profitability of a post-merger price increase is raised. "Profitability" implies consideration of the magnitude of a predicted price increase that more than offsets the losses resulting from lost sales.

The analytical framework in the current MEGs that calls for some consideration of the magnitude of a postulated price increase is more appropriate and useful, and provides sufficient flexibility to consider different magnitudes of predicted price increases as material in different industries.

Conclusion

Thank you for the opportunity to comment on the draft MEGs. I would be pleased to discuss any of my comments with you at your convenience.

Yours truly,

Shawn C.D. Neylan