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# LECG Response to MEGs Consultation

Please find below comments on the Bureau's draft Merger Enforcement Guidelines from Dr. Andy Baziliauskas of LECG and Dr. Roger Ware, Director of LECG and Professor of Economics at Queens University.

In our opinion the draft MEGs represent an important and constructive contribution to the enforcement of the merger provisions of the *Competition Act*. They reflect a sophisticated understanding of the economics underlying competition analysis and should be a useful guide for businesses and competition practitioners. Our comments are primarily intended to assist the Bureau in providing even more clarity to interested parties.

<u>Comments</u>

## PART 2 – The Anti-Competitive Threshold

[2.9-2.11] Prevention of Competition should be clearly defined, and restricted to, cases where entry, and increased competition, would have occurred in a relevant market but for the merger. The first sentence of [2.9] in essence says this, but it could perhaps be more clear. Further down, in [2.11], the reference to the *Canadian Waste* case (footnote 16) is obscure and unclear. If a merger leads to an increased concentration of capacity, in fact to a larger increase in concentration than that arising from output consolidation, then this can be analyzed within the framework of "Substantial Lessening of Competition" and the Draft Guidelines already refer to the relevance of changes in the concentration of capacity. The Bureau should consider removing this from the section on Prevention of Competition.

Further, a reasonable reading of *Canadian Waste* indicates that the Tribunal was referring to "Prevention of Competition" as a merger that prevented prices from falling when they would likely have done so absent the merger, and to "Lessening of Competition" when prices would actually increase as a result of the merger. But these cases are not distinguished methodologically, and in my view should both be considered as issues of Substantial Prevention of Competition.

In addition, there appears to be little if any difference between the scenarios dealt with in this section and in Part 11 of the draft Guidelines on Conglomerate Mergers. The Bureau should consider merging these two Parts.

[2.12] This paragraph contains an inconsistency. It first notes that the in assessing whether competition is likely to be substantially prevented or lessened, it only needs to be determined whether the merger provides the merged entity with the *ability* to materially influence price. But the paragraph further reads:

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"Generally speaking, the prevention or lessening of competition is considered to be 'substantial' where:

- The price of the relevant product(s)…*is likely to be* materially greater in a substantial part of the relevant market than it would be in the absence of the merger…"

We encourage the Bureau to revise this section of the Guidelines to resolve this inconsistency.

[2.13] footnote 24 reads: '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'.

In order to improve clarity, consider changing this sentence to

> '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 more than two years after the merger is substantially completed'

**PART 3 - Market Definition**

General Comment:

The Guidelines should be clear on what assumptions regarding the prices of non-merging firms will be held when the Bureau applies the hypothetical monopolist test. In particular, the Guidelines should clarify whether the prices of non-merging firms are held constant in the hypothetical monopolist exercise. The approach taken by the U.S. enforcement agencies is to assume prices are held constant, and we encourage the Bureau to take a similar approach in its Guidelines.

[3.3] footnote 27 reads: '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.'

This footnote is ambiguous and would benefit from clarification. What does it mean that the Bureau may 'aggregate' markets? Does it mean that market shares willed be summed across product and/or geographic markets, or does it have something to do with supply responses, which is the subject of the sentence that precedes the footnote?

If the Bureau means that market shares may be summed across product and geographic markets, it should clearly articulate the conditions under which it will consider doing this. We believe that summing in this way would only be appropriate in very limited circumstances, if ever.

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[3.4] The first sentence currently reads, in part: 'Conceptually, a relevant market is defined in terms of the smallest group of products and the smallest geographic area…'

We suggest that the Bureau consider amending this sentence to:

> 'Conceptually, a relevant market is defined as the smallest group of products <u>including at least one of the products of the merging firms</u> and the smallest geographic area…'

[3.5] This paragraph is somewhat obscure. It should be made clear that the Bureau starts with a product of the merging firms, and adds substitutes in order of "closeness" (most volume diverted by a price change). There may well be fewer relevant product markets than the number of products produced by the merging firms, because several products may be in the same market.

[3.6] This section describing the Bureau's approach to geographic market definition is ambiguous and would benefit from clarification. In particular, the Bureau should clarify that the starting point for geographic market definition is the area that includes the buyers of the relevant products.

It is also unclear what is meant by the statement 'if buyers are likely to switch their purchases to suppliers located in a more distant area…the more distant area is added to the candidate market'. Does this mean that when market shares are calculated, the buyers serviced by the suppliers in the more distant areas (but not necessarily by the merging firms) are accounted for in the denominator (of the market shares)?

<u>Product Market Definition</u>

[3.18] The first sentence in this paragraph reads: 'A relevant market may consist of a grouping of diverse products that are not themselves close substitutes for each other'.

This is somewhat confusing. The Bureau should clarify that each 'product' in a relevant market may be a composite.

<u>Geographic Market</u>

[3.19] To clarify, consider changing part of the first sentence to "switch their purchases in sufficient quantity from suppliers based in one location to suppliers based in another in response to changes in relative prices." The existing wording almost suggests that buyers are physically changing their location in response to price changes, which is not generally the issue.

[3.24] This paragraph seems to suggest that transportation costs are a switching cost, which is not accurate.

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**PART 4 - Market Share and Concentration**

[4.10] This paragraph reads: 'When distant sellers supply the relevant market from locations outside of the market boundaries, market shares attributable to their products are typically calculated on the basis of actual sales in the relevant market.'

This reference to sellers in 'locations outside of the market boundaries' is not sufficiently clear. Who are these sellers? The Guidelines to this point have only identified two types of sellers that are relevant for market share calculations: 1) firms that produce output that is in the relevant product and geographic market, and; 2) firms that could supply the market with a supply response. If the sellers are 'outside of the market boundaries', then they are not in the set 1), and if they already 'supply the relevant market' they are not in the set 2). The Guidelines should clearly explain who these sellers are.

**PART 5 – Anti-Competitive Effects**

[5.19] The introductory sentence is too categorical. We suggest that it be changed to indicate that the listed factors may contribute to coordinated behaviour. For example, the Bureau could consider the following wording: 'Coordinated (or accommodating) behaviour is more likely to be sustainable when…'.

[5.22] The bullets that follow the first paragraph all appear to be factors that make coordinated behaviour more likely. The Bureau may consider changing the introductory sentence to: 'The following are among the factors that increase the likelihood of coordinated effects'.

**PART 6 – Entry**

The Bureau should consider adding that, when it evaluates the profitability of entry, it will do so using existing (pre-merger) prices, rather than likely post-merger prices.

[6.7] The second sentence reads: 'For instance, if a competitor enters a market on a scale that is below the minimum efficient scale, accepting the cost disadvantage associated with a sub-optimal level of production, the entry is not considered sufficient to eliminate a material price increase.'

Since the contemplated entry is prospective, the terminology ('if a competitor enters') is inappropriate.

In addition, there is no reason to discount entry at less than minimum efficient scale, and in fact we would expect that *most* entry would be at less than MES. The real issue is whether the scale of entry would be likely to drive prices down to pre-merger levels. This can occur at less than MES.

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[6.14] The first sentence is too categorical. The Bureau should consider changing this sentence to: 'Long-term exclusive contracts with automatic renewals, rights of first refusal and termination fees <u>may contribute to barriers to entry</u>'.

**PART 8 – The Efficiency Exception**

[8.26] The draft cites with approval the "socially adverse effects approach" used by the Tribunal in its *Propane* redetermination decision. This is a complex methodology. If it is to be mentioned at all, then a full explanation should be provided, otherwise it is impossible for a business reader to appreciate what is being said, and sanctioned.

[8.29] The second sentence is too categorical. Consider changing to 'For instance, x-inefficiency <u>may arise</u> when firms…'

The economic evidence on the existence of x-inefficiency is mixed, at best. This paragraph threatens to dramatically limit the scope of the efficiency exception by introducing consideration of prospective cost increases that cannot be predicted with any precision. The Bureau should consider softening in particular the last two sentences in this paragraph.

**PART 10 – Vertical Mergers**

This Part could benefit from more clarity about when a vertical merger would cause concerns for the Bureau. In particular, the Guidelines are unclear about when a merger that increased barriers to entry would be likely to substantially lessen or prevent competition.

**PART 11 – Conglomerate Mergers**

There appears to be no difference between this Part and the section on 'Potential Competition'. The Bureau should consider eliminating this Part and referring to conglomerate mergers in [2.9] –[2.11]