THE CANADIAN CHAMBER OF COMMERCE
LA CHAMBRE DE COMMERCE DU CANADA

Canadian Chamber of Commerce

Comments on the draft revised Merger Enforcement Guidelines

Submitted to the Competition Bureau

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The Canadian Chamber of Commerce (the "Canadian Chamber") welcomes the opportunity to provide comments on the Competition Bureau's draft Merger Enforcement Guidelines (the "Draft MEGs"). The Canadian Chamber is Canada's largest and most representative business association, with membership in excess of 170,000 businesses, represented through a network of 350 chambers across the country.

The MEGs play a central guiding role in merger analysis in Canada, especially given the relative scarcity of Canadian jurisprudence on many aspects of this complex area of the law. Since originally issued in 1991, the MEGs have contributed greatly to understanding by the business and legal communities of the Bureau's approach to enforcement of its substantive jurisdiction over mergers. Given the significant legal and economic developments since 1991, the Canadian Chamber recognises the need to update the MEGs

The re-organization of the MEGs into more thematic sections, and the provision of further guidance on issues such as interdependence (or "co-ordinated effects") and the anti-competitive threshold, will make the document more useful as a practical tool, as well as further assist in clarifying the Bureau's approach to those analytical points which have and will likely remain subjects of debate.

In general, the Canadian Chamber believes that the Draft MEGs are clearly written and logical. From that perspective, and with the above in mind the, the Canadian Chamber wishes to raise the following issues for consideration by the Bureau:

Definition of a Merger

The expanded discussion no doubt accurately reflects the Bureau's views that any transaction which results in an ability materially to influence the economic behaviour of another business constitutes a merger, regardless of whether an economic interest in that other business has been acquired. However, the Canadian Chamber is concerned that the discussion in the Draft MEGs creates an overly broad definition of a "merger", potentially capturing ordinary course business transactions which should not be reviewable as mergers. In order to distinguish mergers from ordinary course business arrangements, thus providing better guidance to businesses, the Canadian Chamber believes that greater clarity on the meaning of "significant interest" should be included in the MEGs; particularly on the issue of when a "significant interest" can be established through an agreement in circumstances where no assets or ownership interests in another person are acquired.

The Anti-Competitive Threshold: Substantiality

While agreeing with the Bureau that there ought not to be strict adherence to a particular threshold for the materiality of a price increase that signifies market power in a particular market, the Canadian Chamber urges the Bureau to reinstate reference to a 5% "rule of thumb". The Canadian Chamber strongly urges the Bureau to delete the last sentence of footnote 22 ("In this context, materiality refers to the sustainability rather than the magnitude of the price increase"). The explanation of what is meant by a "substantial" prevention or lessening of competition in paragraph 2.12 of the Draft MEGs clearly distinguishes between the magnitude of the price increase and its sustainability. More importantly, on a conceptual

level, having defined relevant competition markets with reference to price increases that customers will consider to be relevant to their purchasing decisions for the products concerned, the analysis of the competitive impact of the merger within those markets must logically refer not only to the duration of possible price increases, but also to a magnitude of price increase that those same customers consider to be material to their purchasing decisions. For that reason, the Canadian Chamber submits that the same "significant and non-transitory price increase" ought to be used both for market definition and for competitive impact analysis purposes. That said, the MEGs should make it clear (as they do in footnote 29 with reference to market definition) that a 5% price increase is merely a rule of thumb, and what is "significant" to customers with respect to some products may not be significant with respect to others. Nonetheless, the example of the 5% price increase has usefully served to guide businesses to focus not on the outer limits of theoretical competition and substitution, but on a rather immediate, and tight degree of competition. In addition, the 5% "rule of thumb" has been referred to favourably the Competition Tribunal as an analytical tool. As such, it has formed a useful part of the MEGs and should be maintained.[1]

The Anti-Competitive Threshold: Substantiality

On a separate point, reference is made in paragraph 2.13 to the fact that the two-year period over which market power is assessed need not necessarily commence with the merger, but will (according to footnote 24) commence at the time the anti-competitive effects are anticipated to occur. The Canadian Chamber does not object to this approach in theory, but advocates recognition that as the length of a forecast is extended, the reliability of that forecast is generally reduced, such that possible anti-competitive effects in the distant future will generally not lead to a conclusion that such effects are "likely" (as required by the *Act*). The Canadian Chamber also urges the Bureau recognise that a two-year period for analysis of market power is, like the magnitude of the "small but significant price increase", a guideline and need not be rigidly adhered to in all cases.[2] The Canadian Chamber would also point out that the utility of the guidelines as a predictive tool may be undermined by injecting uncertainty as to the timing of the exercise of market power relevant to the Bureau's analysis.

Part 3 – Market Definition

In the explanation of the base price used for the hypothetical monopolist test in paragraph 3.7, the Canadian Chamber believes that reference should be made to the so-called "Cellophane Fallacy". The Draft MEGs would then recognise that the appropriate base price for market definition purposes in markets that are already highly concentrated may not be the current price level, but rather something lower (which lower price would more accurately approximate the "competitive" price).

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[1] Even if the Bureau were to decline to accept this recommendation, the last sentence of footnote 22 ought to be deleted, for the reasons noted above.

[2] For example, if entry in a particular case is certain, but will occur 26 months after the merger (*e.g.*, construction on the plant has commenced), and there are no barriers to such entry being effective, one would hope such entry would not be discounted for the sake of 2 months.

Critical Loss Analysis:

Reference is made in footnote 32 to the possible use of critical loss analysis to assist in market definition. If the Bureau uses this tool, such reference is obviously appropriate. That said, the reference in the Draft MEGs tells the reader little about the circumstances in which the Bureau would consider such analysis to be appropriate. Are the merging parties expected to put forward such analysis? Are there circumstances in which the Bureau would reject such analysis as inappropriate? Does it differ in probative value from direct evidence of demand elasticity? Is there seminal literature on the topic to which an interested reader might refer for further information?

Product Market Definition:

A focus on demand-side substitution is, in most cases, appropriate when defining relevant antitrust product markets. However, the Canadian Chamber is concerned that strict adherence to the "no supply-side considerations" rule at the market definition stage may, in some not-so-rare cases, lead to rather absurd results, and could result in the reviewing case officer (and the merging parties) devising a needlessly complicated market analysis. Certain industries are characterised by sufficiently flexible factors of production that they produce a variety of products that may well not be substitutable by the end-user, but in respect of which the competitors and the conditions affecting competition are identical. For example, this is the case in custom manufacturing of various products such as plastics. Delineation of product markets on the basis purely of demand-side substitution can lead to a needless proliferation of product markets, when at the end of the day, according to Part 4 (Market Shares and Concentration), those suppliers who can readily and quickly enter each of the product markets will be counted as participants and have their capacity (somehow – this is not clear) included when calculating market shares. The MEGs must either: recognise that supply-side substitution will be considered at the market definition stage when a common set of factors of production are used by industry participants to produce a range of products as requested by customers; or recognise that in certain cases, where supply-side responses are likely to be swift and important for a range of products made by a common set of suppliers, market shares will as a practical matter be calculated by adding together all of the production and/or the productive capacities of the sellers across the range of products produced with that flexible capacity. [3]

Calculating Market Shares

In paragraph 4.8, it is not clear why market shares calculated on the basis of capacity increasingly differ from those calculated on the basis of volume or value of sales only when product differentiation increases. Product differentiation would seem logically connected to

[3] On a somewhat more technical note, the Canadian Chamber notes the apparent reference in footnote 38 to "cluster market" theory. To assist in guiding the reader as to the Bureau's practices, this footnote should be expanded by using the relevant economic terminology, explaining in what situations it is useful, and giving an example to elucidate its potential use. Reference should also be made to seminal literature on the subject.

the difference between market shares calculated on the basis of dollar sales and units. As noted in paragraph 4.7, however, the level of excess capacity held by market participants can differ widely, even in commodity markets. The general point that a particular measure of capacity can over (or under) state the relative market position of the participants is well taken. It is a point of much more general application, however, and the focus of paragraph 4.8 on markets with differentiated products seems overly narrow. The Canadian Chamber suggests re-wording the paragraph as follows:

> *4.8 Market shares calculated on the basis of dollar sales, unit sales and capacity can differ widely. Which measure more accurately reflects the relative market power of the participants will depend on the circumstances of the case. For example, in a highly differentiated market, market shares based on capacity or even unit sales may tend to over-state the relative power of a discount seller to constrain the power of the merging parties post-merger. [footnote 49: Other factors may also affect the Bureau's assessment of the relative market position of sellers, which factors may not be fully reflected in some or all market share statistics. For example, two firms may operate with the same capacity…(the rest as is)] For these reasons, data regarding both dollar sales and unit sales, as well as excess capacity, are often requested of merging parties and other market participants [footnote 50 – as is]. In any event, for transactions which warrant investigation, the calculation of market shares and an assessment of the degree of concentration in a relevant market is only the starting point for the analysis (see Part 5 – Anti-Competitive Effects, below).*

Market Share and Concentration Thresholds:

The Canadian Chamber doubts that the Commissioner is likely ever to challenge a merger on the basis of unilateral market power, when the post-merger market share of the merged entity is less than 40% or even 45%. If not, then to provide maximum guidance, the MEGs should state that, while the Bureau uses 35% as a minimum threshold for further examination, absent special circumstances, it is unlikely to challenge post-merger market shares less than 45%. Similarly, one very much doubts that the Commissioner would challenge a merger on the basis of co-ordinated effects if the merged entity would have less than, for example, 20%. The 10% threshold, in particular, seems unnecessarily conservative.

In addition, the Canadian Chamber would like to raise the issue of the "stoplight" approach to market share. The Bureau has gone on the record using the stoplight approach in cases in the grocery and banking industries. If this approach is part of the Bureau's practice it should be referenced and explained in the MEGs.

Finally, footnote 53 refers to the possible use of changes in the Herfindahl-Hirschman Index ("HHI") to indicate the relative change in concentration caused by the merger. The Canadian Chamber supports the focus on changes in concentration, and would urge moving footnote 53 into the body of the MEGs. Indeed, as the Canadian economy is significantly more concentrated than the US economy, even if this footnote remains where it is, the MEGs need to elucidate what levels and changes in the index will be significant as a "rule of thumb."

Co-ordinated Effe cts:

The expanded discussion of co-ordinated effects is an improvement over the rather brief discussion in the 1991 MEGs. That said, the 1991 MEGs referred to "interdependent" behaviour as including explicit agreement, as well as tacit agreements and other forms of non-explicit co-ordination. The Draft MEGs have dropped the reference to explicit agreement, yet many cases that deal with co-ordinated behaviour appear to be concerned with both explicit and agreement and a co-operative understanding short of agreement.[4] With respect to the discussion of co-ordinated effects generally, the Canadian Chamber feels that the language in paragraph 5.19 should be adjusted to make it clear that proof of a likely co-ordinated exercise of market power requires proof that the firms can reach a co-operative understanding, monitor one another's behaviour, and detect and punish deviations. Moreover, the importance of paragraph 5.23 could usefully be stressed more than it is in the current Draft, as the Bureau must not only prove that co-ordinated effects are likely (not just possible), but that the merger is the cause of either creating or maintaining that likelihood.

Entry

Paragraph 6.6 seems somewhat misplaced under the heading of "likelihood" of entry, as it speaks of a history of exit and entry as being probative of both "likelihood" and "sufficiency" of entry. Perhaps it would be better placed at the end of "sufficiency".

Efficiency Exception:

The Canadian Chamber recognises that due to the Federal Court of Appeals decision in *Superior Propane*, the efficiencies section of the MEGs is outdated and requires amendment. The Canadian Chamber believes greater consideration of efficiencies in the merger process is positive. That said, given the process mandated by the Federal Court of Appeals, the treatment of efficiencies would benefit from concrete examples of efficiencies of each type that the Bureau would recognise. While the draft MEGs provide examples of gains in productive efficiency, several illustrative examples of dynamic and allocative efficiencies would also be helpful to provide greater clarity to business. The Canadian Chamber recognises that, without more experience implementing the jurisprudence, it is perhaps difficult at this time to provide concrete examples of how the Bureau would implement the "socially adverse effects" approach (or any other approach) to quantifying many aspects of possible anti-competitive effects. However, we believe greater clarity, including any concrete examples, regarding the approach used to redistributive effects generally would be very helpful.

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[4] See, for example, *DIR* v. *Air Canada et al* (1989), 27 C.P.R. (3d) 476 at 498, as referenced in footnote 8 of the 1991 MEGs.

Failing Firm

The treatment of failing firm is appropriate as far as it goes, but the Canadian Chamber is concerned that the paragraph that used to deal with the reasons why, and the context in which, a failing firm analysis may be appropriate, has been deleted. The general point needs to be made that analysis of past and present market shares and competitive conditions is not always indicative of likely future competitive conditions. Just as analysis of a possible prevention of competition focuses on likely future entry by one of the merging parties into a particular market, so too likely failure of a firm is simply one example of a circumstance in which one of the merging parties is likely to exit a particular market. Firms may exit for reasons other than failure, and the present exclusive focus on failure leaves the reader with the general impression that such reasons may not be taken into account. Furthermore, while it is true that "failure" is not a defence to an anti-competitive merger, the fact remains that unless other evidence of increased concentration and barriers to entry indicates a possible lessening or prevention of competition, the Bureau should not need proof of likely exit by one of the merging parties. On a related topic, the focus on the likely future participation of the merging firms highlights also the relevance of likely retrenchment. This is covered in Part 5, but also ought to be cross-referenced to Part 9. Finally, reference to purchase of the assets by a competitively preferable purchaser ought to continue to refer to a purchase price above liquidation value.