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The Proposals on Market Definition

by
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The draft Merger Enforcement Guidelines issued by the Bureau of Competition Policy for consultation in March 2004 (the "Proposals") offer a more concise and theoretically focused approach to the problem of market definition in merger review[2]. From this point of view, they represent a significant improvement over the Merger Enforcement Guidelines ("MEGs") issued in 1991[3].

It is unlikely, however, that competition lawyers will see the changes as much of an improvement. Counsel would very much like to see a set of written rules and procedures that they could use to predict the markets that the Bureau would accept. This perception, that the MEGs should give definitive rules for the benefit of the merging parties, is the first mistake of counsel.

The merger guidelines in Canada and the United States have never had the objective of showing competition lawyers and advisers how they should do their job. Rather, the guidelines on market definition strive to articulate the set of concepts and principles that the enforcement agencies will adopt when evaluating the welter of information that the merging parties will inevitably present. These ideas find their clearest expression in the "hypothetical monopolist" approach, the modern attempt to avoid the highly intuitive and ultimately arbitrary approach that characterized early merger review in the United States[4].

Accordingly, criticism of the MEGs' treatment of market definition has been largely misdirected. What is needed is a clearer statement of the theoretical approach adopted by the Bureau because the MEGs offer inconsistent and sometimes confusing treatment of this topic. To the extent that the Proposals address these shortcomings, they should be adopted. This note reviews the Proposals from this perspective.

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[1] The author was a full-time lay member of the Competition Tribunal, 1998-2003. Some of the material in this article is taken from his "The Hypothetical Monopolist Approach: An Intuitive Re-Statement", forthcoming in The Antitrust Bulletin. Comments or questions are welcome and may be directed to the author at lschwartz5205@rogers.com.

[2] The Proposals' treatment of market definition are available at: http://competition.ic.gc.ca/epic/internet/incb-bc.nsf/en/ct02818e.html.

[3] Director of Investigation and Research. Merger Enforcement Guidelines, Information Bulletin No. 5, 1991, Ottawa, ¶3.1

[4] It is not surprising that competition counsel frequently criticize the hypothetical monopolist approach for being too abstract and not easy to implement; they are correct on both counts but these criticisms miss the point.

1. Purpose of Market Definition

Market share evidence is the cornerstone of the "structural" approach to merger review, which focuses on the possibility of interdependent behaviour, i.e. post-merger price collusion, whether tacit or explicit, by the remaining sellers of the homogeneous product. As accepted in various antitrust decisions by the U.S. courts, market shares have historically been used to predict whether a merger creates or enhances market power, the economic litmus test for finding a substantial lessening of competition.

In light of the concentrated structure of many Canadian industries, the structural approach has been central to the Competition Act, although evidence of market share and concentration alone is insufficient to find a substantial lessening of competition. Moreover, there is no requirement in the merger provisions of the Act that markets be defined. However, the Competition Tribunal has accepted market share evidence with the proviso that those shares be based on markets that are "relevant".

Historically, neither the case law nor economic theory provided procedures or principles for determining relevancy, whether in Canada or the United States. In the absence of such principles, market definition had become a judicialized decision, highly case-specific and result-oriented. It was not until the publication of the Horizontal Merger Guidelines in 1982 by the United States Department of Justice, Antitrust Division that elaboration of basic principles commenced through the introduction of the "hypothetical monopolist" approach[5].

In 1981, an influential paper by Landes and Posner discussed the possibility that a merger could create market power within the merged firm[6], and thereby stimulated interest in the possible "unilateral effects" of a merger involving differentiated products. While a structural approach can be taken to such mergers, their effects can often be evaluated directly thereby bypassing the market definition stage. In any case, the hypothetical monopolist approach presented in the 1982 U.S. Guidelines responds to the traditional concern in American antitrust for interdependence.[7]

That there are principles for identifying relevant markets in merger review based on conventional economic theory is the striking achievement of the 1982 U.S. Guidelines. Following the 1986 amendments to the Combines Investigation Act, the Competition

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[5] United States Department of Justice, Merger Guidelines: (June 14, 1982) §II.B *reprinted in* 2 Trade Reg. Rep. (CCH) ¶4501-4505 (hereinafter, the "1982 U.S. Guidelines"); (June 14, 1984), § 2.0, *reprinted in* 4 Trade Reg. Rep. (CCH) ¶13,103 (hereinafter, the "1984 U.S. Guidelines"); United States Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines (April 2, 1992), § 1, *reprinted in* 4 Trade Reg. Rep. (CCH) ¶13,104 (hereinafter the "1992 U.S. Guidelines").

[6] W. Landes and R. Posner, "Market Power in Antitrust Cases", Harvard Law Review, vol. 94 at 937.

[7] See G. Werden, "Market Delineation and the Justice Department's Merger Guidelines", Duke Law Journal, 1983, fn. 14 at 514.

Bureau sought to introduce the best practices in merger review and accordingly adopted the hypothetical monopolist approach to market definition in the MEGs. As discussed below, the American enforcement agencies would refine their presentations of the approach in subsequent guidelines, but the Competition Bureau did not.

2. The Hypothetical Monopolist Approach

The approach identifies relevant markets by asking, with respect to each product of the merging firms, whether a profit-maximizing hypothetical monopolist of that product would impose a small, but significant and non-transitory increase in the price of the product ("SSNIP"). In the U.S. guidelines, that monopolist is the one and only seller of the product, both now and in the future[8].

The idea that a hypothetical monopolist would not be able to impose such an increase may itself seem odd; after all, almost by definition, such a monopolist should have that power. From the perspective of conventional economic theory, this idea is mistaken. There is no theoretical reason why a monopolist must have such power simply by virtue of its market share. The demand for the product may be so price-sensitive that even a monopolist would lose so much business that it would not impose a SSNIP. Accordingly, the key measure of a monopolist's market power is not its market share, but rather the price-elasticity of demand for its product.

Accordingly, in merger review, the enforcement agency would like to know whether the price-elasticity of demand for the product is so large that a hypothetical monopolist would not impose a SSNIP in the candidate product market that consists of the good or service in question. If so, then that candidate market is too small and must be expanded. If not, then the relevant product market is confined to that product. In principle, this process iterates until a set of products is found such that the price-elasticity of demand is sufficiently low that a monopolist thereover would impose a SSNIP. When determined in this way, the process identifies the set of products that is the smallest such market over which a monopolist would have market power, and that market is generally the correct market for merger review[9].

It follows that there exists a "critical demand elasticity" such that, if the actual product demand elasticity exceeds this quantum, then a hypothetical monopolist would forego a SSNIP. Conceptually, the hypothetical monopolist approach calls for determination of this critical level and a comparison with the actual demand elasticity. If, for example, the measured demand elasticity for a product were 6.0 at the pre-merger price but the

[8] This strict definition of monopoly is entirely theoretical; such a monopoly exists only in, and for the purpose of, economic theory. Using the hypothetical monopolist approach to delineate markets carries no implications for the merger under review. In light of this strict definition of monopoly, entry considerations cannot be part of the market definition inquiry. As noted below, this is one area where the Canadian MEGs have differed from the U.S. guidelines.

[9] The literature refers to this feature as the "smallest market principle".

corresponding critical demand elasticity were 10.0, then the conclusion would be that a hypothetical monopolist would increase price by at least a SSNIP and the product market would not be broadened to include another product.

Although the merger guidelines in Canada and the United States do not discuss the critical demand elasticity, it is perhaps the core concept of the hypothetical monopolist approach. Regrettably, discussions of this concept and derivations of the formulae in the literature are too brief and have led to misunderstandings by economists and lawyers alike. For the simplest case of linear demand and constant average cost, the critical demand elasticity depends on the SSNIP and the pre-merger price margin in the following way[10]:

$$e_{crit} = \frac{1}{m + 2SNNIP}$$

where m is the (possibly zero) pre-merger margin over the competitive price. Accordingly, if the pre-merger industry can be characterized as competitive (m=0), then the critical demand elasticity is 10 for a SSNIP of 5%[11].

Determined in this way, such a market is clearly a theoretical construct. As the Proposals acknowledge, it may have little in common with the product market as seen by business executives whose industry knowledge is very deep. Seen in this way, markets for merger review purposes are "delineated" on the basis of market power and this in turn is determined solely by consumer preferences and demand. The focus on market power in market definition is therefore clearly consistent with the overall market power inquiry in merger review and establishes the relevance of the approach to that inquiry.

3. Product-Market Definition in the Proposals

The original statement of the hypothetical monopolist approach in the1982 U.S. Guidelines was amended in 1984 and again in 1992. Since the exposition in the MEGs was based on the 1984 U.S. guidelines, it has continued to reflect the statement that the

[10] A simple derivation of this formula is presented by the author in "The Hypothetical Monopolist Approach: An Intuitive Re-Statement" (forthcoming in The Antitrust Bulletin).

[11] Note that the critical demand elasticity is lower if the pre-merger price exceeds the competitive level. For example, if the price exceeds marginal cost by 40% of marginal cost, m=0.29 and the critical demand elasticity is 2.6 for a 5% SSNIP. This feature of the hypothetical monopolist approach surprises some observers but it is consistent with the intuition that if the price is already elevated, the profit-maximizing price requires less of an increase to attain it. Since a critical demand elasticity of 10 may be hard to exceed, this feature is favourable to the merging parties who may wish to argue that the pre-merger price exceeds the competitive level.

U.S. enforcement agencies no longer follow. Moreover, the MEGs diverged from the U.S. guidelines in respect of the role of supply substitutability.

As suggested above, the hypothetical monopolist approach is essentially an exercise in conventional economic reasoning and this mode of thinking does not change at the border. The result is that the MEGs' statement of the hypothetical monopolist approach was largely inconsistent with conventional economic analysis. The Proposals take the view that the conventional analysis is appropriate and conform the description of the hypothetical monopolist approach to the statement in the U.S. guidelines in all respects.

While moving to the conventional analysis, the Proposals retain the principles that "price" refers to the price adjusted for quality changes, that 5% generally is a significant increase, and that non-transitory means at least one year. The proper base for the price increase is, in most cases, the prevailing price because this is the price that would prevail in the market in the absence of the actual merger, even if it were well above the competitive price.

(i) "Would" v. "Could"

A frequently cited alternative to the hypothetical monopolist approach illustrates the approach's reliance on conventional microeconomic theory. The "breakeven critical sales loss" approach of Harris and Simons asks whether a cartel could profitably raise the price by a SSNIP and experience no reduction in profit[12]. The approach of Harris and Simons is a response to the 1984 U.S. Guidelines that, in their view, turns on the question whether a SSNIP would be profitable for a hypothetical monopolist or cartel[13].

The hypothetical monopolist approach calls for a subtle distinction. Its criterion is not whether a SSNIP would be profitable for a hypothetical monopolist. Rather, the question is whether the profit-maximizing price for that monopolist is at least a SSNIP above the price that prevailed at the time of the hypothetical merger to monopoly. The former criterion is not consistent with conventional economic theory; the latter is.

To illustrate, assume that any positive price increase up to and including 8% would be profitable to the monopolist in the sense that any increase in that range would lead to an increase in post-merger profit. It is tempting to conclude that the monopolist would raise the price by 8%. Call this the "profitable increase" standard. With a SSNIP set at 5%, a relevant market would be identified.

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[12] See B.C. Harris and J.J. Simons, "Focusing Market Definition: How Much Substitution is Necessary?", Research in Law and Economics, volume 12, 1989, 207-226. Recent articles evaluate the break-even critical loss. See J. Langenfeld and W. Li, "Critical loss analysis in evaluating mergers", The Antitrust Bulletin, Summer 2001 at 299-337; K. Danger and H. Frech III, "Critical thinking about "critical loss" in antitrust", The Antitrust Bulletin, Summer 2001 at 339-355; D.P. O'Brien and A.L. Wickelgren, "A critical analysis of critical loss analysis", Antitrust Law Journal, Vol. 71, Issue 1, 2003 at 161-184.

[13] Op. cit., at 211.

However, the prediction of a price increase of 8% in this circumstance may be incorrect. As noted above, economic theory posits that an unregulated monopolist would raise the pre-merger price to the level that maximizes its profit. Suppose that the price that yielded the maximum monopoly profit is reached by an increase of only 3%. Thus, even if an 8% increase were profitable, the monopolist would impose only a 3% increase. Call this the "maximum profit" standard. With the SSNIP set at 5%, a relevant market would not be identified.

Thus, the product market delineated under a "profitable increase" standard will be narrower than one in which the "maximum profit" standard is adopted. When delineating markets using the formula discussed above to estimate the critical demand elasticity, one is implicitly adopting the latter standard.

Differences between the "would" and "could" interpretations of the hypothetical monopolist approach have spawned a small literature[14]. Baumann and Godek conclude that while the "would" approach is the correct one to use for market definition, the alternative is not clearly incorrect[15].

(ii) Treatment in the MEGs

The U.S. guidelines define a market based on the price increase that an unregulated profit-maximizing hypothetical monopolist "would" impose in order to achieve the maximum profit. However, the MEGs delineate a market if a hypothetical monopolist

> "...could profitably impose and sustain a significant and nontransitory price increase above levels that would likely exist in the absence of the merger."[16]

The MEGs appear to adopt the "profitable increase" standard advocated by Harris and Simons. The use of the words "could profitably" suggests that a market would be delineated more narrowly under the MEGs than under the U.S. guidelines.
On a literal reading, the MEGs' approach appears to be inconsistent with the formulas for the critical demand elasticity discussed above and hence with the conventional economic analysis that underlies them.

Note that the MEGs were published in 1991 and were influenced by the 1984 U.S. Guidelines then in force. As Baumann and Godek note, those guidelines used the phrase "could profitably" six times and "would profitably" once. As they also point out, the 1992 U.S. Guidelines eliminated the confusion by using "would profitably"

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[14] M.G. Baumann and P.E. Godek, "Could and Would Understood: Critical Elasticities and the Merger Guidelines", The Antitrust Bulletin, vol. 40, 1995, 885-899

[15] Ibid., at 893.

[16] Op. cit. at ¶3.1.

consistently[17]. If, as is likely, the MEGs sought to follow the intent of the 1984 U.S. Guidelines, then the "would" approach is intended[18].

(iii) "Only current and future seller" v. "only seller"

In the U.S. guidelines, the purpose of market definition is the identification of products to be included in the market, and this identification of products is entirely driven by consumer demand in response to a price increase by the hypothetical monopolist that was the "only current and future seller" of the identified products. After the relevant market is found, competitors and potential competitors are identified and their market shares assigned.

In the MEGs, the hypothetical monopolist is the "only seller"[19] of products in a market at the time of the merger; however, that monopolist is not the only future seller. Thus, there could be other sellers in the future, and if those sellers could adapt their existing facilities to produce "future substitutes" in significant quantities and in a short enough amount of time, then these potential competitors are considered during market definition, at least in principle. As Crampton explains,

> "Given that the future substitutes that would be sold as a result of the above-described production substitution are added to the relevant market under the Canadian Guidelines, no distinction needs to be made between market definition (which involves the identification of the products and sales locations that comprise the relevant market) and the firms that sell or would likely commence to sell the relevant product in the relevant geographic area. It is taken for granted that each actual or future substitute and each sales location or future sales location that has been added to the market has a corresponding seller."[20]

Thus, market delineation under the MEGs identifies not only products but also the competitors and potential competitors and their production capabilities. The MEGs acknowledge the difficulties, in practice, associated with establishing the future sales of substitutes by potential competitors[21].

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[17] Op. cit., at 887.

[18] A drafter of the MEGs states that the intent was to be consistent with the intent of the 1984 U.S. Guidelines. See P.S. Crampton, "The DOJ/FTC 1992 Horizontal Merger Guidelines: a Canadian Perspective", The Antitrust Bulletin, Fall, 1993, 665-713 at 682. However, Crampton's discussion is somewhat unclear on this point because of the other main difference between the two jurisdictions' guidelines.

[19] Op. cit. at ¶3.1.

[20] See Crampton,"The DOJ/FTC 1992 Horizontal Merger Guidelines: a Canadian Perspective", at 680; supra fn. 15.

[21] Op. cit. at ¶3.2.2.7, footnote 22, which states "a market share cannot reasonably be attributed to this future production". Crampton states "the future products of likely supply substitutors that are added to the

In effect, the MEGs call for the examination of supply substitutability conditions when defining relevant markets. In so doing, they differ from the 1992 U.S. Guidelines, which postpone the examination of "uncommitted entry" until after the relevant markets have been delineated[22].

It is apparent from this discussion that, unlike the U.S. guidelines, relevant markets in the MEGs are not determined solely on the basis of consumer demand and preferences. This means however that the MEGs do not accept, even in principle, the conceptual approach whereby the price-elasticity of demand at the pre-merger price is compared to the corresponding critical demand elasticity. Essentially, none of the above discussion of the features of the hypothetical monopolist approach is relevant to the application of that approach under the MEGs.

Instead, the MEGs appear to contemplate an all-encompassing investigative process. It is not clear what this investigative process is or how it distinguishes relevant from non-relevant markets. All that can be inferred is that the process identifies both products (current and future) and competitors (actual and potential), and market shares are derived from this investigation. As a result, the statement of the hypothetical monopolist approach in the MEGs is so vague as to invite the traditional criticism of market definition, i.e. that the process is flexible enough to suit the needs of the advocate.

(iv) Treatment in the Proposals

The Proposals address both of these issues. Nevertheless, they also contain some ambiguity.

First, the Proposals drop the "could" terminology and adopt the "would" vocabulary consistently[23]. This indicates that, conceptually at least, the economically correct procedure requires a comparison of the actual demand elasticity with the critical demand elasticity, rather than the Harris-Simon "breakeven critical loss" approach. Although no reference is made to the notion of critical demand elasticity, it clearly follows from the new vocabulary.

This does not mean that the Competition Bureau will require statistical estimates of demand elasticity. It means that the Bureau will attempt to infer this elasticity from the various materials provided by the merging parties and its own research and will, implicitly, compare it with the critical demand elasticity.

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relevant market are given a zero market share." See Crampton, "The DOJ/FTC 1992 Horizontal Merger Guidelines: a Canadian Perspective", at 680; see supra, fn. 15.

[22] Op. cit. at ¶1.32.

[23] See, for example, s.3.4, op.cit. and compare with s.3.1 of the MEGs.

Ambiguity results, however, from the explicit reference and apparent endorsement of "critical loss analysis" in the Proposals [24], apparently based on its adoption by the respondents' expert witness in the remedy phase of the *Canadian Waste* case. It is also confusing, because the Bureau had adopted the hypothetical monopolist approach in the liability phase of *Canadian Waste*, where the key issue was whether the base price for the SSNIP test was to be the pre-merger price or the likely future competitive price.

It is not clear whether the Bureau routinely employs critical loss analysis to delineate markets, and it may be that the analysis delineates the same market as the hypothetical monopolist approach[25]. However, since the point of guidelines is to convey the analytical framework that has been adopted, the reference to critical loss analysis confuses rather than clarifies the Bureau's approach because it suggests the approach of Harris and Simons.

Second, the Proposals clearly state that supply substitutability issues are no longer addressed in the market definition inquiry. Rather, following the U.S. guidelines, these issues are addressed in the analysis of entry conditions [26]. Thus, while the Proposals continue to define the hypothetical monopolist as the "only seller', they must now be understood as referring to the only current and future seller and thereby accord with the approach in the U.S. guidelines.

This change clarifies and narrows the task of product market definition. Whereas the MEGs seemed to describe an all-encompassing inquiry at the market definition stage including competitors and market shares, it is now clear that market definition is properly concerned only with identifying the appropriate products (in geographic market definition, the areas) that will serve as the basis for the subsequent market share analysis.

4. Geographic Market Definition

The Proposals make it very clear that, when delineating geographic markets, the issue to be determined is not the location of identified suppliers but rather the extent of switching by buyers from sellers in one area to sellers in another. This recognition is a welcome clarification of the MEGs. To the extent that the Proposals adopt the hypothetical monopolist approach to geographic markets, they apply the revised thinking discussed above. Accordingly, the conceptual issues involved are once again highlighted.

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[24] *Proposals,* at fn.32.

[25] Werden finds that for large *m* and small SSNIP, the two approaches yield similar results. See G. Werden, "Demand Elasticities in Antitrust Analysis", Antitrust Law Journal, vol. 66, 1998, 363-414, at 389-390.

[26] *Proposals,* at s.3.3.

However, the Proposals also go well beyond a discussion of principles and concepts and into a detailed and confusing discussion of technique. This may be a reaction to the inadequate treatment of geographic market definition in the literature.

(i) The nature of the market

The Proposals indicate that when defining geographic markets, "the Bureau first determines whether a relevant geographic market for a given product market is local, regional, national or international"[27]. The next step, which apparently may not be necessary, is to estimate the "geographic boundaries of the market"[28]. Apparently the Bureau will use "indirect evidence of substitutability" at the first stage of the market definition inquiry to determine the nature of the market, suggesting thereby that other evidence of substitutability will be considered in later steps, should they be necessary.

The Proposals cite the *Propane* case in which the Tribunal purportedly distinguished between the nature of the market and the boundaries of the market[29]. The cited part of the Propane decision states:

> In this case, both parties submit that the geographic market is local in nature rather than provincial, national or international; but the dispute concerns the actual boundaries of these markets.[30]

With respect, if there is a distinction here, it does not suggest the two-step process that the Proposals discuss.

The generality of the first stage in the Proposals may encourage simplistic definitions based on observed consumption patterns: "the product is consumed (inter)nationally, so the geographic market must be (inter)national". It is apparent, however, that this is not the type of analysis that the Proposals call for.

(ii) Delineating geographic boundaries

According to the Proposals, the delineation of market boundaries is a separate step that may not be necessary to identify relevant geographic markets. The Proposals indicate that where markets are local or regional in nature, location factors are particularly relevant:

> …The underlying assumption is that profit-maximizing firms make decisions about where to locate based on the density of their buyer base and an attempt to

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[27] *Proposals*, at s.3.20

[28] *Proposals*, s.3.29

[29] *Proposals*, fn. 43.

[30] The Commissioner of Competition v. Superior Propane Inc., 2000, Comp. Trib. 15 at ¶83

> avoid cannibalization of their own sales that can occur when one of their locations is closely situated to another. In this way, demand responses are still a key determinant of market boundaries. Spatial competition can usefully assist in delineating the boundaries of such localized geographic markets. The methodology for applying spatial competition analysis depends on the characteristics of the industry and the market under consideration. (s.3.29)

This portion of the Proposals is difficult to appreciate, in part because it addresses technique rather than concepts and principles.

The Proposals properly focus on the key question of geographic substitutability, and they point out that transportation costs are not necessarily the only factor in determining substitution by consumers[31]. Beyond these features, however, the Proposals divert almost entirely from the hypothetical monopolist approach.

(iii) The hypothetical monopolist approach in geographic market definition

Conceptually, the hypothetical monopolist approach requires that markets for a homogeneous good be delineated around every point of production of the merging parties. Starting with the counterfactual assumptions of perfect and dense competition and a circle of arbitrary but small radius, the question is posed whether a monopolist of that circle of plants would impose a SSNIP across all plants within the circle[32]. If the answer is no, then the circle cannot identify a relevant market; the radius is increased and the question is posed again. When conducted for each plant of the merging parties, the approach results in a set of relevant geographic markets that are circular, regardless of the observed shipment patterns[33].

Regrettably, the market definition literature has not been as conceptually precise in regard to geographic markets as to product markets. In particular, although the SSNIP test is called for, there is no concept corresponding to the critical demand elasticity for geographic markets. Indeed, the literature suffers greatly for lack of examples illustrating the application of the hypothetical monopolist approach to delineating geographic markets[34].

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[31] *Proposals,* s.3.24. Other considerations are also relevant, particularly when areas outside Canada are to be considered. Even when the good in question is homogeneous, border issues such as exchange rate uncertainty will affect buyer switching (s.3.27).

[32] Note that it is of no consequence that the circle includes plants from both merging parties.

[33] *Proposals*, s.3.26 repeats the view in the MEGs that pre-merger shipment patterns are not dispositive of market relevancy.

[34] The one example is Werden (1983) at 555-561, supra fn. 6. Unfortunately, this example is hard to understand; interested parties are invited to contact the author for a working paper that illustrates the calculations.

The hypothetical monopolist approach begins with a plant-centered delineation and results in geographic markets that are circular, and it may well be that the analysis will show that the relevant market is local, regional, etc. Although, as the Tribunal noted in the *Propane* decision[35], the Commissioner's methodology did not completely adopt the hypothetical monopolist approach, it did follow this plant-centered approach to arrive at 74 distinct local markets for retail propane that coincided with no particular jurisdictional boundaries.

In *Canadian Waste*, geographic markets around each site were aggregated as a matter of convenience and ultimately supported a Southern Ontario market such that a hypothetical monopolist thereover would impose an increase of at least 5% in the tipping fee.

In short, as these examples illustrate, the hypothetical monopolist approach determines the nature of the market by delineating market boundaries. The latter determines the former and cannot be avoided. In this respect, the two-step method presented in the Proposals confuses rather than clarifies.

According to the Proposals, spatial competition theory determines how firms are situated relative to one another[36]. In contrast, the hypothetical monopolist approach makes no such inquiry; it simply posits dense competition around each plant of each merging party. Determined by spatial competition analysis, the boundaries in *Propane* were polygonal rather than circular, which indicates that the hypothetical monopolist approach was not followed in certain respects.

Spatial competition analysis is a technique for, rather than a theory of, geographic market definition in merger review. The market boundaries it produces are not based on market power considerations, but on plant location decisions. It can be presumed that, consistent with spatial competition analysis, observed plant locations reflect profit-maximization but this pattern need not reflect the market power consideration that is the core issue in the hypothetical monopolist approach. Accordingly, the question arises whether, in the *Propane* case, some or all of the geographic markets that were ultimately accepted were not too large. Spatial competition analysis has no counterpart to the "smallest market principle"; indeed, the issue never arises directly, so spatial competition analysis must be complemented with other concepts to identify a relevant market.

Since, for the purposes of geographic market definition, there is no useful distinction to be made between the nature of the market and the boundaries thereof, there is no reason to adopt the two-stage approach presented in the Proposals. The result is that the central concepts for defining geographic markets remain obscure. Clarification in this area is warranted.

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[35] The Commissioner of Competition v. Superior Propane Inc., 2000, Comp. Trib. 15 at ¶100

[36] *Proposals*, fn.44.

5. Final Thoughts

The Proposals perform a valuable service by correcting and clarifying the concepts and principles of the hypothetical monopolist approach in the MEGs. If there is a weakness in the Proposals' treatment of market definition, perhaps it is that they attempt to do too much. Figuring out and communicating the conceptual issues and principles that the Competition Bureau will follow is an important task in itself. Discussions of technique only serve to cloud the main issues.

From counsel's perspective, market definition in merger review is often conceived of as a heavily data-intensive exercise. Merging parties frequently devote considerable resources to support the broadest possible product and geographic markets. Absent any underlying theoretical approach, there is no reason why they should not routinely succeed. Equally however, there is no reason why the enforcement agencies should not routinely succeed.

The hypothetical monopolist approach provides this underlying framework by assessing market power at the market definition stage. Without implicating the merger at issue, the approach asks whether a monopolist would impose and maintain a significant price increase. In doing so, it brings to bear the weight of conventional economic analysis that, for lack of clear exposition in the literature, has yet to be fully appreciated.

Werden's admonition in connection with the 1982 U.S. Guidelines remains apposite:

> The Guidelines provide no specific rules or tests for determining either the product or geographic dimensions of markets but their conceptual framework can be of great value. Market delineation should be considered on a case-by-case basis, using the best available information, analyzed by applying the Guidelines' market delineation principles. In virtually all cases, these principles can be used in conjunction with readily available evidence to narrow greatly the range of plausible market boundaries. … Ultimate conclusions may have to be based on impressions and intuition, but one's intuition should be much keener with the Guidelines' framework than without it. If the Guidelines convey any important message about delineating markets in actual cases, it is that there are no hard-and-fast rules; it is the principle that is important.[37]

Will competition lawyers and advisers find value in the Proposals? The answer is unequivocally yes, if they look. Will they change their approach to market definition issues?

[37] See Werden (1983) at 570, supra fn. 6.