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The Increased Focus on Competitive Effects in Canadian Merger Analysis

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THE INCREASED FOCUS ON COMPETITIVE EFFECTS IN CANADIAN MERGER ANALYSIS

By A. Neil Campbell[1]

The Competition Bureau's new *Merger Enforcement Guidelines*[2] represent an incremental updating rather than any radical departure from the 1991 *Merger Enforcement Guidelines*.[3] The main innovation is a recognition of the importance of analyzing how a particular merger may result in competitive harm. This includes new coverage of "unilateral effects", significantly expanded commentary on "coordinated effects", recognition of the importance of causation, detailed discussion of "prevention of competition" cases, and guidance regarding three relevant "evaluative criteria" not specifically listed in section 93 of the *Competition Act*.[4]

For the most part, these and other elements of the 2004 MEGs reflect mainstream microeconomic thinking and are broadly consistent with the approaches of Canada's key trading partners, the United States and the European Union. However, the Bureau has also included tantalizing references that suggest controversial "raising rivals' costs" ("RRC") and "portfolio effects" theories may be employed, without providing guidance on how such issues will be analyzed. In addition, the ambiguity and limitations of certain analytical factors and causation scenarios are not recognized, and the Bureau continues to demonstrate unwarranted hostility towards product differentiation.

1. New Coverage of Unilateral Effects

The 2004 MEGs contain a discussion of unilateral effects which is generally consistent with modern economic theory[5] and the current approaches followed in Canada,[6] the United States[7] and Europe.[8] Indeed, it adopts the two major sub-categories in the U.S. Merger Guidelines:

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[2] Competition Bureau, *Merger Enforcement Guidelines* (Ottawa: September 2004) (the "2004 MEGs").

[3] Director of Investigation and Research, *Merger Enforcement Guidelines* (Ottawa: Industry Canada, 1991) (the "1991 MEGs").

[4] *Competition Act*, R.S.C. 1985, c. C-34, s. 93.

[5] See, *e.g.*, Jeffrey Church and Roger Ware, *Industrial Organization: A Strategic Approach* (McGraw-Hill, 2000), 722-724.

[6] See Neil Campbell, "The Economic Theory of 'Unilateral Effects' and the Practical Reality of Differentiated Product Mergers," *Papers of the Canadian Bar Association 6th Annual Fall Conference on Competition Law* (Juris Publishing, 1998), 177-182.

[7] See, *e.g.*, U.S. Department of Justice & Federal Trade Commission, *Horizontal Merger Guidelines*, 4 Trade Reg. Rep. (CCH) ¶13, 104 (the "U.S. Merger Guidelines"), §2.2; and *United States of America v. Oracle Corporation*, No. C-04-0807 VRW, North. Dist. Cal., 10 September 2004, 29-47.

[8] See, *e.g.*, E.U. Commission, *Guidelines on the Assessment of Horizontal Mergers Under the Council Regulation on the Control of Concentrations Between Undertakings*, O.J. C 31, 2 May 2004, available on-line at http://europa.eu.int/scadplus/leg/en/lvb/l26107.htm, (the "E.U. Merger Guidelines"), ¶¶24-38. (The Commission uses the term "non-coordinated" rather than "unilateral" effects.)

"Firms Distinguished Primarily By Their Capacities" and "Firms Distinguished Primarily By Their Products."[9] The former focuses on the traditional high unilateral market share scenario which has grounded much of the Competition Bureau's enforcement activities, but the latter is more relevant in the many industries where products are differentiated.

By focusing on whether products of the merging parties are (or are not) particularly close substitutes within a market containing various differentiated products, an attempt will be made to predict whether a price increase on one party's products would (or would not) become profitable once the firm can capture the portion of switching customers who would select the product of the other merging party.[10] The new guidelines also properly acknowledge that ease of repositioning, which is analyzed analogously to supply / entry responses in other contexts, may discipline a unilateral exercise of market power that would otherwise be expected to occur.[11] While such an approach should not be controversial in principle, the recent *Oracle* decision in the United States underscores the importance of probative evidence and rigorous analysis in order to prove that unilateral anti-competitive effects are likely to occur in a concrete case.[12]

Interestingly, the Proposed MEGs do not specifically discuss the comparable geographic analogy: where location is important to customers, unilateral effects are more (or less) likely if the merging parties' locations are (or are not) next best alternatives for a significant number of customers.[13] However, there is an oblique reference to "spatial competition analysis" in the context of "Delineating Geographic Boundaries" for purposes of regional or local market definition.[14] This suggests that the Bureau might also be receptive to a location-based variant of unilateral effects analysis in appropriate cases, and it could be interpreted by merging parties as an invitation to present such arguments when their locations are not best substitutes.

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[9] U.S. Merger Guidelines, §§2.2.1 and 2.2.2.

[10] 2004 MEGs, ¶5.12.

[11] See *ibid*., ¶5.16; and U.S. Merger Guidelines, §2.2.1.2.

[12] *U.S. v. Oracle, supra*, 142-158.

[13] *Cf.*: U.S. Merger Guidelines, §2.2.1.1, n. 21, which notes that "in some markets buyers are primarily distinguished by their relative advantages in serving different buyers" (without specifically focusing on geography-based examples).

[14] 2004 MEGs, ¶3.29. See also the brief discussion of this type of evidence in *Commissioner of Competition v. Canadian Waste Services Holdings Inc.*, CT-2000/002, 28 May 2001, ¶¶74-83.

2. Modernized Commentary on Coordinated Effects

Despite relative sparse jurisprudence on coordinated behaviour in Canada,[15] coordinated effects are a major focus of merger review in the United States,[16] the European Union[17] and, increasingly, Canada. Thus the extensive discussion of the Bureau's approach to these issues is a most welcome development. The 2004 MEG have converged on the U.S. terminology of "coordinated effects" as a replacement for the references to "interdependent behaviour" in the 1991 MEGs. The substantive discussion is almost entirely new and heavily inspired by the U.S. approach as well, although it also draws from material in the 1998 *Bank Merger Enforcement Guidelines*.[18] The main improvements include a clear explication of the fundamental economic framework for establishing anti-competitive harm, the linking of relevant analytical factors to the essential framework elements, and attention to causation issues.

(a) Adoption of the Stigler Analytical Framework

The 2004 MEGs embrace the widely-accepted Stigler framework[19] for assessing the likelihood that cooperative behaviour will occur in an oligopolistic industry.[20] This involves four essential conditions:

- it must be feasible to form an understanding regarding the price and non-price terms of unilaterally profitable coordinated behaviour;
- coordinating firms must have the ability to monitor each others' conduct;
- credible mechanisms must be available to deter or punish deviations from coordinated outcomes; and
- there must be insufficient external sources of discipline (*eg*. remaining competition, buyer power or entry) to prevent a coordinated exercise of market power.

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[15] See, *e.g*., *Director of Investigation and Research v. Imperial Oil Limited*, CT-89/3, Reasons and Decision, 26 January 1990, 36, which contains a brief acknowledgement by the Tribunal that interdependent behaviour is a potential type of anti-competitive effect resulting from a merger; and *Commissioner of Competition v. Superior Propane Inc. et al*., (2000) 7 C.P.R. (4th) 385 (Comp. Trib.), where the Tribunal accepted interdependence concerns as an ancillary source of anti-competitive effects in a case which focused primarily on merger-to-mutual-monopoly issues in various local markets. For a broader discussion of these issues in the context of oligopolistic industries, see Neil Campbell and Omar Hamam, "Coordinated Behaviour and Conscious Parallelism Under Canadian Conspiracy, Abuse and Merger Law", Atlas Competition Law Forum, April 2003, available on-line at http://www.mcmillanbinch.com/mergers.html.

[16] See, *e.g.*, U.S. Merger Guidelines, §2.1.

[17] See, *e.g.*, E.U. Merger Guidelines, ¶¶39-57.

[18] Competition Bureau, *Bank Merger Enforcement Guidelines* (Ottawa: 1998), available on-line at http://competition.ic.gc.ca/epic/internet/incb-bc.nsf/en/ct02484e.html, ¶65. (A revised version of the "BMEGs" is also scheduled to be released later this year.)

[19] George Stigler, "A Theory of Oligopoly", 72 *Journal of Political Economy* 44. This framework has been adopted by the U.S. enforcement agencies (U.S. Merger Guidelines, §2.1); the European Commission (see E.U. Merger Guidelines, particularly ¶¶44-57; and the European Court of First Instance (see *Airtours v. Commission* (Case T-342/99, 6 June 2002)).

[20] 2004 MEGs, ¶5.20.

It is also essential to be able to articulate mechanism(s) of coordination that are of potential concern in particular case. As one of the officials responsible for modernizing the U.S. Department of Justice's analytical methods has reported, "this is important because the price, output and market share patterns that economics predicts should accompany coordination will be sensitive to whether firms are coordinating prices, fixing outputs or assigning geographic territories or customer accounts."[21] Although output is not specifically mentioned, the 2004 MEGs appear to recognize the relevance of identifying the coordination mechanism(s) in a reference to the possibility that either prices and/or various non-price terms may be subject to coordination.[22]

(b) Integration of Relevant Factors With Framework Elements

After a rather brief discussion of the Stigler framework, the Consultation Draft for the new MEGs had placed considerable emphasis on nine potential "facilitating factors" that might be considered in such an analysis.[23] By placing the focus on a lengthy and loose factor list[24] that would generate some "hits" in most industries, there was a risk that Bureau staff would have been encouraged to develop concerns about coordinated behaviour that were not explicitly organized and linked through probative evidence and analysis to the four necessary elements in the Stigler model.[25] There is a widespread perception that this has occurred in various previous cases in Canada[26] and elsewhere.[27]

The U.S. agencies have recently abandoned this type of checklist approach.[28] It is encouraging that the 2004 MEGs have also identified the key factors that will be examined during the

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[21] Andrew Dick, "Coordinated Effects Merger Analysis: New Approaches at the Agencies and Potential Lines of Response", Northwind Professional Institute 2004 Competition Law and Policy Forum, April 2004, 6. For a recent example in which the U.S. Federal Trade Commission cleared an apparent "4-to-3" merger after vigorous empirical testing and rejection of all plausible coordination mechanisms, see "Statement of the Federal Trade Commission Concerning Royal Caribbean Cruises, Ltd./P&O Princess Cruises plc and Carnival Corporation/P&O Princess Cruises plc", October 4, 2002, available on-line at http://www.ftc.gov/os/2002/10/cruisestatement.htm.

[22] 2004 MEGs, ¶5.19.

[23] Competition Bureau, *Merger Enforcement Guidelines, Draft for Consultation* (Ottawa: March 2004) (the "MEG" Consultation Draft"), ¶5.22. Unfortunately, the 2004 MEGs have retained the reference in the MEGs Consultation Draft to "facilitating factors," which invites confusion with the different concept of "facilitating practices" that may be pro-actively adopted by oligopolists. (For further discussion, see James Langenfeld and Margaret Sanderson, "Practices That May Facilitate Collusion in an Oligopoly: The Canadian and U.S. Experiences", undated conference paper.)

[24] For additional discussion regarding the use of analytical factors, see Andy Baziliauskas and Tom Ross, "Lessening of Competition in Mergers Under the Competition Act: Unilateral and Interdependence Effects" (2000), 33 *Canadian Business Law Journal* 373; and Campbell and Hamam, *supra*.

[25] See Neil Campbell, "Taking Competitive Effects Seriously: A Commentary on the Proposed Revisions to the Canadian Merger Enforcement Guidelines," Insight Competition Law Compliance Conference, May 2004, 5.

[26] See, *e.g.*, *The Competition Bureau's Letter to the Royal Bank of Canada and Bank of Montreal* and *The Competition Bureau's Letter to the CIBC and T-D Bank*, December 11, 1998, available on-line at http://competition.ic.gc.ca/epic/internet/incb-bc.nsf/en/ct02083e.html.

[27] This was the basic flaw identified by the European Court of First Instance in *Airtours v. Commission*, *supra*.

[28] Deborah Platt Majoras, "Coordinated Effects Theory in U.S. Merger Review: A Fresh Look", Northwind Professional Institute Competition Law and Policy Forum, April 2004, 2:

assessment of each of the Stigler conditions.[29] For example, product homogeneity, market transparency and cost symmetries are the main considerations in determining whether formation of a cooperative understanding is likely to be possible.

While the ambiguous nature of excess capacity has been recognized,[30] the 2004 MEGs unfortunately do not acknowledge the potential ambiguity of at least three other factors:

- *Symmetry*. It is assumed that symmetry in cost structures or size is a factor which facilitates the formation of a coordinated understanding,[31] without recognizing that the combination of two small firms into a merged entity that is closer in cost structure and size to one or more larger competitors may result in passive "follower" behaviour being replaced by more aggressive rivalry.

- *Size And Frequency Of Sales*. In suggesting that large and infrequent sales make coordinated behaviour less likely (relative to many small buyers making frequent purchases) because of the profit from a deviation,[32] the 2004 MEGs fail to note that a large deviation is more likely to be detected and punished.

- *Historical Activity*. A "history of collusion / cooperation" is simplistically listed as an aggravating factor, without recognition of the possibilities that: (i) if explicit (illegal) collusion had to be resorted to in order to achieve anti-competitive outcomes in the past, this may suggest that "coordinated behaviour" (in the non-cartel form of interest in the merger context) is not likely to be successful; [33] and (ii) if firms are already successfully engaging in a coordinated exercise of market power, it will be difficult to show that a proposed merger will "likely" result in a further "substantial" lessening of competition.[34]

(c) Recognition of the Importance of Causation

While the term causation is not used, the 2004 MEGs acknowledge that there is no basis for interfering with a proposed merger on the basis of coordinated effects unless there is a linkage between the transaction and the creation or enhancement of the ability of the merged firm to

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"Early economic analysis and case law used a 'checklist' approach that often devolved into counting plus and minus sides of the coordination ledger and then applying a subjective (but unstated) weighting scheme to deduce whether conditions were sufficiently conducive to collusion to raise antitrust concerns. The checklist, however, offered neither necessary nor sufficient conditions for coordinated interaction."

[29] 2004 MEGs, ¶¶5.21–5.26.

[30] *Ibid*., MEGs, ¶5.25.

[31] *Ibid.*, ¶¶5.22 and 5.30.

[32] *Ibid.*, ¶5.23.

[33] For a thoughtful critique of the European Commission's similar reliance on past conduct as an indicator of post-merger coordinated behaviour, see Gavin Robert, "Past Coordination and the Draft Notice on the Appraisal of Horizontal Mergers" (2004), 25:3 *European Competition Law Review* 163.

[34] The importance of this "causation" requirement is discussed more fully below.

exercise market power[35] in conjunction with accommodating responses from other significant competitors in an oligolopolistic industry.[36] The causation requirement is fundamental in any coordinated effects analysis[37] because the Competition Bureau must be able to either: identify how a merger enables such market power to begin to be exercised when it heretofore has not been; or demonstrate that there will "likely" be a "substantial" increase in the magnitude of coordinated effects where such market power is already believed to exist pre-merger.

The 2004 MEGs helpfully set out four causation scenarios,[38] although each has potential weaknesses or limitations which are not acknowledged:

- *Reduction Of Asymmetries Between The Merging Firms And Other Major Competitors.*[39] As noted above, the 2004 MEGs assume that asymmetries are always desirable, without considering the possibility that a merger which reduces the size and cost gaps between merging parties and one or more stronger competitors may promote more vigorous rivalry.

- *Removal Of A Maverick Firm Which Has Been Inhibiting Co-ordinated Behaviour.*[40] In light of the potential of even relatively small firms to destabilize the coordinated exercise of market power, a merger involving a firm that has been displaying maverick behaviour is an obvious candidate for concern. However, it cannot be assumed without careful situation–specific analysis that the competitive style of a new firm resulting from the merger of a maverick and a non-maverick firm will be cooperative rather than aggressive – particularly if the maverick brings relatively large sales, profits and/or growth potential to the combined entity.

- *Inhibiting The Behaviour Of A Third Party Maverick.*[41] While it is theoretically possible that a merger could inhibit the competitive vigour or expansion of a firm which is not one of the merging parties, it is not clear that this is likely to have much practical application. The sole example (added subsequent to the MEG Consultation Draft) is "raising rivals' costs by limiting access to the supply of necessary inputs." However, RRC traditionally involves unilateral activity; it is possible that the Bureau is contemplating parallel exclusive supplier contracts or refusals to deal by vertically-integrated coordinating firms, but this has been left unstated.

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[35] It is well accepted that the substantial lessening or prevention of competition test in section 92 of the *Competition Act* is equivalent to the ability to exercise market power: see Neil Campbell, *Merger Law and Practice* (Toronto: Carswell, 1997), 90-96, and cases cited therein.

[36] 2004 MEGs, ¶¶5.18 and 5.28.

[37] Causation is obviously also essential in unilateral effects and prevention of competition cases, but this has generally been recognized in the 1991 MEGs, the 2004 MEGs and the analysis of individual cases.

[38] While there are differences in the scenario descriptions, this approach displays an encouraging similarity to the modernized U.S. approach to coordinated effects analysis which is summarized in Dick, "New Approaches", *supra*, 8-9.

[39] 2004 MEGs, ¶5.30.

[40] *Ibid.*, ¶5.26.

[41] *Ibid*., ¶5.32.

- *Reducing The Number Of Rivals*.[42] This is by far the weakest scenario. All mergers reduce the number of rivals and the only attempt to articulate a standard for identifying situations where one less rival will make a critical difference is the suggestion that a merger could reduce the number of rivals "to a level at which the profitability of coordination makes it a more attractive strategy relevant to competition." The MEG Consultation Draft included a requirement that the removed firm have significant excess capacity that is currently providing important competitive discipline.[43] However, this guidance was removed, perhaps because of the ambiguity surrounding capacity incentives and effects.[44]

3. Detailed Discussion of Prevention of Competition Scenarios

The Bureau has acquired a fair amount of experience with cases where the anti-competitive effects are expected to arise from a prevention of future competition rather than a lessening of current competition.[45] As a result, it has been able to outline the approach used for assessing such issues along with several scenarios in which these concerns are expected to arise.[46] Moreover, the 2004 MEGs properly note the importance of assessing the extent of any pre-existing market power and determining whether other potential entrants would face entry barriers (an essential condition for market power concerns to arise) that would not have deterred entry by one of the merging parties.[47]

4. Restrained Treatment of Vertical Mergers

Vertical mergers have been relegated to the back end of the 2004 MEGs.[48] There has been little change in approach from the 1991 MEGs, which is surprising given the renewed attention being paid to vertical mergers by the U.S. authorities[49] and the increasing prominence of raising rivals' costs theories of competitive harm.

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[42] *Ibid*., ¶5.29.

[43] MEG Consultation Draft, ¶5.24.

[44] In order to establish a causal connection between the merger and a substantial lessening of competition based on this scenario, it would be necessary to show that the acquiree was not part of a group of firms engaging in coordinated behaviour pre-merger and that the merged entity would find it profitable to eliminate or idle the excess capacity. An important alternative requiring consideration is that the merged firm would have economic incentives to use such capacity to expand its output, which would be pro-competitive.

[45] See, *e.g*., *Director of Investigation and Research* v. *Dennis Washington et al.*, CT-1996/01; *Commissioner of Competition* v. *Superior Propane Inc.*, *supra*; *Canada (Commissioner of Competition)* v. *Canadian Waste Services Holdings Inc.* (2001) 11 C.P.R. (4th) 425 (Comp. Trib.); and *Commissioner of Competition* v. *Bayer AG*, CT-2002/003 (Comp. Trib.); as well as various cases dealt with by the Bureau without recourse to contested or consent proceedings before the Tribunal.

[46] Six of the scenarios are set out in 2004 MEGs, ¶2.12. The seventh (a conglomerate merger that supplants *de novo* entry) is discussed in Part 11. One of the most interesting additions is the possibility that a merger could prevent entry by a third party which would otherwise have been expected to occur: *ibid*., ¶2.11.

[47] *Ibid.*, ¶2.11.

[48] *Ibid.*, Part 10.

[49] See, *e.g.*, Howard Morse, "Vertical Mergers: Recent Learning", 53 *Business Law* 1217 (1998).

(a) Continuation of 1991 Theories of Harm

The 1991 MEGs indicated that there were "only" two economic theories of harm that would be expected from vertical mergers: increased barriers to entry resulting from the need for two-stage entry; and upstream coordination facilitated by forward integration into retailing.[50] The 2004 MEGs carry these forward without any material change, except that the "only" reference has been deleted, and additional commentary regarding facilitation of coordinated behaviour through transparency and punishment mechanisms has been added.[51]

(b) An Oblique Reference to Raising Rivals' Costs

While the MEG Consultation Draft was silent on the Bureau's views about RRC theories, the 2004 MEGs have added a brief footnote indicating that "In addition [to the two theories of harm discussed above], a vertical merger could substantially lessen or prevent competition by foreclosing access to inputs or distribution channels, thereby raising the costs of rivals."[52]

It is not a surprise to see such reference, particularly since the Bureau has been receptive to RRC concerns in the past.[53] However, the absence of any substantive guidance is extremely disappointing. It is well known that rivals often have incentives to complain about mergers that will be pro-competitive. A clear analytical framework is therefore essential to distinguish the relatively rare cases of genuine harm to competition from attempts by competitors to protect themselves from increased rivalry.[54]

5. Minimal Attention to Conglomerate Mergers

Conglomerate mergers receive even less attention than vertical mergers in the updated guidelines. The 1991 MEGs approach has been brought forward with minimal change, except for a new footnote that may signal on interest in examining portfolio effects theories in cases involving complementary products.

(a) Continuance of the Classic Entry-Prevention Theory

The "only" theory of anti-competitive harm identified for conglomerate mergers in the 1991 MEGs was that such a transaction may pre-empt entry that would otherwise have occurred.[55] This remains the sole theory of harm articulated in the 2004 MEGs (although the "only" reference has been dropped).[56] The expanded general framework for analysis of

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[50] 1991 MEGs, §4.11.

[51] 2004 MEGs, ¶¶10.2-10.7.

[52] *Ibid.*, ¶10.1, n. 130.

[53] See, *e.g.*, *Commissioner of Competition v. Ultramar Ltd.* (2000), 6 C.P.R. (4th) 519 (Comp. Trib.).

[54] As noted above, there is also a puzzling RRC reference in the context of possible coordinated effects scenarios: see 2004 MEGs, ¶5.32, discussed under "Recognition of the Importance of Causation," *supra*.

[55] 1991 MEGs, §4.12.

[56] 2004 MEGs, ¶¶11.1-11.2.

prevention of competition cases[57] will provide useful supplementary guidance in the conglomerate mergers context as well.

(b) A Portfolio Effects Trojan Horse?

The opening sentence of the conglomerate mergers material in the 2004 MEGs contains a cryptic footnote that was not present in the MEG Consultation Draft: "the analysis of mergers involving complementary products is analogous to that of vertical mergers as described in Part 10."[58] This statement suffers from both sloppy logic and lack of clarity. The main vertical theories – two stage (upstream/downstream) entry and upstream coordination through retailing integration, – do not have obvious applicability to non-vertical complementary products. More importantly, if by "complementary products" the Bureau is intending to refer to mergers that give rise to potential bundling opportunities, it would be desirable to state the Bureau's position on the portfolios effects and related theories that have been controversial in a number of cases including *GE/Honeywell*.[59]

6. Additional Factors for Assessing Competitive Effects

The 2004 MEGs contain a concise new section devoted to countervailing power as well as several references to excess capacity and product differentiation.

(a) New Material on Countervailing Power

The new discussion of buyer power[60] is brief but valuable, particularly since it addresses one of the arguments that companies most commonly raise when dealing with sizeable buyers in a commercial or industrial market.[61] The 2004 MEGs indicate conditions where this can be expected to be effective.[62] They also correctly note the limitations of countervailing power arguments in situations where sellers can price discriminate between customers, which will often result in a group of vulnerable purchasers that do not possess buyer power.[63]

(b) Recognition of the Importance of Excess Capacity

Excess capacity was identified as a potentially important competitive effects factor by the Competition Tribunal in the *Hillsdown* case.[64] The 2004 MEGs contain fragmented references in

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[57] See 2004 MEGs, ¶¶2.10-2.12; and "Detailed Discussion of Prevention of Competition Scenarios," *supra*.

[58] 2004 MEGs, ¶11.1, n.134.

[59] *GE/Honeywell* (Case No COMP/M.2220, 3 July 2001). See also *Guinness/Grand Metropolitan* (Case No IV/M.938, 15 October 1997).

[60] Or, in monopsony / oligopsony cases, countervailing seller power.

[61] 2004 MEGs, Part 7.

[62] *Ibid.*, ¶7.2.

[63] *Ibid.*, ¶7.3. For a useful general discussion, see Mary Lou Steptoe, "The Power-Buyer Defence in Merger Cases," 61 *Antitrust Law Journal* 493 (1993).

[64] *Canada (Director of Investigation and Research)* v. *Hillsdown Holdings (Canada) Ltd*. (1992), 41 C.P.R. (3d) 289 (Comp. Trib.).

several areas where this consideration is relevant to the assessment of competitive effects.[65] While it would have been useful to present an integrated discussion of this topic, significant substantive guidance has been provided. Moreover, the potential negative impacts of excess capacity in respect of entry deterrence or punishment of deviations from coordinated behaviour have been accompanied by a recognition that under-utilized capacity may also provide incentives for the merging parties and rivals to increase rather than restrict output.[66]

(c) Continued Hostility to Product Differentiation

As with excess capacity, references to product differentiation are sprinkled throughout the competitive effects discussion and would have benefited from consolidated treatment under an identifiable heading. More importantly, while the 2004 MEGs have moderated some of the references in the MEG Consultation Draft,[67] there are still signs that the Bureau maintains an unwarranted hostility towards this important dimension of competition in the modern economy:

- *Niche Competition.* Firms which "only occupy a particular niche" may not be viewed as providing effective competition; indeed such strategies are described as a means to "avoid direct competition".[68] This ignores the role of differentiation as a basis of competition which is often highly valued by customers.

- *Coordinated Behaviour.* While product homogeneity is discussed as a factor which facilitates formation of understandings about coordinated behaviour,[69] the 2004 MEGs neglect to mention that differentiated products often make it more difficult to monitor deviations from any such understanding.

- *Entry.* The entry section of the Proposed MEGs focuses on costs facing new entrants to "overcome product differentiation-related advantages enjoyed by incumbents."[70] While this is a potentially significant consideration, product differentiation may also be an important entry-enabler by facilitating expansion, repositioning or innovation that will be pro-competitive.

7. Theories Need to Be Supported by Evidence

Airtours and subsequent jurisprudence of the Court of First Instance have made it clear that the European Commission cannot interfere with mergers in the absence of a coherent theory of

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[65] 2004 MEGs, particularly ¶¶4.7-4.9, 5.4, 5.17, 5.25 and 6.15.

[66] *Ibid.*, ¶¶ 4.2, 5.4, 5.25.

[67] For example, in the context of unilateral effects analysis, the statement that the Bureau will consider the extent to which product differentiation "*limits*" the level of direct competition among firms (MEG Consultation Draft, ¶5.3) has been changed to "*affects*" (2004 MEGs, ¶5.3).

[68] 2004 MEGs, ¶¶5.16 and 6.7.

[69] *Ibid*., ¶5.22.

[70] *Ibid.*, ¶6.11 and Appendix I, ¶¶A.5-A.9.

competitive harm that is supported by cogent evidence and analysis.[71] The same basic reminder has recently been given to the U.S. enforcement agencies by two separate U.S. courts in the *Arch Coal* and *Oracle* cases.[72] Moreover, the *Oracle* trial judge emphasized that general customer angst about a reduction in suppliers or loose preferences that do not use to implement to substitution are not sufficient; like competitor complaints, customer concerns need to be subjected to rigorous analysis.[73]

Such messages are important because enforcement agencies often have a high degree of leverage over merging parties that tend to be reluctant to incur the time and cost of litigation. This is a particular concern in Canada, where markets tend to be relatively small. While the Competition Tribunal has demonstrated considerable attention to proof issues in contested and even consent proceedings, it often is not a plausible forum given the size of transactions relative to the time, cost and risk of litigated proceedings.[74] The 2004 MEGs do not address evidentiary issues. However, it would be appropriate for the Bureau to adopt a formal policy of not requesting remedies from merging parties unless it believes it would have sufficient evidence and analysis to demonstrate competitive harm in a relevant market on a balance of probabilities.

8. Concluding Observations

The 2004 MEGs are based on years of in-depth experience with merger review and, for the most part, sound economic thinking. They properly focus on the necessity of a coherent theory of anti-competitive harm as the basis for finding a substantial lessening or prevention of competition. The increased recognition of causation requirements is also welcome and will hopefully be accompanied by attention to the need for probative evidence in order to establish that anti-competitive effects are likely to flow from a merger.

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[71] See *Airtours v. Commission, supra*; *Tetra Laval/Sidel* (Case No COMP/M.2416, 30 October 2002); *Schneider/Legrand* (Case No COMP/M.2283, 10 October 2001).

[72] See *Federal Trade Commission v. Arch Coal,* No. 04-5291 U.S. Court of Appeals, D.C. Circuit, 20 August 2004; and *U.S. v. Oracle, supra*.

[73] *U.S. v. Oracle, supra,* 53-70.

[74] For a more extensive discussion of institutional design concerns relating to Canada's merger review system, see Campbell, *Merger Law, supra,* c. 16.