PERSPECTIVE

Competition Bureau Issues New Merger Guidelines – What They Mean For Canadian Businesses

October 14, 2011

On October 6, 2011, Canada's Competition Bureau released newly revised *Merger Enforcement Guidelines* ("MEGs"). The MEGs set out the analytical framework used by the Bureau in its review of mergers and acquisitions under Canada's *Competition Act*. Of all the Bureau's various enforcement guidelines, the MEGs are the most used in practice.

These new MEGs replace the prior 2004 edition. Whereas the 2004 revision involved a considerable rewrite of the original 1991 MEGs, the new 2011 MEGs are intended to "address certain discrete areas where the [2004] MEGs do not fully reflect current Bureau practice and current economic and legal thinking". Given that there has been no contested merger decision in Canada since the release of the 2004 MEGs, the latest revision may also be seen as reflecting the Bureau's desire to keep pace with revisions last year to the U.S. Horizontal Merger Guidelines and revisions to guidelines in other jurisdictions.

This perspective provides an overview of key changes in the new MEGs and discusses practical implications for merger parties.

Market Definition

The MEGs' basic "hypothetical monopolist" test for defining relevant product and geographic markets remains intact. The more significant, and controversial, change is the proposition that market definition itself may be unnecessary in certain situations where it is possible to more directly assess potential competitive effects of a merger. Specifically, the MEGs now state that market definition "is not necessarily the initial step, or a required step, but generally is undertaken".

Since the vast majority of mergers obviously raise no significant competition concerns under any conceivable market definition, there may be no need to precisely define markets in many cases.

However, potentially more problematic is the Bureau's suggestion that it may now find a merger to be anticompetitive without engaging in the traditional exercise of defining relevant markets or assessing market shares. In particular, the MEGs now state that where different possible market definitions may yield significantly different market shares, the Bureau "may give greater weight to evidence regarding likely competitive effects that is not based on market share and concentration". For context, developments in economic thinking over the past several years, particularly in the United States, have led to attempts to directly assess (without defining markets) whether the merging firms are particularly close substitutes such that the loss of competition between them is likely to lead to higher prices. For example, in a merger of Firms A and B, the analysis may focus on the extent to which Firm A's prices tend to be lower in markets where Firm B is present (and vice versa) and are less impacted by the presence or absence of other competitors.

It is questionable whether such an approach is consistent with established case law in Canada, which may be interpreted to require that markets be defined. Also, some of the statutory criteria in the *Competition Act* to be considered in merger review (e.g., barriers to entry or effective remaining competition) implicitly presuppose market definition. It seems unlikely in a contested merger case that market definition would not be considered a fundamental issue by the Competition Tribunal.

Nonetheless, insofar as the MEGs signal the internal Bureau approach to merger review, it would be wise to bear in mind that the Bureau will be considering direct indicators of competitive effects. Merger review is document and data intensive. Internal documents and statistical analyses that tend to show the merging parties as each others' closest alternatives for many customers will be particularly likely to attract Bureau attention. Parties should not assume that market definitions that include other competitors and yield apparently low market shares will necessarily dissuade the Bureau from asserting a competition issue.

Competitive Effects

Closely related to the revisions regarding market definition are the revisions to the analysis of competitive effects, particularly for mergers in industries with differentiated products. Notably, the MEGs now have an expanded discussion of the use of "diversion ratios" (a measurement of sales lost by one merging firm to another when one firm increases prices), including a new reference to margin analysis, in assessing whether merging firms are likely to increase prices.

These revisions appear to be inspired by recent economic thinking on techniques to assess competitive effects, including some approaches that are reflected in the 2010 U.S. Horizontal Merger Guidelines, such as "upward pricing pressure". In the United States, adoption of these techniques has not been without controversy. While the new MEGs do not go as far as the U.S. guidelines in expressly discussing some of these newer techniques, the Bureau has at least allowed itself greater latitude to pursue analyses similar to those that may occur in the United States and elsewhere. Consequently, merging parties should expect that the Bureau may focus increasingly on evidence of competitive rivalry between the parties (irrespective of market shares), particularly in the context of cross-border and international mergers where the Bureau often communicates with U.S. and E.U. competition agencies.

Entry

An important mitigating consideration in Canadian merger review has traditionally been whether other firms would likely enter or expand their operations so as to defeat an attempt by the merged firm to increase prices. The prior MEGs established a two-year time frame as generally being an appropriate period for assessing whether such entry was likely to occur. In other words, effective entry within two years would generally be sufficient to avoid a challenge in an otherwise concentrated market. The new MEGs have removed the two-year reference, and instead now refer to whether entry would occur "quickly enough", which may mean that the Bureau would look for entry within less than two years to refrain from challenge.

The Bureau's stated reason for the change is that in practice the appropriate period varies from industry to industry, and that more flexibility was needed to reflect this reality. Also, given the prospect that market definition may now be dispensed with altogether in certain cases, it is perhaps unsurprising that the analysis of entry into a market has been rendered less precise.

Nonetheless, it would have been preferable to retain the two-year time period for general guidance, particularly since it has proven a helpful benchmark in many cases. Moreover, where entry would likely occur within two years to defeat attempts to exercise market power, it is not clear why the Bureau would ever oppose such a merger.

In practice, merging parties should continue to highlight entry that would likely occur within two years (or faster), but be mindful that the Bureau will not simply consider the mere prospect of such entry to address all potential competition concerns.

Minority Interests and Interlocking Directorates

The new MEGs expand the discussion of situations where minority shareholdings could give rise to a "significant interest" and therefore potentially be reviewed under the merger provisions. While the scope for finding a merger now seems broad, the practical impact of these revisions may be modest. New provisions of the *Competition Act* that came into force in 2010 may already give the Bureau considerable latitude to review the competitive impact of minority shareholdings between competitors. Given the choice, parties may prefer that a minority shareholding be treated as a merger, since mergers are subject to a one-year limitation period and also allow for the option of seeking clearance through the advance ruling certificate process.

The MEGs revisions also expand the discussion of interlocking directorates, which may be relevant in two situations. First, they may contribute to establishing a "significant interest" by one party in another (and therefore a merger). Second, a merger may have the collateral effect of creating a new interlock between directors of the merged firm and a third party.

It is clear that interlocking directorates are on the Bureau's radar screen and parties will need to be sensitive to their potential to raise legitimate competition concerns, even though such concerns relate more to information exchanges than the existence of a merger. At the same time, it is hoped that the Bureau will give due regard to the fact that Canadian competition law (which oversees a smaller economy with inevitably more board overlaps) did not opt to follow U.S. antitrust law, which contains specific provisions targeting interlocking directorates.

Non-Horizontal Mergers

The MEGs offer new guidance on the potential competition concerns raised by non-horizontal mergers – i.e., mergers between firms that are not competitors. The comments regarding vertical mergers (between customer and supplier) are straightforward and set out the types of foreclosure concerns that can arise. The Bureau continues to examine such vertical issues with increasing frequency.

More new guidance in respect of conglomerate mergers (where there is no horizontal or vertical relationship between the merging parties) has also been added. However, it is highly speculative in suggesting potential areas of concern, particularly since conglomerate mergers rarely raise competition issues.

Efficiencies

The new MEGs supersede prior Bureau guidance on efficiencies, including the 2009 Bureau bulletin on "Efficiencies in Merger Review". Unfortunately, there continues to be little practical guidance from the Bureau on how it deals with efficiency claims.

In the wake of the 2002 decision by the Competition Tribunal in the *Superior Propane* case, the Bureau appeared to be favouring adopting a "balancing weights" approach to evaluating efficiency claims. This approach is admittedly difficult to apply in practice (for example, it requires measuring, among other things, how much of the "wealth transfer" from consumers to producers should be considered an anticompetitive effect). Nonetheless, it provides a rough framework for weighing efficiency gains against anticompetitive harms. However, the new MEGs do not endorse even the balancing weights approach, preferring instead to leave largely undefined the potential approach the Bureau may take in the future to assessing efficiencies arguments.

It remains to be seen how much practical impact this shift will have. Although efficiencies may offer an important rationale for some mergers, parties rarely proceed with a merger on the expectation that the Bureau will decline to challenge it purely on efficiency grounds. Efficiencies are likely to continue to matter, if at all, where the competition concern is borderline and the efficiencies are compelling. It is doubtful that the new MEGs have significantly changed that dynamic.

Summary

The new MEGs do not fundamentally alter the Bureau's basic approach to merger review, but rather are intended to update the MEGs to more accurately reflect current Bureau practice.

The revisions can be understood foremost as preserving enforcement flexibility for the Bureau given that merger review is inevitably fact specific. While that may be understandable from a practical perspective, the result is a document that now offers less tangible guidance for practitioners. For example, as noted above, gone is the two-year time frame for assessing entry, as well as the balancing weights framework for efficiencies. Gone also are the case references in the footnotes of the 2004 MEGs, which provided a link to the limited Tribunal cases and Bureau enforcement actions to date.

The most notable development in the new MEGs is the indication that the Bureau may find competition concerns in certain mergers without having to define relevant markets. As such, in cases where there is evidence that the merging parties may be particularly close substitutes for many consumers, those parties would be well-advised not to take false comfort from seemingly low market shares or the presence of other competitors in the market.

If you have any questions regarding the foregoing, please contact George Addy (416.863.5588), John Bodrug (416.863.5576), Richard Elliott (416.863.5506), Adam Fanaki (416.863.5564) or Mark Katz (416.863.5578) in our Toronto office or Hillel Rosen (514.841.6443) in our Montréal office.

Davies Ward Phillips & Vineberg LLP is an integrated firm of more than 240 lawyers with offices in Toronto, Montréal and New York. The firm is focused on business law and is consistently at the heart of the largest and most complex commercial and financial matters on behalf of its clients, regardless of borders.

The information and comments herein are for the general information of the reader and are not intended as advice or opinions to be relied upon in relation to any particular circumstance. For particular applications of the law to specific situations, the reader should seek professional advice.