FOREIGN AND INTERNATIONAL COMPETITION LAW DEVELOPMENTS

REVIEW OF RECENT DEVELOPMENTS IN U.S. ANTITRUST LAW

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U.S. administrative agencies have recently disapproved four significant mergers. While the Department of Transportation approved the proposed acquisition of Frontier Horizon Airlines by United Airlines, the Interstate Commerce Commission disapproved the proposed merger of the Atchison, Topeka and Sante Fe Railway Company with Southern Pacific Transportation Company (although the parties have requested reconsideration); the Federal Trade Commission rejected the proposed acquisition by Coca Cola Company of Dr. Pepper; the Department of Transportation disapproved a proposed acquisition of Eastern Airlines by Texas Air Corporation; and the Department of Justice disapproved the acquisition by John Deere & Co. of the agricultural equipment operations of Versatile Corporation. We briefly discuss here the Texas Air and John Deere cases.

The Department of Transportation's disapproval of the proposed acquisition of Eastern Airlines was based on its concern that the acquisition would significantly reduce competition in the "shuttle markets" (the heavily-travelled routes between Washington D.C.'s National Airport and New York's LaGuardia Airport and between LaGuardia and Boston's Logan International Airport). Eastern has long maintained a highly successful shuttle service between these airports. Texas Air owns New York Air, which entered this market more recently and is Eastern's only competitor on the shuttle routes.

The Department had tentatively determined to approve the acquisition, based on Texas Air's promise that it would sell certain landing rights at these airports to Pan Am. This would have enabled Pan Am to compete with Eastern and New York Air in the shuttle markets. However, on further examination, the Department concluded that the landing rights available for sale to Pan Am would leave Pan Am with gaps in its proposed shuttle service at peak hours and other times. The Department concluded that "effective competition requires the ability to operate hourly flights, particularly at peak hours". The Department indicated in its Final Order (No. 86-7-21, Docket 43825) that the acquisition would otherwise satisfy its requirements for approval and that, if the shuttle market service problem is resolved, the applicants can file a new application for approval.

An interesting aspect of the Texas/Eastern application was the definition of the relevant market. The Department found that the shuttle service constitutes a submarket, separable from other air traffic between these cities, even though it had previously determined that "city-pair markets" were the smallest type of relevant market. It found that many passengers, especially business travellers, do not consider the other airports in the Washington and New York metropolitan areas to be reasonable substitutes for Washington National Airport and LaGuardia, and that Eastern and New York Air had been the only carriers operating a significant level of service between these two airports and between LaGuardia and Logan.

This proposed merger is one part of the rapid restructuring of this recently deregulated industry. The increased competition that has occurred in this industry has brought with it severe problems for some companies, including Eastern. Shortly after the disapproval of its acquisition by Texas Air, Eastern announced major budget cutbacks and lay-offs.

The rejection of the John Deere/Versatile proposal by the Department of Justice is interesting from the vantage point of U.S.-Canadian relations. Versatile, a Canadian firm, is involved in many different operations, including agricultural equipment, shipbuilding, cold storage, and energy exploration. Deere is also a diversified company but with a large share of the North American market for agricultural equipment. In disapproving Deere's acquisition of Versatile's agricultural equipment operations, the Department cited increased concentration in the over 200-HP, four-wheel-drive tractors market, and found that the acquisition would have reduced the number of North American producers in this market from four to three. (In 1985, Versatile led the four-wheel drive tractor market with about 33 percent of all North American sales. Deere ranked second with a 26 percent market share. The remaining two significant U.S. manufacturers -- J.I. Case and Stieger Tractor Inc. -- make up the rest of the market. Stieger, however, recently filed for protection from creditors under chapter 11 of the U.S. *Bankruptcy Code.*)

This case involved one of the first uses of the 1984 Memorandum of Understanding between Canada the United States on antitrust. Consistent with the Memorandum, the Department took into account Canadian national interests; in response to the companies argument that the merger should be approved based on the "failing firm" doctrine in spite of its anticompetitive effects, the Department accepted the view of the Government of Canada that, absent a merger, Versatile would not be able successfully to restructure its debt or to reorganize. Nevertheless, it found that the merger did not qualify for the "failing firm" doctrine because Versatile had not performed the necessary search for an alternative purchaser that would not cause the same anticompetive effects. The Department indicated that it would approve the merger if Versatile carried out a comprehensive search for such a purchaser and were unsuccessful, as long as its financial condition had not improved materially in the interim.

It is also worth noting that, consistent with its new merger guidelines, the Department took into account competitive conditions in the North American market and not in the United States alone.

The Supreme Court will in its 1986 session take up an issue involving court orders for the discovery of evidence located beyond U.S. borders. The court has agreed to review *In re Societe Nationale Industrielle Aerospatiale*, 782 F.2d 120 (8th Cir. 1986), *cert granted,*

No. 85-1695, 54 U.S.L.W. 3809 (U.S. Jun. 9, 1986) in which a foreign corporation involved in U.S. litigation refused to produce documents and to comply with other discovery requests based in part on the argument that discovery of information abroad may be effected only pursuant to the *Multilateral Convention on the Taking of Evidence Abroad in Civil and Commercial Matters* (done March 18, 1970 and entered into force for the United Sates on October 7, 1972; it is often referred to simply as the Hague Convention on the taking of evidence abroad). The foreign corporation is a defendent in an action arising out of its doing business in the United States, and the district court has *in personam* jurisdiction over it. The district court ordered compliance with the discovery requests of the plaintiff and refused to require that discovery be conducted in accordance with the procedures in the Hague Convention. The defendant filed an interlocutory appeal seeking a writ of mandamus directing the district court to follow the Hague Convention.

The Court of Appeals denied the motion. It found that the Hague Convention does not apply where a court has personal jurisdiction over the party and the discovery will not take place abroad. Simply ordering the production of documents that are located abroad does not constitute the conduct of discovery in the foreign country. The Court further found that the purpose of the Hague Convention was only to prevent the conduct of discovery abroad, and that to require U.S. parties to litigation to abide by the Hague Convention while their foreign opponents engage in full discovery would give an unfair and unintended advantage to foreign litigants. The Court said:

> The discovery sought in this case neither intrudes on nor threatens French traditional sovereignty or custom. The magistrate's order does not require any foreign attorneys to appear in France to conduct discovery procedures that are typically considered a judicial function by France and other civil law countries. The order simply requires the Petitioners, who are parties subject to the jurisdiction of a United States court, to perform certain acts preparatory to the production of documents and information in the United States. These acts do not require any French judicial participation. Hence we concluded that the Hague Convention does not apply to the discovery sought in this case because the proceedings are in a United States court, involve only parties subject to the court's jurisdiction, and ultimately concern only matters that are to occur in the court's jurisdiction, not abroad.

The Court also apparently agreed with the Department of Justice, which had indicated in a previous case that the courts should consider international comity before resorting to methods other than the Hague Convention. *See In re Anschuetz & Co. GmbH*, 754 F. 2d 602, 605 (5th Cir. 1985). However, in that case the Fifth Circuit's analysis of the respective interest of the U.S. judicial system and the sovereignty of foreign countries suggests that U.S. courts cannot be expected to order U.S. litigants to use the Hague Convention in lieu of discovery under the *Federal Rules of Civil Procedure*, or even as a first resort, with respect to foreign parties over which the courts have personal jurisdiction. The situation might be clarified after the Supreme Court rules on this case.

HEADS OF ANTITRUST AUTHORITIES PARTICIPATE AT INTERNATIONAL BAR ASSOCIATION CONFERENCE

The Honourable Douglas Ginsberg, Assistant Attorney General of the United States Justice Department, the Honourable Peter Sutherland, member of the European Community Commission in charge of Competition Law, and Mr.

Calvin Goldman, Director of Investigation and Research of the Canadian Bureau of Competition Policy, all participated in the meeting of Antitrust Law and Monopolies Committee of the International Bar Association at its Biennial Conference in New York during the week of September 14.

Mr. Ginsberg spoke largely of the Reagan administration's record in antitrust enforcement, stressing its commitment to applying the law in situations only where consumer welfare is clearly in danger. That, in his view, justifies the enforcement priorities of the Antitrust Division in concentrating its activities on horizontal restrictive agreements as well as horizontal mergers.

Mr. Ginsberg stressed the exemplary record of the Reagan administration in increasing the number of cases and convictions involving bid rigging and other horizontal price arrangements. He also emphasized that, contrary to the perception in some quarters, the Reagan administration continues to enforce the Clayton Act with respect to horizontal mergers. He indicated that over 20 merger cases have been the subject of consent decrees in the past five years and that six cases have been litigated. He also indicated that some 14 mergers have not proceeded because of the Divisions's objection to them.

The main thrust of his remarks was to stress the need to provide an adequate deterrence to horizontal price fixing arrangements. He indicated that the Antitrust Division is working closely with a Sentencing Commission created by the Reagan administration in 1984 to provide uniform guidelines for sentencing within the federal court system. Mr. Ginsberg discussed the rationale, which in his view would be the appropriate one, for sentencing by the U.S. judiciary in price fixing cases. His position was that fines should be exacted in an amount to equal the amount of harm done to consumers through raised prices, divided by the probability of detection and conviction. He recognized that it would be difficult to be certain as to the probability of detection and conviction. Nevertheless, he thought there were surrogates which would be acceptable in attempting to determine the likelihood of detection. In particular, he thought the average length of time that price fixing conspiracies exist before detection gave some indication of the likelihood of detection.

His conclusions were that the fines and prison sentences exacted by U.S. courts in horizontal restrictive agreement cases are not anywhere near sufficient to act as a deterrent. He warned the lawyers present, and in particular lawyers outside the United States, that they should alert their clients to the fact that the Antitrust Division is working closely with the Sentencing Commission with the aim of drastically increasing the penalties in horizontal conspiracy cases.

Mr. Sutherland talked about the European Commission's antitrust policy and placed it firmly within the context of the Community's desire to remove all barriers to interstate commerce within the Community by 1992.

He spoke, in particular, about merger control at the Community level. He indicated that recent jurisprudence by the European Court has opened the door a little further to section 86 of the *Treaty of Rome* being used by the Commission as a means of merger control. He indicated, however, that he viewed the bluntness of the instrument, ie. section 86, as making it an undesirable means of effective merger control.

He pointed out that since 1973 the Competition Authorities have had before the Council of Ministers of the European Commission a proposal for merger control. He stated that there have been

discussions in the past year about those proposals but that several member states are still reluctant to agree to the proposal, preferring to maintain national controls over mergers and acquisitions rather than allowing the Community a wide ranging authority in this area. Mr. Sutherland indicated it is his position that unless the Council agrees to the merger proposal, by next year, he will recommend that it be withdrawn. In a not very carefully veiled threat; he pointed out that the result of withdrawing the proposal would be a reliance by the Competition Authorities on section 86 as the means to effect merger control in the Community.

Mr. Goldman discussed the new Canadian merger and joint venture provisions. He also reiterated comments he has made elsewhere in Canada that he views the new law as encouraging parties to seek compliance through his office for mergers and acquisitions thus avoiding litigated proceedings before the Competition Tribunal. Mr. Goldman clearly sees such negotiations as preferable to contesting cases before the Tribunal, at least in certain instances.

RECENT DEVELOPMENTS IN CANADIAN AND U.S. MERGER POLICY

By R.D. Anderson and S.D. Khosla*

I. Introduction

The new *Competition Act*, passed by Parliament in June 1986, represents a substantial modernization of Canadian competition law.[1] A prominent feature of the Act is the change from criminal treatment to civil review of mergers by a specialized Competition Tribunal. The Tribunal is to be composed of members of the judiciary and lay representatives.[2] Upon application by the Director of Investigation and Research, the Tribunal is empowered to issue complete or partial divestiture or prohibition orders regarding mergers or proposed mergers and/or to prohibit specific actions by the parties to the merger. The basic test for the issuance of such remedial orders is whether the merger or proposed merger lessens or would lessen competition substantially.

The review procedure for mergers relies extensively on economic considerations. The legislation specifies a list of economic factors that may be considered by the Competition Tribunal in determining whether a merger lessens competition substantially. It stipulates that a merger cannot be found to lessen competition substantially solely on the basis of evidence of market share or concentration. It provides an explicit defence for mergers that could otherwise be disallowed if they are likely to bring about offsetting efficiency gains. The Act also establishes a pre-notification requirement for certain mergers by companies that have combined assets or sales of $400 million or more and that meet other statutory tests.[3]

It is useful to consider the new Canadian merger provisions in light of the evolution of U.S. merger policy. To the extent that the provisions of Canadian and U.S. merger policy are similar, the Competition Tribunal may be inclined to examine some aspects of U.S. merger jurisprudence in implementing the Canadian law. The comparability of Canadian and U.S. merger policy is also of interest in view of the current Canada-U.S. trade negotiations. It has been suggested that a comprehensive bilateral trade agreement may necessitate substantial harmonization of Canadian and U.S. antitrust policy.[4]

This paper examines select aspects of the merger provisions of the *Competition Act* in light of the evolution of U.S. merger policy. Part II of the paper reviews the changes in the U.S. Department of Justice Merger Guidelines and the underlying economic perspectives from 1968 to 1984. Part III assesses the proposed revisions to U.S. merger law that were put forward by the Reagan Administration in February 1986.

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Part IV considers the substantive merger provisions of the *Competition Act* with reference to the U.S. policy developments. The article is principally concerned with the economic policy issues relating to the merger provisions. It is intended merely to raise certain issues and provide background information on related developments in the U.S. and elsewhere which may be the subject of further consideration by the Competition Tribunal and others as the new legislation unfolds. The paper does not deal with important procedural matters such as interim orders, advance ruling certificates, negotiated settlements or the pre-notification requirements of the Act.

II. The Evolution of U.S. Merger Policy, 1968 to 1984

The principal statutory provision governing mergers in the U.S. is section 7 of the *Clayton Act*, as amended by the *Celler-Kefauver Act* of 1950.[5] Section 7 prohibits mergers the effect of which "may be substantially to lessen competition, or to tend to create a monopoly." The legislative report accompanying the 1950 amendments emphasized the Congress' concern with a "rising tide of economic concentration" and was taken to mean that the section was intended to prevent the lessening of competition within individual lines of commerce "in its incipiency."[6] Section 7 thus provides the basis for a pro-active merger policy aimed at preventing market developments that are likely to result in anti-competitive abuse.

The generality of the wording of section 7 leaves considerable scope for interpretation by the antitrust agencies and the courts in the application of the law. The most important guide to U.S. merger policy is the set of Merger Guidelines issued by the Department of Justice. The Guidelines are intended to provide guidance to the U.S. business community respecting the Department's enforcement policy and to influence the evolution of merger law in the courts. While the Guidelines are not binding on the courts they carry considerable weight and have been cited extensively in judicial decisions.[7] This section of the article discusses the evolution of the Merger Guidelines from 1968 to 1984. It also notes briefly some aspects of the U.S. experience in implementing the Guidelines as they have been revised.

The 1968 Merger Guidelines issued by the U.S. Department of Justice were based on the prevailing belief that anti-competitive conduct and performance could be predicted merely on the basis of structural indicators. The introduction to the Guidelines stated that an assessment of market structure "generally produces economic predictions that are fully adequate" to justify prohibition of mergers. The avowed purpose of the Guidelines was "to preserve and promote market structures conducive to competition".[8] The explicit structuralist approach of the 1968 Guidelines reflected a widespread concern that high levels of market concentration not only facilitated collusive agreements among firms but also resulted in "spontaneous cooperation" among firms (without agreements).[9] This approach was supported by the leading economists of the day.[10]

The 1968 Guidelines indicated that the Department of Justice would challenge horizontal mergers between firms possessing as little as 4% each of the relevant market if the leading four firms in the industry had a combined market share of 75% or more. The Guidelines effectively ruled out the possibility of an efficiency defence in such

cases. The Guidelines also proscribed vertical mergers between supplying firms accounting for 10% or more of their relevant markets and purchasing firms accounting for 6% or more of their markets. Finally, the 1968 Guidelines indicated that the government would challenge conglomerate mergers where they: (i) linked most likely potential competitors; or (ii) were considered likely to result in reciprocal trading, absolute size advantages or other "entrenchment concerns".[11]

Since the 1960s several important developments in antitrust economics have prompted far-reaching revisions to U.S. merger policy. First, there has been a searching re-examination of the asserted concentration-profitability relationship that supported the treatment of horizontal mergers in the 1968 Guidelines. Critics such as Yale Brozen have re-worked the original studies by Bain and others and have raised questions as to whether abnormally high rates of return in concentrated industries persist over time.[12] From another angle, Demsetz and others have argued that observed high profits in concentrated industries are attributable primarily to the superior technical efficiency of large firms.[13] These writers have also disputed the importance of capital requirements, economies of scale, advertising, product differentiation and other purported "barriers to entry" to new competitors.[14] The existence of such barriers is an important element of the concentration-profitability doctrine, since without them the possibility of new entry would tend to prevent firms in concentrated industries from raising prices above competitive levels. Finally, the belief that firms in concentrated industries engage in spontaneous cooperation (without agreements) has been largely subordinated by concerns about explicit agreements and/or dominant firm behaviour.[15]

These criticisms of the concentration-profitability doctrine remain subject to debate in the professional literature.[16] Indeed, important questions remain as to the long run effects of mergers on performance at the industry and firm levels. Nevertheless, by 1983 an influential survey of relevant studies was able to conclude that the traditional view of the concentration-profitability relationship had lost considerable ground. While supporting continued review of horizontal mergers on a case-by-case basis, and suggesting that the focus of concerns should be on mergers that create individual dominant firms in an industry, the survey found that "our theories give us little if any guidance in choosing specific market-share or concentration levels that are likely to lead to poor economic performance."[17]

A second major development in economic thought that contributed to the revision of U.S. merger policy was the growing recognition in the 1970s of the importance of transaction costs in shaping the organization of industries. The 1968 Guidelines were based on the applied price theory tradition in which firms were viewed essentially as production functions, combining capital, labour and material inputs to produce the desired rate of output at the minimum possible direct production costs. There was little recognition of the importance of the costs of transactions in the firm's output and input markets and the potential roles of vertical integration and conglomeration in helping to minimize such costs.[18]

In the 1970s antitrust scholars increasingly accepted the efficiency justification for a wider range of market organizational structures than was previously recognized.[19] Economists in the U.S. recognized that vertical integration can assist firms in overcoming market failures in the input supply chain.[20] It was also suggested that reciprocal dealing within a conglomerate may facilitate efficient contracting through

"credible commitments."[21] These developments did not allay all antitrust concerns about such practices. However, the new transaction cost theory of the firm suggested a need for a more permissive treatment of vertical and conglomerate mergers.

A third major development in economic thought that contributed to the liberalization of U.S. merger policy was the recognition of the efficiency-enhancing role of mergers and acquisitions in the "market for corporate control." This role of mergers derives from potential problems resulting from the separation of ownership and control in publicly held corporations. This separation creates a potential divergence of interest between the corporation's shareholders and its professional managers.[22] The possibility for the shareholders to trade the rights to control the corporation to an alternative management team by accepting a (hostile) takeover bid is an important check against abuse of managerial discretion.[23] Conversely, friendly takeovers accompanied by retention of the target firm's management team help to ensure that the return from the team's human capital is maximized.[24] The importance of reasonably free operation of these market mechanisms is emphasized by the modern theory of the firm.[25]

The revised Merger Guidelines issued by the Department of Justice in 1982 substantially accommodated these developments in antitrust thought.[26] The theme of the Guidelines was that mergers should be prohibited only where they enhance or facilitate the exercise of market power in specific product markets. The Guidelines were based on two theories under which mergers may have this undesirable result: (i) increased likelihood of collusive agreements in more highly concentrated markets; and (ii) monopolistic conduct by a dominant firm.[27] The fact that the Guidelines did not rely on theories of spontaneous cooperation without agreements reflects the above-noted shift in economic thought regarding the likelihood of such conduct.

The 1982 Guidelines noted explicitly that although some mergers are harmful to competition, the majority play a pro-competitive role in a free enterprise economy. The Guidelines put forward a new set of criteria under which horizontal mergers were to be reviewed, using a sophisticated structural indicator of market power - the Herfindahl-Hirschman Index (HHI). The HHI expresses the level of concentration in the market as the sum of the squares of each firm's percentage market share. The U.S. Department of Justice considers this index to be superior to the traditional four-firm concentration ratio since it takes account of the size distribution of firms in the market.[28]

The Guidelines also incorporated a new approach to the definition of the relevant product and geographic market in merger analyses. A market was defined as "a group of products and an associated geographic area such that (in the absence of new entry) a hypothetical, unregulated firm that made all the sales of those products in that area could increase its profits through a small but significant and non-transitory increase in price."[29] Under this approach, the Department undertook first to determine the range of products that the merging firms' customers view as good substitutes at prevailing prices and then to test this provisional product range against a hypothetical (normally 5%) price increase. The provisional product range was then expanded to include substitute products to which consumers would likely switch within one year. The Guidelines further called for expansion of the product market to include the output of firms that would be likely to switch to production of the relevant product within six months in response to such a price increase. A similar approach was adopted to the

determination of the geographic aspect of the relevant market. The Department would first determine a provisional geographic market based on firm shipment data and then include the output of firms in surrounding geographic areas that could supply customers in the provisional market within one year.

The 1982 Guidelines indicated a number of additional factors that the Department of Justice would consider in evaluating the competitive effects of a horizontal merger. These included: (i) the ease of entry to the market through construction of new facilities; (ii) homogeneity of the relevant product; (iii) past anti-competitive conduct of firms in the relevant market; and (iv) evidence of non-competitive performance such as stable market shares or excess profitability. Thus, the revised Department of Justice Guidelines generally took a flexible approach that created a more receptive environment for horizontal mergers.

The 1982 Guidelines went further to establish a substantially liberalized environment for vertical mergers. The new approach reflected the potential benefits of such mergers in minimizing transaction costs.[30] The Guidelines provided that vertical mergers would be challenged only in unusual circumstances where they were considered likely to: (i) create "competitively objectionable" barriers to entry; (ii) facilitate collusion in an upstream or downstream market; or (iii) result in competitive abuse through evasion of rate regulation. The Guidelines also indicated that other non-horizontal (i.e., conglomerate) mergers would be challenged only if they involved the elimination of "specific potential entrants" to highly concentrated markets. The 1982 Guidelines made no mention of the danger of reciprocal dealing or other "entrenchment concerns" regarding conglomerate mergers that were emphasized in the 1968 Guidelines.

Since 1982 two additional developments in the policy environment have forced further adjustments in U.S. merger policy. First, the importance of foreign competition in domestic product markets has received considerable attention. Mergers creating high levels of domestic concentration may nevertheless entail little threat of abuse of market power if increased imports are readily available as a competitive alternative.[31] Second, the case for recognition of efficiency considerations in merger analyses has been increasingly noted in the U.S.[32] The possibility that market power concerns should be outweighed by economies of rationalized production received considerable public attention in the context of the Justice Department's review of the 1984 LTV Corporation-Republic Steel Company merger.[33]

In 1984 the Merger Guidelines were further revised in response to these developments.[34] The revised Guidelines clarified that U.S. sales or dedicated capacity of foreign firms are to be included in the definition of markets and the calculation of market shares. However, the importance of import competition may be discounted where quotas or other import barriers preclude expansion of such competition in response to a domestic price increase. The Guidelines indicated further that the Department will consider possible resulting efficiencies in determining whether to challenge a merger. The efficiencies that may be considered include: (i) economies of scale; (ii) improved integration of production facilities; (iii) plant-level specialization; (iv) lower transportation costs; and (v) general reductions in administrative or overhead costs. The 1984 revisions also gave somewhat greater emphasis to other non-market share considerations in merger evaluations (e.g., the financial condition of the merging firms) and clarified the application of the failing firm defence in merger cases to failing

divisions of otherwise healthy firms.[35] In other respects the 1984 Guidelines generally adopted the above-noted elements of the 1982 Guidelines.[36]

It is important to note that the Department of Justice Merger Guidelines are not binding on the courts. Nevertheless, as a codification of the U.S. Administration's antitrust philosophy the Guidelines have carried considerable weight. The U.S. courts have increasingly adopted an approach to mergers that is similar to that of the Guidelines. For example, the use of the Herfindahl-Hirschman Index as the basic structural indicator of market power is increasingly accepted in the United States. In addition, U.S. courts have recognized that mergers resulting in high HHI levels may nevertheless pose little threat to competition where there are no appreciable barriers to entry.[37] In one important recent case, *FTC v. Bass Bros. Inc.* (the *Carbon Black* case),[38] the court adopted the analytical approach of the Guidelines "virtually lock, stock and barrel".[39] Furthermore, in its 1984 opinion in *American Medical International, Inc.* the Federal Trade Commission went somewhat beyond the Department of Justice Guidelines to recognize the availability of a full efficiency defence in a merger proceeding under section 7 of the *Clayton Act.*[40] The Commission indicated, however, that such a defence should be accepted only where (i) the asserted efficiencies cannot be achieved through a less anti-competitive merger; and (ii) the efficiencies clearly outweigh the anti-competitive effects on the merger.

An important related matter currently under consideration in the U.S. is the issue of whether competitors should have standing to challenge horizontal mergers in private suits under section 7 of the *Clayton Act.* In a number of recent cases, mergers (and joint ventures) have been challenged by firms that compete with the merging firms.[41] These suits have been based essentially on allegations that the challenged merger would harm competition by facilitating some form of predatory conduct vis-à-vis the excluded firms. In a recent U.S. Department of Justice Working Paper, G. Werden has argued that competitors should be denied standing to challenge mergers on this basis.[42] Werden believes that the predominant effect of mergers is highly unlikely to be predatory. In his view, denying competitors standing would help to safeguard competition by preventing suits that seek to block efficient, pro-competitive mergers. The U.S. Supreme Court is expected to clarify the issue in its pending decision in the *Monfort* case.[43]

The impact of the revised U.S. Merger Guidelines has been reviewed in several studies. The Guidelines' approach to market definition has been criticized by Stigler and Sherwin as "completely non-operational." They argue that "No method of investigation of data is presented, and no data, even those produced by coercive process, are specified that will allow the market to be determined empirically."[44] Stigler and Sherwin favour an alternative approach based on the similarity of price movements in different geographic locations and across different product lines. The logical basis of this approach is the classical definition of the market as the area (and product range) within which price is determined.[45] Adoption of this approach could result in significantly different definitions of the relevant market in individual cases. Markets defined using the Department of Justice Guidelines' approach will generally be narrower than those based on the parallel price movements approach.

In other respects, the Guidelines' impact appears to have been strongly favourable. A recent statistical study found that the major revisions to the Guidelines in 1982 and the concomitant increased emphasis on economic analysis in merger policy enforcement resulted in a dramatic shift in emphasis by the Department from investigating vertical to horizontal mergers. The study found that the number of investigations of vertical mergers initiated by the Department decreased from 441 in 1968 to 7 in 1984, while during the same period the number of investigations of horizontal mergers increased from 51 to 108.[46] As a result, the ratio of horizontal to vertical merger cases increased from 0.1 in 1968 to 15.4 in 1984. Furthermore, the study found a more effective targetting of cases by the Department following the 1982 changes, toward highly concentrated markets in which anti-competitive abuses were more likely to occur. The overall shift in emphasis in the revised Guidelines to an eclectic economic approach has been generally accepted by the U.S. antitrust community.[47]

III. The Current Proposals for Revisions to U.S. Merger Law

In February 1986 the Reagan Administration submitted to Congress a set of several proposals for revisions to U.S. antitrust statutes.[48] These proposals were the outcome of an in-depth review of the antitrust laws for the U.S. Cabinet Councils on Economic Policy and Domestic Policy. The policy review was initiated subsequent to suggestions by the Secretary of Commerce, Malcom Baldridge, that section 7 of the *Clayton Act* (the primary statutory basis of U.S. merger policy) should be repealed.[49] While the extent of support for the President's proposals in Congress is unclear (and some knowledgeable commentators have expressed opposition),[50] the proposals are of interest for what they reveal about the U.S. Administration's antitrust philosophy.

Two aspects of the U.S. Administration's proposals are directly concerned with merger policy. First, the "Merger Modernization Act of 1986" would revise the wording of section 7 of the *Clayton Act*. The thrust of the revisions would be to codify the above-noted economic approach to mergers in the 1984 U.S. Department of Justice Guidelines. Thus, where section 7 currently prohibits mergers the effect of which would be "substantially to lessen competition, or to tend to create a monopoly" the revised wording would prohibit mergers that "substantially increase the ability to exercise market power."

The proposed revisions incorporate a standard definition of market power as "the ability of one or more firms profitability to maintain prices above competitive levels for a significant period of time." Furthermore, the proposed changes specify that in determining whether a merger is likely to increase the ability to exercise market power, the courts shall consider "all economic factors relevant to the effect of the acquisition." These factors shall include not only the number and size distribution of firms in the relevant market but also: (i) the feasibility of entry by domestic and foreign firms; (ii) the ability of existing smaller firms to expand production in response to price increases; (iii) the nature of the product and terms of sale; (iv) the prior conduct of firms in the market; and (v) efficiencies that may result from the acquisition. As several observers have pointed out, enactment of these revisions would not substantially alter current U.S. merger enforcement policy. It would, however, make it difficult for a subsequent Administration to adopt a more interventionist enforcement policy without first obtaining a substantial strengthening of the antitrust statutes.

Merger law would also be affected by another aspect of the Administration's antitrust reform proposals, the "Promoting Competition in Distressed Industries Act." This legislation would authorize the President to grant a limited exemption from the antitrust laws for mergers and acquisitions in industries that are found by the U.S. International Trade Commission to be experiencing serious injury due to imports. The antitrust exemption would be provided as an alternative to other forms of import relief (e.g., duties and quotas). The Administration believes that such exemption would assist distressed industries to regain competitive strength through restructuring.[51]

Other aspects of the Administration's proposals, while not primarily concerned with mergers, re-inforce the overall direction of the Administration's antitrust policy. The "Antitrust Remedies Improvements Act of 1986" would limit the scope for treble damage awards to competitors in private antitrust suits while enabling the U.S. government to recover treble damages in cases where it is directly affected by antitrust violations (e.g., bid rigging). The "Interlocking Directorates Act of 1986" would substantially expand the scope for interlocking directorships among small businesses and firms not competing in the same markets. The "Foreign Trade Antitrust Improvements Act of 1986" would clarify and provide new procedures for challenging the jurisdiction of the U.S. in antitrust cases involving international trade and commerce.

IV. The Merger Provisions of the Canadian Competition Act

The new civil merger provisions of the *Competition Act* were enacted in response to two major deficiencies in the corresponding sections of the previous legislation. First, the merger provisions of the *Combines Investigation Act* were criminal legislation. A conviction under section 33 of the Act (in conjunction with the definition of a merger in section 2) required proof beyond a reasonable doubt that competition was or was likely to be lessened "to the detriment or against the interest of the public." The strict criminal standard of proof was considered excessive since merger evaluations usually involve a probabilistic weighing of future consequences that cannot be foretold with certainty. Furthermore, criminal procedures and penalties were inappropriate to deal with business transactions which, while sometimes harmful to competition, are normally lacking in the moral reprehensibility which characterizes criminal behaviour.

A second major difficulty with the merger provision of the *Combines Act* was the apparent fusion of the tests applicable to mergers and monopolies under the judicial interpretation of the section. The judicial limitation of the merger provision dates back at least to the *Canadian Breweries* and *B.C. Sugar* cases of 1960.[52] The Supreme Court of Canada decision in *R. v. K.C. Irving* in 1976 confirmed and extended the trend apparent in the earlier cases.[53] The Court held that in order for the Crown to succeed in a merger prosecution, it must prove that the acquisition would result in "specific detriment" in the sense of unreasonable profits and prices. This was essentially the test that applied in monopoly cases. The Court rejected the argument that the requisite detriment to the public could be inferred from the lessening of competition itself. The Court thus effectively ruled out the possibility of a pre-emptive merger policy to deal with monopoly problems in their incipiency.[54]

The merger provisions of the *Competition Act* should rectify these deficiencies in the previous legislation. Section 64 of the Act establishes a civil regime for mergers using the basic test of whether they "lessen competition substantially." Mergers and proposed mergers that meet this test may be dealt with by the issuance of complete or partial prohibition or divestiture orders or by orders prohibiting specific actions by the parties to the merger.[55] The new review procedure for mergers will be administered by a civil Competition Tribunal rather than the criminal courts. The standard of proof in cases before the Tribunal will be the civil standard of proof on a balance of probabilities, rather than the criminal standard of proof beyond a reasonable doubt.

The wording of section 64 is important in several respects. The basic test of lessening competition substantially, which appears in similar language in section 7 of the U.S. *Clayton Act*, seems to involve both quantitative and qualitative considerations.[56] The section applies to the lessening of competition: (i) "in a trade, industry or profession;" (ii) "among the sources from which a trade, industry or profession obtains a product;" (iii) "among the outlets through which a trade, industry or profession disposes of a product;" or (iv) "otherwise" than as described above. The reference to a "trade, industry or profession" in section 64 emphasizes the application of the provision to service as well as goods industries. The references to the sources from which a product is obtained and the outlets through which it is disposed would seem to reinforce the applicability of the section to vertical as well as horizontal mergers. The section would seem to be applicable to conglomerate mergers to the extent that they lessen competition substantially within the meaning of section 64 of the *Competition Act*.[57]

The test of lessening competition substantially in section 64 is qualified in several important ways. To begin with, sub-section 64(2) of the Act specifies that the Competition Tribunal shall not find that a merger lessens competition substantially "solely on the basis of evidence of concentration or market shares." This provision effectively nudges the Tribunal toward a mixed quantitative and qualitative approach to merger evaluation.

The eclectic approach implied in sub-section 64(2) is strongly reinforced by section 65 of the Act. This section provides that, in considering whether a merger lessens competition substantially, the Competition Tribunal may have regard to a number of economic factors. To some extent these economic factors appear to parallel corresponding provisions of the U.S. Department of Justice Merger Guidelines.

Section 65(a) provides that the Tribunal may consider "the extent to which foreign products or foreign competitors provide or are likely to provide effective competition" to the parties to a merger. As noted in Part II, recognition of the potential for foreign competition to prevent abuse of market power in the domestic economy was one of the significant developments in merger analysis in the U.S. in the past decade. The importance of foreign competition in ensuring efficiency in domestic markets was strongly endorsed in the recent report of the Macdonald Commission.[58] The wording of the factor in section 65(a) is significant in that the mere existence of foreign production or imports will not exonerate a merger. Rather, the Tribunal is asked to consider whether foreign production will provide effective competition for the merged companies. The U.S. Merger Guidelines suggest that it may be appropriate to discount the effectiveness of foreign competition, for example, where quotas or duties would prevent an expansion of imports in response to a domestic price increase.

CANADIAN COMPETITION POLICY RECORD

Section 65(b) of the Act provides that, in adjudicating a merger case, the Competition Tribunal may consider "whether the business, or a part of the business of a party to the merger or proposed merger has failed or is likely to fail." This provision is merely a factor that may be considered by the Tribunal (and not a defence). In the U.S., the Merger Guidelines and jurisprudence recognize a defence to a challenge under section 7 of the *Clayton Act* for mergers involving "failing firms".[59] The defence in the U.S. is based on a recognition that absorption by a competitor of a firm that is otherwise likely to exit the market does not diminish competition in a meaningful sense. It also reflects a general concern to avoid the socio-economic costs associated with business failure.[60] In the U.S., the defence involves three elements: (i) the firm to be acquired must face imminent financial failure; (ii) it must have negligible prospects for successful reorganization under relevant bankruptcy provisions; and (iii) the firm must have made good faith efforts to find other available purchasers whose merger with the failing firm would be less restrictive of competition.[61] The Competition Tribunal may wish to consider the appropriateness of similar conditions in its application of the failing firm factor in merger cases under the *Competition Act*.

Section 65(c) invites the Competition Tribunal to consider "the extent to which acceptable substitutes for products supplied by the parties to the merger or proposed merger are or are likely to be available." As noted in the discussion of U.S. developments, the U.S. Merger Guidelines emphasize the availability of substitutes as one of the most basic considerations in merger analysis. The Guidelines emphasize this consideration not merely in assessing the effect of the mergers in a market but first and foremost in defining the relevant product market. The U.S. Guidelines' approach is to include in the relevant market not only the specific product made by the merging firms but also all reasonably close substitutes for that product, since the availability of close substitutes directly limits the ability of firms to raise prices above competitive levels.[62]

Section 65(d) of the *Competition Act* provides that in considering whether a merger lessens competition substantially, the Competition Tribunal may have regard to "any barriers to entry into a market." Such barriers may include: (i) "tariff and non-tariff barriers to international trade;" (ii) "interprovincial barriers to trade;" and/or (iii) "regulatory control over entry." The section indicates that the Tribunal may also consider "any effect of the merger or proposed merger on such barriers." As noted, the U.S. Merger Guidelines also deal specifically with the treatment of entry barriers. The U.S. Guidelines indicate that "If entry into a market is so easy that existing competitors could not succeed in raising prices for any significant period of time, the Department is unlikely to challenge mergers in that market." Conversely, "The more difficult entry into the market is, the more likely the Department is to challenge the merger."[63] The *Competition Act* goes somewhat further than the U.S. Guidelines in emphasizing the role of government-imposed entry barriers (tariff and non-tariff barriers, interprovincial barriers and regulatory controls). The section does not specifically mention traditional barriers such as capital requirements, excess capacity, advertising, economies of scale, etc. It will be for the Tribunal to decide what importance it considers appropriate to attach to such barriers in the context of individual cases.

Section 65(e) of the Act specifies that in adjudicating merger cases, the Competition Tribunal may have regard to "the extent to which effective competition remains or would remain in the market...." This sub-section appears merely to reinforce the principle of the test of lessening competition substantially in section 64. It emphasizes

that the Tribunal is to consider not merely the direct structural effects of the merger but also the state of competition in the market that prevails or would prevail following consumation of the merger. In the public debate prior to passage of the *Competition Act* some business spokesmen indicated a preference to incorporate the concept of substantial competition remaining in place of the basic test of lessening competition substantially.[64] To the extent that this has not been done the merger provisions of the *Competition Act* may be better able to prevent mergers that would ultimately have anti-competitive effects.

Section 65(f) of the Act provides that the Competition Tribunal may also have regard to "any likelihood that the merger or proposed merger will or would result in the removal of a vigorous and effective competitor." This provision, which has no direct parallel in the U.S. Merger Guidelines, was inserted in the Act by the Legislative Committee of Parliament that studied Bill C-91 before it was passed. Its purpose would seem to be to counterbalance the other more market-oriented factors noted in section 65 by emphasizing that the direct effects of mergers in eliminating competitors remain important in and of themselves.

Section 65(g) of the *Competition Act* indicates that in evaluating mergers the Tribunal may also consider "the nature and extent of change and innovation in a relevant market." This factor was also inserted in the Act by the Legislative Committee prior to its passage. It is potentially one of the most important yet difficult-to-apply of the factors noted in section 65. As several economists have pointed out, market structures which appear to be anti-competitive in a static sense may nevertheless be beneficial in the dynamic sense of facilitating technological advancement and growth.[65] However, the implications of mergers for technological change in specific cases are inherently difficult to predict. The "change and innovation" factor underscores the complexity of the determination that the Tribunal is charged with making under the merger provisions of the *Competition Act*.

It is important to note section 65(h) of the *Competition Act*, which indicates that the Tribunal may also consider "any other factor that is relevant to competition in a market" affected by a merger. The Tribunal appears to have broad discretion in this area. Some factors that are noted in the U.S. Merger Guidelines and that might be considered as relevant by the Tribunal include: (i) special characteristics of a product that increase the feasibility of collusion (e.g., product homogeneity); (ii) the past conduct of the merging or other firms in the market (e.g., a history of collusion or collusion-facilitating practices such as delivered pricing, product standardization or price protection); and (iii) unusually high profitability or unchanging firm market shares.

Section 66 of the Act provides for two exemptions from the regime for mergers in section 64. First, paragraph 66(a), essentially a transitional provision, clarifies that the Tribunal may not make an order in respect of a merger "substantially completed" before the coming into force of the section. Second, paragraph 66(b) indicates that the Tribunal may not make an order respecting an amalgamation or proposed amalgamation under section 255 of the *Bank Act*, or an acquisition or proposed acquisition of assets under section 273 of the *Bank Act*, where the Minister of Finance has certified to the Director of Investigation and Research that the amalgamation or acquisition is "in the interest of the financial system". The Minister must also certify the names of the parties to such mergers. The Tribunal would retain jurisdiction over bank mergers that have not been certified by the Minister of Finance under this provision.

CANADIAN COMPETITION POLICY RECORD

Section 67 of the *Competition Act* introduces a separate exception from the regime in section 64 for certain joint ventures. Such ventures must be formed for the purpose of undertaking a specific project or program of research. The joint ventures to be expected must also meet a number of other criteria. Essentially these require that: (i) the project or program would not likely have taken place in the absence of the combination; (ii) no change in the control of any party to the venture would result from the venture; (iii) the parties establish a written agreement governing the contribution of assets to the venture and their continuing relationship; (iv) the agreement restricts the range of activities to be carried on by the joint venture and provides for termination on completion of the project or program; and (v) the joint venture does not lessen competition except to the extent necessary to undertake and complete the project or program of research. While different in its specific provisions this exception seems similar in spirit to the special treatment for R&D joint ventures in the U.S. *National Cooperative Research Act* of 1984, although the latter is more restricted in that it applies only to R&D joint ventures.[66]

The treatment of mergers under section 64 of the *Competition Act* is further qualified in an important way by the efficiency defence in section 68 of the Act. Sub-section 68(1) provides that the Tribunal shall not make a prohibitive or remedial order respecting a merger under section 64 where it finds that a merger "has brought about or is likely to bring about gains in efficiency that will be greater than, and will offset, the effects of any prevention or lessening of competition that will result or is likely to result from the merger..." *and* that "the gains in efficiency would not likely be attained" if an order were made. Sub-section 68(2) provides further that in considering whether a merger meets the criteria noted in sub-section 68(1), the Competition Tribunal shall consider whether the efficiency gains will result in (a) "a significant increase in the real value of exports;" or (b) "a significant substitution of domestic products for imported products." In addition, sub-section 68(3) of the Act clarifies the efficiency defence by stipulating that the Tribunal shall not find that a merger meets the criteria for the defence "by reason only of a re-distribution of income between two or more persons."

Section 68 does not specify the types of efficiencies that may be considered in individual merger cases, leaving this as a matter to be determined by the Tribunal. A recent paper by J.E. Kwoka and F.R. Warren-Boulton of the U. S. Department of Justice suggests that some of the more common efficiencies that may be attibutable to mergers, depending on the facts in each case, may include: (i) reduced transportation costs as the merged firm transports materials to and from geographically closer but previously separately-owned plants; (ii) rationalization of product mix and achievement of longer-production runs in the various plants; and (iii) infusion of superior managerial or production techniques among the constituent firms.[67] The paper argues, however, that in many cases these efficiencies may be achievable through joint ventures or other agreements that stop short of full merger of the firms involved. It should be noted that section 68 of the *Competition Act* constitutes a statutory efficiency defence and is not merely a factor to be considered as in the U.S. Merger Guidelines.

Sub-section 68(2) of the Act, referring to increased exports and import substitution, is consistent with the achievement of efficiency gains from longer domestic production runs. The sub-section also emphasizes the government's commitment to export growth. Sub-section 68(3) is an important limitation on the efficiency defence, since it ensures that mere income transfers (e.g., lower input prices due to increased bargaining power) do not qualify as efficiency gains.[68]

There appears to be a complementary relationship between the merger provisions of the *Competition Act* and the new provisions dealing with abuse of dominant position that replace the old criminal monopoly offence. Section 51 of the Act deals with situations in which a person or persons who "substantially or completely control, throughout Canada or any area thereof, a class or species of business" engage in a "practice of anti-competitive acts." An illustrative list in the legislation indicates that the latter concept may include margin squeezing by a vertically integrated supplier, vertical acquisitions by suppliers or customers, pre-emption of scarce facilities and several other types of acts, when these are undertaken for the purpose of eliminating or preventing the entry or expansion of a competitor in a market. However, the term anti-competitive act is explicitly open-ended. Like the merger provisions of the Act, the issuance of remedial orders pursuant to the abuse of dominance section is subject to the basic test of lessening competition substantially.

There may be some circumstances in which a "merger" case could be brought under the abuse of dominance provision. This could be the situation, for example, where a firm has engaged in a series of acquisitions of smaller competitors and it is the cumulative effect rather than any single acquisition which lessens competition substantially.[69] The abuse of dominance provision may also be somewhat easier to apply where the series of events alleged to have lessened competition has already occurred.[70] The abuse of dominance provision may also complement the merger provisions in their application to conglomerates.[71]

V. Conclusions

The evolution of the U.S. Department of Justice Merger Guidelines from 1968 to 1984 reflects important developments in economic thought regarding the role and effects of mergers in a market economy. While these developments have not allayed all concerns regarding anti-competitive mergers, they have highlighted the need for an eclectic case-by-case policy. The approach outlined in the Guidelines has been increasingly adopted in the U.S. courts, which have considered the roles of entry barriers, foreign competition, the financial condition of the merging firms and efficiencies in several recent cases. The Guidelines' approach is also directly reflected in the Justice Department's merger enforcement record, which reveals an increase in the ratio of horizontal to vertical merger cases from 0.1 in 1968 to 15.4 in 1984. This re-focusing of enforcement effort is believed to have substantially increased the Department's overall effectiveness.

Despite the fairly explicit guidance to the Competition Tribunal in the merger sections of the Canadian *Competition Act,* a great deal remains to be determined by the Tribunal in implementing the new law. As discussed in this paper, the Tribunal will have to consider such complex matters as the treatment of entry barriers, the manner in which efficiency gains may be balanced against the lessening of competition and the treatment of the failing business factor in merger cases. In reaching its determinations on these matters the Tribunal may find it useful to take into consideration the recent U.S. jurisprudence on these issues.

In taking into consideration the U.S. experience, it will also be important for the Tribunal to take note of certain structural differences between the Canadian and U.S. economies that have been documented in recent studies. For example, in many Canadian industries, concentration levels and leading firm market shares are significantly higher than in the U.S.[72] Studies have also suggested that lower productivity levels in certain sectors of the Canadian economy relative to the U.S. may be attributable at least partly to a failure to achieve product-specific economies of scale and/or specialization.[73] This suggests that a careful case-by-case assessment of the interplay of efficiency factors and competition in merger cases may be even more important in Canada than in the U.S.[74]

With reference to the ongoing Canada-U.S. trade negotiations, Canadian merger policy under the *Competition Act* seems to be largely compatible with U.S. policy. It should be noted that the degree of judgement which is inherent in the application of both countries' laws is such that individual cases may still be treated differently by the respective antitrust agencies. This possibility exists even within the U.S. domestic economy, where the Department of Justice and the Federal Trade Commission share concurrent jurisdiction over the enforcement of section 7 of the *Clayton Act*.[75] In addition, the greater scope for private antitrust suits in the U.S. gives rise to potential conflicts of antitrust jurisdiction and procedures.[76] Nevertheless, the common commitment in Canada and the U.S. to a market-oriented case-by-case policy, which takes into account both qualitative and quantitative factors, will help to minimize substantive policy differences between the two countries. There will still be a need for effective coordination mechanisms to avoid unnecessary conflicts in merger cases involving both countries' interests.

NOTES

1. *An Act to provide for the general regulation of trade and commerce in respect of conspiracies, trade practices and mergers affecting competition (the Competition Act)*, Bill C-91, Part II, proclaimed June 19, 1986 (except for certain of the pre-notification provisions of the Act).

2. The Tribunal will consist of: (i) not more than four members to be appointed from among the members of the Federal Court of Canada, Trial Division; and (ii) not more than eight other members to be appointed by the Governor in Council on the recommendation of the Minister of Consumer and Corporate Affairs. *Competition Tribunal Act*, Bill C-91, Part I.

3. See the *Competition Act*, Part VIII, sections 80-96.

4. See "The Implications of Bilateral Free Trade for Competion Policy," in M.J. Trebilcock, "Bill C-91: What are the Costs of Closure," *Canadian Competition Policy Record*, vol. 7, no. 1, March 1986, pp. 1-6.

5. 15 U.S.C. 18 (1982). It should be noted that in principle mergers may also be dealt with under section 1 of the *Sherman Act* (dealing with contracts, combinations or conspiracies in restraint of trade) or section 2 of the Act (dealing with monopolization, including mergers-to-monopoly). However, since the language of section 7 of the *Clayton Act* is generally considered broader, it is used as the primary vehicle for the enforcement of U.S. merger policy.

6. S. Rep. No. 1775, 81st Cong., 2d. Sess. 3 (1950). The phrase "in its incipiency" appears in the U.S. Supreme Court's discussion of section 7 in its opinion in *Brown Shoe Co. v. United States,* 370 U.S. 294 (1962). See also the discussion of the legislative history of the Act in Derek C. Bok, "Section 7 of the Clayton Act and the Merging of Law and Economics," *Harvard Law Review,* vol. 74, 1960, pp. 226-355, at 233-238.

7. "Although the Merger Guidelines are not 'the law' on mergers, they are, in fact, the most important statement on the subject." Gregory J. Werden, "Challenges to Horizontal Mergers by Competitors under Section 7 of the Clayton Act," Department of Justice, Economic Policy Office, Discussion Paper, No. 85-16, December 6, 1985. See also Baker and Blumenthal, "The 1982 Guidelines and Existing Law," *California Law Review,* vol. 71, 1983, p. 311.

8. U.S., Department of Justice, *Merger Guidelines 1968* (Reprinted in CCH: Trade Regulation Reports, July 9, 1982).

9. The term "spontaneous cooperation" was popularized in William J. Fellner, *Competition Among the Few* (1949). The theory that high concentration levels produce monopolistic performance without agreements was originated in Augustin Cournot, *Researches into the Mathematical Principles of Wealth* (1837).

10. See, e.g., Joe S. Bain, *Industrial Organization* (New York: Wiley and Sons, 2nd ed., 1968). A strict structuralist approach to merger policy was also supported by the 1968 White House Task Force on Antitrust Policy (the Neal Task Force). The latter also recommended new legislation to *deconcentrate* industries with four-firm concentration ratios of more than 70%. Interestingly, a strict structuralist anti-merger policy was also supported by Professor George J. Stigler in the 1950s. See Stigler, "The Case Against Big Business," *Fortune,* vol. 45, May 1952, p. 123. By the late 1960s, however, Stigler had changed his position. In 1969, when testifying before the House of Representatives' Special Subcommittee on Small Business, Stigler stated "I personally have serious misgivings about the Neal proposal for deconcentration. I worry about the fact that where we have substantial large economies of scale, deconcentration puts burdens on us. Where the economies are not large, private rivals have a tendency to enter and eliminate (excess) profits themselves.... There was a time when I was younger and perhaps wiser when I was enthusiastic for that scheme. I no longer am." Quoted in Yale Brozen, *Concentration, Mergers and Public Policy,* (New York: MacMillan, 1982), at pp. 391-392.

11. For further details, see Oliver Williamson, "Transforming Merger Policy: The Pound of New Perspectives," *American Economic Review,* May 1986, pp. 112-119. Horizontal mergers are mergers between firms operating in the same market. Vertical mergers are mergers between firms operating at different levels of an individual product supply chain (e.g., a manufacturer and its distributors). Conglomerate mergers are mergers involving firms operating in different product markets.

12. Yale Brozen, "Bain's Concentration and Rates of Return Revisited," *Journal of Law and Economics,* vol. 14, 1971, pp. 351-69. See also Brozen, *Concentration, Mergers and Public Policy, supra* note 10, especially Chapters 1, 5 and 7, and references cited therein.

13. Harold Demsetz, "Industry Structure, Market Rivalry and Public Policy," *Journal of Law and Economics,* vol. 16, 1973, pp. 1-10. See also Brozen, *supra* note 10, Chapter 3.

14. See Harold Demsetz, "Two Systems of Belief about Monopoly," in *Industrial Concentration: The New Learning,* ed. Harvey J. Goldschmid, H. Michael Mann and J. Fred Weston (Boston: Little, Brown & Co., 1974), pp. 164-184. See also Brozen, *supra* note 10, Chapter 9 and references cited therein.

15. In the past decade, a number of antitrust scholars have argued that the spontaneous cooperation theories are unfounded and that the core concern of antitrust policy should be with collusion by agreement (or with dominant firm behaviour). Werden, *supra* note 7, pp. 22-23, especially note 93. See, e.g., Robert Bork, *The Antitrust Paradox* (New York: Basic Books, 1978), pp. 163-197, Brozen, *supra* note 10, pp. 147-185, and references quoted therein. This view grew out of Stigler's

analysis of the inherent difficulties in enforcing cartel arrangements and the consequent realization of the advantages of a formal agreement for effective collusion to take place. See George J. Stigler, "A Theory of Oligopoly," *Journal of Political Economy*, vol. 72, February 1964.

16. See, e.g., Dennis C. Mueller, "Mergers and Market Shares," *Review of Economics and Statistics*, May 1985, pp. 259-67. See also Mueller, "United States Antitrust: At the Crossroads," (mimeo, 1985) and references cited therein. In an interesting recent contribution, Khemani and Shapiro argue that previous studies may have underestimated the importance of barriers to *de novo* entry and overestimated barriers to inter-industry mobility by existing firms. R.S. Khemani and D. Shapiro, "On Entry and Mobility," *Antitrust Bulletin*, forthcoming.

17. Paul A. Pautler, "A Review of the Economic Basis for Broad-Based Horizontal Merger Policy," *Antitrust Bulletin*, vol. XXXVII, Fall 1983, pp. 571-651, at p. 650.

18. Oliver E. Williamson, "Transforming Merger Policy: The Pound of New Perspectives," *supra* note 11.

19. The core insights were originated in Ronald Coase, "The Nature of the Firm," *Economica*, vol. 4, 1937, pp. 386-405.

20. Benjamin Klein, Robert Crawford and Armen Alchian, "Vertical Integration, Appropriable Rents and the Competitive Contracting Process," *Journal of Law and Economics*, October 1978, pp. 297-326.

21. See Oliver Williamson, *The Economic Institutions of Capitalism* (New York: Free Press, 1985) and refererences cited therein.

22. Concerns about the divergence of interests between stockholders and managers were popularized by Adolf A. Berle and Gardiner C. Means, *The Modern Corporation and Private Property* (New York: Macmillan, 1932). Berle and Means' concern was anticipated by Adam Smith in 1776 when he wrote: "The directors of such companies, however, being the managers rather of other people's money than of their own, it cannot be well expected, that they should watch over it with the same vigilence with which the partners in a private copartnery frequently watch over their own... negligence and profusion, therefore, must always prevail, more or less, in the managment of the affairs of such a company." Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (New York: Modern Library, 1937, originally published in 1776), p. 700.

23. Henry G. Manne, "Mergers, Buyouts and the Market for Corporate Control," *Journal of Political Economy*, vol. 73, April 1965, pp. 110-120.

24. Mark Hirschey, "Mergers, Buyouts and Fakeouts," *American Economic Review*, vol. 76, no. 2, May 1986, pp. 317-322.

25. See, e.g., Michael C. Jensen and William H. Meckling, "Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure," *Journal of Financial Economics*, vol. 3, October 1976, pp. 305-360. Empirical support for the importance of these market mechanisms is reported in B. Espen Eckbo and Peggy Weir, "Antimerger policy under the Hart-Scott-Rodino Act: A re-examination of the market power hypothesis," *Journal of Law and Economics*, vol. XXVIII, 1985, pp. 119-149 and references cited therein. For an interesting discussion of evidence from the Canadian scene, see B. Espen Eckbo, "Mergers and the market for corporate control: the Canadian evidence," *Canadian Journal of Economics*, vol. XIX, no. 2, May 1986, pp. 236-260.

26. U.S., Department of Justice, *Merger Guidelines* (Washington, D.C.: 1982).

27. Gregory J. Werden, "Challenges to Horizontal Mergers by Competitors under Section 7 of the *Clayton Act*," *supra* note 7 at p. 22 and the accompanying notes.

28. U.S., Department of Justice, *supra* note 26. The Guidelines indicated that the Department of Justice was unlikely to challenge mergers with a post-merger HHI of less than 1,000 points. The Department was likely to challenge mergers resulting in an HHI of between 1,000 and 1,800 if the

merger increased the HHI by more than 100 points, unless other characteristics of the market suggested that the danger of abuse of market power was small. The Department was likely to challenge all mergers resulting in an HHI of 1,800 or more, where the merger caused an increase in the HHI of 50 points or more. These market share threshold criteria were carried over in the 1984 revisions to the Guidelines.

29. Department of Justice, *supra* note 26, at p. 4, note 6.

30. Williamson, *supra* note 18.

31. Jeffery J. Leitzinger and Kenneth L. Tamor, "Foreign Competition in Antitrust Law," *Journal of Law and Economics,* vol. XXVI, April 1983, pp. 87-102.

32. For an overview of the issues, see Oliver E. Williamson, "Economies as an Antitrust Defense Revisited," *University of Pennsylvania Law Review,* vol. 125, 1977, p. 699. Williamson argues that even small gains in productive efficiency will normally offset any welfare losses resulting from price increases due to a merger. There is, however, a problem with Williamson's calculations. See the comment in R. Posner and F. Easterbrook, *Antitrust: Cases, Economic Notes and Other Materials* (Chicago: 2nd ed., 1980), pp. 920-21.

33. Ann Reilly, "Antitrust Policy after the Steel Veto," *Fortune,* March 14, 1986, pp. 85-98.

34. U.S., Department of Justice, *Merger Guidelines Issued June 14, 1984 and Accompanying Policy Statement* (BNA Antitrust & Trade Regulation Report, No. 1169, Special Supplement).

35. For discussion of the failing firm defence, see notes 59-61, *infra,* and the accompanying text.

36. For a useful overview of the 1984 changes to the Merger Guidelines, see Tyler A. Baker, "The 1984 Justice Department Guidelines," *Antitrust Law Journal,* vol. 53, issue 2, 1984, pp. 327-334. In a related development, in 1984 the application of the U.S. antitrust laws to joint ventures was also clarified. The *National Cooperative Research Act* of that year indicated that R&D joint ventures are to be judged under a permissive rule of reason standard. Specifically, the Act provided that no activity undertaken by a properly-constituted R&D joint venture may be judged illegal by a court without considering the pro-competitive effects of the activity i.e., its role in facilitating innovation and generating new economic activity. While this legislation was to a large extent a codification of previous judicial decisions, it exemplified the trend toward more permissive treatment of mergers and joint ventures generally. See William F. Baxter, "Antitrust Law and Technological Innovation," *Issues in Science and Technology,* Winter 1985, vol. 1, no. 2, pp. 80-91.

37. See, e.g., *U.S. v. Waste Management, Inc.*, 743 F. 2d 976 (2d Cir. 1984).

38. 1984-1 Trade Cas. 66, 041 (N.D. Ohio 1984).

39. David A. Clanton, "Recent Merger Developments: Coming of Age under the Guidelines," *Antitrust Law Journal,* vol. 53, issue 2, 1984, pp. 345-357, at p. 345.

40. 3 Trade Reg. Rep. (CCH) 22, 170 (FTC), modified 3 Trade Reg. Rep. (CCH) 22, 209 (FTC 1984).

41. These cases are reviewed in Werden, *supra* note 7 at pp. 2-16.

42. Werden, *supra* note 7.

43. *Cargill, Inc., v. Monfort of Colorado, Inc.,* No. 85-43, cert. granted, 106 S. Ct. 784 (1986). The U.S. Department of Justice has prepared an *amicus curiae* brief in the case arguing that competitors should be denied standing to challenge horizontal mergers in section 7 cases, based on the considerations noted in Werden's analysis. "High Court Permits Government to Attack

Competitor Standing in Merger Cases," *Antitrust and Trade Regulation Report* (BNA), vol. 50, no. 1262, April 24, 1986, pp. 707-708.

44. George J. Stigler and Robert A. Sherwin, "The Extent of the Market," *Journal of Law and Economics,* vol. XXVIII, no. 3, October 1985, pp. 555-586, at p. 582. In practice, the U.S. antitrust agencies recognize the difficulty of obtaining data on hypothetical market responses and seem to take a more flexible approach to the market definition issue. See David T. Scheffman, "Merger Policy and Enforcement at the Federal Trade Commission: the Economist's View," *Antitrust Law Journal,* vol. 54, issue 1, 1985, pp. 117-121.

45. See the discussion in Alfred Marshall, *Principles of Economics* (var. ed., 1961), p. 325.

46. Richard L. Johnson and David D. Smith, "Antitrust Division Merger Procedures and Policy," Department of Justice, Economic Analysis Group, Discussion Paper No. 86-10, June 9, 1986, p. 16, Table 3.

47. See the roundtable discussion in "Antitrust in Transition: Crossing the Threshold of Change," *Antitrust Law Journal,* vol. 54, issue 1, 1985, pp. 5-37. See also the (U.S.) Conference Board, *Antitrust Conference 1986* (Research Bulletin, No. 197).

48. *Reagan Administration's Package to Congress for Revision of Federal Antitrust Laws,* BNA Antitrust & Trade Regulation Report, vol. 50, no. 1253, Special Supplement, February 20, 1986.

49. See "Baldridge Endorses Repeal of Section 7 to Aid U.S. Firms in Global Markets," *Antitrust & Trade Regulation Report* (BNA), vol. 48, no. 1204, February 28, 1985, pp. 385-86. See also the Honourable Malcolm Baldridge, "Luncheon Address to the Antitrust Section of the American Bar Association," *Antitrust Law Journal,* vol. 53, issue 2, 1984, pp. 397-407.

50. See "Antitrust Legislative Package is Debated by Present, Former Government Officials," *Antitrust and Trade Regulation Report,* vol. 50, no. 1258, March 27, 1986, pp. 534-35.

51. *Reagan Administration's Package, supra* note 48, pp. S-12 to S-13.

52. For details, see C.W. Bergsdorf, "The Virtually Unconstrained Legal Environment for Mergers in Canada," *Antitrust Bulletin,* 1973, pp. 809-825.

53. *R. v. K.C. Irving and Three Other Corporations* (1976), 32 C.C.C. 1 (S.C.C.).

54. "(The Supreme Court) has adopted a conduct approach in which specific detriment must be shown beyond a reasonable doubt before an offence will be created. With this decision the anti-merger provisions virtually cease to be of any effect... In effect, the Supreme Court has ruled that the creation of a monopoly by merger, even if the elimination of all competitors is involved, is legal provided the Crown cannot show specific detriment to the public interest flowing from the merger or the resulting monopoly." G.B. Reschenthaler and W.T. Stanbury, "Benign Monopoly: Canadian Merger Policy and the K.C. Irving Case," *Canadian Business Law Journal,* vol. 2, August 1977, pp. 135-168, at 135.

55. See *Competition Act,* sections 64(1)(e) and (f). Section 63 of the Act defines a merger broadly as "the acquisition or establishment, direct or indirect, by one or more persons, whether by purchase or lease of shares or assets, by amalgamation or by combination or otherwise, of control over or significant interest in the whole or a part of a business of a competitor, supplier, customer or other person."

56. In the U.S. the test has been held to be met by horizontal mergers involving firms with as little as 5% of the relevant market. However, recent cases under section 7 of the *Clayton Act* suggest that mergers involving firms with much higher combined market shares may be acceptable where there are no appreciable barriers to entry to the market. See, e.g., *U.S. v. Waste Management, Inc.*, 743, F. 2d. 976 (2d. Cir. 1984).

57. The application of the *Competition Act* to conglomerate mergers will require careful consideration by the Tribunal. While practices of conglomerates can certainly lessen competition, in many cases the principal concern with conglomerates relates to aggregate concentration and potential abuse of socio-economic power. During the Legislative Committee hearings on Bill C-91 the Honourable Michel Côté, the then Minister of Consumer and Corporate Affairs, indicated that "this Bill deals with competition and not concentration." House of Commons, *Minutes of Proceedings and Evidence on Bill C-91*, Issue No. 1, p. 19.

58. "In those sectors of the economy whose goods and services flow freely across national borders, international competition is usually all that is required to ensure that domestic markets are competitive." Royal Commission on the Economic Union and Development Prospects for Canada, *Report*, vol. II, p. 220.

59. U.S., Department of Justice, *Merger Guidelines, supra* note 34, paragraphs 5.1 and 5.2.

60. For discussion, see Thomas J. Campbell, "The Efficiency of the Failing Company Defense," *Texas Law Review*, vol. 63, no. 2, October 1984, pp. 251-283.

61. *Citizen Publishing Co. v. U.S.*, 394 U.S. 131.

62. "If readily available alternatives were, in the aggregate, sufficiently attractive to enough buyers, an attempt to raise price would not prove profitable, and the tentatively defined product group would prove to have been too narrowly defined." U.S., Department of Justice, *Merger Guidelines, supra* note 34, paragraph 2.11.

63. U.S., Department of Justice, *Merger Guidelines, supra* note 34, paragraph 3.3.

64. See the discussion in *House of Commons, Minutes of Proceedings and Evidence on Bill C-91*, Issue No. 4, p. 8.

65. F.M. Scherer, *Industrial Market Structure and Economic Performance* (2nd ed., 1980), pp. 22-23. This view was originally developed in Joseph Schumpeter, *Capitalism, Socialism and Democracy* (New York: Harper and Row, 1942).

66. See the discussion of the new U.S. regime for joint ventures in note 36, *supra.*

67. John E. Kwoka and Frederick R. Warren-Boulton, "Efficiencies, Failing Firms, and Alternatives to Merger: A Policy Synthesis," U.S., Department of Justice, Economic Analysis Group Discussion Paper No. 86-14, August 29, 1986.

68. See the discussion in Kwoka and Warren-Boulton, *id.*, at pp. 3-4.

69. It seems possible that the series of acquisitions leading up to the *Canadian Breweries* case, (1960) 33 C.R. 1, could fit this pattern. For a useful analysis of the fact situation in that case, see J.C.H. Jones, "Mergers and Competition: The Breweries Case," *Canadian Journal of Economics and Political Science*, vol. 33, no. 4, November 1967, pp. 551-568.

70. The merger provisions apply in situations where "a merger or proposed merger presents or lessens, or is likely to prevent or lessen competition substantially" *(Competition Act*, section 64.) The abuse of dominance provision applies in situations where a practice of anti-competitive acts *"has had*, is having or is likely to have the effect of preventing or lessening competition substantially in a market." *(Competition Act*, section 51, emphasis added.)

71. The application of abuse of dominance provisions to conglomerates in West Germany is discussed in C. Green, "Some Comments on Abuse of a Dominant Position," Paper prepared for the Insight Conference in Toronto, February 17, 1986.

CANADIAN COMPETITION POLICY RECORD

72. In Canada, 34% of manufacturing industries have four-firm concentration ratios of 70% or higher. In the U.S., only 13% of manufacturing industries have similarly high concentration levels. R.S. Khemani, "The Extent and Evolution of Competition in the Canadian Economy," in D.G. McFetridge, ed., *Canadian Industry in Transition* (Toronto: University of Toronto Press for the Royal Commission on the Economic Union and Development Prospects for Canada, 1986), pp. 135-176, at p. 152.

73. See Donald J. Daly, "Rationalization and Specialization in Canadian Manufacturing," in D.G. McFetridge, ed., *Canadian Industry in Transition, id.*, pp. 177-210, and references cited therein.

74. The need for a case-by-case approach is re-inforced generally by a recent empirical study of the nature and incidence of mergers in Canada in the 1970s by Baldwin and Gorecki. The study finds that the proportion of horizontal mergers has decreased from 61% of all mergers in 1971-73 to 47% in 1974-77 and 39% in 1977-79. Furthermore, the majority of mergers take place among firms of approximately the same size. The study suggests that such mergers may strengthen the ability of small firms to compete with larger ones. The study also notes that some mergers perform a pro-competitive function in facilitating entry into industries traditionally thought to be uncompetitive. The authors caution that these findings do *not* mean that mergers have no anti-competitive consequences. John R. Baldwin and Paul K. Gorecki, "Mergers and Merger Policy in the Canadian Manufacturing Sector: 1971-79" (Economic Council of Canada, Discussion Paper No. 297, March 1986).

75. The Department of Justice and the FTC meet regularly to decide which agency will take responsibility for individual cases on the basis of their respective areas of expertise and interests. See the discussion in Johnson and Smith, *supra* note 46.

76. As noted, the U.S. Supreme Court is expected to clarify the standing of competing firms to challenge horizontal mergers under section 7 of the *Clayton Act*, in its pending decision in the *Monfort* case. In addition, the availability of treble damages to competitors in such suits could be affected by passage of the Reagan Administration's antitrust reform proposals, discussed in part III of the article. It should be noted, however, that in the majority of private merger cases the parties seek not damages but rather orders barring the merger.

NOTES

CANADIAN COMPETITION POLICY RECORD

HIGHLIGHTS

COMPETITION TRIBUNAL REFUSES PALM DAIRY CONSENT ORDER

MORROW ON THE OIL INQUIRY

CASE REVIEWS: THOMPSON NEWSPAPERS, IOF, IRVING

UPDATE ON COMPETITION ACT IMPLEMENTATION

COMPETITION TRIBUNAL RULES REVIEWED

EVANS ON THE ESTEY COMMISSION

EXPLORING THE LIMITS OF THE REGULATED INDUSTRY DEFENCE

DAVIDSON ON DELIVERED PRICING

FIRST FEDERAL ANNUAL REGULATORY PLAN PUBLISHED

WYLIE ON BROADCASTING AND TELECOMMUNICATIONS REGULATION

CLARK ON CANADIAN TRADE DEVELOPMENTS

HORLICK ON U.S. TRADE DEVELOPMENTS

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