

COMMENT AND ANALYSIS

THE NEW EC MERGER CONTROLS: AN APPRAISAL

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Introduction

On December 21, 1989, the Commission of the European Communities (the Commission) adopted Council Regulation No. 4064/89 (the Regulation), which established European Communities (EC) control of large community-wide mergers and acquisitions (mergers) as of September 21, 1990.¹ This marks an important and necessary step towards the realization of the Single Market of 1992. EC merger control is important because it creates jurisdictional powers for the Commission in an era of worldwide external growth of enterprises. Furthermore, EC merger control is necessary because of a wide divergence of merger policies and of enforcement of merger control among member states, ranging from non-existence of control (Belgium, Denmark, Greece, Italy, Luxembourg, The Netherlands, Portugal and Spain) to enforcement levels which are comparable to North American practices (Federal Republic of Germany, Great Britain, and – to a lesser extent – France and the Republic of Ireland).²

The discussion and assessment of the EC Regulation begins with a glance at the past treatment of mergers under the *Treaty of Rome* and the earlier attempts to introduce EC merger control. Next follows an examination of the Council Resolution, with particular emphasis on the thresholds of merger prenotification and appraisal. A hypothetical merger case and the potential application of thresholds conclude the discussion.

Previous Merger Treatment Under EC Auspices

The *Treaty of Rome* of 1957 (the Treaty) does not have specific provisions for merger control. This meant that the Commission had no judicial procedure for supervising and controlling an increasing tide of Community-wide mergers. The only exceptions were mergers in the coal and steel industries, which were – and still are – subject to the merger control provisions of art. 66 of the *ECSC Treaty* of 1951.

In order to establish some influence on larger mergers, the Commission used art. 86 and, to a lesser extent, art. 85 of the *Treaty* as instruments for merger control. Art. 86 prohibits abuse of dominant positions. Consequently, application of this rule to mergers presupposes the situation of a pre-merger dominant firm acquiring another firm in the same relevant market, and thus a substantial lessening, if not elimination, of post-merger competition in the market. This reasoning was first applied in the *Continental Can* case in 1971, when the Commission challenged the acquisition of Thomassen N.V. of The Netherlands by Schmalbach-Lubeca AG of West Germany, a subsidiary of Continental Can.⁴ An order of prohibition was issued on grounds that Schmalbach dominated the West German markets for tins for meat and fish products, and metal closures and crown corks. Furthermore, it was held that the acquisition of Thomassen, which held an equally strong position in the same markets in The Netherlands, was an abuse of Schmalbach's position, because its dominance would be strengthened to the extent of virtually eliminating competition in the relevant product markets. The order of

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prohibition was eventually reversed by the European Court of Justice in 1973.⁵ However, the reversal was issued because of a wrong delineation of the relevant geographic market, and not because of the application of art. 86 to mergers. This is important since the Court reaffirmed the Commission's interpretation of art. 86 as an instrument for controlling mergers, which virtually eliminate competition. The *Continental Can* case remains the only order of prohibition of a merger under art. 86 to date. There were 19 other mergers examined by the Commission under this rule, but the examinations never went beyond the issuance of recommendations for certain modifications of the merger or closure of the case because there was no evidence that the merger would result in an abuse of a dominant position.⁶ The poor record indicates the very limited scope, if not unsuitability, of art. 86 for merger control. Even more questionable is the application of art. 85 of the *Treaty* as an instrument of merger control to agreements to acquire stock of another enterprise, since it is a rule prohibiting collusive agreements, and refers to agreements between firms which remain independent.⁷ However, in its frustration about the lack of progress in establishing EC merger control rules, the Commission applied art. 85 in the *Philip Morris-Rothmans* case in 1982.⁸ Philip Morris had acquired an indirect minority stake from the Rembrandt Group in Rothmans International (RI) through the acquisition of 50% of Rothmans Holding Ltd. which, in turn, controlled RI. There was also an agreement that joint control over RI would be established.⁹ Subsequently, the Commission ordered cancellation of the control agreement, and restructuring of the shareholding in RI. In compliance with this order, Philip Morris assumed a direct 24.9% stake in RI, while Rembrandt re-established sole control of Rothmans Holding Ltd. However, other tobacco manufacturers objected to this settlement on grounds of a violation of either art. 85 or art. 86. They applied to the European Court of Justice to have the amended shareholding agreement disallowed because, in their view, the acquisition of a minority of a larger competitor could be regarded as a lessening of competition. The Court decided not to disallow the said agreement.¹⁰ However, in a somewhat ambiguous reference, the Court recognized that the acquisition of a competitor's stock — although in itself not an immediate instrument of lessening competition, could become such an instrument when the acquirer achieves gradual control over the business of the acquiree in the long run.¹¹

Apart from the legal difficulties of extending arts. 85 and 86 to merger control, the procedural inconvenience of having no pre-merger notification process cannot be overlooked: it is much easier to disallow a notified, and thus not yet consummated, merger than to retroactively disband an already consummated merger. All this was on the Commission's agenda in its repeated attempts to establish EC merger control.¹² These moves were prompted by recommendations on this matter by the European Council of Ministers in 1964 and, later, by the European Parliament in 1971 and the Paris Conference in 1972.

Subsequently, a proposal for an EC merger control regulation was submitted to the Council of Ministers in July, 1973.¹³ According to this proposal, merger control pertains to mergers which may endanger or impede the trade between member states and which:

- (i) involve at least one EC firm,
- (ii) have combined sales of more than ECU 200 million,¹⁴ and
- (iii) exceed 25% of the market in one and the same member state.

Such a merger would be considered as incompatible with the Common Market when effective competition in the Common Market or a significant part thereof is threatened or blocked. Exceptions to this rule could be applied to otherwise incompatible mergers for reasons of technological and other socio-economic requirements. A pre-merger notification is mandatory for mergers where the combined sales of the merger partners exceed ECU 1 billion, unless the sales of the acquired firm are less than ECU 30 million.

The proposal was accepted by the European Parliament in 1974, but it was not approved by the Council of Ministers. Further amendments of the regulation proposal in 1981, 1984 and 1986 dealt mainly with the aforementioned thresholds and the notion of compatibility of EC merger control and

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merger control in individual member states. The 1981 amendment altered the threshold of merger control to:

- (i) a post-merger share in excess of 20% of the EC Market, or
- (ii) combined sales of the merger partners in excess of ECU 500 million.

A further amendment in 1984 changed the merger control criteria to:

- (i) combined sales of the merger partners in excess of ECU 750 million, or
- (ii) a post-merger share of a significant part of the EC Market in excess of 50%.¹⁵

Again, both amendments failed to get approval, but the European Parliament suggested the drafting of a new proposal. Consequently, the Commission presented a completely new proposal for a merger control regulation in April 1988, which eventually became the regulation of December 21, 1989.

The Merger Control Regulation

The 1988 proposal established new dimensions of EC merger control by introducing the concept of Community-wide concentrations in the sense of mergers having a significant impact on intra-Community business.¹⁶ A concentration is defined in art. 3 as a merger of two or more previously independent companies, or the acquisition of control of one or more companies. Since no minimum threshold for the meaning of control has been set, a concentration may be deemed to arise in cases of minority control.¹⁷ Joint ventures and other operations aimed at a co-ordination of competitive behaviour, where the partners remain independent, do not constitute a concentration. The determination of "concentrations with a Community-wide dimension" gains momentum in view of creating new and sole jurisdiction of the Commission for such mergers. According to art. 1, both magnitude and area of operation of the concentration make a concentration Community-wide, *viz.*

- (i) the aggregate worldwide sales of the merger partners (referred to as "undertakings") exceed ECU 1 billion,
- (ii) the worldwide sales of the acquired firm exceed ECU 50 million, and
- (iii) the sales of each of the merger partners do not exceed three-quarters of their respective total Community sales in one and the same member state.

The third criterion is the most important one, and has been frequently referred to as the "three-quarters rule". The importance of this rule is enhanced by the legal vacuum which exists without EC merger control: national merger control leaves cross-border mergers untouched unless there is an impact on the domestic market. Thus, the Commission has clearly indicated its resolve to focus on mergers with an international or even global dimension and to leave the mergers which have their main impact in one member state under the jurisdiction of national authorities. In this respect, it is not surprising that national authorities initiated a kind of tug-of-war in order to lower the three-quarters rule and to raise the thresholds of the merger magnitudes in order to defend their formerly unchallenged territory of merger control. However, a closer inspection reveals that application of the third criterion is very restricted: it applies only when each of the two or more merger partners achieves more than 25% of its Community sales outside the same member state. This requires substantial international activity of the merger partners who, by taking account of the paramount importance of the North American market, may derive close to or even more than 50% of their sales outside the domestic arena.

The first two criteria in art. 1 of the regulation proposal, which refer to the size of the merger partners, have to be evaluated with regard to the dimensions of the Common Market, and to the potential merger impact upon the lessening of competition. The dual threshold of ECU 1 billion and ECU 50 million clearly puts the focus on larger mergers. The notion of what constitutes a large and Community-wide merger in the realm of EC merger control became the subject of heated debate among antitrust officials from EC member states and from the EC Competition Directorate. German and

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British representatives in particular had strong reservations about the EC's attempts to assume a prominent role in their hitherto unchallenged domain of merger control enforcement. The main reason for their concern was the potential for too lenient a treatment of mergers which otherwise might have been challenged under national merger rules. Thus it was felt that as few mergers as possible should be left for EC merger control.¹⁸ Consequently, German and British counter-proposals were made to raise the first threshold to ECU 10 billion, along with an increase of the second threshold and a lowering of the Community-wide activity criterion. After some manoeuvring a compromise was made regarding the thresholds for a Community-wide concentration in art. 1 of the regulation, *viz.*

- (i) the aggregate worldwide sales of the merger partners exceed ECU 5 billion,
- (ii) the Community-wide sales of at least two of the merger partners exceed ECU 250 million each, and
- (iii) the sales of each of the merger partners do not exceed two-thirds of their respective Community-wide sales in one and the same member state.

Table 1: EC Merger Control Thresholds

<p>I. Proposal for a Council Regulation (April 25, 1988)</p> <p>A concentration (merger) has a Community dimension when</p> <ul style="list-style-type: none"> (i) the aggregate worldwide sales of the merger partners exceed ECU 1 billion, (ii) the worldwide sales of the acquired firm exceed ECU 50 million, and (iii) the sales of each of the merger partners do not exceed three-quarters of their respective Community-wide sales in one and the same member state.
<p>II. Council Regulation No. 4064/89 (Dec. 21, 1989)</p> <p>A concentration (merger) has a Community dimension, when</p> <ul style="list-style-type: none"> (i) the aggregate worldwide sales of the merger partners exceed ECU 5 billion, (ii) the Community-wide sales of at least two of the merger partners exceed ECU 250 million, and (iii) the sales of each of the merger partners do not exceed two-thirds of their respective Community-wide sales in one and the same member state.

In comparison to the 1988 proposal this represents a fivefold increase of the first two thresholds, and a reduction from a "three-quarters rule" to a "two-thirds rule" (see. Table 1). A closer inspection reveals that the second criterion has been increased less than fivefold, since reference is made to the lower Community-wide sales rather than to worldwide sales. These are very high thresholds, but the Commission has already indicated its intention of downsizing the global threshold to ECU 2 billion along with a reduction of the Community threshold to ECU 100 million within four years of the passage of the Resolution.¹⁹

How many mergers would be subject to EC merger control? The Commission's Directorate General for Competition estimated a caseload of about 200 mergers in 1987, which would have qualified for review under the proposal thresholds.²⁰ While it is difficult to clearly delineate an exact potential caseload because of the three thresholds, an upper limit can be determined by simply focusing on the first threshold. This has been done in Tables 2 and 3. Overall, there is a 58% decline in the number of large mergers when the threshold is raised from ECU 1 billion to ECU 5 billion and a further, but lesser, 20-point decline when the threshold is raised to ECU 10 billion (see. Table 2). The larger mergers are concentrated in France, Germany, and Great Britain, which may explain the concerns of antitrust officials from those countries (see. Table 3). While the worldwide threshold (first criterion) sets an upper limit of potential merger cases, the Community-wide size threshold (second criterion) and the Community-wide activity threshold (third criterion) substantially decrease the number of merger cases. In fact, the Commission now estimates that under Regulation thresholds a total of only 50 merger cases per year will come under Community jurisdiction in the near future.²¹

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Table 2: Numbers of Mergers in Manufacturing, Trade, Banking and Insurance in the EC, by Total Sales of the Merger Partners (ECU bill.), June 1986 - May 1989

Year/Sales	>1	>2	>5	>10
1986/87	220	151	88	41
1987/88	342	240	140	73
1988/89	449	350	199	113

Source: EC-Commission, *Nineteenth Report on Competition Policy*, Brussels, 1990, p.312.

Table 3: Numbers of Mergers^a in Manufacturing, Trade, Banking and Insurance in EC Member States,^b by Total Sales^c (ECU Bill.) of the Merger Partners, June 1987 - May 1988

MEMBER STATE	>1	>2	>5	>10
Belgium	11	7	4	4
Denmark	3	—	—	—
F.R. of Germany	58	44	28	18
France	105	76	47	26
Great Britain	71	46	20	11
Greece	—	—	—	—
Republic of Ireland	4	3	2	—
Italy	46	32	25	9
Luxembourg	1	1	1	—
The Netherlands	17	13	8	3
Portugal	1	1	1	1
Spain	25	17	4	1
EC	342	240	140	73

- Involving at least one of the 1,000 largest EC firms and including acquisitions of majority of stock. Includes mergers between EC and non-EC firms, when there is an impact on the Community market.
- According to the registered office of the acquiring firm.
- Refers to one-tenth of total assets with banks and to premium revenue with insurance companies.

Source: Monopolkommission, *Conception of a European Merger Control*, Baden-Baden: Nomos, 1989, p.53; by kind permission.

A pre-notification of mergers with a Community dimension has to be submitted to the Commission within one week after a merger agreement has been reached among the participants. Subsequently, the merger will be appraised in view of whether or not a dominant position has been created or strengthened in the Common Market or in a substantial part thereof. According to art. 2 of the Regulation, a "substantial lessening of competition" test will be applied in the appraisal. Among the criteria for an assessment are the financial power of the merger partners, barriers to entry, opportunities for suppliers and buyers, market structure, and potential competition from within the Community and from third countries. Market share in relevant markets is the leading indicator for dominance. In its jurisdiction on cases under art. 86 of the *Treaty*, the Court of Justice has established ranges of dominance and of assumption of dominance as follows:²²

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>80%	Dominant position in the sense of virtual monopoly
>60%	Dominant position, when the spread to the second-largest firm is about 50 points
45%-80%	Presumption of a dominant position in connection with other criteria, particularly the distribution of the shares of other competitors
20%-45%	Presumption of a potential for prevention of effective competition provided that economic and financial power along with technological and commercial advantages <i>vis-à-vis</i> the competition are present
<20%	Absence of dominance

A merger which does not create or strengthen a dominant position will be found as compatible with the Common Market; such compatibility is presumed to exist when the post-merger share of the merger partners in a market is below 25% (Point 15 of the preamble of the Regulation). The Commission has to decide within one month of notification whether to allow a merger to go ahead or to start proceedings to eventually disallow the merger; such proceedings may include recommendations for restructuring the merger in order to avoid a negative decision.²³ The merger partners can present their views in hearings, which are held *in camera*. The time frame within which the Commission must make its decision is four months after the initiation of proceedings. Such decisions are final and binding; a merger found to be incompatible with the Common Market cannot proceed.

The Commission's merger proceedings are exclusive inasmuch as there are no concurrent proceedings at the member state level. However, there are some exceptions which try to alleviate the concerns of some member states. First, there is the so-called "German Clause" (art. 9), which provides for the possibility of referring a case to the national authorities of a member state whenever a merger creates a dominant position in a distinct market of that member state; the decision to do so rests with the Commission. There is also the so-called "British Clause" (art. 21, para. 3), which refers to legitimate interests of a member state which are not covered by the Regulation, such as public security and plurality of the media. Under these conditions, the member state may take appropriate measures to protect its interests in the sense of prohibiting a merger which was considered as compatible in the Commission's view; however, there is no provision for reversal of an incompatible merger.²⁴ Mergers which do not have a Community dimension are in principle not subject to the Regulation. However, art. 22, para. 3 provides for the possibility of "forward-referral" of such mergers to the Commission by member states, which do not have national merger control legislation. An appraisal of a merger can be considered by the Commission upon request by a member state whenever a dominant position is created in that member state.²⁵ The Netherlands and Denmark sponsored this provision because there is no merger control in these countries.

A Hypothetical Merger Case

In order to illustrate the potential application of the EC merger Regulation, a *hypothetical* horizontal merger in the EC beer industry has been considered, *viz.* the merger between Heineken and Carlsberg. The merger impact on concentration in the Common Market and in individual member states is presented in Table 4. Concentration has been measured in terms of 1988 beer production and is expressed in terms of the Hirschman-Herfindahl Index (HHI).²⁶ At the Community level, concentration in the beer industry is low, but in individual member states concentration reaches very high levels. This is important, since EC merger control refers not only to the Common Market as a whole, but also to significant parts thereof.

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Table 4: Heineken-Carlsberg (Hypothetical Merger)

	1988 Production Share (%)		Merger Impact on Concentration		
	Heineken	Carlsberg	Pre-Merger	HHI Level Post-Merger	Δ HHI
EC	8.8	6.4	313	426	113
Denmark	—	69.2 ^a	6511	6511	—
F.R. of Germany	—	0.9	220	220	—
France	25.9	—	3654	3654	—
Great Britain	—	4.2 ^a	1254	1254	—
Greece	60.0 ^a	—	4688	4688	—
Ireland	10.0	—	6923	6923	—
Italy	31.0	7.8	2762	3246	484
Spain	17.9	6.8	1558	1801	243
The Netherlands	52.0	—	3262	3262	—

a. Estimate

Sources: Company reports; trade magazines.

The Heineken-Carlsberg merger would link the EC's no. 1 and no. 3 beer producers; in their domestic markets the two brewing giants have a commanding lead, *viz.* 52% of the Dutch market (Heineken) and 69% of the Danish market (Carlsberg). As can be seen from Table 4, the merger should have a direct impact on the markets of two member states, and an indirect effect on seven additional markets. Under the present thresholds of the Regulation, this merger would satisfy the Community threshold of more than ECU 250 million each of Community-wide sales for the two partners and the two-thirds rule, but it would marginally fail to reach the worldwide-sales threshold of more than ECU 5 billion.²⁷ Thus, it would not have a Community dimension and would not be subject to EC merger control. However, under art. 22, para. 3 of the Regulation (see above) should a request for an appraisal of the merger be forwarded to the Commission by the Dutch and/or Danish antitrust authorities, then the Commission might begin proceedings, which could very likely result in a challenge and potential disallowance of the merger. This scenario refers to either of the two beer markets where the dominant positions of Heineken or Carlsberg would indirectly be strengthened. Alternatively, no such forward-referral will be needed at a time when the thresholds for Community-wide mergers will have been lowered (see above). At that time, the merger would easily qualify for pre-notification and subsequent Commission appraisal; a potential challenge would hinge upon the delineation of a "significant part" of the Common Market. As can be seen from Table 4, the merger would have a direct impact on the Italian and Spanish markets, with 30% of the Community's population. While this may very likely be considered as a "significant part", the establishment of a post-merger share of 29% of the Italo-Spanish beer market may not likely be regarded as a potential for prevention of effective competition, all other things being equal.

Notes

1. Council Regulation (EEC) No. 4064/89 of 21 December 1989 on the control of concentrations between undertakings, *Official Journal of the European Communities*, Vol. 32, No. L395, 30 December 1989, pp. 1-12.
2. Monopolkommission, *Conception of a European Merger Control*, Baden-Baden: Nomos-Verlag, 1989 (hereinafter referred to as "Conception"), pp. 17-18.

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3. Art. 66 of the ECSC Treaty applies to mergers where at least one partner produces coal or steel in the ECSC; such a merger can proceed unless control over prices, production or distribution of products in a significant part of the market is achieved. Because of massive state aid and government-sponsored restructuring in the coal and steel industries, art. 66 never gained much prominence [Monopolkommission, *Conception*, pp. 23-24].
4. EC Commission, Order of Dec. 9, 1971, Rs. IV/26811.
5. European Court of Justice, Ruling of Feb. 21, 1973, in Case No. 6/72 (*Continental Can Co. Inc., Europemballage Corp. v. Commission of the European Communities*).
6. Monopolkommission, *Conception*, pp. 25-26.
7. Reynolds, M., "European Merger Control: Deadlock at Brussels," *FT Mergers and Acquisitions*, November 1988, p. XIV.
8. EC Commission, *Fourteenth Report on Competition Policy*, Brussels, 1985, pp. 81-83.
9. Monopolkommission, *Conception*, p. 28; EC Commission, *Seventeenth Report on Competition Policy*, Brussels, 1988, p. 94.
10. European Court of Justice, Ruling of Nov. 17, 1987, in cases 142/84 and 156/84 (*British American Tobacco Ltd. and Reynolds Industries Inc. v. Commission of the European Communities*.)
11. Monopolkommission, *Conception*, p. 28.
12. The following recount draws heavily on the presentation in Monopolkommission, *Conception* ch. IV.
13. *Official Journal of the European Communities*, C 92, Oct. 31, 1973.
14. The European Currency Unit (ECU) – formerly referred to as European Units of Account (EUA) – is a basket of the currencies of the Member States, where the amount of each currency reflects the economic size of the respective Member State. The 1989 average value of the ECU was: ECU 1.00 = CAD 1.30.
15. EC-Commission, *Thirteenth Report on Competition Policy*, Brussels, 1984, p. 49; *Fourteenth Report on Competition Policy*, Brussels, 1985, p. 46.
16. Amended proposal for a Council regulation on the control of concentrations between undertakings, *Official Journal of the European Communities*, No. C130, 19 May 1988, pp. 4-11; EC Commission, *Eighteenth Report on Competition Policy*, Brussels, 1989, pp. 50-51.
17. In a presentation at the Second International Antitrust Seminar at the Free University of Berlin, Dr. H.J. Ruppelt of the Federal Cartel Bureau indicated that an acquisition of 25% of stock – the benchmark under German legislation – would not be regarded as a concentration under EC Merger Control; rather, he felt that the lower threshold would be upwards of 35%.
18. Monopolkommission, *Conception*, pp. 49-50.
19. Monopolkommission, *Wettbewerbspolitik vor neuen Herausforderungen*, Hauptgutachten 1988-89, Baden-Baden: Nomos-Verlag, 1990, p. 15.
20. Schwarz, D., "Europäische Fusionskontrolle aus der Sicht der EG-Kommission" *Europäische Fusionskontrolle*, Cologne: FIW, 1988, p. 18.
21. EC-Commission, *Nineteenth Report on Competition Policy*, Brussels, 1990, p. 34.
22. Monopolkommission, *Conception*, pp. 60-61.
23. EC-Commission, *Nineteenth Report on Competition Policy*, Brussels, 1990, p. 36.
24. *Ibid.*
25. *Ibid.*, p. 37
26. HHI is expressed as the sum of the squared market shares of all firms in a relevant market: $HHI = (\sum p_i^2) 100$, where p_i is the share of the i -th firm, and $0 < HHI \leq 10,000$. According to the U.S. Merger Guidelines, low concentration means $HHI < 1,000$; moderate concentration means HHI between 1,000 and 1,800, and high concentration means $HHI > 1,800$; The change in concentration through a merger, ΔHHI , is the product of the market shares of the merger partners and multiplied by 2.
27. This conclusion is based on 1988 data with combined total sales of the merger partners of ECU 4.9 billion.

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**RECENT DEVELOPMENTS AFFECTING STANDING IN
U.S. ANTIDUMPING AND COUNTERVAILING DUTY LAW**

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The substantial costs of defending against a trade complaint filed under U.S. antidumping and countervailing duty laws, and the disruption and uncertainty these cases create for exporters and importers and their customers in the U.S. market are well-known. Because of long-standing policies of the Department of Commerce and the U.S. International Trade Commission, the agencies which decide these cases, it has been for all practical purposes impossible to avoid an antidumping or countervailing duty investigation even though the U.S. company which filed the petition may not have the legal right (referred to as "standing") to request relief under the antidumping statute.

Two recent decisions, one by the U.S. Court of International Trade and the other by a GATT panel in Geneva, should significantly expand the ability of respondents named in trade complaints to challenge the right of the petitioner to start an investigation, and perhaps enable them to avoid extended involvement in antidumping or countervailing duty proceedings. These recent decisions may even discourage the filing of trade cases by U.S. companies in the future. These legal developments and their potential impact for Canadian exporters are discussed below.

The Legal Issue — Who may File a Petition?

The *Trade Agreements Act* of 1979 requires that all antidumping and countervailing duty petitions be submitted "on behalf of" a U.S. industry. This is consistent with the *GATT Antidumping Code* and the *GATT Subsidies/Countervailing Duty Code*, which the 1979 Act implemented in the United States. This basic requirement derives from the theory that antidumping and countervailing duty cases are not simply private disputes (such as a breach of contract) involving the interests of individual companies only. Rather, these cases affect all imports from the country or countries named in the petition, and any remedial action is supposed to benefit an entire industry in the United States that is experiencing economic harm, not just individual companies that may be facing financial difficulty. (The definition of the relevant domestic industry is itself an important issue in every trade case, and is frequently contested by the parties.)

Thus, antidumping and countervailing duty cases are matters of public significance. That is why any antidumping and countervailing duties collected from importers are deposited in the U.S. Treasury, and are not paid to the United States companies which allegedly have been injured by dumped or subsidized imports.

Notwithstanding the GATT requirements and U.S. law, the U.S. Department of Commerce (DOC) has never strictly enforced the "on behalf of" standard. Instead, it has presumed that even a single petitioning company or labour union is acting "on behalf of" the domestic industry, unless a large number of significant U.S. producers steps forward to aggressively challenge the petitioner's "standing." (Even in those circumstances, DOC does not necessarily abandon its presumption.) Silence by other U.S. producers of the relevant product, or the unwillingness of such producers to publicly object to the petition, is interpreted by DOC as evidence of support for an antidumping or countervailing duty investigation. If objections are stated, DOC, in weighting the extent of opposition to a petition, will usually disregard the views of U.S. firms that are either closely related to foreign producers, or are significant importers of the product under investigation.

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The History of the Standing Issue

A fundamental principle of the U.S. legal system is that a court or tribunal cannot act unless a case is presented to it by a party who has a genuine stake in the outcome and who is authorized by law to call upon the tribunal for relief. In all legal proceedings in the United States, one of the first responsibilities of the tribunal is to determine whether or not the initiating party has standing. In most court actions, the burden of demonstrating standing ordinarily is on the plaintiff or petitioner.

By taking the opposite approach (contrary to fundamental legal principles), and interpreting the law of standing heavily in favour of petitioners DOC has prevented opponents of antidumping and countervailing duty proceedings from blocking an unjustified investigation in a number of major cases. One investigation in 1985, involving hundreds of millions of dollars worth of offshore oil drilling platforms to be imported from Japan and Korea, was initiated at the request of a single U.S. company that lacked the capability or capacity to supply even a fraction of U.S. demand. Nevertheless, without any support from the dozens of other American companies involved in the market, this petitioner was able to launch an investigation that cost the respondents millions of dollars in legal fees (with no antidumping duties ever collected). During the investigation, DOC officials at all levels essentially ignored the issue of standing, notwithstanding numerous protests by U.S. interests. In another case, started during 1988, a single U.S. manufacturer of 3.5" microdisks (used for data storage) persuaded DOC to initiate an antidumping investigation without the consent of any other U.S. companies. DOC again was deaf to legitimate questions raised about the petitioner's standing.

The Court of International Trade Ruling

There is reason to believe that DOC may soon be obliged to change its current practice of ignoring the basic legal requirement of standing. In response to an appeal of one such DOC decision to the Court of International Trade (CIT), a Federal judge has ruled that DOC must revise its practice on examining standing. The decision by Judge Musgrave will be reviewed by a court of appeals. It appears likely that, even if the appellate court does not uphold the full extent of the CIT's decision, it will recognize that some discipline must be imposed on DOC in this area.

The CIT case, *Suralv. United States* (Slip. Op. 90-79), involved antidumping and countervailing duty petitions filed by Southwire Company against imports of electrical conductor (EC) rods from Venezuela. DOC made a routine finding that Southwire had filed its petition "on behalf of" the U.S. industry, even though no other U.S. producers of EC rods had expressed any support for the investigation. Of the other leading U.S. producers, Reynolds Aluminium had taken no position, while Alcoa actually had submitted objections to DOC. DOC decided to interpret Reynolds' neutrality as "support" for the petition, and disregarded Alcoa's objections because Alcoa accounted for only 16 percent of U.S. production.

The U.S. International Trade Commission (ITC) also had an opportunity to examine Southwire's standing in making its preliminary and final injury determinations. The ITC learned that Southwire had no domestic support because the informational questionnaires sent by the ITC to all U.S. producers asked each recipient to indicate a position on the investigation — in favor, neutral or opposed. Alcoa opposed, Reynolds and three other producers (collectively representing 50 percent of U.S. production) remained neutral, and only the petitioner, Southwire (with 34 percent of U.S. production) expressed support. The ITC (which has six commissioners, and decides cases by majority vote) deferred to DOC's judgment that Southwire had standing to file the petition, because only Alcoa had actively opposed the investigation. (One commissioner, Ronald Cass, who has since resigned from the ITC, and another, Anne Brunsdale, still a member, did note the lack of industry support for Southwire's action. Cass deferred to DOC's finding on standing, while Brunsdale would have dismissed the petition. Moreover, she indicated in her opinion that the lack of support by other U.S. companies could be evidence that they are not injured.)

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On August 22, 1990, the CIT issued a decision that reversed the DOC and ITC determinations. Judge Musgrave harshly criticized both agencies for failing to terminate the investigation at the start. He ruled that a petitioner must demonstrate majority support, and that silence by other producers (i.e., neutrality) does not constitute support. Thus, if companies that account for over 50 percent of U.S. production oppose or *take no position on* a petition, DOC or the ITC would have an obligation to terminate the investigation.

DOC plans to appeal Judge Musgrave's decision to the Court of Appeals for the Federal Circuit, and it will not modify its standing requirements until the higher court has decided the appeal (probably at least nine to twelve months from now). DOC's refusal to change its practice in response to instructions from the CIT is not unusual, although it is legally questionable. Its adherence to current policy not only directly contradicts Judge Musgrave's instructions, but also conflicts with a *GATT* panel's interpretation of U.S. obligations under the *Antidumping Code*.

The *GATT* Panel Decision on Stainless Steel Pipe and Tube from Sweden

The requirement of U.S. law that a petitioner must file "on behalf of" a domestic industry is taken directly from Article 5.1 of the *GATT Antidumping Code* and Article 2.1 of the *Subsidies/Countervailing Duty Code*. On December 1, 1988, Sweden requested that the *GATT* Committee on Antidumping Practices convene a panel under article 15.5 of the *Antidumping Code* to review DOC's initiation of an antidumping investigation of stainless steel pipe and tube from Sweden. (Sweden also alleged other violations of *GATT* by the U.S. in the conduct of DOC's investigation.) Sweden argued that prior to initiating the case, DOC had failed to investigate whether the petitioner (a trade association) had support from "a major proportion" of the U.S. industry. The United States' position was that no U.S. producers had publicly opposed the petition, and the support of "a major proportion" of the industry could therefore be assumed.

In a report issued on August 20, 1990 the *GATT* panel upheld the Swedish position. (*GATT* panels are composed of experts from countries not involved in the dispute.) It ruled that DOC must determine before initiating an investigation whether "a major proportion" of the domestic industry supports the petition, and that DOC cannot simply assume the existence of such support if no U.S. producers come forward to object. Unlike the CIT in the *Sural* decision, the panel was not requested to, and did not, define the meaning of the term "a major proportion", for example, whether it signifies at least 50 percent of domestic production.

The U.S. administration has not yet indicated whether it will comply with the *GATT* panel decision. At the October, 1990 meeting of the *GATT* Committee on Antidumping Practices, the U.S. and Swedish delegations requested more time to continue bilateral consultations. At a special meeting of the Committee held in November at the request of Sweden, the U.S. indicated that its domestic law contains no provision allowing it to revoke the antidumping order and reimburse the duties collected, as recommended by the panel. It appears that this issue of the remedy recommended for the specific case, rather than the panel's finding on the procedural issue of standing, is holding up adoption of the report by the Antidumping Committee. Adoption of the report by the Committee would precede its implementation by the U.S.

Reform of U.S. practice on standing is a major objective of Canada, Japan and other important U.S. trading partners participating in the current Uruguay Round of Multilateral Trade Negotiations taking place under the *GATT*. The *GATT* panel decision will strengthen the negotiating position of these countries in their efforts to persuade the United States to agree to change its practice. But the Uruguay Round negotiations also provide the Bush administration with an excuse to delay acceptance of the panel decision until after completion of the Round, now expected in January or February 1991.

A coalition of U.S. manufacturing industries that make extensive use of U.S. antidumping and countervailing duty laws, and their numerous allies in Congress, have pressured the Bush administration to reject the demands of foreign negotiators in Geneva for reforms in these laws. Because of the *GATT*

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panel decision and the CIT ruling, the administration might ultimately have to agree to modify DOC's practice regarding standing. Significant U.S. concessions on other antidumping and countervailing duty issues appear less likely, however, because the Bush administration is concerned that concessions on these important subjects might provoke Congress to reject the entire Uruguay Round package of agreements. The Uruguay Round agreements are not self-executing, and must be implemented by each GATT member according to its national laws and procedures. In the U.S., notification of the GATT agreements must be submitted to Congress by March 31, 1991, and implementing legislation will then be drafted and acted upon. Given the current mood of Congress, this process is likely to be contentious.

Consequences for Canadian Companies

Under current U.S. practice, a petition filed by a single U.S. producer, regardless of its size or share of U.S. production, almost invariably results in the initiation of an antidumping or countervailing duty investigation by DOC, even if most of the relevant U.S. industry remains neutral. Although DOC will not change its existing policy immediately, the Uruguay Round negotiations, the GATT panel report and the CIT decision (depending, of course, upon the outcome of the appeal) are likely to eventually affect DOC's standing requirements, making it more difficult for companies, trade associations or labour unions representing a minor proportion of U.S. domestic production to initiate investigations. These developments could also influence practice under other U.S. trade laws, such as section 201 ("safeguards" or emergency measures) and section 301 (retaliatory trade actions). The net result is that it will probably become more difficult for individual companies to use the trade laws to harass foreign competitors. These developments will therefore afford Canadian and other foreign exporters somewhat greater security of access to the U.S. market.

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NEW TRANS-TASMAN COMPETITION LAWS

By: H.R. Spier
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Australian Trade Practices Commission

Introduction

Recent amendments to the *New Zealand Commerce Act* and the *Australian Trade Practices Act* introduce new prohibitions into the competition laws of New Zealand and Australia which seek to prevent certain misuses of market power in trade between the two countries. These amendments are operative as from July 1, 1990.

Background

Article 4 of the *Australian New Zealand Closer Economic Relations Trade Agreement - Protocol on the Acceleration of Free Trade in Goods* provides, *inter alia*, for the removal of controls on dumping in trade between the two countries and for the extension of competition laws to relevant anticompetitive conduct

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affecting trans-Tasman trade in goods.

This agreement is given effect to in the *Commerce Law Reform Act 1990* (New Zealand) and the *Trade Practices (Misuse of trans-Tasman Market Power) Act 1990* (Australia). These Acts introduce extended competition law provisions relating to trans-Tasman trade in goods and in goods and services, but not to trade exclusively in services. These provisions prohibit some uses of market power in trans-Tasman trade and allow for a trans-Tasman jurisdiction. The Acts also provide for extended powers for the New Zealand Commerce Commission and the Australian Trade Practices Commission in order to assist in enforcing the new prohibitions.

Section 36A of the *Commerce Act* (as amended by the *Commerce Law Reform Act 1990*) prohibits any person who has a dominant position in a market in Australia or New Zealand, or in Australia and New Zealand, from using that position for the purposes of:

- restricting entry into a market (not being a market exclusively for services) in New Zealand; or
- preventing or deterring competition in a market (..) in New Zealand; or
- eliminating a person from a market (..) in New Zealand.

Section 46A of the *Trade Practices Act* (as amended by the *Trade Practices (Misuse of trans-Tasman Market Power) Act 1990*) provides that:

A corporation that has a substantial degree of market power in a trans-Tasman market (being a market in Australia, New Zealand or Australia and New Zealand) must not take advantage of that power for the purpose of:

- eliminating or substantially damaging a competitor of the corporation...in an impact market (being a market in Australia that is not exclusively for services); or
- preventing the entry of a person into an impact market; or
- deterring or preventing a person from engaging in competitive conduct in an impact market.

The two Acts also provide for the Commerce and Trade Practices Commissions to use their information gathering powers in the other country. Thus the Commerce Commission is empowered to issue a notice requiring the supply of information and documents by an Australian company. It is an offence under the *Trade Practices Act* to fail to comply with such a notice. Similarly, the Trade Practices Commission is empowered to issue similar notices to New Zealand companies and an offence of failing to comply is established under the *Commerce Act*.

Detailed changes to court procedures are also being made to facilitate the operation of these new laws. These are contained in the *Trade Practices (Misuse of trans-Tasman Market Power) Act 1990* (Australia) and the *Law Reform (Miscellaneous Provisions) Act 1990* (New Zealand).

Approach to Market Conduct

The Trade Practices Commission has issued a guideline and background paper to section 46 (abuse of market power prohibited) of the *Trade Practices Act*. As section 46A parallels section 46, the Trade Practices Commission intends to adopt a broadly similar approach to dealing with section 46A matters to that outlined in the section 46 guideline.

In this guideline the Trade Practices Commission identifies conduct which it believes does not generally restrict competition, which may restrict competition, and which does restrict competition. These are:

Conduct which does not generally restrict competition

Here the examples include:

- research and development leading to the introduction of a new product;
- refusal to license intellectual property rights or disclose confidential information.

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Conduct which may restrict competition

Under this broad heading conduct which may be restrictive of competition could include the following:

- refusal to deal because of selective distribution arrangements;
- vertical integration resulting in price or supply "squeeze";
- intellectual property licensing arrangements;
- raising rivals' costs and the strategic creation of entry barriers;
- denial of access to essential facilities;
- refusal to supply or allow reasonable access to spare parts, manuals, etc.

Conduct which restricts competition

Such conduct or practices might include:

- predatory pricing;
- exclusive dealing arrangements and requirements contracts;
- withdrawal of supply to customers who deal with competitors;
- inducing price discrimination and loyalty rebates;
- tie-ins and similar practices;
- "lease only" policies.

In respect of categorising particular practices as being of more or less concern, the Commerce Commission would take a somewhat different approach to that of the Trade Practices Commission. All the practices placed by the Trade Practices Commission under the two headings "Conduct which may be restrictive of competition" and "Conduct restrictive of competition" would be placed by the Commerce Commission under the first heading.

The Commerce Commission's concerns about possible effects on competition intensify with increasing concentration of market power in the market in question. It is that concentration of market power that is the focus of the first stage of the Commission's inquiry. The second stage then examines the relevant practice or practices in terms of the wording of the legislation.

The Commerce Commission's spectrum of concerns does not range from one list of practices to another but from lower to higher concentrations of market power. The Commerce Commission would see both lists as a non-exhaustive enumeration of practices which *may* be of concern. It would not wish to make any *a priori* judgments about a particular practice.

The Commerce Commission is at one with the Trade Practices Commission in its readiness to provide any assistance it can to businesses in interpreting the legislation. As far as possible, it will also provide guidance on its approach to endorsement of the legislation, its main concerns and priorities.

Such guidance must be seen in context of the Commission's endorsement of the Trade Practices Commission's important points:

- (i) that no Commission guideline can be seen as presenting precise criteria or benchmarks on which the Commission will rely in looking to this administration of the law;
- (ii) nor can these guidelines be regarded as "the law" the definitive interpretation of which of course rests with the courts.

Approach to Establishing a Breach of the Law

The Trade Practices Commission's section 46 guideline establishes a ten-step process which, as a general rule, it will use in assessing whether a corporation has engaged in conduct in breach of section 46. These steps are:

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1. Identify the product or products involved.
2. Identify the geographic area in which the corporation supplies these products and the levels at which it operates, i.e. manufacturing, wholesaling, distributing, retailing, etc.
3. Identify the nature and the height of any barriers hindering potential competitors from entering the market in competition with the corporation, and hence the extent to which the corporation is constrained by the threat of entry by potential competitors.
4. Identify the nature and extent of any constraints exerted on the corporation by existing competitors.
5. Identify the extent to which the countervailing power of suppliers and purchasers represents a constraint upon the corporation's conduct.
6. Assess the sources of the market power of which the corporation is said to have taken advantage.
7. Assess whether the degree of market power held by the corporation in question is substantial.
8. Examine whether advantage has been taken of market power, by asking whether the same conduct could have been carried out profitably if the corporation did not possess market power.
9. Examine the purpose(s) of the corporation's conduct to establish if the corporation had an anticompetitive purpose. It may be possible to infer purpose from the conduct complained of.
10. Assess the extent to which competition has been suppressed or destroyed by the conduct, and the degree of damage or potential damage suffered by consumers of the products.

The Commerce Commission, due to a different legislative and procedural environment, has modified this approach for use in determining whether conduct in contravention of section 36A has occurred.

The Commerce Commission's steps for section 36A are:

1. Identify the relevant market in which the corporation (person) is said to have market power, identify the product or products involved; identify the geographic area in which the corporation (person) supplies these products and the levels at which it operates, i.e. manufacturing, wholesaling, distributing, retailing etc.
2. Identify the nature and extent of any constraints exerted on the corporation (person) by existing competitors, including competition from imports.
3. Identify the conditions of entry relevant to the market and whether barriers to entry exist which would hinder potential competitors from entering the market in competition with the corporation (person) and hence the extent to which the corporation (person) is constrained by the threat of entry by potential competitors.
4. Identify the extent to which the countervailing power of suppliers and purchasers represents a constraint upon the corporation's (person's) conduct.
5. Assess whether the degree of market power held by the corporation (person) amounts to a dominant position in a market.
6. Assess whether or not the relevant level of market power has been used, by asking whether or not the same conduct (actual or prospective) could be carried out profitably over time if the corporation (person) did not meet the relevant market power threshold.
7. Examine the purpose(s) of the corporation's (person's) conduct to establish if the corporation (person) had a prohibited purpose. It may be possible to infer purpose from the conduct complained of.

Priorities for Enforcement Actions

The Trade Practices Commission has identified in its section 46 guideline its priorities and approach to complaints concerning section 46. The Trade Practices Commission intends to apply similar criteria to considering complaints alleging contravention of section 46A.

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Thus the Trade Practices Commission will take into account the following general considerations:

- whether the conduct adversely affects the competitive process in a market; in other words, whether it adversely affects the rivalry or competitive pressures that are essential for good performance;
- whether the conduct adversely affects consumers or users of the goods or services in terms of price, quality, availability, choice or convenience and whether it has impaired competition in an unnecessarily restrictive way;
- whether the conduct raises the costs of entry to a market or prevents or hinders potential competitors from entering the market or, having entered the market, from growing; or
- whether the conduct can be explained by a good business justification such as efficiency or the desire to engage in genuine competitive rivalry.

In addition, the Australian government has asked the Trade Practices Commission, when it considers a section 46A complaint, to take full account of the expense and difficulties that the complainant would incur, due to the trans-Tasman nature of the matter, if it had to carry out the investigation itself.

The Commerce Commission has also determined its investigation and enforcement criteria for restrictive trade practices. Its enforcement priorities lie in areas where the practice has, or is likely to have, a wide detrimental effect on competition. It also intends to concentrate on cases where successful action is most likely and cases which have higher deterrent and educative effect. The Commerce Commission intends to use these criteria in determining priorities in respect of section 36A.

Mutual Assistance In Investigations

Each Commission has agreed that it will, on behalf of the other Commission, undertake the preliminary investigations of fact necessary to determine *prima facie* whether or not the corporation (person) complained of has the requisite power in a market in its home country to provide the basis for a contravention of the provision relevant to its trade with the other country.

For example, where a New Zealand company is alleged to have contravened section 46A of the *Trade Practices Act*, the Commerce Commission will, at the request of the Trade Practices Commission, investigate that company's position in New Zealand in order to assist the Trade Practices Commission in determining whether or not that company has a substantial degree of power in a market relevant to its trans-Tasman trading activities.

This agreement is, of course, subject to staff and other resource constraints faced by both Commissions and to overall operating priorities. The Commissions have agreed to monitor their respective costs in this regard.

In relation to any subsequent investigations of an alleged contravention of section 36A or section 46A each Commission has agreed to assist the other as appropriate. In a particular case, where circumstances warrant, the Commissions have agreed to consider conducting a joint investigation with staff from both organizations reporting the results to each Commission for consideration of legal proceedings.

The Commissions have agreed that when either commences an investigation in the other country the local Commission will be advised. Where one Commission issues a statutory demand for information into the other country, it has been agreed that the other Commission will be informed and will facilitate compliance. Both Commissions have also undertaken to keep the other fully informed of general developments in relation to these sections.

Safeguards

The Commissions intend to introduce safeguards relating to the transfer of information between them in order to protect any bases of confidence upon which the information was obtained.

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Harmonization of Trans-Tasman Competition Law

These amendments are seen as a first step in the harmonization of trans-Tasman competition laws and there is a program in place to move to harmonization although not necessarily to common legislation.

TRIBUNAL RELEASES NUTRASWEET DECISION

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On October 4, 1990, the Competition Tribunal handed down its decision in the application by the Director of Investigation and Research concerning certain alleged anti-competitive practices carried on by the NutraSweet Company (NSC). The decision was signed by Mr. Justice Barry Strayer on behalf of the unanimous panel which also included Mr. Justice Max Teitelbaum and Dr. Frank Roseman, the lay member.

The decision followed an application in June 1989 by the Director of Investigation and Research seeking orders against NutraSweet under the exclusive dealing and tied selling sections of the *Competition Act* as well as the provisions with respect to abuse of dominance. NutraSweet produces an artificial sweetener called aspartame which is marketed under the brand name NutraSweet along with its famous "swirl logo". NutraSweet controls over 95% of the Canadian aspartame market. The Tribunal found that NutraSweet had used its market power to keep other suppliers out of the Canadian market with the effect of lessening competition substantially.

The decision also dealt with the question of whether the Competition Tribunal is constitutional. This Tribunal dismissed that challenge, finding the Tribunal as created meets the constitutional requirements under the *Charter of Rights and Freedoms*.

The decision is precedent-setting since it is the first decision under the new civil "abuse of dominance" section of the *Competition Act*. NutraSweet has appealed the decision to the Federal Court of Appeal. The Director has cross-appealed, seeking different remedies than those imposed by the Tribunal. NutraSweet also sought to stay certain provisions of the Tribunal's order pending the outcome of the appeal to the Court of Appeal. This application was heard by the Court in early December and was dismissed.

The decision of the Competition Tribunal is divided into two areas. First, it deals with the substantive issue of whether the practices of NutraSweet constitute anti-competitive practices. The second part deals with the constitutional issues related to the Tribunal.

The Substantive Issues

ABUSE OF DOMINANCE

The Tribunal's decision first analyzes the abuse of dominance section, considering each of the major legal requirements under the law.

Product Market

The issue here was not only how to define the product market, but also whether a distinction could be made between the proper definition of the market and the requirement of the legislation that there must be substantial or complete control of "a class or species of business".

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In considering the product market definition, the Tribunal looked at all sweeteners, including caloric sweeteners. It looked at the demand for those sweeteners on the buying side as well as the different products available in the "high-intensity sweetener" market. In particular, it considered the regulatory hurdles facing marketers of high-intensity sweeteners.

The Tribunal also looked at the evidence of cross-elasticity of demand between various types of sweeteners.

The Tribunal's decision on the product market was that there was no direct evidence of competition between aspartame and caloric sweeteners, and only weak evidence of indirect competition between such sweeteners. There was some competition between aspartame and other currently approved high-intensity sweeteners, but the Tribunal felt that no other high-intensity sweetener was a good substitute for aspartame across large market segments. They therefore decided to define the product market as aspartame. They felt, however, that it mattered little whether the definition was "aspartame" or "high-intensity sweeteners" because of the very limited degree to which non-aspartame, high-intensity sweeteners were present in the Canadian market.

Geographic Market

The issue here was whether the product market was that proposed by the Director, namely all of Canada, or whether it was better to use the respondent's position that the market was worldwide.

The Tribunal reviewed price comparisons between Canada and other jurisdictions and also reviewed the contractual arrangements where country-specific clauses tended to be included in multi-country contracts. They concluded that it was reasonable to treat Canada as a geographic market.

Entry Barriers

The Tribunal analyzed the difficulty of entry into the aspartame business. They found there were significant entry barriers in the form of patent portfolios, economies of scale, and sunk costs. They also thought it would take a minimum of two years before a new entrant could commence large-scale production.

Having reviewed these elements of the economic factors of the production of aspartame, the Tribunal then moved to an analysis of section 79 itself. It was here that the Tribunal provided significant legal guidance on the meaning of the section. The following is a summary of the principal findings.

Control

The first question was the meaning of the term "substantially or completely control". The Director argued that control meant control over supply as defined by the normal dictionary meaning. NutraSweet argued that it meant "market power". Market power would mean an ability to set prices above competitive levels for a considerable period.

The Tribunal accepted the respondent's position as being the better view. However, they stated: This finding is of little practical import because, ultimately, all relevant indicators of market power must be considered in determining whether there is likely to be a prevention or lessening of competition substantially.

Having accepted the respondent's definition of control, the issue then became whether large buyers, such as Coca-Cola and Pepsi, were able to protect their interests through their own strong bargaining position. The Tribunal concluded that although Coca-Cola and Pepsi have considerable resources to protect their interests, this did not in and of itself eliminate NutraSweet's market power.

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The Tribunal concluded:

The evidence that NSC possesses appreciable market power given its market share (over 95% of sales in Canada), entry conditions and the constraints operating on its largest customers is sufficiently compelling so that the boundaries of substantial need not be explored. Its "control" is clearly substantial.

The Tribunal obviously felt that the facts in this case were more than sufficient to meet the test of "substantial", and they did not need to define the minimum threshold of "substantial" required to satisfy the statutory condition.

Class or Species of Business

The Tribunal considered how it should define "class or species of business" as used in the section. The Director argued that these words should be interpreted in the commercial sense rather than in an economic sense, and that on this definition the business of NutraSweet was the manufacture and supply of aspartame. The Tribunal took the view of the respondent, however, that "class or species of business" is the same thing as the relevant product market.

This is an important decision, since it had been unclear how the Tribunal would interpret "class or species of business." It is particularly important since the Tribunal's decision contradicts the *Eddy Match* decision of the Québec court, under the old monopoly section. The Tribunal justified this distinction in the following manner:

Based on the facts in *Eddy Match Co.* and the different legislative schemes of the *Combines Investigation Act* and the *Competition Act*, the Tribunal does not believe that this case provides a sound basis for identifying "class or species of business" without referring to possible substitutes. The court in that case was seized with charges under a criminal statute, a case in which the accused had engaged in highly aggressive conduct towards other producers of wooden matches; Eddy certainly acted as though wooden matches were sufficiently distinct so that it was worthwhile for it to concentrate its efforts on that industry. In the present statute, however, s.79 provides other remedies and the deciding body is a specialized tribunal. It would run contrary to the spirit of this legislation for the Tribunal to eschew other relevant factors (i.e. possible substitutes) on some presumed technical ground.

The decision by the Tribunal that it will not necessarily follow previous jurisprudence under the *Combines Investigation Act* in criminal matters is an important indication of the Tribunal's attitude toward its responsibilities.

Practice of Anti-Competitive Acts

The Tribunal considered the requirements of "practice of anti-competitive acts" as contained in section 79. In this area also, the Tribunal's decision is an important precedent. The Tribunal stated:

This list of anti-competitive acts is clearly not meant to be exhaustive and the respondent admits that other conduct not specifically mentioned in s.78 can constitute an anti-competitive act. A number of the acts share common features but, as recognized by the Director and the respondent, only one feature is common to all: an anti-competitive act must be performed for a purpose, and evidence of this purpose is a necessary ingredient. The purpose common to all acts, save that found in paragraph 78(f), has an intended negative effect on a competitor that is predatory, exclusionary or disciplinary.

This also is a very important finding since it indicates the Tribunal believes there must be some element of intent or purpose to constitute an anti-competitive act.

The Tribunal's interpretation of the meaning of "practice" is also very instructive. It stated: If there is a good reason to avoid a limiting interpretation of "practice" under criminal law, it is all the more important to do so under s.79. The anti-competitive acts covered in s.78 run a wide gamut. Some almost certainly entail a course of conduct over a period of time, such as freight equalization in paragraph 78(c), whereas others consist of discrete acts, such as the setting of product specifications in paragraph 78(g). The interpretation of "practice" must be sufficiently broad so as to allow for a wide variety of anti-competitive acts. Accordingly, the Tribunal is of the view that a practice may exist where there is more than an "isolated act or acts." For the same reasons, the Tribunal is also of the view that different

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individual anti-competitive acts taken together may constitute a practice. It is important to stress, however, that this does not in any way relieve the Director of the burden of establishing an anti-competitive purpose for each of the acts.

This statement settles the issue of whether a practice must be a practice for each anti-competitive act. It also reaffirms that any anti-competitive act must be done for an anti-competitive purpose.

The Tribunal then considered how one would establish an anti-competitive purpose. It recognized that this was a difficult task. The Director submitted that this test could be met through evidence of subjective intent, such as verbal or written statements of personnel of the respondent, or through a consideration of the nature of the act itself, the latter being based on the premise that a corporation intends the necessary and foreseeable consequences of its acts. The Tribunal accepted the Director's position on this point. It also indicated that, in most instances, the purpose of a particular act will have to be inferred from the surrounding circumstances.

Contractual Exclusion of Potential Competitors

The Director had alleged that a contract between a Japanese competitor of NutraSweet whereby the Japanese company would not sell aspartame in Canada was an anti-competitive act. The Tribunal reviewed the evidence in this point and found that the fact that such a contract exists is, in and of itself, not sufficient to make the contract an anti-competitive act. The Tribunal stated:

A consistent pattern in the anti-competitive acts cited in s.78 (save for that in paragraph (f)) is that the competitor of the dominant firm is a target not a fellow actor. While the Tribunal is reluctant to conclude that all horizontal arrangements are excluded from ss.78 and 79, we do not believe that we have been provided with adequate justification for including the NSC-Ajinomoto arrangement (insofar as it affects Canada) as an anti-competitive act under s.78.

This is an interesting indication of the Tribunal's attitude toward the section. It clearly believes that the section has more relevance in vertical relationships than in horizontal relationships, although it has not precluded the possibility of it applying completely to horizontal arrangements.

Contractual Exclusivity Requirements

The Tribunal then looked at the principal argument of the Director with respect to exclusivity, namely, that contracts requiring exclusivity, either directly or through discounts related to trade-mark display or meet-or-release clauses, were tantamount to exclusive dealing.

With respect to meet-or-release clauses, the Tribunal found that large customers such as Coca-Cola or Pepsi used them as a way of mitigating the effect of being locked into an exclusive contract. The Tribunal stated:

If exclusive supply is objectionable in the instant case, so is a meet-or-release clause: by making exclusivity more acceptable to customers it serves as an inducement for customers to enter into exclusive arrangements.

With respect to the most-favoured-nation clause whereby NutraSweet contractually agreed to offer its best price in its contracts, the Director had argued that this was an inducement to exclusive dealing. The Tribunal found that:

The Director submits, correctly in the Tribunal's view, that only a firm with a very large market share can be expected by its customers to provide a most-favoured-nation clause because only it will almost certainly be selling to the customers' competitors.

However, the Tribunal appeared not to find all of these practices as anti-competitive acts. It stated: The Tribunal sees little purpose in the context of the present case in determining whether each clause constitutes an anti-competitive act. It is doubtful whether the meet-or-release and most-favoured-nation clauses would exist in the absence of an explicit or implicit exclusive supply agreement. In the Tribunal's view, the issue is whether the agreements requiring exclusive supply and all the contract terms related to it, have an exclusionary purpose. The Tribunal is persuaded that this is the case.

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This again is a most interesting finding. The Tribunal, in essence, has refused to find whether certain of the related terms of the contracts, such as meet-or-release or most-favoured-nation, were in and of themselves anti-competitive acts, preferring to treat them as part and parcel of an overall exclusive supply agreement. However, these clauses are not at all uncommon in normal contractual relationships and are often found in situations where there is no exclusive supply term or a dominant supplier. Whether they, on their own, could ever be anti-competitive acts is undecided and remains uncertain.

Selling Below Cost

The Director had alleged that NutraSweet had engaged in the anti-competitive act set out in paragraph 78(i) of "selling articles at a price lower than the acquisition cost for the purpose of disciplining or eliminating a competitor". It accepted the respondent's argument that acquisition cost is not easily applied in a manufacturing situation. The Tribunal also found that the language of the paragraph suggested that Parliament intended it to be applied mainly to distribution situations where the articles would be resold.

The Tribunal, while limiting the application of paragraph 78(i), considered whether there could be an anti-competitive act or some form of predatory pricing not specified in section 78 but nevertheless, caught by the dominance provisions. The Tribunal, in an important conclusion, stated that it was satisfied that the section was broad enough to cover other forms of predatory pricing. It then considered the appropriate test for predatory pricing and basically concluded that the Areeda-Turner test is the appropriate standard.

Use of U.S. Patent to Foreclose Competition

The Director had alleged that NutraSweet was using its patent in the United States to gain a competitive advantage in Canada. This U.S. market power was alleged to have been used with Coca-Cola and Pepsi in particular. The Tribunal accepted the Director's position that the use of a monopoly position in one country to obtain a competitive advantage by a dominant firm in another market constitutes an anti-competitive act.

Substantially Preventing or Lessening Competition in a Market

This is the basic test to be used in issuing an order under the section. The Tribunal stated: The factors to be considered in deciding whether competition has been or is likely to be substantially lessened are similar to those that were discussed in concluding that NSC has market power. In essence, the question to be decided is whether the anti-competitive acts engaged in by NSC preserve or add to NSC's market power.

This is a most interesting finding. In essence, the Tribunal is stating that determination of whether market power exists in and of itself will be sufficient to decide whether there is or is likely to be substantial lessening of competition, if there is any anti-competitive act involved. This sounds very similar to the *Irving Newspaper* case where the trial judge found that once Irving had been found to have a monopoly in English language newspapers in New Brunswick, "detriment to the public" was to be presumed.

One of the arguments advanced by the respondents was that the exclusivity used by NutraSweet was necessary to protect it against "free riding". The argument was that NutraSweet had borne all the costs of obtaining regulatory approvals and developing the markets for aspartame, and now other suppliers would reap the benefits of those efforts. The Tribunal concluded:

The Tribunal does not accept that NSC is entitled to any more protection against competition than it was able to obtain through patent grants that provided it with a considerable head start on potential competitors.

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Conclusion on Dominance

The Tribunal concluded its extensive consideration of the requirements of the dominance section by finding that NutraSweet substantially controls through its market power a class or species of business, namely the sale of aspartame in Canada. It also found that NutraSweet had engaged in a practice of anti-competitive acts and that those acts were several in number and frequently repeated. The particular acts it found to be anti-competitive were exclusive supply and use clauses, logo display allowances, cooperative marketing allowances, meet-or-release clauses, and most-favoured-nation clauses¹. It also included the use of U.S. patents to foreclose competition by a system of rebates on exports from the United States to induce Canadian importers to have only NutraSweet aspartame in their products. It therefore concluded that those practices were having the effect of preventing or lessening competition substantially.

EXCLUSIVE DEALING

The Director had also alleged that NutraSweet had engaged in the practice of exclusive dealing covered by section 77 the *Competition Act*. The *Act* defines exclusive dealing as either requiring a customer to deal only in particular products or inducing them to do so. The Director argued that the mere fact of including an exclusive supply clause in a contract would meet the requirements of the section. The Director relied on normal contractual law and principles. However, the Tribunal concluded:

But we are of the view that in considering an allegation of exclusive dealing it is the circumstances in which the particular terms of supply were agreed upon that are critical....The Tribunal agrees that there is no evidence on the record that customers were refused or threatened with a refusal of aspartame supply if they did not enter into exclusive contracts with NSC.

The Tribunal then found that the requirements in section 77(1)(a) were not met.

The Director also submitted that customers had been induced to deal exclusively with NutraSweet. The Tribunal had no trouble in finding that the financial incentives amounted to inducement within the meaning of section 77(1)(b).

Practice

With respect to the requirement of a practice contained in the exclusive dealing section, the Tribunal found that the same principles applied as those in the abuse of dominance section.

Major Supplier

The Tribunal followed the decision of the Restrictive Trade Practices Commission (RTPC) in the *Bombardier* case in finding that NutraSweet was a major supplier.

Substantial Lessening of Competition

On the question of substantial lessening of competition, the Tribunal basically followed the conclusion it had reached in the abused dominance section that once the practices were found to exist, and the other requirements met, substantial lessening of competition would follow.

REMEDIES

The Tribunal moved to consider the sort of order it should issue. It made two significant findings here. First, it found that the remedies should be of the kinds requested by the Director, with such

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modifications as might have fairly arisen in the course of arguing the case. In other words, it did not feel it to be appropriate or fair to impose an order of which the respondent had no formal notice.

It also considered whether it could declare various contracts, even those not made in Canada, to be invalid in whole or in part. Apparently an issue had been raised of whether the Tribunal had jurisdiction to make such declarations. The Tribunal felt it was not necessary to decide that issue since it would confine itself to issuing directions to the respondent with respect to enforcing the contracts. It also stated that it believed the order should be relatively certain and enforceable.

The Tribunal, having set out these principles of issuing orders, ordered NutraSweet not to enforce certain contracts already in existence and not to enter into contracts with the same terms in the future.

B. Constitutional Validity of the Tribunal

The Tribunal next considered the constitutional issue raised by the *Couture* case. One such issue raised was that Parliament is prohibited by the *Constitution* from conferring judicial functions on any person or body which does not enjoy the individual and institutional independence of normal courts. With respect to this argument, it found:

The Tribunal recognizes that most of its functions are of a judicial nature. In substance we determine facts on the basis of evidence and we apply pre-existing law to those facts to render binding decisions. Procedurally it is clear that we must respect the rules of natural justice and fairness in the conduct of our hearings. But we are, as the Federal Court of Appeal has recently pointed out, "an inferior Court". We do not have the implied powers of a superior court and we are subject to the supervision of a superior court.

The Tribunal concluded that it did not believe the tenure and reappointment provisions of the *Competition Tribunal Act* and the fact that Dr. Roseman was a continuing member of the RTPC, would create a reasonable apprehension of bias. It found there were sufficient safeguards in the *Competition Tribunal Act* to protect against any possible apprehension of bias.

The respondent had also argued that if a person may be called upon in another role to exercise executive functions, he cannot legally exercise any judicial functions. The Tribunal found that "we see no support in the law for such a rigid separation of powers, assuming there is no reasonable apprehension of bias in respect of a given case."

Another argument had been made that the Tribunal's functions were those of a superior court, and that sections 96 to 100 of the *Constitution* preclude provincial legislatures and also the Parliament of Canada from conferring such functions on any body other than a superior court. The cases cited dealt principally with the limitations on the provincial legislatures' power to give such judicial functions to its own courts. But the Tribunal found these to be of little help in determining whether the *federal* government could create such powers. It relied on the federal government's powers in section 101 to create other courts for the better administration of justice, and found that that power was given notwithstanding the obligations contained in sections 96 to 100 of the *Constitution*. The Tribunal did not support the respondent's argument and found that the respondent's contention that Parliament could give judicial functions only to section 96 courts required too much. The Tribunal stated:

The result would be that any federal tribunal to which such judicial functions are assigned could consist only of lawyers, members of the Bars of the respective provinces as prescribed in sections 97 and 98. Further, if they exercise any "superior court functions" they would have to have security of tenure to age 75 in accordance with section 99 and presumably they would have to devote themselves full time to the Tribunal. This would not only invalidate a host of existing federal tribunals but would also preclude for the future the inclusion in such tribunals of persons with specialized knowledge (other than that of law) or persons who wish to continue on a part-time basis the careers from which they derived the economic, business, or other special knowledge which they are expected to bring to that tribunal. We find it difficult to believe that the Constitution of Canada compels such a result.

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C. Conclusion

The decision is interesting in that it settles a number of unanswered questions about the interpretation of the dominance section. The decision with respect to the *Constitution* seems well reasoned.

As to the implications of the decision for business, it will have fairly important ramifications, particularly because exclusive dealing arrangements are not at all uncommon in normal commercial business in Canada, and a number of the clauses which the Tribunal used to found an abuse are also very common.

The decision also simplifies the basis on which an order will be available under the dominance section. Whether it has gone too far remains to be seen.

As mentioned above, NutraSweet is appealing the decision, raising many grounds of error.

1. The conclusion seems somewhat inconsistent with the Tribunal's earlier conclusion not to find each contract term related to exclusion as an anti-competitive act.

THE NEW CANADIAN DRAFT MERGER GUIDELINES — A PRELIMINARY ASSESSMENT

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In November 1990, the Director of Investigation and Research, Mr. Howard Wetston, released comprehensive proposed Merger Enforcement Guidelines (the Guidelines). Since he took office, Mr. Wetston has promised to produce Merger Guidelines, even though certain commentators had suggested they were unnecessary. The draft Guidelines are well thought out, well written and represent an important advancement in the sophistication of merger enforcement in Canada. The Director will be conducting extensive consultations on the draft Guidelines with interested parties in the early part of 1991. However, there is little doubt the Director intends to adopt the Guidelines, and probably without significant changes in philosophy.

The Director stresses that the Guidelines are to be that, guidelines. They do not bind the Director and, of course, are not determinative before the Competition Tribunal or the courts.

The Guidelines also state that they do not represent a significant change in the current enforcement policy of the Director. This has provided some comfort to lawyers who have been involved in the consultation process. It begs the question, however, of the relevance of the Guidelines in future decision-making. The Guidelines set out a far more technical and analytical approach to merger assessment than has been adopted to date by the Bureau in most merger reviews. If the Bureau attempts to review all mergers on the basis of the proposed Guidelines, it would require considerably more attention to detail and competitive analysis by merging parties than has been the case in the last four years.

The following are comments on various aspects of the proposed Merger Enforcement Guidelines.

The Definition of "Merger"

The Guidelines briefly set out how the Director defines the word "merger", and in particular the words "significant interest" in that definition. Generally speaking, the Guidelines take the view that one has a significant interest where one has "the actual or potential ability to materially influence the economic behaviour" of another business.

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A significant interest would be found where one party holds sufficient voting shares to obtain representation on the Board of Directors of a corporation or to block special or ordinary resolutions of the corporation. It further states that direct or indirect ownership of more than 25 per cent of the voting shares would normally be found to constitute a "significant interest". It states that ownership of less than 10 per cent would not constitute a "significant interest", but that it is possible shareholdings between 10 and 25 per cent could do so.

The Guidelines also state that it is possible to engage in a merger under the *Act* even after having previously acquired a significant interest in a competitor. For example, if a shareholding is increased so that Board representation can be increased, the latter acquisition of shares could also constitute a "merger".

The discussion of the definition of "merger" focuses almost exclusively on ownership of voting securities. It does not discuss whether the definition is broad enough to allow a situation where mutual interdependence is established by contractual relationships, whether of a purchaser/supplier nature or otherwise, or through a debtor/lender relationship. It might be useful if the Director would express his views on non-equity situations which could give rise to a merger.

The Meaning of "Anti-competitive"

The *Act* talks about preventing or lessening competition, and the Guidelines give a brief discussion of the meaning of the words "prevention or lessening". Generally speaking, the Guidelines propose that the primary focus in determining an effect on competition will be the ability to exercise a greater degree of market power. In determining market power, the focus will be primarily on the "price dimension of competition". Other qualitative features of competition will be assessed but price will be the dominant concern.

The Guidelines also indicate that either a price increase can happen unilaterally as a result of the increased market power resulting from a merger, or it might result from the increased possibility of "interdependent behaviour in the market." "Interdependent behaviour" includes:

...an agreement or arrangement with respect to one or more dimensions of competition as well as other forms of behaviour that permit firms to implicitly coordinate their conduct, e.g., through facilitating practices, the interplay of market signals, or conscious parallelism.

The Guidelines, in this sense, copy the prevailing view in the United States and, indeed, a view that has been supported by the Tribunal in both the *Imperial Oil* and *Air Canada* cases, where the enhanced ability for collusion was used as a test for determining the effect of a merger on competition.

The Guidelines also address the question of when an effect on competition would be substantial. In this regard, they state that a substantial effect on prices would be one that is materially greater over the large part of the effective market, and that would not likely be competed away within two years by new or increased competition. This definition begs the question of what would be a materially greater price, and in this regard the Guidelines seem to suggest that since the Director intends to define markets on the basis of whether prices can be increased by 5 per cent, the same 5 per cent figure would be viewed as material for the purpose of determining a substantial effect on competition.

Market Definition

The Guidelines contain an extensive discussion of the definition of markets, a crucial feature in any merger analysis. They adopt the following conceptual basis for defining markets:

Conceptually a relevant market for merger analysis under the *Act* is defined in terms of the smallest group of products in the smallest geographic area in relation to which sellers, if acting as a single firm ("hypothetical monopolist") that was the only seller of those products in that area, could profitably impose and sustain a 5 per cent price increase for one year above prevailing levels or levels that would likely exist in the absence of the merger.

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The Guidelines recognize that it is often difficult to test the market definition hypothesis using this basis and, therefore, set out evaluative criteria which the Director would use in determining both product and geographic markets. With respect to product market definition, these criteria are proposed to be:

- a) the views and behaviour of buyers of the product,
- b) the views of other competitors in the same business,
- c) the functional substitutability of products in the market,
- d) the physical and technical characteristics of the product,
- e) the costs a buyer would incur in switching to a different product,
- f) price relationships or relative price levels between two products,
- g) costs of adapting or constructing facilities to sell the product, and
- h) whether there exists a second-hand, reconditioned or leased product market.

With respect to geographic market definition, the evaluative criteria set out in the Guidelines are:

- a) the views of buyers in the marketplace,
- b) the switching costs of moving from one producer's product to another,
- c) transportation costs as an impediment to sourcing product outside a defined area,
- d) any local setup costs for a new entrant,
- e) inherent characteristics of the product which could be relevant, such as perishability,
- f) review of price movements in different geographic areas and any evidence of correlation,
- g) the shipment patterns of the product in the past, and
- h) foreign competition.

The Guidelines then move to a discussion of the evaluative criteria set out in section 93 of the *Act*. In this part of the document, the Guidelines provide very useful indications of the Bureau's thinking. The first topic discussed is the role of market share and concentration. Although the Guidelines make it clear that the Director would never bring a case based only on market share or concentration evidence, it is still a very significant factor in determining the effect on competition.

The approach the Director is taking in the draft Guidelines is to state levels below which it is very unlikely a merger would ever be challenged. This "safe harbour" concept should provide considerable comfort, although it appears the Director proposes to adopt rather low thresholds. It is proposed that the merger would not likely be challenged where the post merger market share was less than 30 per cent or where the post merger market share of the four largest firms in the market was less than 65 per cent, and the market share of the merged entity itself was less than 10 per cent.

In situations where market shares are above these thresholds, the Guidelines do not state that there will always be a serious competition problem. However, it does indicate that the higher the market shares, the more likely it is that there will be a serious concern with the merger. The danger with the "safe harbour" concept is that either the private sector or, worse, the Bureau will fall into the trap of viewing any merger above the safe harbour thresholds as presenting a serious problem. This should not be the case and, if it were, it would reflect a significant change in the Bureau's current operating philosophy. As mentioned previously, the introduction to the Guidelines indicates that they do not represent a change in present enforcement policies.

The Guidelines review each of the criteria set out in section 93. Perhaps the most significant criteria discussed are barriers to entry, effective competition remaining, and failing firm. These three criteria are singled out as being more important since a determination with respect to any of them could result in a decision not to challenge the merger. In other words, if the evidence showed that entry would likely take place on a sufficient scale in a proper market to ensure that no price increase could be sustained for more than two years, that in and of itself would be a sufficient criterion for letting the merger proceed. Likewise, the Guidelines state that:

...where it is clear that the level of effective competition that would likely remain in the relevant market is not likely to be reduced as a result of the merger, this alone will generally justify a conclusion not to challenge the merger. This is so whether the absolute level of effective competition in the market appears to be high or low.

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The Guidelines contain an extremely detailed discussion of the process which the Bureau would take in determining whether a firm is failing. These include the time within which the firm might become insolvent, a search for a purchaser who would be prepared to offer more than the firm's breakup value, and the necessity of providing detailed financial information. The Guidelines also state it will take the Bureau three to six weeks to determine whether a firm is indeed failing (on the assumption that it has not already gone out of business by that time), and also the possibility of involving a third party to find a buyer.

The discussion of failing firms seems far too onerous and difficult. It may be appropriate in situations where a failing firm is the sole criterion which would be used to allow a merger to proceed, but this seems to discount the possibility that, based on lesser evidence, weight could be given to the financial health of a business in reviewing the overall criteria and making a determination whether to challenge the merger. It would be helpful if the Guidelines made a distinction between these situations.

The Guidelines propose to add two criteria to those normally considered by the Bureau in assessing mergers. The first is market transparency. The Guidelines state that:

...where a merger raises concerns that it may be likely to facilitate interdependent behaviour, the extent of transparency in the relevant market will ordinarily be assessed. Transparency in this context connotes information that is readily available in the market about competitors, prices, levels of service, innovation initiatives, product quality, product variety, level of advertising, etc. In general, as the level of transparency in a market decreases, coordinated behaviour becomes increasingly difficult, because firms find it harder to detect and retaliate against secret discounts and other deviations from interdependent situations.

The Guidelines also talk about schemes which increase transparency such as delivered pricing systems, product standardization, exchanges of information through trade associations or otherwise, public disclosure of information by buyers or government sources, and "meeting competition" contractual terms.

The second criterion added is transaction value and frequency. This is also related to mergers where interdependent behaviour may be a concern. It states:

Interdependent behaviour often becomes increasingly difficult as the frequency and regularity of sales of the relevant product decrease, and as the value of each sale increases.

The Guidelines do not state how important these two new criteria are. However, it is interesting that they both relate to the interdependent behaviour or tacit collusion basis on which the Director might challenge a merger.

Efficiency Defence

The Guidelines contain an extensive discussion of the efficiency defence contained in the Act. Generally, this discussion reflects past Bureau philosophy and indicates that the most significant weight will be given to well-documented, quantitative assessments of efficiency savings, usually arising from economies of scale or scope. It does indicate, however, that dynamic or qualitative efficiency gains will also be given appropriate weight.

Procedural Matters in the Merger Review Process

The discussion of procedural issues is largely a reiteration of rules with respect to prenotification and confidentiality, etc. However, its most significant feature is a discussion of the time it would take the Bureau to review mergers. The Guidelines indicate that the Director should be able to make a preliminary determination about whether there is a serious question (within three weeks). By this, they appear to mean that in three weeks the Bureau should be in a position to inform the parties whether the transaction can proceed. If it still has questions a longer period of time will be necessary. In these cases,

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... a determination can be made of whether a merger prevents or lessens competition substantially within eight weeks after the parties have provided all requested information. This period of time is required in order to review this information, and to gather and review information provided by customers, suppliers, competitors, experts, others in the industry in government departments that have information pertaining to the market(s) in question. Where information is not provided upon request by merging parties or others, the Director may seek to exercise the formal powers provided under section 15 or 16 of the *Act*.

The Guidelines also indicate that where there is still a significant issue after this period of time, which presumably means that the Director has concerns about the merger, it can take up to a further four months before the Director makes a final determination on whether to refer the matter to the Tribunal.

These time periods clearly will frighten many businessmen as being unduly lengthy. On the other hand, they probably reflect experience under the provisions to date and are, therefore, realistic.

Conclusion

The recently released draft Merger Enforcement Guidelines represent a significant improvement in the understanding and analysis of merger enforcement law in Canada. The concern some have expressed that they would fetter the Director's review of mergers appears to be largely unfounded. The Director has cast them in educative as well as normative terms. He has also made sure that criteria, when they are spelled out, are not spelled out in a limiting fashion.

They may have the effect of increasing the sophistication of merger analysis in Canada. One question remains, however. That is whether the Bureau, Canadian businessmen and their advisors, or economic experts are sophisticated enough to analyze mergers as thoroughly as the Guidelines would suggest. It is doubtful they can, at least in the short run. It is also doubtful that it is necessary to go to the depth of analysis the Guidelines suggest except in the most serious anti-competitive mergers.

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SUMMARY COMPARISON OF DRAFT CANADIAN MERGER GUIDELINES AND U.S. DEPARTMENT OF JUSTICE MERGER GUIDELINES

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Set out below is a summary of the draft Merger Guidelines (Canadian Guidelines) released by the Director of Investigation and Research in early November 1990. For comparison, noted in the right column below is a summary of similar provisions discussed in the U.S. Department of Justice Merger Guidelines (U.S. Guidelines).

CANADIAN GUIDELINES

U.S. GUIDELINES

Part I: Definition of Merger

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| <ul style="list-style-type: none"> • The section 91 merger definition is broad enough to cover any manner in which control over a "significant interest" in the whole or part of a business of another person is acquired or established or proposed to be acquired or established. • The "significant interest" is held where one or more persons have actual or potential ability to influence materially the economic behaviour of a business or part of a business. Examples provided include the acquisition of more than 25 percent of the voting shares of a corporation, the movement from a minority, but significant shareholding in a corporation to <i>de jure</i> or <i>de facto</i> control, and the acquisition of the assets of a division of a business. | <ul style="list-style-type: none"> • No definition is provided. |
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Part II: The Anticompetitive Threshold

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| <ul style="list-style-type: none"> • A merger prevents or lessens competition only if the parties to the merger are or would likely be able to exercise a greater degree of "market power", unilaterally or interdependently, in any part of the relevant market than they would if the merger did not proceed. • "Market power" refers to the merged entity's unilateral or interdependent ability to overcome the constraining forces of | <ul style="list-style-type: none"> • The U.S. Guidelines state that a merger should not be permitted to create or enhance "market power" or to facilitate its exercise. • "Market power" is defined as the ability of one or more firms profitably to maintain prices above competitive levels or to eliminate rivalry |
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competition through either pricing or non-pricing behaviour (i.e., product quality).

If a merger is likely to result in the price of the relevant product being greater in a substantial part of the relevant market than it would be in the absence of the merger, and if this price differential would not likely be eliminated within two years by existing or new competitors, the prevention or lessening of competition is considered to be "substantial".

on variables other than price for a significant period of time. "Market power" also encompasses the ability of a single buyer or group of buyers to depress the price paid for a product to a level that is below the competitive price.

Part III: Market Definition

- The relevant market is determined by reference to the smallest group of products and the smallest geographic area in relation to which sellers, if acting as a single firm that was the only present and future seller of those products in that area, could profitably impose a five percent price increase for one year above prevailing levels that would likely exist in the absence of the merger.
- A "market" is defined as a product or group of products and a geographic area in which it is sold such that a hypothetical profit-maximizing firm, not subject to price regulation, which was the only present and future seller of those products in that area would impose a "small but significant and non-transitory" increase in price, the Department in most contexts will use a price increase of five percent lasting one year.
- A postulated price increase may be made unprofitable by: (1) buyers switching to substitute products; (2) buyers switching to the same product sold in other areas; (3) new entrants constructing facilities or sellers of other products adapting existing facilities to commence production of substitute products; or (4) sellers of substitute products located in distant areas diverting their product to the area in question.
- A postulated price increase could be made unprofitable by: (1) consumers switching to other products; (2) consumers switching to the same product produced by firms in other areas; or (3) producers of other products switching existing facilities to the production of the product by substantially modifying existing facilities or by greenfield entry.

Product Market

- Supply-side criteria used to define the relevant product market and evaluate the effect of a postulated price increase include: (1) historical pricing movements; (2) cost and likelihood of greenfield entry (including marketing and distribution costs); (3) the availability of used or recycled products as substitutes; (4) the ability of vertically integrated firms to enter the market; (5) past behaviour of the merging parties; and (6) views of third parties in the industry.
- The Department's evaluation of a merger focuses primarily on firms that currently produce and sell the relevant product. In addition, the Department may include other firms and consider: (1) production, diversion or substitution by existing suppliers (taking into account entry costs); (2) the availability of used or recycled products as substitutes; and (3) the ability of vertically integrated firms to enter the market.

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- Demand-side criteria used to define the relevant product market and effect of the postulated price increase include: (1) the views and strategies of buyers; (2) the extent to which two products are functionally interchangeable in end use; (3) physical and technological characteristics of the relevant products; and (4) product switching costs.
- In evaluating product substitutability, the Department gives particular weight to: (1) evidence of buyers' perceptions; (2) historical differences in price movements of the products; (3) similarities between the products in customary usage, design and other technical characteristics; and (4) evidence of sellers' perceptions that the products are or are not substitutes.

Geographic Market

- Criteria used to define the relevant geographic market and evaluate the effect of a postulated price increase include: (1) transportation costs within the market and from secondary markets; (2) local set-up costs for distant suppliers (i.e. warehousing); (3) inherent characteristics in product which may impede transportation from distant suppliers; (4) historical price movements in geographical areas; (5) shipping patterns; (6) foreign competition (domestic and international); and (7) views and past behaviour of buyers.
- To determine the relevant geographic market, the Department will give particular weight to: (1) historical shipping patterns of the merging firms with which they actually compete; (2) evidence of buyers having actually considered shifting their purchases among sellers at different geographic locations; (3) differences in price movements of the relevant product over a period of years; (4) transportation costs; (5) costs of local distribution; and (6) excess capacity of firms outside the location of the merging firms. Where price discrimination is possible, the Department will consider defining additional, narrower geographic markets consisting of particular locations in which a hypothetical monopolist could profitably impose a "small but significant and non-transitory" increase in price.

Part IV: Evaluative Criteria

Market Share and Concentration

- The Director will consider concentration or market share levels together with one or more other factors in finding that merger prevents or lessens, or is likely to prevent or lessen, competition substantially.
- In general, a merger will not be challenged on the basis that the merging parties will unilaterally be able to exercise greater market power where the post-merger market share of the merged entity is less than 30 percent. Similarly, the Director generally will not
- In the case of horizontal mergers, the Department will consider both the post-merger market concentration and the increase in concentration resulting from the merger. A post-merger HHI below 1000 will generally be considered unconcentrated. Post-merger HHI between 1000 and 1800 raises competitive concerns. The Department is likely to challenge mergers in this range which produce an increase in the HHI of more than 100 points unless it otherwise concludes that the merger is not likely to lessen competition

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challenge a merger on the basis of interdependent exercise of market power where: (1) the post-merger market power of the four largest firms is less than 65 percent and (2) the post-merger market share of the merged entity is less than 10 percent. As market shares and concentration levels increase, the Director is more likely to conclude that the merged entity may be able to exert unilateral or interdependent competitive behaviour.

- Market share is determined by aggregating the entire actual output of suppliers located in the relevant market (less output that is diverted to other markets) and actual sales of distant suppliers in the relevant market immediately prior to the merger.
- The Department normally will include in the market the total sales or capacity of all domestic firms identified as being in the relevant market. To the extent available information permits market shares will be assigned to foreign competitors in the same way in which they are assigned to domestic competitors.

Section 93 Factors

- Discussion of the section 93 factors entitled "Foreign Competition", "Business Failure", "Availability of Acceptable Substitutes", "Barriers to Entry", "Effective Remaining Competition", "Removal of Vigorous and Effective Competitor", "Change and Innovation" and a catch-all "Additional Evaluative Criteria" has been provided. Each is relevant to market definition and as a criterion for evaluating the likely effect on competition of the merger.

Foreign Competition

- If foreign products are not supplied in the relevant market and this cannot be attributed to the existence of a tariff, the Bureau will not include foreign sources of product in the relevant market.
- To evaluate the likely competitive discipline that foreign suppliers may exert in the relevant market, the Bureau considers tariff barriers, the extent to which such barriers may be reduced under the *Free Trade Agreement* and the *GATT*, domestic packaging and regulatory
- The U.S. Guidelines contain no discussion on matters which the Department would consider in determining the competitive significance of foreign suppliers.

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standards vis-à-vis similar foreign standards; and many other "soft" criteria that are relevant in the industry.

Business Failure

- Given that there may be alternatives to the merger which would likely result in a less anti-competitive market situation than if the merger proceeded, the fact that one of the parties to a merger is likely to fail is not in itself sufficient to warrant a finding that the merger does not infringe the substantive merger test.
- A firm is considered to be "failing" where it is likely to become insolvent within six months or where it has or will likely be subject to bankruptcy proceedings or a receivership within that period. The Bureau requires three to six weeks to complete its assessment of business failure.
- The Bureau will consider whether a third party (whose purchase of the existing firm would likely result in a substantially higher level of competition) may be willing to purchase the failing firm at a price in excess of the break-up value of the firm. Third party purchasers should be sought for a period of at least 60 days by an independent party such as an investment dealer or broker. Public requests for third party offers need not be made if the existing firm would suffer significant damage as a result of public disclosure of its financial condition.
- An absence of feasible and likely retrenchment scenarios for the existing firm weighs in favour of a conclusion by the Director not to challenge the merger. Objective verification of claims that a firm is not likely to remain in the market by retrenchment or otherwise is required.
- The Department is unlikely to challenge an anti-competitive merger in which one of the merging firms is allegedly failing when: (1) the allegedly failing firm would probably be unable to meet its financial obligations in the near future; (2) it probably would not be able to reorganize successfully under Chapter 11 of the *Bankruptcy Act*; and (3) it has made unsuccessful good-faith efforts to elicit reasonable alternative offers of acquisitions of the failing firm that would both keep it in the market and result in a less severe effect on competition than the proposed merger.
- The U.S. Guidelines contain no extensive discussion on retrenchment and liquidation alternatives.

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- If retrenchment or third party sale scenarios are impossible, the Bureau will consider whether liquidation of the existing firm will result in a substantially higher level of competition in the market than if the merger proceeded.

Availability of Acceptable Substitutes

- Other products are acceptable substitutes only if they are available in the relevant market.
- The Bureau will consider if producers of acceptable substitute products have the capacity and are likely to increase their supply of such products to ensure that the post-merger entity cannot impose price increases or reduce the benefits of non-price competition without facing competitive discipline from such producers. An assessment will also be made of whether it is likely that the total supply of acceptable substitutes in the relevant market will in fact increase sufficiently to ensure that a material price increase cannot be sustained for two years.
- A similar discussion is set out in the U.S. Guidelines.

Barriers to Entry

- The Bureau will determine whether entry by potential competitors would likely occur on a sufficient scale, in response to a material price increase or other change in the relevant market brought about by the merger, to ensure that such a price increase could not be sustained for more than two years.
- An analysis of entry conditions focuses not on whether barriers exist but rather upon: (1) what potential competitors must do to enter the market on a sufficient scale to eliminate a material price increase; (2) factors such as sunk costs and time which may delay entry; and (3) whether potential competitors are likely to enter the relevant market given the risks involved and likely rewards.
- If entry into a market is so easy that existing competitors could not succeed in raising price for any significant period of time (two years), the Department is unlikely to challenge the merger.

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Effective Remaining Competition

- Effective remaining competition refers to the collective influence of all sources of competition in a market including foreign competition, acceptable substitutes, new entry and the nature of innovation and change in the market.
- Where it is clear that the level of effective competition which would probably remain in the relevant market is not likely to be reduced as a result of the merger, this alone will generally justify a conclusion not to challenge the merger, notwithstanding whether the absolute level of effective competition may be high or low.

Removal of Vigorous and Effective Competitor

- Removal of a vigorous and effective competitor through a merger is generally not sufficient in itself to warrant enforcement. It must also be established that as a result of the removal, prices will be materially higher than in the absence of the merger.

Change and Innovation

- An assessment is made of the general nature and extent of change and innovation, be it technological or soft considerations such as service, packaging and buyer's tastes, to determine whether there are broader considerations that should be taken into account in deciding whether enforcement action is warranted.

Additional Evaluative Criteria

- Two additional criteria generally assessed where the borrower is concerned are whether a merger would be likely to facilitate the exercise of interdependent behaviour on market transparency and transaction value and frequency.
- As the level of market transparency decreases, coordinated behaviour becomes more difficult. Interdependent behaviour is also more difficult
- The U.S. Guidelines suggest that collusive agreements are more likely (and the Department is more likely to challenge a merger) where the market is transparent or where orders for the relevant product are frequent, regular and small relative to the total output of a typical firm in the market.

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as the frequency and regularity of sales of the relevant product decrease and as the value of each sale increases.

Vertical Mergers

- Vertical mergers generally only raise concerns where: (1) the merger leaves only a small amount of unintegrated capacity at either of the stages at which the acquiror or acquiree operate; (2) the merger results in or increases an existing higher degree of vertical integration between an upstream market and a downstream market and a downstream retail market; or (3) a particularly significant downstream buyer is eliminated as a result of the merger. When such circumstances exist, an assessment of the evaluation criteria discussed above will be undertaken.
- A vertical merger will raise concerns where: (1) the merger creates competitively objectionable barriers to entry; (2) the merger results in a high level of vertical integration by upstream firms into the associated retail market; (3) the merger results in the elimination of a particularly disruptive buyer in the downstream market.

Conglomerate Mergers

- In general, conglomerate mergers only give rise to concerns where it can be demonstrated that in the absence of the merger one of the merging parties would likely have entered the market *de novo*. Such a proposition must be supported by objectively verifiable information.
- A "non-horizontal" merger may give rise to concern where it effectively removes the acquiring firm from the edge of the market.

Part V: The Efficiency Exception

- To offset anti-competitive concerns, efficiency gains must: (1) not likely be attainable through less anti-competitive means; (2) not be merely redistributive in nature; (3) be greater than the likely anti-competitive effect of the merger.
- Each efficiency gain claimed must be precisely described in nature and magnitude and be documented by supporting evidence.
- The U.S. Guidelines note that some mergers the Department otherwise might challenge might be necessary to achieve significant net efficiencies.

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Gains that would otherwise Likely be Attained

- Where the claimed efficiency gains would likely be attained through less anti-competitive means (such as internal growth, merger with third party, joint venture, specialization agreement), they cannot be attributed to the merger and will not be considered in the section 96 "trade-off" analysis.
- The Department will reject claims of efficiencies if equivalent or comparable savings can reasonably be achieved by the parties through other means.

Gains that are Redistributive in Nature

- The claimed efficiency gains must (1) be demonstrably brought about by savings in resources; (2) result in a reduction of ongoing expenditures associated with operation of the subject assets; or (3) result in a lower overall cost of capital to the firm.
- The U.S. Guidelines contain no similar discussion.

"Greater Than" and "Offset"

- The words "greater than" indicate the efficiency gains must be "more weighty" than, more "extensive than", or of "larger magnitude" than the anti-competitive effects likely to result from the merger. The gains must also "offset", or neutralize, counterbalance or compensate for the likely anti-competitive effects. The evaluation is subjective in nature and involves an exercise of the Director's discretion.
- The parties must establish a greater level of expected net efficiencies, the more significant are the competitive risks identified.
- The calculation of "anti-competitive effects" is difficult and imprecise in nature, involving both quantitative and qualitative analysis.

Part VI: Process Matters

- Matters discussed in Part VI are limited to prenotification, confidentiality, substantial completion, timing and information exchanges between merging parties and Investment Canada.
- The U.S. Guidelines contain no similar discussion.

PRICE DISCRIMINATION

Section 50(1)(a) of the Competition Act

DISCUSSION PAPER

Director of Investigation and Research

***Bureau of Competition
Policy***

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